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PCAOB Release No. 2017-002
Proposed Amendments to Auditing Standards
For Auditing Accounting Estimates, Including Fair Value Measurements

The California Society of CPA's ("CalCPA") Accounting Principles and Assurance Services Committee (the "Committee") is the senior technical committee of CalCPA. CalCPA has approximately 43,500 members. The Committee consists of 55 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are in international firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee has provided responses to the specific questions set forth in the Release below.

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?**

   The Committee believes the discussion of the reasons to improve auditing standards sufficiently describes the nature of the concerns relating to auditing accounting estimates. The Committee is unaware of other concerns requiring further attention and generally supports a single-standard approach.

2. **Does the information presented above reflect current audit practice? Are there additional aspects of current practice of both larger and smaller audit firms that are relevant to the need for standard setting in this area?**

   The Committee generally recognizes that practices described within the exposure draft. While the Committee also recognizes the results of PCAOB inspections and enforcement actions, we do not believe such actions are necessarily representative of the majority of audits of significant estimates. The Committee further notes the while diversity in audit approaches may exist with regards to auditing the fair value of certain financial instruments and impairment testing given firm size and resources, we do not believe audit methodologies are significantly disparate when gathering audit evidence for other significant estimates.

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?**

   The Committee has none to recommend.

4. **Are there any other areas relating to auditing accounting estimates that the Board should address in the proposed standard (e.g., are there related areas of practice for which additional or different requirements are needed, such as the use of data analytics)?**

   The Committee has none to recommend.

5. **Are there considerations affecting accounting estimates relative to the financial reporting frameworks, such as recent changes to revenue recognition or impairment of financial instruments, that the proposed standard does not adequately address?**

   No. The Committee believes that while changes to revenue recognition, impairment and other standards may create accounting challenges, the proposed audit standard is sufficiently responsive to relevant risks of material misstatements. While accounting standards and the relevant underlying transactions may evolve, the Committee believes that audit standards should be sufficiently broad to allow an auditor to apply such standards across accounting frameworks and transactions. We believe it futile to try to update basic audit standards for each new accounting standard or underlying transaction.

6. **Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to further assess current practice.**

   The Committee has none to recommend.

7. **The Board requests comment generally on the analysis of the need for the proposal. The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature.**

   The Committee recognizes the reasons noted to improve existing standards and the underlying analyses noted within the proposal. We have no additional analysis to recommend for consideration.

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

The Committee has none to recommend.

9. **The Board requests comment generally on the potential costs to auditors and companies they audit. Are there additional costs the Board should consider?**

   The Committee recognizes the incremental fixed and variable costs to auditors expressed by the PCAOB in connection with implementing and applying the proposed standards. The Committee also recognizes that these costs may be significant for smaller firms lacking resources and access to industry/market information. However, it is the Committee's expectation that many smaller firms, applying AICPA Audit Standards and International Auditing Standards on other engagements will have developed audit procedures responses to many of the requirements proposed by the PCAOB. This should result in a reduction of costs.

10. **Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to assess potential benefits and costs.**

    The Committee has none to recommend.

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?**

    The Committee generally does not believe that the unintended consequences specifically contemplated by the Board outweigh the benefits of the proposed standards. The responses observed by the PCAOB are generally adequate.

12. **The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?**

    The Committee generally supports the reorganization of the three current PCAOB standards into a single standard. We therefore do not support retaining the existing three standards at issue for EGCs. We agree that such a distinction within standards runs counter to the proposal's objective of improving audit practice by setting forth a more uniform, risk based approach to auditing accounting estimates. Furthermore, we believe it would be improperly inconsistent to require auditors to adhere to different PCAOB standards purporting to address similar risks of material misstatement.

    Regarding the potential impact the proposal may have on EGCs, the Company recognizes that increased audit costs identified by the PCAOB within the proposal as well as the related concerns above could translate into a greater audit fees and cost of doing business.

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

    The Committee has none to recommend.

14. **Are there any factors specifically related to audits of brokers and dealers that may affect the application of the proposal to those audits?**

    The Committee has none to recommend.

15. **How much time following SEC approval would accounting firms need to implement the proposed requirements?**

    While the largest audit firms may have developed audit methodologies that include documentation of the evaluations contemplated within the proposal, we believe many smaller and mid-sized firms will be required to expand their existing audit methodologies, guidance and training programs. Accordingly, the Committee believes the Board should provide accounting firms at least one year following the end of the calendar year in which the SEC's approves the standard to facilitate adjustments to audit methodologies, the development of requisite training materials and annual training cycle.

16. **Would the effective date as described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?**

    Consistent with our response to Question 15, the Committee believes compliance with an adopted standard and amendments should be required for audits of fiscal years beginning on or after December 15th of the year following the SEC's approval. For example, if the SEC approved the standard on September 30, 2018, the standard and amendments should be effective for audits of fiscal years beginning on or after December 15, 2019.

17. **Are the scope and objective of the proposed standard clear?**

    The Committee believes the proposed scope and objective is clear.

18. **Are there challenges in tailoring the scalability of the auditor's response to identified risks of material misstatement as described in the proposal? If so, what are they and how can they be addressed?**

    The Committee does not believe there will be significant challenges in tailoring the scalability of the auditor's response to identified risks of material misstatements described in the proposal.

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

The Committee believes it is inappropriate to limit the auditor's selection of a particular audit approach. The selection of specific audit approach is usually driven by the specific entity circumstances and the experience of the auditor. However, we note that the proposed audit standard appropriately requires that an auditor, who obtains audit evidence about events or transactions that occur after the measurement date, evaluate whether the evidence supports or contradicts a company's estimate.

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?

The Committee believes the proposed requirements for evaluating whether a company's method(s) used to develop accounting estimates are clear.

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

The Committee has none to recommend.

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?

The Committee believes the proposed requirements for evaluating whether data was appropriately used by the company are clear. The Committee has no other criteria to recommend.

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?

Ultimately, the Committee believes that the identification of which assumptions used by management are significant assumptions should be done by management and tested by the auditor. While the Committee believes this understanding should be clarified in the standards, we did not identify any practical difficulties in applying the proposed standard.

The Committee also believes the proposed requirements for evaluating whether the company has a reasonable basis for significant assumptions used is clear. However, the Committee believes that establishing consistency with International Standards on Auditing is important. In this regard, the Committee recommends that the PCAOB use language similar to that contained in ISA 540. Specifically, ISA 540 identifies specific factors than an auditor "may consider" when evaluating the reasonableness of assumptions. The Committee recommends that the PCAOB use similar language. For example, the Committee notes the following alternative proposed language could be used in place of paragraph 16:

.16A The auditor should evaluate the reasonableness of the significant assumptions used by the company to develop the estimate, both individually and in combination. The auditor should evaluate whether the company has a reasonable basis for the significant assumptions used and, when applicable, for its selection of assumptions from a range of potential assumptions.

.17A When evaluating the reasonableness of significant assumptions used by the company, an auditor may consider whether the assumptions are consistent with the following factors, if applicable:

i. Relevant available industry, regulatory, and other external factors, including economic conditions;
ii. The company's objectives, strategies, and related business risks;
iii. Existing market information;
iv. Historical or recent experience, taking into account changes in conditions and events affecting the company; and
v. Other significant assumptions used by the company in other estimates tested.

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?

The Committee believes the proposed requirements for developing an independent expectation are clear. The Committee has identified no other matters relevant for consideration.

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?

The Committee believes 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, is clear. The Committee has identified no other matters relevant for consideration.

26. Are there instances today when auditors generate or accumulate data directly and use that data to develop an independent estimate, rather than obtain data from a third party or the company under audit? If so, please describe those instances and how the proposed requirements should address them.

The Committee has none to note.

27. **Are there instances when auditors obtain methods from third parties in developing an independent expectation of an accounting estimate? If so, please describe those instances and whether and how the proposed requirements should address them.**

The Committee has none to note.

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

The Committee believes the proposed requirements for developing an independent expectation when using the company's data, assumptions, or methods is clear.

29. **Is the proposed requirement for an auditor's range clear? Are there other matters relevant to the auditor developing a range that the Board should consider?**

The Committee believes the proposed requirement for an auditor's range is clear. We have identified no other matters relevant for consideration.

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?**

The Committee has identified no other matters relevant for consideration.

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

The Committee has identified no other matters relevant for consideration.

32. **Are there other matters that the auditor should take into account when obtaining an understanding of the nature of the financial instruments being valued? If so, what are they?**

The Committee has identified no other matters relevant for consideration.

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

The Committee has identified no additional sources of pricing information that should be addressed.

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?**

The Committee believes the proposed requirements for using information from a pricing service are clear. We have identified no other matters relevant for consideration.

35. Do the requirements included in the proposed standard pose operational challenges for audit firms that use centralized groups? If so, what are they and how could they be addressed in the proposed standard?

The Committee is unaware of any significant operational challenges for audit firms that use centralized groups.

36. Is the auditor's responsibility when evaluating relevance and reliability of pricing information from multiple pricing services clear?

The Committee believes the auditor's responsibility when evaluating relevance and reliability of pricing information from multiple pricing services is sufficiently clear.

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

The Committee has none to recommend however, we believe the factors affecting relevance and reliability of pricing information should clearly state that the listing is not all inclusive. For example, consider the following language in paragraph A9:

> *A9. When the company's fair value measurement is based on a quote from a broker or dealer ("broker quote"), the relevance and reliability of the evidence provided by the broker quote depends on various factors, including whether [...]*

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

We have identified no other factors relevant for consideration.

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

While the Committee appreciates the complexities of combining three standards into a single standard, we believe that the proposed language in Appendix A to AS 1105 raises certain questions. As proposed, Appendix A appears more rules-based and in many ways, is similar to a prescriptive audit program. In this regard, existing standards recognizes that audit evidence about valuation "may", rather than "should", include various types of responsive information. The Committee believes this should be clarified within Appendix A. The Committee also recognizes investments accounted for by the cost method for which there is a risk of material misstatement regarding impairment may not require valuing the investment based on the investee's financial condition or operating results. Accordingly, the PCAOB should clarify that the "Examples" listed in the "Note" following .A1 "may", but not always, include those listed.

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?

The Committee does not believe the proposed guidance represents a significant change in practice for audits of investment companies.

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

The Committee has identified no other matters relevant for consideration.

42. Is it appropriate to include how financial statements could be manipulated through management bias in accounting estimates in significant accounts and disclosures, as part of the discussion among key engagement team members of the potential for material misstatement due to fraud? If not, describe why it is not appropriate.

The Committee believes that a discussion among key engagement team members about how financial statements could be manipulated through management bias is appropriate.

43. Are the additional risk factors to identify significant accounts and disclosures involving accounting estimates clear?

The risk factors included at AS2110.60 are sufficiently clear.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

Matthew J. Lombardi
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants