

August 30, 2017

Ms. Phoebe W. Brown
Office of the Secretary
PCAOB
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Delivered Electronically

**Re: PCAOB Rulemaking Docket Matter No. 043/Release No. 2017-02,
Proposed Auditing Standard – *Auditing Accounting Estimates, Including
Fair Value Measurements and Proposed Amendments to PCAOB Auditing
Standards***

And

**PCAOB Rulemaking Docket Matter No. 044/ Release No. 2017-03, *Proposed
Amendments to Auditing Standards for Auditor’s Use of the Work of
Specialists***

Dear Board Members:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) in response to the solicitations for public comment by the Public Company Accounting Oversight Board (PCAOB or Board) with respect to Proposed Auditing Standard, *Auditing Accounting Estimates, Including Fair Value Measurements* (Estimates Proposal) and the *Proposed Amendments to Auditing Standards for Auditor’s Use of Specialists* (Specialists Proposal) (collectively, the Proposals).

NAREIT is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

REITs are generally deemed to operate as either Equity REITs or Mortgage REITs. Our members that operate as Equity REITs acquire, develop, lease and operate income-producing real estate. Our members that operate as Mortgage REITs finance housing and commercial real estate, by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.



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A useful way to look at the REIT industry is to consider an index of stock exchange-listed companies like the FTSE NAREIT All REITs Index which covers both Equity REITs and Mortgage REITs. This Index contained 228 companies representing an equity market capitalization of \$1.121 trillion at July 31, 2017. Of these companies, 188 were Equity REITs representing 94% of total U.S. stock exchange-listed REIT equity market capitalization (amounting to \$1.054 trillion)¹. The remainder, as of July 31, 2017, is represented by 40 stock exchange-listed Mortgage REITs with a combined equity market capitalization of \$67 billion.

NAREIT previously responded to the PCAOB's August 19, 2014 PCAOB Staff Consultation Paper on *Auditing Accounting Estimates and Fair Value Measurements* (NAREIT letter dated October 31, 2014²) and the May 15, 2015 PCAOB Staff Consultation Paper on *The Auditor's Use of the Work of Specialists* (NAREIT letter dated August 3, 2015³). We appreciate the PCAOB's effort to address a recommendation we previously made in not viewing a third-party expert hired by management as an extension of management. We agree with the Specialists Proposal's guidance to provide a risk-based approach in the application of audit procedures surrounding external experts hired by management. Additionally, we generally agree with the format that the Board developed to apply different audit procedures depending on whether the specialist is hired by management, employed by management, hired by the auditor, or is employed by the auditor. While we appreciate these aspects of the new iterations of the Proposals, we continue to question why a fundamental change in audit guidance is necessary.

This letter has been developed by a task force of NAREIT members, including members of NAREIT's Best Financial Practices Council. Members of the task force include financial executives of both Equity and Mortgage REITs, representatives of major accounting firms, institutional investors and industry analysts.

Why is a change to the existing audit framework for auditing accounting estimates and the auditor's use of specialists warranted?

NAREIT is not persuaded that a change to the audit framework for the audit of accounting estimates or the auditor's use of specialists is necessary. In NAREIT's view, any expansion of audit requirements for accounting estimates and corresponding audit work for the work of specialists are unnecessary changes given the amount of work performed by auditors today. Additionally, adding additional audit work does not automatically lead to more accurate accounting estimates.

¹ <https://www.reit.com/sites/default/files/returns/FNUSIC2017.pdf>

² <https://www.reit.com/sites/default/files/NAREIT%20Comment%20Letter%20on%20PCAOB%20Staff%20Consultation%20Paper%20Auditing%20Estimates%20and%20FV%20Measurements%20FINAL.pdf>

³ <https://www.reit.com/sites/default/files/media/PDFs/NAREITCommentLetter20150803.pdf>



NAREIT's member companies observe that external auditors currently perform a significant amount of audit work surrounding accounting estimates prepared by specialists pursuant to existing audit standards. For example, multiple member companies have indicated that the audit fees for auditing fair value estimates of real estate and auditing purchase price allocations in business acquisitions at times *exceed* the fees paid to the third-party valuation companies that develop the estimates. In NAREIT's view, the proposed amendments to audit guidance in the Estimates Proposal and the Specialists Proposal do not pass a cost benefit test.

Why do the Proposals repeatedly use the words "inherent management bias" and "moral hazard?"

The Proposals include a negative connotation toward management's responsibility in preparing financial statements. The repeated use of the words "management bias" and "moral hazard" seem to go above and beyond the auditor's responsibility to conduct the audit with professional skepticism. These words imply that management has a predisposition to inflate financial results instead of being stewards of public capital and reporting financial results faithfully in accordance with U.S. GAAP. Given the negative tone, auditors may feel compelled to do more audit work than they do today. In our view, the Proposals would expand the work that auditors perform, with no increase in the reliability or credibility of the audited financial statements. Further, as discussed below, there is no evidence that the existing auditing standards on auditing accounting estimates or the auditor's use of the work of specialists fail to detect significant errors in financial statements. In short, NAREIT sees no basis to conclude that increased audit work (and corresponding audit fees) would provide any measurable benefit to improve audit quality.

What are the underlying problems that the Estimates Proposal and Specialists Proposal are trying to solve?

NAREIT does not believe that either the Estimates Proposal or the Specialists Proposal articulate a pervasive problem that would be solved by a change in auditing standards. The Proposals seem to justify a significant increase in audit work (and cost) based on academic research papers and limited circumstances where *existing audit guidance was not followed by the auditor*. The Specialists Proposal acknowledges that "inspection staff have observed a decline in the number of instances by larger firms in which auditors did not perform sufficient procedures related to the work of an auditor's specialist."⁴ Failure to conduct an audit in accordance with current audit guidance does not, in and of itself, warrant revised auditing standards. Rather, this seems to be an "easy fix" for the PCAOB to address in its inspections of audits conducted by public accounting firms.

⁴ <https://pcaobus.org/Rulemaking/Docket044/2017-003-specialists-proposed-rule.pdf> at page 14.



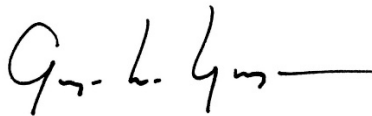
Summary

NAREIT appreciates the PCAOB's staff efforts in their endeavor to enhance audit quality. However, NAREIT does not believe that the PCAOB has presented solid evidence to warrant further amendments to auditing standards. While the PCAOB cites academic research papers and limited examples of where the auditor failed to follow existing auditing standards, NAREIT fails to recognize these issues as the basis for a change in auditing standards. In the event that the PCAOB decides to move forward with some change to existing auditing standards, NAREIT recommends that the PCAOB use a targeted approach that addresses the root cause of problems that are identified.

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We thank the PCAOB for the opportunity to comment on the Staff Paper. If you would like to discuss our views in greater detail, please contact George Yungmann, NAREIT's Senior Vice President, Financial Standards, at gyungmann@nareit.com or 1-202-739-9432, or Christopher Drula, NAREIT's Vice President, Financial Standards, at cdrula@nareit.com or 1-202-739-9442.

Respectfully submitted,



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