

3 November 2014

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Dear Mr. Baumann,

**Re.: Staff Consultation Paper: Auditing Accounting Estimates and Fair Value Measurements – August 19, 2014**

The IDW would like to thank you for the opportunity to comment on the above mentioned Staff Consultation Paper: Auditing Accounting Estimates and Fair Value Measurements released August 19, 2014 (hereinafter collectively referred to as the “paper”).

We appreciate the need to revise the PCAOB’s interim standards in this area. Nevertheless, we would caution that in doing so, the PCAOB will need to be extremely sensitive to the risk of increasing public expectations concerning this particular aspect of the audit. For example, increasing the level of prescription in particular areas as discussed in the paper may inadvertently increase public perceptions that provided the entity applies the “right” process or model an acceptably reliable estimate can “more or less always” be included in the financial statements, when in fact the desired degree of precision remains unattainable in respect of certain accounting estimates. Of course to the extent that PCAOB inspections reveal insufficient levels of testing by auditors, a better clarification of requirements within a new standard could help enhance audit quality; however no new standard can compensate fully for the fact that

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accounting estimates are subjective in nature, such that hindsight may always reveal a degree of imprecision that no audit can compensate.

We have chosen not to respond in detail to individual questions, but have instead concentrated our comments on those of the specific issues raised within the broader sections of the paper for which we have a specific view.

#### The Potential Need for Standard Setting

The IDW agrees that the extant PCAOB standards dealing with accounting estimates are in need of revision, for the reasons explained in the paper.

As a long-term supporter of the International Standards on Auditing (ISAs), the IDW has consistently called for maximum possible alignment of the PCAOB's auditing standards with the ISAs. We are therefore pleased to note on page 14 of the paper that staff recognizes that many firms with international audit practices are familiar with and use ISA 540. To the extent that auditors use external expertise in auditing accounting estimates ISA 620 would also be relevant.

In our view, there are a number of specific challenges from an audit perspective that are not specifically discussed in the paper. For example, different perceptions of the relevant accounting requirements (both IFRS and US GAAP) between preparers and auditors and between jurisdictions is one such issue. Firms with international operations certainly observe that cultural influences exacerbate the inherent subjectivity in the interpretation of requirements in the accounting standards between jurisdictions, for example, concerning the question as to whether prices obtained from a pricing agency can be regarded as level 1 in the accounting hierarchy or not, given the resultant impact on disclosures required to be made within the notes to the financial statements. We understand that reporting entities also often see this issue from a reputational perspective, and would generally prefer to be seen to report level 1 rather than level 2 information where permissible. The auditor is thus faced with having to accept or reject the company's adopted treatment as being in compliance with the applicable financial reporting framework and also with the difficulties in obtaining the necessary supporting evidence, since pricing agencies often do not have an interest in making their business models transparent for competitive reasons. Consequently, we believe that the PCAOB can play an important role in sensitizing financial reporting standard setters, such as the FASB and the IASB, that financial reporting standards ought to recognize the need for

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preparers to obtain adequate evidence to support their estimates even when third-party pricing agencies are used.

#### Staff Consideration of Alternative Approaches

We agree that issuing staff guidance cannot be the long-term solution, and would support the issuance of a single standard mirroring ISA 540 to replace the existing PCAOB auditing standards in this area.

As the PCAOB staff is no doubt aware, the IAASB has recently undertaken a post-implementation review of its so-called clarity standards issued in 2009 in order to inform itself as to any need for revision. The IAASB's report detailing findings from the post-implementation review includes specific mention of ISA 540 on page 38. One of the goals identified in this report is: "To emphasize the importance of professional skepticism and ensure that attention is paid to indicators of possible management bias and their audit implications". This is a key aspect in the area of accounting estimates, as concerns have been expressed in some quarters that auditors do not consistently challenge management estimates to a satisfactory degree. Consequently, we were surprised to note that this was not discussed in the paper.

We do not believe that it would be appropriate to include industry specifics as requirements since the standard should be applicable to all entities that use estimates. Specific guidance using examples would be the preferred way of dealing with any industry specifics.

#### Key Aspects of a Potential New Standard and Related Potential Requirements

In our opinion the approach taken by the IAASB in ISA 540 with respect to risk identification and assessment requirements pertaining to accounting estimates is appropriate to assist auditors in obtaining sufficient appropriate evidence in relation to accounting estimates. The application and other explanatory material in ISA 540 contains valuable information, much of which would add helpful clarification if included – as guidance – in the PCAOB's standard(s). In this context, we note that the PCAOB staff pose a number of questions as to the desirability of further clarification, such as is discussed on page 30 et seq. We generally support such clarification in the ISAs and their potential application within a principles-based suite of standards, but do not believe it is appropriate for the PCAOB to go further in requiring the auditor perform additional procedures as put forward in the paper; procedures that are based on guidance

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as opposed to requirements within the ISAs. Such a level of prescription may be appropriate in relation to particular significant risks, but be excessive in some other circumstances and, in our view, is generally best dealt with as clarification about how the auditor may fulfil the overarching requirement. Additional requirements should either be conditional requirements or be restricted to those risks that the auditor had determined are significant risks, as appropriate.

On balance and given the sensitivity of accounting estimates from an audit quality perspective, dealing clearly with all aspects of accounting estimates in the audit in a single standard can be helpful, although this might also be achieved with appropriate cross-referencing within the suite of PCAOB standards. This equally applies to other areas such as recourse to external experts, evaluation of audit evidence and presentation within the financial statements. In view of the comments we have made above concerning divergent interpretation of the requirements of accounting standards in the area of fair values, we agree that it may be useful to include a specific material on note disclosures concerning levels within the fair value hierarchy to draw attention to this issue.

If you have any further questions about our comments, we would be pleased to discuss our comments with you.

Yours truly,

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Executive Director

Gillian Waldbauer  
Technical Manager, International Affairs