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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

August 3, 2015

Ms. Phoebe W. Brown
Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803
comments@pcaobus.org

Delivered Electronically

Re: Staff Consultation Paper No. 2015-01 - *The 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 solicitation for public comment by the Public Company Accounting Oversight Board (PCAOB or Board) with respect to the Staff Consultation Paper, *The Auditor's Use of the Work of Specialists* (the Staff Paper).

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.

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 224 companies representing an equity market capitalization of \$890 billion at June 30, 2015. Of these companies, 183 were Equity REITs representing 93.5% of total U.S. stock exchange-listed REIT equity market capitalization (amounting to \$832 billion)¹. The remainder, as of June 30, 2015, is represented by 41 stock exchange-listed Mortgage REITs with a combined equity market capitalization of \$58 billion.

¹ <https://www.reit.com/sites/default/files/reitwatch/RW1507.pdf> at page 21.



NAREIT appreciates the PCAOB's efforts toward improving audit quality since its inception in 2002. However, NAREIT has significant concerns with the Staff Paper as drafted. NAREIT's comments are primarily focused on the areas that would impact NAREIT member companies (*i.e.*, use of specialists in valuing investment properties, equity and mortgage-backed securities, and derivative positions.)

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

NAREIT is not persuaded that a change to the audit framework for the auditor's use of specialists is necessary. In NAREIT's view, the expansion of audit requirements for the work of specialists is an unnecessary change given the amount of work performed by auditors today. NAREIT's member companies observe that external auditors currently perform a significant amount of audit work surrounding 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 *exceed* the fees paid to the third party valuation companies that develop the estimates. In NAREIT's view, the suggestions in the Staff Paper would not pass a cost benefit test. The suggestions in the Staff Paper would only expand the work that auditors perform today, 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 related to 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 thus audit fees) would provide any measurable benefit.

What is the underlying problem that the Staff Paper is trying to solve?

NAREIT does not believe that the Staff Paper articulates a pervasive problem that would be solved by a change in auditing standards. The Staff Paper seems to be justifying 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. Further, NAREIT is not aware of any significant audit failures (with "audit failures" defined as restatements of financial statements) driven by the inappropriate reliance on work performed by a specialist in recent history that would necessitate standard setting by the PCAOB.

Why should external third parties be considered an extension of management?

NAREIT strongly objects to the alternative of expanding the scope of audit work in the evaluation of processes and controls when management uses a third party specialist or pricing services. NAREIT continues to believe that the auditor's evaluation of the objectivity of the specialist and the accuracy of information provided to the third party are appropriate. Additionally, NAREIT considers the existing requirements for both management and auditors to evaluate the information provided by third parties to be sufficient in accordance with current audit literature.

The idea that either management (in its assessment of the adequacy of the company's internal controls over financial reporting) or the external auditor (in its evaluation of management's



assessment) could evaluate third parties' processes and controls is simply not operational. NAREIT notes that existing audit guidance in AU 342.04 *Auditing Accounting Estimates* acknowledges that "[a]s estimates are based on subjective as well as objective factors, it may be difficult for management to establish controls over them."² Finally, third party specialists and pricing services are separate entities from the companies that engage them. To assume otherwise is not factual.

By suggesting that the auditor treat third party specialists as part of the entity that they are auditing, the Staff Paper seems to be requiring management to understand and evaluate the operating effectiveness and sufficiency of controls at third party vendors. There are two clear business reasons why companies engage third parties to assist in the development of estimates: (i) the company does not have the requisite expertise or time to perform the work in-house; and (ii) the company's management believes that the use of third parties enhances the objectivity and reliability of its estimates. Requiring management and the auditor to evaluate the third parties' processes and controls as if they were part of the company itself would exacerbate the company's resource constraints in the first scenario and potentially discourage the company's efforts to utilize outside specialists in the second scenario. NAREIT cautions the PCAOB of the potential for the unintended consequence of management deciding not to use outside expertise in order to avoid incremental audit fees.

Summary

NAREIT appreciates the PCAOB's staff efforts in their endeavor to further audit quality. However, NAREIT does not believe that the PCAOB has identified the root cause that would necessitate 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 see the impetus 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 address the root cause of problems that are identified.


* * *

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.

² <http://pcaobus.org/standards/auditing/pages/au342.aspx>

Ms. Phoebe W. Brown
August 3, 2015
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Respectfully submitted,

Handwritten signature of George L. Yungmann in black ink, consisting of the letters 'G', 'L', and 'Y' in a cursive style, followed by a horizontal line.

George L. Yungmann
Senior Vice President, Financial Standards
NAREIT

Handwritten signature of Christopher T. Drula in black ink, written in a cursive style.

Christopher T. Drula
Vice President, Financial Standards
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