Auditing Accounting Estimates and Fair Value Measurements: Project Update and Discussion

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Disclaimer

The views expressed by each of the presenters are their own personal views and not necessarily those of the PCAOB, members of the Board, or the PCAOB staff.
Agenda

- Introduction
- General Direction of the Project
- Areas Where Additional Information Is Needed
Introduction

- Staff Consultation Paper, Auditing Accounting Estimates and Fair Value Measurements, issued August 19, 2014
- SAG meeting held October 2, 2014
  - 44 participants (SAG members and panelists)
  - 8 observers
- Comment period ended November 3, 2014
  - 40 comment letters
  - Discussed preliminary summary of comments with the SAG on November 21, 2014
Staff Activities Since November 2014

- Completed detailed analysis of the comment letters received
- Conducted additional research on:
  - Measurement uncertainty
  - Use of third parties
- Participated in panel discussion on biases related to estimates and fair value measurements at the 2015 PCAOB-AAA Annual Meeting
General Direction of the Project

Need for Standard Setting

- Areas discussed in staff consultation paper
  - Audit deficiencies noted by PCAOB and by other audit regulators
  - Changes in the financial reporting frameworks
  - Growing reliance on the work of third parties
  - Concerns expressed by some over perceived inconsistencies in existing standards

- Identified additional considerations based on outreach and commenter input
  - Greater emphasis on professional skepticism in a new standard
  - More specific requirements to further address measurement uncertainty
General Direction of the Project (cont'd)

SAG Member Discussion of the Need for Standard Setting

Question:
- Do SAG members think there are other considerations that support the need for standard setting in this area?
General Direction of Project (cont'd)

General Direction of the Project

- Single standard approach discussed in staff consultation paper
- Further integration with risk assessment
  - Targeted amendments discussed in staff consultation paper
  - Additional references to risk assessment standards in a new standard to highlight specific requirements
General Direction of the Project (cont'd)

Substantive approaches

- Retain the three existing audit approaches with certain refinements
  - Testing management's process
  - Developing an independent estimate
  - Evaluating subsequent events
General Direction of Project (cont'd)

SAG Member Discussion of General Direction of Project

Questions:

- Do SAG members agree with the general direction of the project being considered by the staff?
- Are there other considerations that the staff should take into account relating to the general direction of the project?
Areas Where Additional Information Is Needed

- Emphasizing professional skepticism
- Addressing significant measurement uncertainty
- Use of third parties
Areas Where Additional Information Is Needed (cont'd)

Emphasizing Professional Skepticism
The staff is exploring alternatives that, in the staff's view, would further emphasize professional skepticism:

- Explicit requirement for the auditor to identify which of the assumptions used by management are significant when testing management's process
- Revising terminology referring to "corroborating" management's estimate
- Including reminders in a new standard about the auditor's existing responsibility to exercise professional skepticism
Areas Where Additional Information Is Needed (cont'd)

Emphasizing Professional Skepticism (cont'd)

- Emphasize the auditor's existing responsibility to consider relevant audit evidence, whether it corroborates or contradicts management's assertions.
- Extend the requirements for the fraud discussion in AS No. 12 to more specifically address estimates.
- Change the current order of the substantive approaches to begin with evaluating subsequent events to be consistent with preferential ordering idea stemming from academic research (i.e., (1) evaluating subsequent events, (2) developing independent estimate, and (3) testing management’s process).
Areas Where Additional Information Is Needed (cont'd)

SAG Member Discussion of Alternatives to Emphasize Professional Skepticism

Questions:

- What are SAG members' views on the alternatives being considered by the staff to further emphasize professional skepticism?
- Are there other alternatives to further emphasize professional skepticism that the staff should take into account?
Areas Where Additional Information Is Needed (cont'd)

Addressing Significant Measurement Uncertainty

The staff is exploring alternatives that, in the staff's view, would more specifically address measurement uncertainty:

- Amending AS No. 12 to include factors that may be relevant to evaluating the extent of measurement uncertainty in accounting estimates as discussed in the staff consultation paper
- Including a requirement to evaluate how management considered alternative assumptions or outcomes (similar to paragraph 15a and 16 of ISA 540) for significant risks
Areas Where Additional Information Is Needed (cont'd)

Addressing Significant Measurement Uncertainty (cont'd)

- Add requirements to test a model when the complexity of the model used to develop an estimate gives rise to a significant risk
- Require a sensitivity analysis when a range of reasonable outcomes exists
- Include specific disclosure and/or communication requirements to:
  - Require communication of estimates with significant measurement uncertainty as an audit committee communication
  - Disclose in the auditor's report
Areas Where Additional Information Is Needed (cont'd)

SAG Member Discussion of Alternatives to Address Significant Measurement Uncertainty

Questions:

- What are SAG members' views on the alternatives being considered by the staff?
- Are there other alternatives to address significant measurement uncertainty that the staff should take into account?
Areas Where Additional Information Is Needed (cont'd)

Use of Third Parties

- Management's use of a specialist

  The staff is exploring alternatives that could apply to management's use of a specialist:

  - Address the issue in Board's project on The Auditor’s Use of the Work of Specialists
  - Retain approach largely as discussed in staff consultation paper (i.e., to require the auditor to test information provided by a company’s specialist as if it were produced by the company)
Areas Where Additional Information Is Needed (cont'd)

Use of Third Parties (cont'd)

- Management's use of a specialist - alternatives (cont'd)
  - Retain similar approach discussed in staff consultation paper, but limit it to:
    - Testing only the assumptions as if they were developed by management; or
    - Applying the approach discussed in staff consultation paper but only when a significant risk is identified; or
    - Testing information provided by management to the specialist and considering management's ability to influence the results of the specialist
Areas Where Additional Information is Needed (cont'd)

Use of Third Parties (cont’d)

- Management's use of a pricing service

  The staff is exploring alternatives that could apply to management's use of a pricing service:
  
  - Include factors related to pricing services as part of the AS No. 12 amendment to obtain an understanding of management's processes used to develop accounting estimates (for example, controls and processes that management has in place to review the work of pricing services)
  
  - Consider, under varying circumstances, how the auditor uses the work of a pricing service used by management, including how the work of a pricing service used by management could affect the nature, timing and extent of the auditor's work
Areas Where Additional Information Is Needed (cont'd)

Use of Third Parties (cont'd)

- Auditor's use of a third party

  The staff is exploring alternatives that could apply to the auditor's use of a third party including:

  - Specifying that circumstances where the auditor uses the same third party as management does not constitute an independent estimate
Areas Where Additional Information Is Needed (cont'd)

Use of Third Parties (cont'd)

- Auditor's use of a pricing service

  The staff is exploring alternatives that could apply to the auditor's use of a pricing service:
  - Retain approach discussed in staff consultation paper largely as described in the paper and:
    - Clarify the auditor's ability to group securities with similar characteristics and risk
    - For exchange-traded securities, acknowledge evidence provided by quoted market prices that are readily available to the public through national exchanges
  - Include an appendix to the standard that addresses the use of pricing services by either management or the auditor as well as other considerations specific to auditing financial instruments (for example, consensus pricing)
Areas Where Additional Information Is Needed (cont'd)

SAG Member Discussion of Alternatives to Address the Use of Third Parties

Questions:

- What are SAG members' views on the alternatives being considered by the staff?
- Are there other alternatives relating to the use of third parties that the staff should take into account?