

FROM: Dr. Steven Glover (Professor at Brigham Young University)
Dr. Brant Christensen (Professor at University of Missouri)

TO: Office of the Secretary, PCAOB

DATE: August 29, 2017

SUBJECT: Comments on Proposed Auditing Standard, *Auditing Accounting Estimates, Including Fair Value Measurements (Docket Matter No. 043)*

We appreciate the opportunity to submit comments on the Board's Proposed Auditing Standard on *Auditing Accounting Estimates, Including Fair Value Measurements* (hereafter referred to as the Proposed Standard). We, along with two other colleagues, previously submitted comments on the Board's related Staff Consultation Paper on Auditing Accounting Estimates and Fair Value Measures.¹ Having performed recent academic research regarding fair value, estimates, and estimation uncertainty,² we support the Board's efforts to clarify expectations and requirements in these areas. Our comments in this letter center on the subject of estimation or measurement uncertainty.

We believe the Proposed Standard, as currently written, inadequately addresses important issues around measurement uncertainty. As a result, we are concerned that the PCAOB is missing an opportunity to clarify auditing standards in important ways. Academic research by Glover, Taylor and Wu (2017b) indicates that a lack of clarity in the existing standards is a contributing factor to the persistence in reported PCAOB audit deficiencies associated with auditing estimates and fair value measurements. Findings in that study suggest both auditors and PCAOB inspectors lack clarity on what constitutes sufficient appropriate audit evidence and adequate disclosure regarding estimates for which the reasonable range of measurement uncertainty (i.e., outcomes considered reasonably likely by experts) exceeds materiality. Audit experts in the study indicate that they would welcome more guidance from PCAOB standards as the current lack of clarity leads to disagreements between auditors and inspectors regarding the auditors' responsibilities, work effort, and documentation associated with auditing estimates with significant estimation

¹ We believe the Board would benefit from additional consideration of the comments we previously submitted; that letter included more specific details from our relevant research.

² For additional information, see:

-Christensen, B. E., Glover, S. M., & Wood, D. A. (2012). Extreme estimation uncertainty in fair value estimates: Implications for audit assurance. *Auditing: A Journal of Practice & Theory*, 31(1), 127-146.

-Christensen, B. E., Glover, S. M., & Wolfe, C. J. (2014). Do critical audit matter paragraphs in the audit report change nonprofessional investors' decision to invest? *Auditing: A Journal of Practice and Theory*, 33(4), 71-93.

- Christensen, B. E., Glover, S. M., Omer, T. C., & Shelley, M. K. (2016). Understanding audit quality: Insights from audit professionals and investors. *Contemporary Accounting Research*, 33(4), 1648-1684.

-Glover, S. M., Taylor, M., & Wu, Y. (2017a). Current practices and challenges in auditing fair value measurements and complex estimates: Implications for auditing standards and the academy. *Auditing: A Journal of Practice and Theory*, 36(1), 63-84.

-Glover, S. M., Taylor, M., & Wu, Y. (2017b). Mind the gap: Why do experts have differences of opinion regarding the sufficiency of audit evidence supporting complex fair value measurements? Working Paper, Brigham Young University and Case Western Reserve University.

-Glover, S. M., Taylor, M., & Wu, Y. (2017b). The Gap between Auditing Experts' Performance and Regulatory Expectations when Auditing Complex Estimates and Fair Value Measurements: Causes and Potential Solutions Working Paper, Brigham Young University, Case Western Reserve University, and Texas Tech University.

Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2504521

uncertainty. Research indicates that the most frequently mentioned areas for which audit experts desire additional guidance include: (1) clarification regarding what constitutes an acceptable range of estimation uncertainty and (2) clarification regarding how the auditors are to address and disclose such uncertainty.

Until the PCAOB auditing standards more clearly acknowledge the existence of significant measurement uncertainty, and more clearly indicate what constitutes sufficient appropriate audit evidence and appropriate disclosure, we will continue to see an expectations gap between auditors and PCAOB inspectors. This expectations gap will likely result in persistent reporting of audit deficiencies primarily due to differences of interpretation and opinion.

We note that the discussion material released with the Proposed Standard refers to the reality that the reasonable range of measurement uncertainty can exceed materiality. This awareness and open acknowledgement is an important step for the profession. However, that same awareness and acknowledgment does not appear to be in the Proposed Standard itself (i.e., Appendix 1) or the proposed amendments to other standards (i.e., Appendix 2). In fact, we were surprised to find only one reference to measurement uncertainty in Appendix 1. In rather stark contrast, the IAASB's exposure draft to *Auditing Accounting Estimates and Related Disclosures* (ED-540) contains over 85 references to estimation/measurement uncertainty. A read of ED-540 illustrates just how central, fundamental, and important the concept of estimation uncertainty is in auditing estimates.

The Board appears to have considered requiring specific procedures in response to measurement uncertainty, but eventually deemed those procedures duplicative to other standards that require auditors to direct additional attention to significant risks (pg. 50-51 of the Proposed Standard). However, due to their inherent and irreducible uncertainty, estimates with material measurement uncertainty are fundamentally different from other significant risks encountered during the audit process and thus merit specific audit procedures and disclosure considerations. While proposed amendments to AS 2110 do suggest the degree of measurement uncertainty is an important risk factor for auditors to consider, we believe that the Proposed Standard falls short in addressing the following fundamental questions (for the benefit of the Board, we provide references in parentheses where ED-540 appears to address these questions):

- How do auditors reconcile a reasonable range of estimation uncertainty that is greater than quantitative materiality and the requirement to provide a high level of assurance that estimates are fairly stated in all material respects? (see ED-540 A2, A134, A142-A146)
- What should auditors do to address and respond to significant estimation uncertainty, particularly when the reasonable range of uncertainty is inherently large and cannot be reduced by additional effort from management or the auditor? (see ED-540.19 and A113-134)
- What is management's and the auditor's responsibility in performing sensitivity analyses to understand the extent of estimation uncertainty? (see ED-540.13c, 19, A2, A46, A92, A109, A113-A115, A123, A126-127, A136).
- How to assess whether the level of estimation uncertainty is adequately disclosed to users of the financial statements, both by management and by auditors? (see ED-540 A116-A125).

- How should auditors address the reality that some estimates cannot be made in accordance with reporting frameworks? (see ED-540 A90)
- How should auditors and the audit opinion address the potential impact on the financial statements as a whole (and in particular on seemingly precise summary point estimates such as earnings per share) of the aggregated uncertainty from multiple financial statement estimates containing significant estimation uncertainty?

In subsequent revisions of the Proposed Standard and related conforming amendments, we encourage the Board to provide guidance to address the important issues associated with significant estimation uncertainty.

We appreciate the opportunity to offer our comments.

Sincerely,

A handwritten signature in blue ink, appearing to read "Brant Christensen".

Dr. Brant Christensen, University of Missouri

A handwritten signature in blue ink, appearing to read "Steven Glover".

Dr. Steven Glover, Brigham Young University