



The Association of
Accountants and
Financial Professionals
in Business

February 25, 2015

Mr. Martin F. Baumann, Chief Auditor
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: Staff Consultation Paper – *Auditing Accounting Estimates and Fair Value Measurements*

Dear Mr. Baumann:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the Public Company Accounting Oversight Board's (PCAOB or Board) Staff Consultation Paper, *Auditing Accounting Estimates and Fair Value Measurements* (Consultation Paper).

The IMA is a global association representing more than 70,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org in the Advocacy Activity section under the About IMA tab.

While we support the PCAOB's efforts to provide more guidance to auditors to assist them in auditing accounting estimates and fair value measurements, we are concerned that the Board is considering making changes that will require the auditor to perform more procedures, creating an impression of increased quality, but that will not significantly increase the quality of the amounts reported in financial statements due to the inherently subjective nature of many estimates and fair value measurements. We note that the PCAOB staff, based on its research and outreach, was not led to a conclusion that the common approaches for testing accounting estimates and fair value measurements in the existing standards required replacement. Accordingly, we question the need for a new approach that would lead to wholesale changes to auditing estimates and fair value measurements. While the Consultation Paper indicates that the potential need for improvements in auditing standards relating to auditing estimates and fair value measurements is illustrated by audit deficiencies noted by the PCAOB and other audit regulators, it is not clear to us whether those deficiencies are the result of inadequate guidance in the standards or due to poor execution of the existing standards by audit engagement teams. Before the Board decides to modify or replace existing standards, we believe that the PCAOB needs to conclude that audit deficiencies were the direct result of inadequate guidance in those standards.

Accounting estimates and fair value measurements are the responsibility of management pursuant to Generally Accepted Accounting Principles (GAAP) as mandated by the Financial Accounting Standards Board. Management, the Disclosure Committee and the Audit Committee of a public company take seriously their responsibility to review the determination of estimates and fair values. Further, when significant, those matters are prominently disclosed, both in the financial statement footnotes and in Management's Discussion and Analysis. Many of these estimates and fair value measurements are extremely judgmental and based on



assumptions about matters that may not be resolved in some cases until many years into the future. For example, companies may use complex models to estimate the fair value of financial instruments in Level 3 of the fair value hierarchy. Developing the inputs to those models may require the company to exercise significant judgment. As contemplated by the accounting standards, there could be reasonable alternative inputs that could result in significantly different fair value measurements for such financial instruments. Similarly, the measurement of asset retirement obligations for nuclear power plants requires a considerable amount of judgment, particularly where the retirement is not expected to happen for 30 or 40 years.

A company is required to do its best under GAAP to record accounting information where estimates of the future are inherent in the process. AU342, *Auditing Accounting Estimates*, requires an auditor to “obtain sufficient appropriate evidential matter to provide reasonable assurance that (a) all accounting estimates that could be material to the financial statements have been developed, (b) those accounting estimates are reasonable in the circumstances, and (c) the accounting estimates are presented in conformity with applicable accounting principles and are properly disclosed.” AU328, *Auditing Fair Value Measurements and Disclosures*, requires an auditor to “obtain sufficient appropriate evidential matter to provide reasonable assurance that fair value measurements and disclosures are in conformity with GAAP.” Both standards provide certain items the auditor should consider in obtaining “sufficient evidential matter” regarding estimates and fair value measurements. We believe that the principles-based approach in the existing standards is clear and are concerned the Board will simply mandate specific substantive procedures that may not be necessary or appropriate in all circumstances but, because of concerns that an audit will be found to be deficient, will be performed anyway. Further, if the Board develops specific procedures to address certain estimates or fair value measurements, it is likely that those procedures will quickly become outdated as the types of transactions in which companies engage evolve. We believe that approach would not be an improvement.

Based on the extensive list of questions in the Consultation Paper, we are concerned that this project, if added to the Board’s standard-setting agenda, may lead to a new standard that calls for significantly greater work by auditors that goes beyond what is truly needed to attest that management’s judgments in developing estimates and fair value measurements are appropriate. Because of the subjectivity associated with many estimates and fair value measurements, requiring the auditor to perform additional procedures will not necessarily result in a better estimate or fair value measurement. We have the following specific comments and questions on the Consultation Paper.

1. We do not believe the Board should change existing Generally Accepted Auditing Standards (GAAS) as it relates to management’s use of specialists. The approach discussed in the Consultation Paper (pages 37 and 38) would, if adopted by the Board, require the auditor to test information provided by a specialist retained by management as if it had been provided by the company. If an auditor were required to, for example, recompute the projected benefit obligation for a pension or post-employment benefit plan provided by an actuary retained by the company, it would increase compliance costs. It is highly unlikely the actuary would agree to provide the auditor with access to its proprietary models, which would require the auditor to recompute the estimate. It is also likely that the auditor (who may have access to models within the firm that can be used to recompute the projected benefit obligation or may be required to retain a third party actuary) will identify differences between the original measurement and the recomputation, which if significant will require further investigation simply because the estimates and models are subjective and could produce a wide range of results, not because the inputs or methodologies used by the actuary were unreasonable. We believe that the exercise will increase compliance costs, but will not significantly enhance the value of the information reported in the financial statements; both valuation models may result in reasonable estimates of



the item being measured. We do not see incremental value in having an auditor test the models used by an actuary to estimate the projected benefit obligation of a pension or post-employment benefit plan. We believe the approach in AU Section 336 has served users, auditors and preparers well over the years and see no compelling reason to change that guidance.

2. On page 35 of the Consultation Paper, the staff provides a list of assumptions that could be included in a new standard to help the auditor determine whether the significant assumptions have been identified. If the Board believes it is appropriate to provide a list of assumptions, we believe only the first assumption should be included. Unless a change in an input could have a significant effect on the measurement of the estimate, it is not, by definition, a significant assumption. We would be concerned that an auditor could be required to spend a significant amount of time getting comfortable with an input that is based on unobservable data when changes in that input would not significantly change the measurement of the asset or liability.
3. The Consultation Paper discusses (on page 32) a potential requirement that the auditor evaluate whether a company's methods are accepted within the company's industry, even when GAAP permits judgment in selecting the method for determining an accounting estimate. We believe the focus should be on whether a method is appropriate given a company's particular facts and circumstances. Only if the auditor concludes the selected method is not appropriate should additional procedures be performed to address the risks arising from the selected method. We believe requiring the auditor to evaluate whether a company's methods are accepted within the company's industry places the auditor in an untenable position if information about the method applied by other companies is not readily available and the auditor does not audit a majority of the companies within the industry. Further, we believe a requirement that the auditor assess the methods used, particularly valuation models, could result in a migration to methods and models that are easier for the auditor to assess, but may not be as appropriate for the particular facts and circumstances as a method (or model) that is newly-developed but not widely used within the industry.

We believe existing GAAS provides an appropriate framework for auditors to test management's approach and are not aware of any significant issues with that framework when it is applied appropriately. Any significant expansion of the auditing guidance in this area is unlikely to increase the accuracy of the amounts recorded in financial statements. Most companies desire relatively rigorous auditing to ensure that their processes for recording significant estimates and fair value measurements are appropriate and the judgments they have employed are reasonable. Adding procedures that increase the amount of work the auditor is required to perform but that do not enhance the usefulness of the financial statements (i.e., through increased accuracy of estimates and fair value measurements) fails the cost-benefit test.

We appreciate the Board's consideration of these comments. We are available to discuss our comments at your convenience.

Sincerely,

A handwritten signature in blue ink that reads "N. Schroeder".

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Institute of Management Accountants
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