



Office of the Secretary
PCAOB

Submitted via email:
comments@pcaobus.org

30 October 2014

Ref.: AUD/AKI/HBL/NRO/HBU/EBL

Dear Sir or Madam,

Re: FEE comments on the PCAOB Staff Consultation Paper: “Auditing Accounting Estimates and Fair Value Measurements”

FEE (the Federation of European Accountants) welcomes the opportunity to comment on the PCAOB Staff Consultation Paper: “Auditing Accounting Estimates and Fair Value Measurements” (hereafter referred to in this letter as “Consultation Paper”). Our main comments are summarised hereafter.

General Comments

Given the deficiencies detected in audit inspections in the area of audits of accounting estimates and fair value measurements, and the fact that PCAOB standards covering this subject matter have not been revised recently, FEE commends the PCAOB for undertaking this project and seeking stakeholder’s views with this Consultation Paper.

FEE welcomes the idea of developing a specific standard dedicated to this subject matter. However, this task should be undertaken cautiously keeping in mind the following:

- If there is one standard covering the whole subject matter, it will need to contain high level principles and allow practitioners to use a level of judgement to adapt their work depending on the nature of the estimates and fair value measurements to be audited. FEE is in favour of a principles-based rather than a rules-based standard as it might better accommodate a variety of different situations as well as innovation in auditing. There is also a danger that if the standard becomes over-engineered, the public expectations may become unrealistic in relation to the auditor's ability to obtain evidence for what remain subjective estimates.

- In some cases, it would also be welcomed to include a level of ‘conditionality’ in those requirements which are not applicable in all circumstances. ISA 540¹ *Auditing Accounting Estimates, including Fair Value Estimates, and Related Disclosures* managed to bring these two areas together: it is a high level standard in which guidance is developed in a sufficient level of detail as needed.
- It is worth noting that the concept of ‘challenging management’ when auditing accounting estimates and fair value measurements does not appear in the Consultation Paper. In our view, this aspect is essential in dealing with this topic and FEE would therefore encourage the PCAOB to emphasise more the due process to be applied in the proposed standard, to correctly apply professional judgments, having the right state of mind etc. to support third-party evidence.
- It would be helpful if the new PCAOB standard could be aligned with the IAASB standard ISA 540 *Auditing Accounting Estimates, including Fair Value Estimates, and Related Disclosures*. In general, the right balance will have to be found between applying principles and requiring auditors to undertake certain detailed procedures. The priority should be that both standards remain consistent with each other.

FEE has been consistently advocating for the alignment of auditing standards globally to the maximum extent possible that enhances both the quality of audits and the acceptance of audit work globally.

Our detailed responses to the questions stated in the Consultation Paper are set out below. For further information on this FEE² letter, please contact Hilde Blomme on +32 2 285 40 77 or via email at hilde.blomme@fee.be or Noémi Robert on +32 2 285 40 80 or via email at noemi.robert@fee.be from the FEE team.

Yours sincerely,



André Killesse
FEE President



Olivier Boutellis-Taft
FEE Chief Executive

¹ A revision of ISA 540 is not mentioned in the [IAASB strategy and work programme](#), but some amendments are in consideration against the backdrop of the use of professional scepticism and the audit of financial institutions. Reference is made to pages 27 and 32.

² FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 47 professional institutes of accountants and auditors from 36 European countries, including all of the 28 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 800,000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

Appendix: Responses to Questions

Questions 1-3: Current Requirements and Certain Audit Practices

The information included in the Consultation Paper satisfactorily reflects the current audit practice. FEE agrees with the PCAOB that it is not acceptable for the auditor to take valuations at face value without further investigation.

The Consultation Paper mentions that many firms with international audit practices are familiar with and use ISA 540³. As referred to above in our general comments, it would be very helpful if both PCAOB and IAASB standards could be consistent with each other. ISA 540 was updated more recently than the PCAOB standards and consistency of both sets of standards would enhance both the quality of audits and the acceptance of audit work globally.

When considering standard setting in this area, we would like to emphasise that guidance provided by standards that are aimed at being applied internationally should not be turned into a set of excessive additional requirements. The right balance will have to be found between applying principles and requiring auditors to undertake certain procedures. We do not believe that auditing standards need to address issues relating, for instance, to national level pricing desks. They are essentially issues of methodology and are not relevant to the development of auditing standards.

Questions 4-9: Staff consideration of Alternative Approaches

FEE welcomes the idea of developing a single standard dedicated to this subject matter. However, if there is one standard covering the whole subject matter, it will have to contain high level principles and allow practitioners to use judgement to adapt the work depending on the nature of the estimates and fair value measurements to be audited. In some cases, it would also be welcomed to include a level of “conditionality” in those requirements which are not applicable in all circumstances.

We note in our general comments in the covering letter that we support international harmonisation to the maximum extent possible. The success of the IAASB standard ISA 540 is linked to the application of the principles-based approach with high level requirements supported by non-mandatory application material, and in this case also a practice note, IAPN 1000.

³ A revision of ISA 540 is not mentioned in the [IAASB strategy and work programme](#), but some amendments are in consideration against the backdrop of the use of professional scepticism and the audit of financial institutions. Reference is made to pages 27 and 32.

It is worth noting that the concept of “challenging management” when auditing accounting estimates and fair value measurements does not appear in the Consultation Paper. In our view, this aspect is essential in dealing with this topic and FEE would therefore encourage the PCAOB to emphasise more the due process to be applied in the proposed standard, to correctly apply professional judgments, having the right state of mind etc. to support third-party evidence.

Questions 10-16: Identifying and Assessing Risk of Material Misstatement

FEE supports that the specific risk assessment requirements and procedures associated with accounting estimates and fair value measurements be included in AS No.12. The potential amendment to AS No. 12 described in the Consultation Paper is appropriate and might also refer to fair values.

FEE does not support the inclusion of “presumed significant risks”. If the standard includes a presumption, it should be a rebuttable presumption. The wording used in question 16 appears to be taking away auditor judgment when assessing whether a significant risk actually exists or not.

Questions 17-21: Responding to the Risks of Material Misstatement

FEE does not consider it appropriate to include specific procedures for the audit of disclosures relating to accounting estimates (we refer specifically to question 19 in this respect) given the fact that it removes the use of auditor judgement.

In addition, there is a risk that it will result in an outdated standard given the frequent changes occurring in disclosure requirements. Principles-based standards that can accommodate changes in accounting standards are preferable.

Questions 22-24: Substantive Procedures for Testing Accounting Estimates

The auditor’s selection of approaches related to testing accounting estimates is important. Where there is a choice between developing an independent estimate, reviewing subsequent events or performing work on management’s process, the latter is often chosen. It might be helpful to suggest that this is not always the most appropriate approach and that professional scepticism should be demonstrated by challenging rather than seeking corroborative evidence only. Nevertheless, we do not believe that auditing standards should attempt to cover all eventualities in this level of detail.

Questions 25-31: Testing the Company’s Process

Generally speaking, it is difficult to argue against the “best practices” as included in the grey boxes on pages 33 and 35 of the Consultation Paper. An issue would arise if all these proposals were included as requirements for all types of accounting estimates: it would be an additional unnecessary burden that will not enhance the quality of audit evidence.

For an actuarial valuation, following the requirements included in the grey box on page 33 would not be an issue. However, it could be a challenge in other circumstances, for instance for unique products or for instruments where valuation assumptions and models are not shared or where internal models had or would need to be developed.

In connection with evaluating assumptions as elaborated in the grey box on page 37, the Consultation Paper refers to both “minor variation in the assumption” and further to “significant assumptions”. This wording inconsistency could lead to some confusion in practice as to how much attention the auditor must pay to what information, i.e. at what level should the bar be set. It might be clearer if the term ‘material’ was used. We are indeed concerned that the list on page 37 may result in too many assumptions being identified as significant simply because they meet one of the characteristics listed. In practice, this may not have a material impact on the estimate or fair value measurement. In such circumstances, it would not be effective for the auditor to be required to perform audit procedures on such assumptions.

The proposed text on page 38 that requires information produced by a specialist to be treated as if it had been produced by the company effectively ignores the fact that a specialist does not ordinarily form part of the company. Instead, we believe that the focus should be on understanding the independence and objectivity of the specialist and the process that was put in place to develop the estimate.

Questions 32-35: Developing an Independent Accounting Estimate

Auditors often develop “a range” of acceptable estimates or fair value measurements, but developing an independent accounting estimate by the auditor, as referred to in the Consultation Paper, might not be the best way forward.

We would prefer a methodology that develops a hierarchy of approaches and a scaled audit response. Emphasising the need to challenge the estimate provided by the entity is an important step forward⁴: the auditor will have to question its reasonableness, benchmark it and compare the amount to a realistic scale for a given industry and instrument. Having said that, it might sometimes also be difficult for the auditor to find other sources of information, benchmark this information or compare the amount to a realistic scale for a given industry. This is the reason why FEE would not completely rule this independent estimate out of the standard as this solution might be needed to perform a proper evidence-based audit.

⁴ Reference is made to ISA 620 *Using the Work of an Auditor's Expert*. Consideration might also be given to ISA 220 *Quality Control for an Audit of Financial Statements* that deals with situations where the engagement team includes a member, or consults an individual or organization, with expertise in a specialized area of accounting or auditing and ISA 500 *Using the Work of a Management's Expert*.

Questions 36-37: Evaluating Audit Evidence from Subsequent Events

FEE agrees that subsequent events or transactions occurring after the balance-sheet date should be addressed by the PCAOB Standard. The requirements described in the Consultation Paper appear adequate. An important caveat is that subsequent events should only be taken into account to the extent that it is permitted by the accounting principles relevant to the estimate in question.

Questions 38-43: Use of Third Parties

Regarding the information provided by third parties, we would like to promote the guidance provided by ISA 620⁵ that properly reflects the actual needs and practices of the profession, this standard having been recently revised.

Additionally, according to the Consultation Paper as stated in the grey box on page 44, if the third party providing information to the auditor is the same party that provides the information to the entity, the information should be dealt with as a piece of information provided by the entity. In our opinion, the auditor should understand how the calculation is done. If the auditor is satisfied and if the expert is competent, independent and objective, ignoring the fact that it is third-party information is a step too far. As proposed in the Consultation Paper, it seems that the same rules would apply when the entity uses an internal actuary rather than an external actuary.

Questions 44-45: Economic Impacts

Whilst it is difficult to provide specific comments given that the incremental work required will depend upon the specific facts and circumstances, we would like to volunteer some general observations as follows:

- A detailed list of requirements to be applied in all situations will most probably result in a “check the box approach” that will increase costs but not necessarily improve quality;
- The proposed approach to effectively ignore the competence and objectivity of third parties, and instead, treat information produced by them as if produced by the company will increase costs as well as be potentially impractical.

⁵ Using the Work of an Auditor's Expert accessible at : <http://www.ifac.org/sites/default/files/downloads/a035-2010-iaasb-handbook-isa-620.pdf>