

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on June 18, 2015 that relates to the Board's project on *Auditing Accounting Estimates, Including Fair Value Measurements and Related Disclosures*. The other topics discussed during the June 18, 2015 meeting are not included in this transcript excerpt.

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1 MR. BAUMANN: Well thank you very much for getting
2 back after break. I see everybody running to their seats
3 and trying to hit our target time.

4 We're in the home stretch here, but we have a very
5 important discussion left in the remaining time, and that
6 is moving ahead and continuing to make progress on our
7 proposed standard on auditing accounting estimates and fair
8 value measurements.

9 As we know, financial statements are largely a
10 conglomeration of estimates and fair value measures, so
11 there can't be a more important auditing standard.

12 Barbara Vanich has been leading the project and will
13 lead the discussion. Barbara?

14 MS. VANICH: Thank you, Marty, and good afternoon.
15 It's my pleasure to talk to the SAG this afternoon about
16 our project on auditing accounting estimates and fair value
17 measurements.

18 Before I start to talk, we're going to try to keep
19 this light. We realize you've had a lot of heavy lifting.
20 It has been a very technical agenda, so I'll talk briefly,
21 and then we'll give you a chance to put in some comments.

1 But I would like to introduce my righthand women,
2 literally, to my side, my teammates on this project,
3 Dominika Taraszkievicz and Nike Adesoye.

4 So this afternoon, we're going to talk about various
5 aspects of the project.

6 First, we'll spend a few minutes providing a brief
7 introduction, which will include a summary of our
8 activities since we last briefed you on this project last
9 November.

10 Next, we'll talk about the general direction of the
11 project. This will include a brief discussion of the need
12 for standard setting, along with the areas of the project
13 where the staff feels fairly confident about making a
14 recommendation to the Board.

15 We previously talked about the need for standard
16 setting back in October. However, today's discussion will
17 reflect some refinements based on comments received on the
18 staff consultation paper on accounting estimates and fair
19 value measurements.

20 We're interested in whether SAG members believe
21 there may be additional needs for the staff to consider.

1 The discussion on the general direction of the
2 project will also include a brief overview of the areas
3 that based on comments or other outreach the staff feels
4 prepared to talk to the Board about a recommendation. SAG
5 members will have their chance to provide a view on these
6 areas.

7 And then lastly, we want to talk about three areas
8 where the staff continues to perform research. For each of
9 these three areas: addressing significant measurement
10 uncertainty; emphasizing professional skepticism; and the
11 use of third parties; we'll talk about certain
12 alternatives, many of which were provided by commenters.

13 SAG members will then have a chance to provide views
14 on the alternatives discussed along with alternatives that
15 we might not have mentioned.

16 This morning we heard from some great panelists and
17 had lots of great discussion on specialists, how and in
18 what way they interact with companies and auditors. Some
19 of what you heard this morning has direct relevance on our
20 discussion regarding the use of third parties, so when we
21 get to that part of today's conversation, I'll summarize my
22 thoughts on what I heard because I think you may have

1 already responded to some of the alternatives and questions
2 we want to ask today.

3 So very briefly, it has been about ten months since
4 we issued the staff consultation paper on auditing
5 accounting estimates and fair value measurements. We had a
6 special meeting of the SAG last October. We had a great
7 discussion about the consultation paper at that time.

8 The comment period ended in November, and we
9 received 40 comment letters. We discussed a summary of
10 those comments with the SAG in November.

11 Since then, the staff has completed a detailed
12 analysis of the comment letters received. We've conducted
13 additional research on measurement uncertainty and on the
14 use of third parties. And we also participated in a panel
15 discussion on biases related to estimates and fair value
16 measurements at the 2015 PCAOB-AAA Annual Meeting.

17 It was through preparing for that panel discussion
18 and listening to the SAG meeting back in October and then
19 reviewing the notes from that meeting that we got to one of
20 our topics for discussion this afternoon, and that is how
21 to better emphasize professional skepticism in a new

1 standard on auditing accounting estimates and fair value
2 measurements.

3 So let's turn our discussion to the need for
4 standard setting. As Marty talked about this morning,
5 considering the need for standard setting is a key part of
6 our economic analysis.

7 The staff included a discussion of our preliminary
8 view on the need for standard setting in the staff
9 consultation paper, and that need included audit
10 deficiencies noted by the PCAOB and by other audit
11 regulators, changes in the financial reporting frameworks,
12 growing reliance on the work of third parties, and concerns
13 expressed by some over perceived inconsistencies in the
14 existing standards.

15 Through comment and SAG discussions, we have
16 identified several other needs that we're going to spend
17 time on a little bit later today, but the first, as I
18 mentioned, is how to greater emphasize professional
19 skepticism in a new standard.

20 And then lastly, and I think this also came up in
21 the discussion today, what could the staff do to further
22 address significant measurement uncertainty?

1 And with that, I'll just open the floor to SAG
2 members, if you have any views on the needs for standard
3 setting that I just covered.

4 All right, Tom Selling?

5 MR. SELLING: Thanks, Barbara.

6 I was happy to see in the previous session that we
7 had a presentation in oil and gas because it represents, I
8 think, a very interesting case study when we're thinking
9 about estimates in general.

10 That's because for most of the oil and gas
11 estimates, management can produce the numbers in a filing,
12 but on the other hand, unlike the auditing rules that we
13 have, management also has the option to outsource that
14 information content to a specialist.

15 Another interesting contrast I think is that
16 although auditors perform limited procedures on the oil and
17 gas disclosures, that information isn't audited either.

18 So it's an interesting case study, and specifically,
19 if you look at AU 328 Paragraph 4, it states that
20 management must be responsible for making the fair value
21 measurements and the disclosures included in the financial
22 statements.

1 I think this is interesting because the PCAOB owns
2 this language, that unlike other disclosures in a filing, I
3 am not aware of the securities laws that explicitly state
4 that management is responsible for the numbers.

5 Management does have specific responsibilities for
6 financial reporting in the securities laws, and I'm not a
7 lawyer here, and so I fully expect John White to be
8 responding pretty soon about this, but to my mind, this
9 particular provision in Paragraph 4 that we see in 328 and
10 we see in similar places imposes additional requirements
11 over and above the securities laws.

12 My point is that this is not immutable, that it's
13 not something that's given to us from the outside. And
14 it's possible to rewrite that paragraph such that, like oil
15 and gas, we can give the preparer an option, that the
16 preparer can either obtain an estimate from an independent
17 specialist or not, and if a preparer -- and particularly
18 with respect -- and the reason why I'm focusing on 328 is
19 because I think fair value estimates are a good place to
20 start rather than talking about estimates in general, but
21 given that there are evaluation experts out there, this
22 would be a good place to start.

1 And perhaps when that's the case, then if the fair
2 value estimate is outsourced, that triggers one certain
3 type of level of audit responsibilities and procedures.
4 When it's insourced, then we have the traditional
5 specifications, which are already in 328, and to my mind
6 are perfectly adequate -- I shouldn't say perfectly
7 adequate, but to my mind are what you would expect in that
8 regard.

9 And on top of that, perhaps when it's material,
10 either the audit report or the notes to the financial
11 statements could provide appropriate disclosures when an
12 independent specialist is elected.

13 Now, my remarks are, I think, a little bit forward-
14 looking here because I think we'd all agree that everything
15 here has to be predicated on what we talked about before,
16 that there has to be an environment where there is a proper
17 specialist infrastructure, where there are certification
18 and independence requirements, so I think that, you know,
19 moving to what I am talking about here would be highly
20 incremental, but I believe, and I'd like to encourage the
21 PCAOB and the SEC to work toward that type of goal.

1 There is nothing in the securities laws that say
2 management has to produce the numbers. Management has to
3 disclose the numbers, and they have to have controls over
4 those disclosures, they have to have disclosure controls
5 and procedures, but there's nothing that says they actually
6 have to produce the numbers, and as we move toward more
7 current evaluations and things like that, I think we ought
8 to think about or rethink the model.

9 MR. BAUMANN: Just an observation, and I think maybe
10 securities lawyers at the table might have observations as
11 well, Tom.

12 I don't think the AU 328 Paragraph 4 was intended to
13 put any burden on the part of management via auditing
14 standards, so I think this statement is a reflection, in my
15 view, of the fact that there are books and records laws
16 with respect to securities laws for companies to keep
17 accurate books and records and produce financial statements
18 that present fairly financial information in conformity
19 with the accounting framework.

20 So I don't think that sentence states anything other
21 than what is already required by securities laws, so I
22 don't know if anybody has any other perspective on that,

1 but on that point, I don't think companies look to our
2 auditing standards and say there's a new requirement there
3 for them.

4 MR. SELLING: Well, but by extension, the audit
5 report then says that management is responsible for the
6 numbers, and our responsibility is to audit them.

7 And I could be wrong, but I don't believe that comes
8 out of securities laws. I think that that audit report
9 language comes out of the auditing standards, and that
10 language is not immutable. The language could say
11 management is responsible for most of the numbers, with the
12 exception of the fair value of our loan portfolio.

13 MR. BAUMANN: Loretta Cangaliosi?

14 MS. CANGALIOSI: Yes, I just feel compelled to
15 respond to that. Stop laughing, Larry.

16 (Laughter.)

17 MS. CANGALIOSI: But, you know, management is
18 responsible for the entire financial statements: the
19 footnotes, the entire thing, okay? And we take
20 responsibility for it.

21 The fact that we hire a specialist, again, my first
22 comments were that that's not a throw-it-over-the-wall

1 exercise. It isn't as if I hire a specialist and I tell
2 him go out and do this. I am involved in that, and it's my
3 responsibility to not only understand the inputs and help
4 provide the inputs, but to understand the outputs of that
5 specialist.

6 I can't outsource, and I never can outsource, my
7 responsibilities for the financial statements or the
8 internal controls. I don't know any company that operates
9 on a different standard than that. Wally, do you have any
10 thoughts? No.

11 So I guess I feel like I own those financial
12 statements, so when they go out, it's my name that's on
13 those financial statements, and I need to make sure that I
14 am comfortable with what has been put in, even by a
15 specialist, because they are mine.

16 MR. SELLING: I would say that's because the audit
17 standards say that you need to own those financial
18 statements, otherwise we're not going to audit them. And
19 you are describing what is. I am describing what can be,
20 and what can be without an Act of Congress.

21 You may disagree with what my vision is, and you may
22 think that we are in the best of all possible worlds that

1 way, but I think there is a lot of evidence to indicate
2 that it's not working too well as the need for management's
3 estimates increase.

4 MR. BAUMANN: Bruce Webb?

5 MR. WEBB: Well, I 100 percent agree with Loretta
6 that irrespective of their use of a specialist, management
7 is fully responsible for the financial statements, just as,
8 irrespective of their use of specialists, the auditor is
9 fully responsible for the opinion expressed on those
10 financial statements.

11 MR. BAUMANN: Thank you.

12 Harrison Greene?

13 MR. GREENE: I am not an expert on the securities
14 laws, but I know in every 10-K, there is usually a
15 certification by management that they take responsibility
16 for the financial statements and preparation of the
17 financial statements, internal controls and everything, and
18 those sorts of things, and particularly with our fiduciary
19 rules, there is a requirement that management is
20 responsible.

21 They have to do a statement of responsibilities in
22 their annual reports to us that they're responsible for the

1 preparation of the financial statements in accordance with
2 GAAP, that they have to have internal control structures
3 set forth, they're responsible for all that.

4 The auditor is only opining on those financial
5 statements that are prepared by management, so they're
6 management's sole responsibility for the preparation and
7 the content of those financial statements and notes.

8 MR. BAUMANN: I'd like to get Barbara back, more on
9 topic on the subject of auditing estimates in our project.
10 Ken, unless you had something more you wanted to -- ?

11 MR. GOLDMAN: I remind those that are involved with
12 public companies' CFOs, just think of your management rep
13 letter that you signed, which goes, it used to be 5 or 10
14 pages, probably 20 pages long, which does clearly lay out
15 all the responsibilities that I think we all feel we do own
16 and control.

17 I could not agree more with the comment. I have
18 always felt there are certain things you cannot outsource.
19 One of those is the accounting and the sanctity of the
20 accounting numbers and the planning, and so I am very much
21 in favor of that and the responsibility thereon.

1 One of the things, I think the other point I did
2 want to make though is, you know, there are some things I
3 think we go about on the estimates that we put in our
4 filings which frankly I am not always sure, it would be
5 interesting to have a discussion here with some of the, you
6 know, users and not the preparers of the statements,
7 because my sense sometimes is we go through a lot of work
8 to create some of those estimates, which I am not sure are
9 used very well, and I'm not sure could be improved.

10 So I hope we get more into how to make that part of
11 the filings more applicable and more useful, but I think in
12 terms of ownership of statements and numbers,
13 certifications thereon, I think that, you know, anyone that
14 I know that practices in our roles takes those, you know, I
15 could almost say damn, but certainly extremely seriously.

16 MR. BAUMANN: Wouldn't your disclosure of critical
17 accounting estimates help users use the information --

18 MR. GOLDMAN: I don't know if that's true. I would
19 like to test that, because I can't recall ever having an
20 investor, an analyst, a sell side or buy side ever ask me a
21 question on that, ever, and so I am glad for someone else

1 to say anything different, but I am not sure, you're
2 shaking your head, you do or don't get -- ? So we don't.

3 So I am just positing that maybe we could do some
4 improvement on that section, so again, there's other people
5 here, maybe a lot smarter -- I am sure a lot smarter than I
6 am on that, but I just know, when I talk to investors, I
7 don't get questions on that. I get a lot of questions on
8 MD&A and a lot of other things, but that is one area I
9 can't think of the last time I got a question on it,
10 honestly.

11 Oh, one other thing. And just to put a, you know, a
12 bullet point on the importance of the management rep letter
13 and why we do own responsibility, is I do remember there's
14 some folks that when things are incorrect there, that's, in
15 theory, you're lying to the SEC. That's the law as I
16 understand it.

17 So that management rep letter and everything you do
18 to make sure those numbers are correct, you own.

19 MR. BAUMANN: All right. Bill Platt?

20 MR. PLATT: Okay, and Barbara, I am going to try to
21 pull it back to the question you asked when you started
22 with us, so back to a different topic, but related.

1 You know, you talked about, in the feedback process,
2 you identified that additional consideration would be given
3 to incorporating more on professional skepticism and then
4 management uncertainty. And I would be supportive of both
5 of those concepts.

6 You know, I often think in standard setting, we silo
7 our activities into what the activity is, estimates, and we
8 don't think holistically enough about it, and I think, if
9 you were to look at, for example, and not to bring up a
10 sore subject that Bob raised this morning, but internal
11 controls, you would see a lot of audit deficiencies in the
12 area of internal controls related to management estimates
13 and the controls around management estimates.

14 And so I would think that if we were going to do a
15 standard, you would at least more than just say AS 5 is out
16 there, go follow it. Use it as an opportunity to clarify
17 what expectations might be, what performance might be, and
18 the like.

19 And so the more you can take concepts like
20 skepticism, controls, and look at it holistically in a
21 standard so when an auditor goes to it, they can kind of,

1 if they're auditing in that area, think about it broadly, I
2 think would be helpful.

3 MS. VANICH: Well, thank you, Bill. Bob Herz?

4 MR. HERZ: Yes, not the same point as Tom's, but it
5 did remind me of, you know, Level 1 fair value estimates,
6 they're traded, they're quoted, you can look them up and
7 all that. Level 3 requires a lot of work and assumptions
8 and expertise and all that.

9 But there is kind of the stuff in between.
10 Sometimes it's Level 2, you know, where there's pricing
11 services, and for whole swaths of classes of assets, they
12 have fairly uniform methodologies.

13 And I think I probably raised this in the session
14 last October, but would a service bureau type approach kind
15 of work there in terms of a structural solution for, you
16 know, that might be more efficient across the system,
17 versus every audit firm have to go to each one and, you
18 know, and all that, and it might encourage, you know, Race
19 to the Top in terms of some of those, you know, if in fact
20 they have to be quality outfits and all of that and
21 independent and that, you know.

1 I can't remember the lady's name over there --
2 Susan, yes, I was impressed with what she had to say about
3 Harvest and all that, and I'm not sure why every firm and
4 every engagement team needs to reduplicate the effort.

5 MS. VANICH: Okay, thanks. Thank you, Bob.

6 Now I want to focus briefly on some areas where, as
7 I mentioned earlier, the staff feels fairly confident that
8 we're nearing being able to make a recommendation to the
9 Board.

10 So the single-standard approach, which was discussed
11 in the staff consultation paper, under that approach, the
12 staff would draft a recommendation to the Board, a single
13 standard that addressed auditing accounting estimates and
14 fair value measurements.

15 Today, just by review, we have auditing accounting
16 estimates, AU Section 342, we have a standard on fair value
17 measurements, AU Section 328, and then we also have some
18 valuation guidance in AU Section 332.

19 A number of commenters, including auditors, thought
20 that developing a single standard to address both estimates
21 and fair value measurements would have advantages. I will
22 mention that not all commenters agreed.

1 However, the commenters that did not agree,
2 generally their comments focused on the difference between
3 fair value measurements and other types of estimates rather
4 than on how the audit approach would differ. The IAASB and
5 AICPA have one standard that addresses both fair value
6 measurements and estimates. Commenters who were not
7 supportive of a single standard did not attribute their
8 views to any issues with those standards, and so the staff
9 feels fairly strongly that that is a good recommendation
10 for the Board.

11 Another point is that the further integration with
12 risk assessment, and I think this is consistent with some
13 of the discussion we had earlier that standards should be
14 risk-based and audit attention should be focused where more
15 risk of material misstatement lies.

16 In the staff's view, a potential new standard that's
17 further integrated with the risk assessment standards would
18 help auditors improve their overall risk assessment and the
19 responses to the risk of material misstatement, including
20 risks associated with estimates and fair value
21 measurements.

1 This view was discussed in the staff consultation
2 paper. In the staff consultation paper, we had included
3 several potential amendments that would be made to the risk
4 assessment standards. Commenters generally agreed. Some
5 gave us some editorial suggestions which the staff is
6 certainly going to consider, but there was general support
7 around further aligning the standard with risk assessment,
8 and we're certainly interested in SAG members' views on
9 additional ways we can further integrate the standard.

10 The staff is also considering, though, that some
11 commenters said having information or requirements about
12 assessing risk within the standard on estimates and fair
13 value measurements would be helpful, and so I guess as
14 maybe a way of handling both comments, we've thought about
15 just including maybe placeholders or some explanatory
16 material to help auditors understand how this standard
17 would work with the risk assessment standards.

18 And the last point I want to cover in this session,
19 or this section, of our discussion this afternoon, is that
20 in the staff's view a new standard would retain the three
21 existing approaches for testing estimates and fair value
22 measurements subject to certain refinements.

1 These approaches are included today in both AU
2 Section 342 and AU Section 328, and that partially is the
3 reason why we think that a single standard is a very good
4 recommendation for the Board.

5 The staff has not seen evidence that these
6 approaches are flawed. When I talk about refinements to
7 the existing requirements, those refinements would include
8 changes to emphasize skepticism and would also include
9 taking maybe the existing requirements, but making sure
10 they're broad enough to apply to both estimates and fair
11 value measurements.

12 Commenters were broadly supportive of retaining the
13 common approaches in a new standard, and no new approaches
14 were suggested.

15 With that, I'd like to again allow SAG members, if
16 you have any views on these areas, to provide comment.

17 MR. BAUMANN: Tom, is your card up again? If you
18 want to make a comment, go ahead.

19 MR. SELLING: All right. This will be just 30
20 seconds.

21 I just want to correct the record that the
22 certification does not say that the financial statements

1 are the responsibility of management. The certification
2 says based on my knowledge, the financial statements and
3 other financial information included in this report fairly
4 present in all material respects the financial condition,
5 et cetera, et cetera, for the periods presented in this
6 report.

7 Then it goes on to talk about its responsibilities
8 for internal controls over financial reporting and for
9 disclosure controls and procedures.

10 I was not proposing to change any of that, all I was
11 proposing is that in the interests of efficiency, that
12 auditors are better at verification and assessing the
13 reasonableness of estimates, that there should be some
14 flexibility given to management to obtain independent
15 estimates that would be subject to different auditing
16 standards than estimates that were generated by management.

17 MR. BAUMANN: Thanks. Philip Johnson?

18 MR. JOHNSON: Thank you, Marty.

19 I certainly agree that as Wallace mentioned in the
20 October 2014 session that one standard is preferable, and
21 so I do agree with the general direction of the project,
22 certainly agree with that.

1 But I would raise one cautionary note, and that is
2 it's always easy to keep adding requirements as commenters
3 make points, and rarely do we take the matters away. And
4 so we can get into a situation where I think, as Wallace
5 mentioned in the last session, in this particular area, we
6 shouldn't take away judgment, and therefore, having higher-
7 level principles, I think, are important here so that
8 practitioners can use the judgment when they're doing
9 auditing estimates and fair values, because it's not a
10 precise science.

11 So I would just have that cautionary note, that if
12 we add too much from what commenters are saying, we could
13 get into -- ourselves into a straitjacket of dealing with
14 everything in one particular way.

15 MR. BAUMANN: Right, thanks.

16 We certainly take commenters' points into account
17 and address them as part of our proposals and releases and
18 consider which ones we should take and which ones we
19 comment on that we thought about and just, maybe it's
20 application guidance or something in the release.

21 Bob Herz?

22 MR. HERZ: You may get to this next as you proceed.

1 But I remember when I was reading the material,
2 there's something that kind of said that the best evidence
3 is looking at subsequent events, and I would disagree with
4 that unless it's like two minutes afterwards, because the
5 world changes, the facts on which the estimate was based
6 change, so that doesn't mean you don't look at it and, you
7 know, the reasonableness is the underlying thing, but be
8 careful not to reinforce the notion that, you know, as
9 Loretta said, it's going to turn out to not be that way.
10 That doesn't mean it wasn't a good estimate at the time.

11 MS. VANICH: If I could just respond to that, we
12 weren't suggesting that it's always the best way to audit,
13 but it certainly in cases can be an effective way to audit
14 when a subsequent event is relevant.

15 MR. HERZ: That's got to happen pretty quickly,
16 though.

17 MS. VANICH: David Kane?

18 MR. KANE: Yes, Bob Herz read my mind.

19 We've generally found that the subsequent event, in
20 and of itself, doesn't constitute sufficient appropriate
21 audit evidence. Fair market value and markets change,

1 fluid, so I think it can give you a false sense of security
2 on that.

3 And it also doesn't appropriately reflect the
4 measurement uncertainty. So let's just say you had a bond
5 at 1231 that was, you know, par was 100, and it settled in
6 February at 100, and there was a 60 percent chance it was
7 going to pay you, and a 40 percent chance it wasn't.

8 Well, the settlement value ended up being \$100.
9 That doesn't necessarily mean what the fair value was, and
10 a market participant would factor in that possibility of a
11 credit loss. So we see some teams actually placing over-
12 reliance on that, so I just get a little bit concerned if
13 you were to kind of reorder it that the inference might be
14 made that that is actually more, you know, of a reliable
15 method than some of the others.

16 MR. BAUMANN: Thanks. Good points, in both cases,
17 but I think we want to think not just for fair value
18 measures, but remember the project, we're talking about a
19 single standard for accounting estimates and fair value
20 measures, and certainly settlement of a lawsuit before the
21 financial statements goes out is probably better evidence
22 than whatever estimate legal counsel may have given or

1 management may have come up with as part of their
2 determination of that lawsuit, so there are probably some
3 estimates where the subsequent event provides maybe better
4 evidence than the estimate itself.

5 So I think we will certainly think about that, but I
6 understand your point on fair value securities compared to
7 maybe some other estimates, however, where it really is a
8 confirming event compared to what may have been a rough
9 estimate of what that settlement cost might have been in a
10 lawsuit.

11 Sri Ramamoorti?

12 MR. RAMAMOORTI: With respect to the comments on
13 the three existing approaches, the testing management's
14 process, developing an independent estimate, and evaluating
15 subsequent events, I had two kind of thoughts, but this is
16 more for discussion. You know, I am not myself very sure
17 where I am going with this, but I think it will be
18 important.

19 So we talked about sensitivity analysis, but we also
20 talked about there being kind of a black box, and you know,
21 we don't really know what's going on, it's beyond our

1 capability as auditors, it's maybe too complex and we're
2 not trained, whatever.

3 Well, I think it's imperative that we learn and we
4 continually evolve in terms of our competencies, and we
5 improve the whole process, and so rather than just conduct
6 sensitivity analysis, I'd like for us to maybe think about
7 stress testing these models, and the idea there would be
8 can we come up with tighter internal estimates with greater
9 degrees of confidence? Can we do that, and how can we, you
10 know, move in that direction, at least, over time?

11 And then, maybe even more controversial, back-
12 testing, which is this business of looking at subsequent
13 events, and let me take you to the extreme end: Professor
14 Baruch Lev at New York University has actually talked about
15 how when you have intangible assets that are really
16 difficult to value, but as time passes and subsequent
17 events provide you more information, then yes, now you know
18 how the modeling should have been done.

19 I don't deny there is hindsight and all that, but
20 what he says is, how about then going back and just for the
21 heck of it recalibrate the financial statements to look at,
22 you know, how would it change?

1 So you're going back now that you know what you
2 should have known but you didn't because it was, you know,
3 early in the game.

4 And so the idea of back-testing would really be to
5 give us a sense of what were the assumptions before the
6 fact that we made that totally didn't pan out?

7 Some which were impossible to do anything about
8 because it is such a unique transaction that, you know,
9 that's it, you know, even future information is not going
10 to help you in any way.

11 But where future information can let you know
12 something about the modeling process, if that can help you
13 learn how to model better, I think that's something we
14 should absolutely, you know, keep the thing open, I mean
15 that possibility.

16 And we work with management, and as a profession, we
17 continue to get better at this. That's really the goal.

18 MR. BAUMANN: Thanks, Sri.

19 Maureen McNichols?

20 MS. MCNICHOLS: So your slides in the document refer
21 to academic research that supported this preferential
22 ordering, and I am just curious, I didn't see the citations

1 to those specific studies. They may be in an earlier
2 document, but I'd be curious to look at those and also
3 maybe hear just a few comments about the nature of those
4 studies and how they led to that conclusion.

5 MS. VANICH: Let me respond because I know we're
6 jumping ahead just a little bit, and actually, maybe what
7 we could do is just advance the slides and start to cover
8 this area, because I think people's comments are getting to
9 this issue.

10 So a number of the alternatives that were included
11 in the advance material in the slides with respect to how
12 the staff could emphasize professional skepticism, it
13 included an explicit requirement for the auditor to
14 identify which of the assumptions used by management are
15 significant when testing management's process.

16 That was included in the staff consultation paper,
17 and commenters were generally acceptant of that
18 requirement.

19 I'll just jump ahead to answer the question and then
20 go back, but changing the order of the substantive
21 approaches, and I think maybe a couple of the comments
22 related to this. I didn't have the citations in the

1 materials, although we could certainly provide them, and I
2 think it was at least more than one study, but we've also
3 heard it talked about at some forums. One way of increasing
4 skepticism without changing requirements is to present
5 things in different orders, and I think this got to Bob's
6 point where putting subsequent events first might not be
7 the best alternative.

8 But to do this alternative would not involve
9 increasing requirements, it was just the general
10 presentation. So I don't know if anyone else has a view on
11 that.

12 MR. HERZ: I think there is a good point there that
13 the other comment brought up.

14 I mean, I think about the loss development triangles
15 that are disclosed for insurance companies, which is kind
16 of what, you know -- what it does, it does help you
17 understand management's ability to model and forecast, you
18 know, some of that at least. It does give you some of
19 that.

20 But what it doesn't tell you exactly is whether the
21 estimate at that point in time, you know, was the best
22 number or not, because there is new information.

1 But I think they're related, but there's a slightly
2 different purpose. Now that auditor skepticism, to kind of
3 look at the track record, you know, their track record in
4 predicting things and that, but you've got to be careful
5 again because the world changes.

6 MR. BAUMANN: I agree with that point, but looking
7 at track records is a valuable piece of information as
8 well. But those are all good points.

9 Phil Santarelli?

10 MR. SANTARELLI: Thanks Marty.

11 I do -- I wanted, as an auditor, I wanted to react
12 to Sri's comments just a bit, and I think it piggybacks on
13 what Bob just said.

14 But the -- when I think about testing management's
15 process, I don't think solely with respect to what's in the
16 black box, if there is in fact a black box. What I think
17 about is how management is dealing with the black box,
18 because I believe that's a big part of internal control
19 over financial reporting: how capable is management of
20 knowing how the estimates are developed? I think Loretta,
21 you spoke to this a little bit before.

1 And the concept of back-testing and backward-
2 looking, we've used that for years, and a very common area
3 is with respect to percentage of completion accounting,
4 when you're auditing that.

5 The thing is that is a build-up of information about
6 the capabilities of management and their estimation
7 process. It is not necessarily a discrete piece of
8 information within an audit period, and it takes time to
9 build that up.

10 So you get a history, you get a confidence with a
11 particular system and process that management is using. I
12 think the standard should enable you to draw on that, much
13 as you do in AS 5 and so forth, your knowledge of what they
14 did in the past may inform your risk assessments, et
15 cetera.

16 But because of the constraints of financial
17 reporting, there is just, in many cases, it's impossible to
18 do in a tight window. So it builds up over a period of time
19 and you become more confident, with Bob's caveat that the
20 world changes, including people changing and processes
21 changing. It is up to the auditors to note that, you know,
22 if something has happened.

1 And from the skepticism standpoint, a change in
2 management's process has to -- has to put a red flag up,
3 you know? You did it this way for five years, what
4 happened? What happened in your world that caused you to
5 question that methodology, because it in fact had been
6 pretty effective?

7 So I think that's a skepticism-type thing, so -- .

8 MR. BAUMANN: Thanks, Phil.

9 Jouky Chang.

10 MR. CHANG: Thanks, Marty.

11 And I thought I'd share a little bit with the group
12 here about how we, when we're engaged on valuation
13 engagements, how we deal with sort of this question of
14 doing the work post the actual transaction date, if you
15 will.

16 Because a lot of what we do is beyond the date of --
17 of the, you know, whether it's the transaction, the
18 business combination that's happened, or we're doing a --
19 for example, a goodwill impairment analysis, it's generally
20 beyond the actual testing date.

21 So the question we always ask ourselves is, you
22 know, what type of information is knowable or known as of

1 the date of our valuation, and what we end up assessing is,
2 you know, if there is a subsequent confirming event,
3 subsequent event that confirms the outcome while we're
4 still performing our analysis, is should we have known that
5 information? Should we have known about that, you know,
6 how the value would have played out when we were doing our
7 work?

8 So it allows us to sort of -- so we don't accept it
9 blindly, right? Just because the trade happens two weeks
10 after our valuation date, we don't accept that blindly and
11 say hey, we should really be marking it 107 instead of 105.

12 We really look at was there even any transaction
13 being contemplated? Was there negotiations, for example,
14 for this sale as of the valuation date, such that we can
15 then decide whether or not -- is it a change in market
16 conditions that led the value to move, or is it merely
17 information that we should have known, but it just wasn't
18 really concretely set forth?

19 Another context of it is, for example, maybe take it
20 to more of an intangible asset world, is we're trying to
21 value -- one asset we value very frequently is customer
22 relationships, right?

1 And as of the valuation date, the company may be
2 engaged in substantive discussions with a customer on
3 either renegotiating the terms or expanding or contracting
4 the relationship that they have.

5 That's important information to filter into our
6 analysis if it is known -- if it's completed, that
7 negotiation or that discussion is completed, so that we're
8 narrowing what the potential outcome might be, because that
9 is relevant, rather than ignoring that just because it is
10 done a couple weeks later, or a few -- or a month later.

11 So I just wanted to share that with you on that.

12 And in the other context of when we're -- for
13 example, when we're assisting, you know, private equity
14 firms and hedge funds on the marking of their quarterly
15 investment portfolio, that -- the whole back-testing and
16 calibrating our models, that certainly happens all the
17 time, right?

18 So when there is a trade that happens after the
19 quarter ends -- after that year ends, we do look at it and
20 say how can we improve our model, how can we -- you know,
21 what -- does it confirm the model that we're using or the
22 input that we're using, and if it doesn't, why not?

1 And we look, and we then apply that prospectively.

2 MR. BAUMANN: Sri, is your card back up?

3 MR. RAMAMOORTI: Yes. All right. Jouky's comments
4 reminded me of February 12th, 2002, when former Secretary
5 of Defense Donald Rumsfeld waxed poetic and gave us the
6 beautiful known knowns, known unknowns, and unknown
7 unknowns logic, which I just find very impressive, and it
8 is, because the Boeing Corporation uses the unknown
9 unknowns, calling it unk-unks.

10 So this is actually not a bad way for us to perhaps
11 get auditors thinking about variables that are there,
12 aren't there, should be there, and, you know, how do you go
13 about modeling them, and how do you think about it?

14 So it is a nice methodology, so it sounds silly, but
15 it actually is profound.

16 MS. VANICH: I don't see any more tent cards up, so
17 I do want to back up just a little bit because I don't want
18 to slight some of the alternatives that we'd like to get
19 your input on.

20 So with respect to emphasizing professional
21 skepticism in a new standard, as I mentioned, one of the
22 ideas put forth in the staff consultation paper was to have

1 the auditor identify when the auditor has decided to test
2 management's process of the assumptions used by management
3 which are significant for testing.

4 It wouldn't require the auditor to identify
5 assumptions not used by management, but rather just to
6 start with management's assumptions to determine what the
7 auditor would test.

8 Another alternative, and I think with respect to the
9 alternatives we're going to talk about for skepticism,
10 these alternatives could be done all in a new standard, and
11 in some other places where we'll talk about alternatives,
12 one alternative might replace another, but these would be
13 things that would be relatively easy to do and work
14 together.

15 A point we heard, and I believe this was discussed
16 back in the October SAG, was to revise terminology to
17 establish a mindset of professional skepticism, and that
18 would include removing, for example, words like
19 "corroborating management's estimate." It wouldn't change
20 the requirement, but we'd just use a word that might lend
21 itself more to being skeptical, like "to evaluate against
22 management's estimate."

1 The staff has also considered including reminders in
2 a new standard about the auditor's existing responsibility
3 to exercise skepticism. It wouldn't seek to change the
4 auditor's responsibility for exercising skepticism, but
5 rather to reference those requirements to add emphasis, and
6 I think that may be consistent with the comment we heard
7 earlier that that often carries some weight.

8 Let me go through these last three, and then I am
9 going to open it again for comment.

10 Another alternative that we're looking at is to
11 emphasize the auditor's existing responsibility to consider
12 relevant audit evidence, whether it corroborates or
13 contradicts management's assertions. The risk assessment
14 standards already require the auditor to consider the audit
15 evidence obtained, whether it corroborates or contradicts
16 management's assertions, so again, this is not suggesting a
17 new requirement but would remind the auditor of the
18 existing requirements.

19 We've also thought about extending the requirements
20 for the fraud discussion in the risk assessment standards
21 to more specifically address estimates and fair value
22 measurements. Auditing Standard Number 12 includes

1 requirements related to having a discussion from a -- with
2 the key engagement team members about the potential for
3 material misstatements due to fraud, sometimes referred to
4 as a brainstorming session.

5 This discussion could often likely include a
6 discussion that relates to estimates and fair value
7 measurements. However, the staff is considering whether it
8 would be beneficial to just more specifically identify
9 measurements and -- fair value measurements and estimates
10 as something that would be important to consider in that
11 discussion.

12 And then the last alternative that we included in
13 the materials was something I think we've already covered,
14 just related to this concept of preferential ordering.

15 And so, again, I do see some tent cards, so I am
16 going to open back up the floor for any comments on these
17 alternatives, also any other alternatives you might think
18 that we could consider about skepticism. Also interested
19 in whether any of the auditors have a view on maybe any
20 issues in practice that would arise as a result of the
21 alternatives we talked about.

1 MR. BAUMANN: I think this really was a pervasive
2 comment in October from the -- when we had the full-day
3 meeting on this standard about the need to really build
4 professional skepticism into this particular standard when
5 you're talking about estimates and fair value measures, so
6 this is an important discussion for us about how to do
7 that, and your comments about whether or not you think we
8 have it right here, or there are other things we should be
9 doing, are very important to us.

10 So Jon Lukomnik?

11 MR. LUKOMNIK: Thank you.

12 I think it's a -- it's a wonderful list. I do have
13 one question.

14 As you point out, your requirement is for the
15 auditor to identify which of the assumptions used by
16 management, and you specifically said we're not asking them
17 to consider assumptions not used by management, and I go
18 back to sort of what Jouky said earlier about why do you do
19 things as well, because if you start with what's already on
20 the paper, you may miss the most significant assumptions.

21 So for instance, on financial instruments, there is
22 virtually always the assumption that there is liquidity in

1 the marketplace, right? Usually, that is what gets people
2 into problems, but it is not one that would be an explicit
3 management assumption.

4 When you talk this way, I assume what you mean are
5 the inputs that go into it, not the contextual assumptions
6 that matter, and so my question would be -- and if you're
7 talking about legal reserves, you're assuming that current
8 case law doesn't change between the time of the estimate
9 and the time of the report.

10 Having valued those things, it often does change for
11 active cases. There are intermediate judicial rulings.

12 So my question is why would you specifically exclude
13 sort of the context in which the assumptions are made which
14 allow the assumptions to work?

15 MS. VANICH: All right, that's an excellent point,
16 and sometimes it's difficult to talk about these
17 alternatives without using too many words.

18 But as I mentioned earlier, the staff would seek to
19 retain the three existing approaches, one of which includes
20 testing management's process.

21 So in the case where the auditor has decided to test
22 management's process, the staff asked questions about

1 whether the auditor should look to assumptions other than
2 the ones used by management or start with the ones used by
3 management with the auditor selecting which ones to test.

4 The staff, based on review of the comments and I
5 think other outreach, felt that to go beyond what
6 management used in an estimate when testing management's
7 process probably started to feel like you weren't testing
8 management's process.

9 When we get to talking about measurement
10 uncertainty, we do have some suggestions that would -- that
11 could potentially require the auditor to look at
12 management's process for how management has considered
13 alternative assumptions.

14 When developing an independent estimate, though, the
15 auditor would certainly be able to consider developing
16 their own assumptions. I hope that answers your question.

17 MR. LUKOMNIK: It does, and it's perfectly
18 reasonable.

19 I'll just go back to something that Bill Platt said
20 earlier that we sometimes look at things siloed, and that I
21 would hope that as you wordsmith this, because that's
22 really what we're talking about, this doesn't come to be

1 seen as an overall limitation, because clearly, those are
2 the places usually -- or often are places where people get
3 into trouble, where the -- the methodology for the
4 estimation doesn't work anymore because the oxygen that
5 enables it to breathe has somehow been taken away.

6 So I thank you, it makes perfect sense the way you
7 explained it, but I would hope you'd look at it
8 holistically as you write the entire standard.

9 MR. BAUMANN: Did you have a follow-on to that?

10 MR. HERZ: Yeah. I think in this area of
11 professional skepticism, just kind of as an audit committee
12 member, I always ask the auditors about consistency, you
13 know, in the approaches used by management over time, or if
14 they change, you know, why did it change, and, you know, is
15 there a good reason for changing that?

16 And in terms of the inputs and ranges of inputs,
17 that there is no overt bias from period to period, you
18 know, the kind of similar place in the fairway each time.

19 MR. BAUMANN: And sometimes, if it didn't change,
20 why didn't it change, right?

21 Guy Jubb? I am sorry -- Tom -- well, Tom Selling
22 and Guy Jubb.

1 MR. SELLING: I want to briefly follow up on Sri's
2 observation about unknown unknowns, because I think it
3 really helps to make the point I was trying to make earlier
4 to this highly resistant audience.

5 (Laughter.)

6 MR. SELLING: Unk-unks are factors that are present
7 in a great many audit estimates. How good are management
8 or anyone's forecasts of the negotiations between the EU
9 and the Greek government going to turn out? What if the
10 Greek government goes off the Euro?

11 What about estimates of future technologies? And
12 very close to home now, what about lifetime estimates of
13 credit losses as of the date that a loan is originated?

14 These are often the most critical accounting
15 estimates we would make, yet I would submit they are
16 inherently un-auditable. And yet auditors have to
17 eventually conclude, according to the standards, that
18 somehow these estimates, these unk-unks, are somehow
19 reasonably made, and they have to associate themselves with
20 those estimates, just as they associate themselves with the
21 verification of inventory quantities.

1 It's -- you know, it strikes me as very -- very
2 unbalanced.

3 And it's a frightening prospect when the unk-unk
4 actually occurs. It doesn't reflect well on auditors. It
5 doesn't reflect well on regulators or accounting standards
6 setters.

7 I think we have enough history to know that this is
8 a scenario that we as a group in the PCAOB should be
9 working to avoid, and I don't believe that incremental
10 changes to audit procedures to help auditors get more
11 comfortable with the reasonableness of unk-unk estimates is
12 going to help.

13 MR. BAUMANN: I think that's an excellent comment.
14 Certainly there has been some research and studies from The
15 American Assembly over time that talked about the fact that
16 there is variable assurance, if you will, on cash compared
17 to inventory quantities compared to some of these estimates
18 that are hopefully auditable that have a great degree of
19 estimation uncertainty, and there isn't a clear
20 distinguishment in terms of the audit report in terms of
21 that.

1 I do hope that critical audit matters communications
2 can help in that regard, and I think the U.K. experience is
3 indicating that auditors can communicate it through an
4 audit report with CAMs, those more difficult, subjective,
5 complex matters with greater risk of material misstatement,
6 and give differential reporting through the audit report.

7 At the end of the day, they have to make sure that
8 they're giving an opinion that they include in the
9 financial statements, present fairly, but the CAM is going
10 to at least give the reader that yeah, there was different
11 risks of material misstatement in the various elements to
12 which you were talking about and with respect to these
13 various different estimates, so I appreciate that point.

14 Bill, did you have a follow-on to that? It looked
15 like your card jumped up --

16 MR. PLATT: Yeah, I just had a follow-on that, you
17 know, I think you have to take a step back and say what are
18 we trying to measure in the financial statements?

19 So you take the example you have about what is going
20 to happen with Greece and the EU and Greek debt and
21 everything else, and I don't think that accounting is -- is

1 to predict exactly what is going to happen and then reflect
2 that in your financial statements today.

3 What the accounting today in measuring something is
4 what are the current market participants thinking about
5 that situation?

6 So for example, if market participants said, you
7 know what, there should be a 30 percent discount, you know,
8 it should be valued at 70 percent on the dollar, but you
9 really were perfect in predicting, and say you know, this
10 thing is all going to get worked out, we think it's really
11 worth 95 cents, even though you're perfect in your
12 prediction, you would not be justified in recording at 95
13 cents even if you can prove to me that you were right and
14 market participants were wrong today.

15 So I think it's a little misleading to think about
16 we're always trying to predict the future with certainty.
17 What we're trying to do is to assess what do market
18 participants today believe about the future, how they
19 reflect that in their valuations?

20 MR. SELLING: I agree with that 100 percent, and
21 that is why I support current value estimates, because I

1 think that is the only aspect of what market participants
2 are thinking that we are capable of -- of estimating.

3 MR. BAUMANN: Thanks.

4 Guy Jubb?

5 MR. JUBB: I welcome the move away from the word
6 "corroborate," and you mentioned, Barbara, the substitution
7 perhaps of the word to "evaluate."

8 And that is a small and useful step in the right
9 direction, but I do, as an investor, suggest that it
10 probably doesn't go far enough in terms of what
11 shareholders are expecting of auditors.

12 And I would like to see the word to evaluate and
13 challenge. We have had, we have referred to it several
14 times today, the benefit of the enhanced auditor reporting
15 in the United Kingdom, and it is very interesting when
16 reading these, and it may be therefore a source of some
17 information for the PCAOB, to look at the words which are
18 used by the individual audit firms.

19 I mentioned Royal Dutch Shell earlier today in a
20 particular light, but in relation to estimation of
21 decommissioning provisions, they say, this is the auditors,
22 "We critically appraised management's account appraisal."

1 And that has a degree of granularity that goes
2 beyond just valuation, and as shareholders, I think that
3 consideration of just adding those -- something beyond
4 valuation would be a very, very useful step.

5 Thank you.

6 MR. BAUMANN: Thank you, Guy.

7 Phil Santarelli?

8 MR. SANTARELLI: Yeah, just briefly.

9 I wanted to, as an auditor, say that we would agree
10 with enhanced guidance as far as auditor skepticism. I
11 think that's appropriate to put into the standards in more
12 than one spot.

13 With respect to the explicit requirements to
14 identify which assumptions used by management are
15 significant, I don't think we should take it to a situation
16 where the auditors need to develop their own assumptions to
17 match up against, but rather, have a process where they
18 would inquire of management diligently as to assumptions
19 that were considered and rejected and then try to, from the
20 standpoint of skepticism, say why were they thrown out?

21 That's a little bit I think what Bob was getting at
22 from that bias that comes into it, and where in fact they

1 had, you know, if you can get transparent enough, they had
2 the, you know, point A and point B and split it or took B
3 because it was higher, and that's part of bias, and we
4 really need to evaluate that as part of the fraud
5 assessments, so -- .

6 MR. BAUMANN: Good, I think that's -- I think that's
7 where we're headed, and we appreciate that support.

8 Sri?

9 MR. RAMAMOORTI: Marty and Barbara, I am teaching a
10 graduate course in forensic accounting this semester, so
11 obviously, I have been looking at a lot of references.

12 So I came across one, don't know what's the formal
13 procedure to introduce books and other references into this
14 August discussion, but you folks are happy to take a look
15 at it, it's called Fair Value Accounting Fraud, so I think
16 it's highly relevant that, you know, you should at least
17 take a look. I am happy to leave this copy with you, so --
18 .

19 MS. VANICH: Okay. You'll notice that the topics
20 don't get easier, but I know that everyone wants to leave
21 on time, so I am sure that everybody is going to give us
22 some great input.

1 The next topic that we want to talk about is
2 addressing significant measurement uncertainty, and I think
3 it also was discussed briefly earlier today, that you can't
4 have a discussion about estimates and fair value
5 measurements without talking about it.

6 Several commenters suggested that a new standard
7 should further address significant measurement uncertainty,
8 and the staff has carefully considered these comments along
9 with some relevant academic research.

10 Significant measurement uncertainty is inherent in
11 certain accounting estimates, including for example
12 contingent liabilities, environmental remediation
13 liabilities, Level 3 securities, the allowance for loan
14 losses.

15 But with that said, and I think Marty has probably
16 covered it earlier, the auditor's role is to determine
17 whether there is a misstatement, not to eliminate
18 measurement uncertainty, and there's certainly procedures
19 that need to be performed, and the auditor needs to
20 consider available evidence and evaluate whether there is a
21 reasonable range and points on that range.

1 And so the staff is very carefully weighing what
2 would be an appropriate response to include in a new
3 standard that would increase audit quality and reduce the
4 risk of material misstatement, but not increase maybe an
5 expectations gap, like I think we heard earlier.

6 So the potential alternatives include, the first was
7 discussed in the staff consultation paper, amending the
8 risk assessment standards to include factors that may be
9 relevant to evaluating the extent of measurement
10 uncertainty and accounting estimates as discussed.

11 This would supplement and aid the auditor in
12 determining when a significant risk exists because of
13 measurement uncertainty.

14 Another alternative, and I briefly touched on this,
15 was to include a requirement similar to a requirement in
16 ISA 540, particularly paragraph 15 and 16, to require the
17 auditor in the case of significant risk or of significant
18 measurement uncertainty to evaluate how management
19 considered alternative assumptions or outcomes.

20 Several commenters who raised this issue suggested
21 including that requirement, and also then if management has
22 not adequately addressed the effects of estimation

1 uncertainty, the auditor would then need to develop a range
2 to evaluate the reasonableness of the estimate.

3 A few other alternatives which I think people may
4 have already touched on would be requirements to test
5 models when the complexity of the model is giving rise to
6 the significant risk. I think we heard about today the
7 black box. It's difficult, auditors may not have access to
8 it. Those are some of the things we have heard.

9 But at the same time, the model can be very
10 important to the development of an estimate, and I think we
11 heard mixed views, so if -- but if people have new views to
12 add or want to recap what they have said, we're very
13 interested in hearing it.

14 A few commenters suggested a requirement for the
15 auditor to perform a sensitivity analysis, but at the same
16 time, some of those commenters acknowledged that that might
17 be very difficult for the auditor to do.

18 And the last alternative that we included would be
19 to require communication of estimates with significant
20 measurement uncertainty as an audit committee
21 communication.

1 What I'd say here is I would think that given the
2 existing requirements to communicate matters to the audit
3 committee that these estimates are likely already being
4 discussed, probably in a very detailed way, so maybe when
5 you give us your views, if there's some nuance that you
6 think would be valuable to add, we certainly want to be
7 prudent and aware of audit committee's time. It is
8 valuable, and they already have a lot to get through, so
9 not just looking to add requirements.

10 And the last alternative would be to take on some
11 element of reporting in this standard that would address
12 significant measurement uncertainty, having the auditor
13 make some type of communication. This certainly could
14 potentially overlap with our project on the auditor's
15 reporting model.

16 And so with that, I'd again like to open the floor
17 to SAG members. So Bruce?

18 MR. WEBB: Thank you, Barbara. That is quite a lot.

19 Clearly, I think, you know, amending AS 12 to
20 include factors that might be relevant to weighing the
21 extent of measurement uncertainty makes sense. Certainly,
22 no objection to including a requirement to evaluate how

1 management considered alternative assumptions, similar to
2 ISA 540.

3 I think when you move into some of the other
4 specific proposals there, while I think, you know, in most
5 cases, when you're talking about a significant estimate
6 with significant measurement uncertainty, you're talking
7 about a significant risk, and you're probably talking about
8 a fraud risk.

9 So I would think that most auditors would do exactly
10 what you're talking about here, yet to throw specific
11 requirements in in all cases causes me some pause.

12 Similarly, I would think most of the time, those
13 estimates would be already included in audit committee
14 communications, and would therefore be a source for -- for
15 critical audit matters that you're covering in the auditor
16 reporting model project. I don't think I'd want to have a
17 separate disclosure requirement in this standard, but would
18 want that to be subsumed in CAM.

19 MR. BAUMANN: David Kane?

20 MR. KANE: Yeah, just a couple brief points.

21 I think even when the valuation guys are coming up
22 with a corroborative or point estimate, sometimes they are

1 concluding that it's within a reasonable range, but they're
2 not necessarily identifying what that entire range is.

3 So I think that is a subtle but important difference
4 if this were to be required in terms of developing a range.
5 That would require a little bit more work, I think, is one.

6 Two, I think in terms of the testing, it depends on
7 what you mean by testing the model. So the points we
8 talked about this morning in terms of the level of detail
9 that you have to get into. Is it really the inputs? Is it
10 looking at the model assumptions? Or is it really looking
11 at the granularity within the model?

12 The last piece in just thinking about this and
13 requiring a sensitivity analysis, I could see this becoming
14 more challenging particularly when you test management's
15 process.

16 So let's just say for example like the allowance for
17 loan loss. Would the auditor be required to develop his or
18 her own estimate of what that range might be?

19 And I think to Bill's point a little bit earlier,
20 it's easier in a fair value construct when you're thinking
21 of market participant assumptions, but it can be a little
22 bit more challenging when you're thinking about

1 corroborative or contrary evidence, particularly where we
2 may be going on certain estimates.

3 So let's say like the allowance for loan loss, where
4 the FASB is going, in terms of the current estimate of
5 credit losses. You might have one bank that thinks we're
6 going to fall off a cliff, another bank that might think
7 we're actually going to do well, and they could have the
8 same loan but have very different estimates of what that
9 allowance might look like and be considering, you know,
10 whether corroborative or contrary.

11 So how would auditors be thinking about that when
12 similarly trying to develop a sensitivity for a range?

13 MS. VANICH: Those were all excellent points, and if
14 I could just respond because I would also be interested in
15 views.

16 I mean, I think that what is valuable for us to hear
17 in this -- in this discussion today is some of the
18 practical issues that could arise if we were to move
19 forward with recommending some of these alternatives.

20 I think that when we've heard about models, and I am
21 looking forward to maybe hearing about this more when -- in
22 the comment period for the specialist paper, but we've

1 heard in some cases, you know, auditors maybe considering
2 controls or activities of a model validation process that
3 issuers may have in place. In other cases, we have heard
4 that people test the model by perhaps having management run
5 alternative assumptions through the model, and then they
6 see if the output behaves in a way that they expect it to
7 behave.

8 I think we've also heard that another option is to
9 run management's assumptions through maybe a similar, it
10 might not be as sophisticated a model as management is
11 using, but just to get a general idea of whether
12 management's estimate is reasonable.

13 The other point, I think that when we talked about
14 potential for including a requirement like ISA paragraphs
15 15 and 16, I would be very interested if auditors have any
16 views on how that has worked in practice. I think that by
17 the -- of all the alternatives we've talked about, that one
18 probably had the most support from commenters.

19 And I think Bill, you might be next?

20 MR. PLATT: Yeah, I just wanted to maybe ask a
21 question, and maybe it's an observation in the form of a
22 question.

1 But, you know, I think that this whole measurement
2 uncertainty probably causes a lot of people to be confused
3 or have concerns about the lack of precision of an amount
4 in a set of statements, and I understand that.

5 But I guess before -- I have a hard time -- before
6 jumping to what more should the auditor do, I'd really take
7 a step back and say well what is the objective? What would
8 you like to get out of an audit that's different than you
9 get today around this, and then you could evaluate well
10 what -- are there any procedures we can do that will help
11 move us in that direction or achieve that objective?

12 But I have a hard time with -- you know, I think at
13 times, and I realize the staff is not doing this, but I
14 think at times people think that if we've got an estimate
15 that has a wide range, even if the company is in the middle
16 of it, that somehow, by auditing, we can make the range
17 narrower, and in fact, somebody made a comment before about
18 having a narrower range and a higher degree of confidence.
19 I think that is generally not achievable because usually
20 the higher the degree of confidence, the wider the range
21 you would get, and vice versa.

1 So, you know, I guess I would -- I would just -- I
2 don't know if you have an answer to that question now, or I
3 would encourage you to address it as you go through the
4 project.

5 MS. VANICH: No, I think that is a good question.

6 I mean, I think that commenters -- and I hate to
7 speak on behalf of commenters, but maybe they're also
8 feeling this angst, whether it's angst on the part of
9 auditors, whether it's angst on behalf of investors, but I
10 think that enough people raised the issue. In some cases,
11 I think people would feel better if there were more
12 disclosures. In other cases, people maybe thought that the
13 disclosure framework that exists today is adequate, but
14 really making sure that you're evaluating the disclosures
15 to make sure that the disclosures adequately convey the
16 measurement uncertainty.

17 But I think that that's a good question for the
18 staff to continue to pursue, but interested in if anyone
19 has any comments.

20 MR. BAUMANN: I'll just add onto that, again, many
21 of the commenters did say that they -- first of all, we

1 don't -- we agree with you, auditors can't audit away
2 measurement uncertainty. It is what it is.

3 So, but the question is what should auditors do
4 about it? In the -- and we asked that question in the
5 consultation paper.

6 Many commenters said this was not a problem that
7 PCAOB could solve by itself, that this was a problem of the
8 financial reporting system and that the PCAOB and SEC and
9 FASB should work together, and maybe is there more
10 reporting that can be done on behalf of management, with
11 respect to estimation uncertainty, than exists today?

12 And so that came up a lot in comment letters.

13 But I think what we're trying to do at a minimum on
14 our end is say -- and I think it goes back into tying into
15 the point of Barbara's about changing language from
16 "corroborate" to "critically evaluate," or whatever the
17 terms might be.

18 If auditors today are corroborating an estimate,
19 while there is a wide range of measurement uncertainty,
20 then I don't think we're achieving the objectives of what
21 we want the auditor to do. We want the auditor to
22 understand whether or not there is a wide range of

1 measurement uncertainty, and then, with respect to that
2 risk of material misstatement because of that wide range,
3 address their auditing procedures around that considering
4 how management addressed that wide range of measurement
5 uncertainty and how it considered various alternatives and
6 why they picked the assumptions they did pick as opposed --
7 and reject other assumptions and come up with the answer
8 they did.

9 So I think -- I think we're on the same page here,
10 not auditing it away, but what are the right procedures to
11 make sure the auditor considers all of the options around
12 that measurement uncertainty.

13 MS. VANICH: Brian?

14 MR. CROTEAU: Actually, a lot of what I was going to
15 say I think Marty has just said, and Bill as well, frankly,
16 and I think it's very helpful.

17 Again, my own views here on this, but as you hear
18 and think about -- well, first of all, maybe thinking about
19 the fair value project when you think about specialists,
20 when you think about the reporting model and CAMs, I think
21 all of these things can have some interrelationship, but
22 you know, as you think about reasonable assurance and you

1 think about uncertainty, levels of precision, these
2 concepts I think are -- you need to think about them all
3 carefully and in their compartments, and then how they
4 interrelate.

5 And from at least my perspective, I think this is a
6 good dialogue to be having as you're working on all of
7 these projects, and I guess I would just encourage, as
8 people are thinking about providing feedback, to step back
9 and think about them and to give some consideration to
10 making sure that we're not doing something that we're
11 trying to solve, to Marty's point, something that could be
12 a management disclosure issue through the auditing
13 standards, and if we're thinking about something that
14 belongs in the auditing standards, perhaps in the auditor's
15 reporting model, what is that and why, and how does that
16 relate to something that management may already have
17 obligations for or not?

18 So I think these are very important concepts, and I
19 wouldn't want to put Jim on the spot, but you know, I don't
20 think from a IAASB perspective you know, the idea was
21 certainly to have different levels of assurance or change
22 the reasonable assurance models with KAMs as opposed to

1 CAMs, and I think that's critical to think about as you're
2 -- as you're providing feedback on these projects.

3 MR. BAUMANN: Thanks, Brian.

4 Bob Dacey?

5 MR. DACEY: Thank you, and these are my personal
6 views as well and not necessarily those of GAO.

7 But just observations. I guess I would have some
8 concerns, as was mentioned before, about adding specific
9 requirements when you have significant measurement
10 uncertainty, but at the same time, I guess some of our work
11 kind of crosses over with sensitivity analysis and trying
12 to identify those assumptions or drivers of that range of
13 uncertainty to help understand and focus attention on those
14 areas to see if we have sufficient evidence to support that
15 those are, you know, reasonably supported by sufficient
16 appropriate evidence to really hone in on those key
17 drivers.

18 Thanks.

19 MR. BAUMANN: Thanks, Bob.

20 Bob Herz?

21 MR. HERZ: Yeah. I guess it was this morning that
22 Liz Murrall mentioned that in the U.K. auditor reporting,

1 they actually explicitly talk about the materiality level
2 that they set, and I don't know whether you're thinking
3 about that in our auditor reporting here in the U.S., but
4 if you are, and I am starting to think about how all this
5 would relate to that, and expectation gaps, and how that
6 can be communicated appropriately, because, you know, we
7 said here, you know, let's say for a particular audit they
8 said it's five million dollars and there's particular
9 estimates that individually are -- some individually, and
10 certainly in the aggregate, are much more than, you know,
11 an uncertainty range of five million dollars, and, you
12 know, how that all gets related to that disclosure of the
13 materiality.

14 It has got to be explained. Otherwise, I think it
15 increases the -- it could increase the expectation gap.

16 MS. VANICH: Yeah, I think that some commenters did
17 kind of specifically point out that some people dealt with
18 this as when measurement uncertainty exceeded materiality,
19 I think from the staff perspective we definitely thought
20 that that would be incredibly challenging because unless
21 you disclose materiality and just say it was larger than
22 materiality, I would assume that as an investor I would

1 want to know whether it's a dollar more or a billion
2 dollars more.

3 And then if people would be interested, maybe more
4 in aggregate for the balance sheet, has measurement
5 uncertainty exceeded materiality?

6 So those areas are certainly not without challenge.

7 I think Sri?

8 MR. RAMAMOORTI: Bob, thanks for so eloquently
9 trying to, you know, communicate what I am going to try and
10 say too.

11 I have very strong opinions on this one. I agree
12 completely with Tom that we don't want to be in a position
13 where the measurement uncertainty significantly exceeds the
14 threshold in that it could even be a multiple of the
15 materiality threshold because if that were true, the
16 standard audit report language that the financial
17 statements present fairly in all material respects, that is
18 actually meaningless.

19 How could you even make that statement? Because
20 these things are totally, you know, out of the, like,
21 reservation, I guess. I mean, they are like so far out,
22 you have no idea.

1 So I don't think you certainly cannot audit them
2 away, we talked about that, but I think we can't even opine
3 on these numbers, and if we do opine, the danger we put
4 ourselves in is that we are now dignifying numbers about
5 which we have no clue. We have no clue. We don't know
6 where they've gone, but we're happy to I guess have our
7 name associated with them. Why would we do that? That's
8 not a very smart thing.

9 So my preference would be if there is some way to
10 dissociate from this area by basically saying we are happy
11 to look at management's process, and what kind of integrity
12 did they show, what kind of diligence did they show in
13 terms of coming up with what is admittedly a very
14 challenging issue?

15 We sympathize, and we understand, so that would be
16 my first preference, if you can do it.

17 However, I also understand how hard you folks have
18 worked because I am totally impressed with all these
19 alternatives that you have come up with, and to me, the
20 last one, which is maybe lumping these as part of the
21 critical audit matters, maybe roping in the audit committee
22 in terms of formal communication, and most interestingly,

1 if you could disclose in the auditor's report that folks,
2 this is way beyond, you know, our ability to meaningfully
3 opine on, and it's basically putting the public on notice
4 that we really shouldn't be relied upon to be opining very
5 meaningfully, I think then we are protecting ourselves.

6 MR. BAUMANN: Well, I don't think we've teed up the
7 latter one in this discussion, that the auditor would say
8 that we can't opine on this because the measurement
9 uncertainty is too wide.

10 But I -- as commented earlier, there certainly was
11 various different groups in the past, as I mentioned The
12 American Assembly, that talked about varying levels of
13 assurance, that certain numbers are more capable of
14 assurance than others.

15 So if auditors believe that these numbers were not
16 auditable, or we believe that, I think we have to address
17 that issue. I don't think we're at that state, but
18 certainly that would be an important matter to take up.

19 I do think as long as they are auditable, the
20 importance of this expanded audit report in critical audit
21 matters helps tell investors the story that there are
22 different sets of numbers here in the financial statements

1 and some have far greater risk of material misstatement and
2 some have far greater measurement uncertainty, and that's
3 important I think for investors to understand.

4 MS. VANICH: Okay, you know, I'm keenly aware that
5 we're starting to lose people as they have to leave to
6 catch their transportation.

7 Again, we've probably saved -- I don't know if this
8 is a tougher issue than measurement uncertainty, certainly
9 sometimes it feels like it is, but the last -- the last
10 topic of the day is use of third parties, and there is a
11 lot of overlap with what we talked about this morning, the
12 content of the staff consultation paper on auditor
13 specialists, and the area of auditing fair value
14 measurements and estimates.

15 The first panel this morning, and not to slight the
16 second panel, but the first panel, what you heard I think
17 was really more closely related to something we were going
18 to talk about today, which was management's use of the
19 specialist.

20 But in the interest of time and because I would like
21 to talk about the auditor's use of pricing services, if
22 it's okay with everyone, I'd like to walk through what I

1 heard and kind of where I think -- how it affects this
2 project, and certainly we would obviously wait for the
3 comment period to close to make any kind of conclusion.

4 But I think one of the things we heard and heard
5 relatively strongly was to consider retaining AU Section
6 336, or have some other type of standard relating to the
7 auditor using the work of management specialists.

8 The staff consultation paper had started to go down
9 a path of having the auditor treat information from
10 management specialists as if it were developed by
11 management. I think that the specialist team benefitted
12 from the comment that we've received that that might not be
13 the best way to go about standard setting.

14 So with respect to management's use of a specialist,
15 I think that we probably have some homework to do. I don't
16 know if anyone disagrees with that view, you're welcome to
17 get to -- to let us know.

18 But I don't want to close out the day, and so I
19 assume this will be kind of our last discussion of the day
20 that I want to get to is the auditor's use of a third
21 party, and in particular, the approach that the staff had
22 put forth when using a pricing service.

1 So the staff included in the staff consultation
2 paper some example requirements that could apply when an
3 auditor uses a pricing service, which in the staff's view
4 is different than a traditional specialist. I think we
5 heard part of that today, that pricing services provide a
6 uniform product to subscribers for a fee. We heard from
7 commenters that there is certainly less opportunity for
8 management to bias that number, if any opportunity at all,
9 maybe depending on the exact process.

10 Commenters generally agreed that the pricing
11 services are different than specialists. Some suggested
12 additional procedures or other procedures. Some commenters
13 were unsure based on the consultation paper whether the
14 staff was suggesting there would be procedures for each and
15 every individual security in a portfolio, and some also
16 suggested that for many easy-to-value securities, their
17 first procedure is to look at exchanges or information
18 that's in the public domain rather than to go to a pricing
19 service.

20 So the first alternative that we wanted to talk
21 about was whether it would be maybe more beneficial, and
22 this is an either/or alternative, I should mention that, to

1 retain the approach discussed in the staff consultation
2 paper largely as described, however to clarify the
3 auditor's ability to group securities with similar
4 characteristics and risk, and to also acknowledge, and I
5 would say acknowledge because this was not inconsistent
6 with the staff's view when we developed the paper, that for
7 exchange-traded securities, acknowledging that evidence
8 provided through quoted market prices that are readily
9 available to the public through national exchanges would
10 serve as audit evidence.

11 The other alternative, and this is really kind of a
12 much broader alternative to what was discussed in the staff
13 consultation paper, is to take a different approach and to
14 address not only the pricing service used by the auditor,
15 but to consider what -- whether the auditor could in some
16 way use the work of management's pricing service. I think
17 we certainly heard support today for retaining the
18 auditor's ability to use management's specialists, so I
19 think it would be reasonable for us to look into whether
20 the auditor could use the work of management's pricing
21 service, given we've heard that there is less chance of
22 bias.

1 Under that approach, we also thought it would be
2 beneficial to consider what other types of auditing
3 requirements and guidance would be useful for financial
4 instruments on a broader basis, and that could include
5 considerations relevant for assessing risk with -- related
6 to financial instruments, responding to risk, and
7 addressing perhaps specific topics like impairment of
8 financial instruments.

9 I know that is a lot to get through in a few
10 minutes, but I really wanted to get your reaction to this
11 alternative and discussion.

12 Larry?

13 MR. SMITH: So in reading the paper, I was a little
14 disappointed that there was not something else on there
15 that you were considering which has been mentioned
16 previously today, so I am going to strongly encourage the
17 PCAOB to listen to the sage advice provided by my former
18 boss in terms of developing -- particularly for Level 2
19 measurements, developing a SAS-70-type report in which an
20 auditor of the pricing service provides a report on the
21 internal control system and also provides a report
22 summarizing the results of substantive tests in which, and

1 you pick it, the confidence level is x, that the error rate
2 doesn't exceed y, and then allow other auditors of
3 companies that are using that pricing service to rely on
4 the results of that single audit and not do any other work
5 on it.

6 I think that would take tremendous costs out of the
7 system.

8 MS. VANICH: Jay?

9 MR. HANSON: I just wanted to express my support for
10 Larry's comments and Bob's earlier comments that as I kind
11 of pragmatically step back and think about it, and I am
12 going to look at Jouky for a minute and say gee, there is
13 probably nobody in this room who knows more about -- well,
14 Jouky and Susie -- pricing financial instruments than the
15 two people there, so either we could have everybody in the
16 room without the skills to do it try to audit it, or have
17 those two tell us the prices, and we test what they -- they
18 told us, and all of us rely on it. I would vote for two
19 experts determining the price, and the rest of us relying
20 on it.

21 MR. BAUMANN: Larry's got your statement in, and
22 you're walking out before I can get my response back there?

1 (Laughter.)

2 MR. BAUMANN: Make the comment and run.

3 Certainly I think that's a good comment. If there
4 could be an audit of pricing services and a report on the
5 pricing service that auditors could rely on where the test
6 of the process and controls and test of the substantive
7 tests of actual valuations of different types of categories
8 and that type of report could be developed, I think that it
9 would certainly help take costs out of the system and
10 enable auditors to use pricing services more freely without
11 performing maybe additional tests there in each case.

12 I think there's an authority question there in terms
13 of the Board in terms of could we mandate that pricing
14 services have to have these types of studies done? So, I
15 mean, if they're done and pricing services engage somebody
16 to do all these services, the question is we don't have
17 authority over pricing services, we have authority over the
18 audit of the issuer, so I think there's at least a question
19 there as to what's the mechanism for that to take place.

20 I am happy to explore that, whatever that mechanism
21 is, happy to hear more about it, but certainly, to the

1 extent that we're there, that's a dialogue we'd love to
2 have further.

3 I think that without that mechanism, I think what
4 we're looking at is, yeah, use the third-party pricing
5 service and assess the extent to which they are
6 independent, that their prices are widely used, that they
7 have some processes and controls. I know the larger firms
8 today are doing a lot of what was just said. Some of the
9 larger firms are going into that pricing service one time,
10 evaluating the controls around that, processes, their
11 prices, doing substantive tests of different categories,
12 and creating the ability to therefore -- so that all their
13 engagement teams don't have to go in, they have gone in and
14 made that valuation, and then the firm, I think the teams
15 test selected prices along the way.

16 So I think that that is happening today to benefit
17 the large firms. The smaller firms that can't do that
18 don't have the same benefit, so I think this is an area
19 that's continuing to evolve, and we're looking for ways to
20 do what Larry said, to get costs out of the system and to
21 get a benefit of an overall study of these pricing
22 services.

1 So ideas in this area are certainly -- are valued,
2 and I will look forward to more.

3 Brian Croteau, you have your card up.

4 MR. CROTEAU: Thanks Marty.

5 I was just going to add, that's what you'd say
6 certainly from an authority perspective, some have asked me
7 as well from time to time about the SEC, and without
8 getting into that, I think a first question that some
9 pricing services may have registration requirements with
10 the SEC depending on the nature of the services they're
11 offering, but that doesn't necessarily follow relative to
12 authority to just mandate some type of audit.

13 But then you get into the question of the standards
14 against which the audit would be performed, and the
15 questions that in fact I think Larry is raising about
16 precision, essentially, and level of confidence that one
17 would need to think about relative to the potential than an
18 individual company has one individual security that could
19 be hugely material that may, you know -- that needs to be
20 thought about in the context of the overall audit of a
21 pricing service if that kind of an approach were even
22 market-driven.

1 So I think to Marty's points, it's an interesting
2 area to really give a lot of thought to, but I think, you
3 know, there's a lot of issues to think about when doing
4 that, and not just authority questions: what the auditing
5 standards would be around it, would it be market driven,
6 would the precision levels stand the test of thinking about
7 the example I gave of one security being hugely material?

8 I am not raising these issues to say we shouldn't
9 think about it, I am raising them to add to what Marty has
10 described. I think it's worthy of thinking about, but, you
11 know, thinking about all these issues as we do so.

12 MS. VANICH: If I could add onto -- if I --

13 MR. HERZ: I was thinking much more of a market-
14 driven thing, not that you -- I don't think you have that
15 authority, but something that if, you know, they got, you
16 know, a service bureau's SOC 1 Report, and kind of an
17 equivalent in this area to maybe what Larry said, but if
18 that occurs and it's -- it meets those standards, then, you
19 know, for those pricing services, that, you know, that
20 would be another way to go.

1 MS. VANICH: If I could -- if I could add to that,
2 though, there is one point that I think that's particularly
3 relevant.

4 Based on the staff's outreach, it would be
5 interesting if anyone has any views or data on how this
6 would take costs out of the system.

7 As Marty mentioned, the large firms have in-house
8 expertise that does a lot of work with pricing services.
9 We don't hear from enough small firms, but from some of the
10 smaller firms we heard from, they don't extensively use
11 pricing services. It's just not part of their business
12 model to pay for an ongoing subscription or to have a
13 relationship. Because their issuers may or may not have
14 very many securities, they may be more likely to test
15 management's process or to go to a specialist, so I think
16 that we would have a lot of questions to ask around whether
17 it really would, on the audit side of the house, take costs
18 out of the system.

19 MR. BAUMANN: Bruce Webb.

20 MR. WEBB: Thank you, Marty and Barbara.

21 I just, you know, I think Larry's idea is an
22 intriguing one. Just a couple of points.

1 I mean, first of all, pricing services I believe in
2 some cases are a service organization, in other cases maybe
3 a specialist. It depends on -- on how they determine the
4 value of a security.

5 So, you know, today, we do have -- we do have the
6 SOC 1 approach for internal controls that they're
7 considered to be a service organization, they could elect
8 to issue a service organization report and have a service
9 auditor report on their internal controls.

10 That gets you partway there, but, you know, you
11 can't rely solely on tests of controls, so some substantive
12 procedures still need to be performed, and I think what
13 Larry was proposing is some sort of a combined
14 controls/substantive audit of a service organization that
15 would, I think, require some sort of new standards setting
16 because there's not a standard today that would enable that
17 sort of approach to allow an auditor to rely on that as
18 audit evidence without doing their own work.

19 MR. BAUMANN: I think to maybe Bob's point, if there
20 is a lot of cost in the system, you'd think it would be a
21 market-driven event to say -- for this report and this
22 study to happen, because the market would say that would be

1 an efficient use of pricing services, and would standards
2 setters, you know, permit auditors to reduce the scope of
3 their work if this type of report, this type of both
4 internal control and substantive testing of prices in
5 different categories, took place, much as what I think the
6 large firms are actually doing for their own teams?

7 And I don't know if any of the large firms want to
8 comment on that or it's proprietary, but so speaking
9 generically then of large firms.

10 Well, good. So I think -- Jean Joy, and I also
11 would be interested, James, if you think this is something
12 that is being discussed at the -- at the IAASB, but let me
13 -- I don't want to put you on the spot in that regard, but
14 in the meantime, Jean.

15 MR. GUNN: No, thank you very much, I had -- I just
16 -- general comments from today's discussion, and first of
17 all, I'd like to state the obvious: I think the PCAOB and
18 staff's efforts of looking at these performance standards
19 both on specialists and fair values is the right place to
20 be, so much support from the Board and the IAASB staff for
21 your continued efforts on the two topics that you've raised
22 today.

1 We are -- we do not have a particular project on
2 third-party pricing sources, and we're not in the state of
3 reviewing ISA 620 at the moment.

4 However, we've -- we've undertaken an exercise, and
5 I think we started off on the premise of financial
6 institutions because that area has many issues in terms of
7 fair value estimations, modeling, use of experts internally
8 and externally, and so forth.

9 And so we've taken away the industry factor, and I
10 think we are going to be focusing more around the IFRS 9
11 issues, loan loss provisions and the implications of that
12 relative to the auditor's work in modeling, testing, and so
13 forth.

14 We do know that this is an area, third-party pricing
15 sources, where there could be further enhancements within
16 the standards, so we -- we look to monitoring your
17 activities and considerations quite closely to inform our
18 future activities.

19 MR. BAUMANN: Thanks, James.

20 Now Jean? And Jean, it looks like, unless anybody
21 else wants to put a card up on this subject, you get the
22 last word, but I'll monitor the table on this.

1 MS. JOY: It's never a good position to be in.

2 I'll make this very brief since you asked about the
3 small-firm perspectives and cost in the system.

4 And I would just continue to suggest that there --
5 there be more attention paid to the risk assessment and the
6 -- the banning, if you will, of testing back to a client's
7 pricing service, to me, is still sometimes ineffective or
8 just not warranted, meaning if you have really assessed the
9 risk of a portfolio and you're talking about, you know,
10 Level 2 securities for the most part, at least
11 understanding the nature of those securities, and are you
12 really gaining further audit evidence that would have any
13 material impact on the financial statements by -- by having
14 to test to a second source?

15 So I'm always troubled by -- that is adding cost to
16 the system because we don't have pricing specialists, and
17 we are paying an additional service to test back to pricing
18 sources that are deemed to be very reputable, so to see a
19 ban on that without an appropriate risk assessment, I think
20 I'm troubled by the fact that we keep getting away from
21 that, but I'd still like to see some focus on when the risk

1 assessment is appropriate, that you don't have to go to a
2 second source.

And I think anything we can do to get the credentials, if you will, of the service provider more transparent so that they can be relied upon by many firms, I think that that would be a tremendous step forward.

MS. VANICH: Well, I think that everyone has done a great job, and I appreciate all the effort you put into preparing for today, and so to -- we're going to end on time, but again, I want to thank you for -- for your time and helpful comments.

MR. BAUMANN: Thanks, thanks Barbara.