

*American Accounting Association ♦ Auditing Section  
Auditing Standards Committee*

March 11, 2002

Gretchen Fischbach  
Audit and Attest Standards, File 1827  
AICPA  
1211 Avenue of the Americas  
New York, New York 10036-8775

**RE: Invitation to Comment on Proposed International Standard on Auditing (To Be Considered by the AICPA Auditing Standards Board as the Basis for a Statement on Auditing Standards), *Auditing Fair Value Measurements and Disclosures* (File Ref. 1827)**

Dear Ms. Fischbach:

The Auditing Standards Committee (ASC) of the Auditing Section of the American Accounting Association welcomes the opportunity to comment on the Proposed International Standard on Auditing (ISA), *Auditing Fair Value Measurements and Disclosures*, and the process under which the Auditing Standards Board (ASB) is undertaking in considering this standard as the basis for a Statement on Auditing Standards (SAS). Overall, the ASC supports a general auditing standard providing guidance on auditing fair value measurements and disclosures. Furthermore, we support the process that the ASB has put forth as a mechanism to co-develop standards with the international community and expedite the standards setting process. With that spirit in mind, the ASC provides the following recommendations for improving the proposed ISA and implementing this process for co-developing auditing standards with the international community.

The proposed ISA

*Insufficient Emphasis on Realization of Fair Values*

Additional emphasis on the markets in which fair values would be realized should help auditors focus on the external forces impacting fair value determination, particularly those which impact the business risks associated with fair value determination. While there are several references in the proposed ISA to economic conditions, most of the emphasis placed on fair value determination in the standard relates to knowledge of the business and management's process for determining fair values. While both of these factors are important, they de-emphasize the other parties involved in settling the financial reporting element under consideration, which could reduce the degree of scrutiny placed on the realizeability of fair values being determined. Some examples of how the standard could be altered include:

- Paragraph 11: Why not expand this guidance to include assessing the business risks associated with the underlying element subject to fair value determination to

- understand the economic conditions under which the fair value process is being employed?
- Paragraph 14: Consider adding “and appropriate for the economic conditions underlying the financial statement elements and markets in which the valuations would be realized” at the end of the paragraph.
  - Paragraph 16: Consider adding the comment in bold. “The auditor’s understanding of the requirements of the financial reporting framework and knowledge of the business **and industry**, together with the results of other audit procedures.”
  - Paragraph 22 (c): Consider altering the end of the phrase to be more explicit to include the comment in bold. “the valuation method is appropriate in relation to the business **and industry, reflecting the underlying markets in which fair values would be realized.**”
  - Paragraph 35: Consider adding, “affecting the underlying financial statement element or the market in which fair values would be realized.”
  - Paragraph 43 (a): Consider altering to state, “the impacts of the general economic environment and the entity’s economic circumstances on the markets in which fair values would be realized.”

#### *Paragraph 45*

Performing sensitivity analyses on the underlying assumptions of fair value estimates is a very important aspect of auditing fair values. We suggest emphasizing this requirement more throughout the standard, possibly including an example. For an appendix can illustrate the impact on the value of a derivative instrument should underlying interest rates or exchange rates be different than what are assumed in the fair value estimate.

#### *Paragraph 46*

The ASC is not sure why a wide difference in results obtained from two or more valid estimating techniques leads to a fair value not being reasonably determinable. We agree that variation increases the implications associated with implementing an inappropriate option or utilizing inappropriate assumptions. However, if there is an option that appropriately reflects economic reality (i.e., the realizeability of fair values under one option seems more reasonable than for other options), why use another form of valuation that might be inferior to the better fair value option?

#### *Appendix 1, Paragraph 4*

The information in this paragraph should be included in the body of the ISA standard. Users of this standard should be presented with mechanisms for obtaining fair values at the beginning of the standard, particularly because of the standard’s general nature. (The information in Paragraph 6 also could be moved into the body of the standard using the same line of reasoning, but it is not as helpful as the information in Paragraph 4.)

#### The Standard Setting Process Being Considered by the ASB

We fully support this mechanism for promulgating auditing standards when resources are not available for the ASB to consider an important issue starting at the task force level.

We believe a *better* process for co-developing standards is being undertaken with the risk assessment project, under which a joint task force is utilized to develop exposure drafts of proposed standards. However, when resources do not allow for this type of co-development, we support basing SASs on existing ISAs when this type of comment process is utilized (a short invitation to comment period followed by a short exposure draft comment period). In turn, we expect to see ISAs developed from existing SASs using a similar process when IAPC resources do not allow for co-development of standards by participating in joint task forces with the AICPA.

This support is partially driven by the current crisis surrounding self-regulation of accounting and auditing standards. One of the major criticisms, standard-setting cycle time, is improved using the co-development processes for this and the risk assessment projects. Furthermore, a lack of global standardization for auditing and accounting standards often is cited as a constraint to effective international capital markets, particularly when competitors within the same or similar industries are based in different countries and traded in different capital markets. We view this process as a definite step in the right direction for creating consistent international standards and encourage further innovations in AICPA/IAPC standard-setting development.

One aspect of ISA standards that the committee finds useful is the use of bold lettering for principles and non-bold lettering for related guidance. We understand that using bold lettering for part of a pronouncement is a concern to some U.S. regulators because they believe that auditors might focus only on the bold statements and not follow the non-bold related guidance. Our belief is that providing emphasis on key principles helps in understanding a standard and how to apply it. However, we encourage the ASB to utilize the academic community to help in identifying research in other fields (e.g., cognitive psychology) that might shed some light in resolving this issue. Our belief is that the AICPA and the ASB should continue to pursue ways to improve the understandability of auditing standards so that they are applied in a manner consistent with the intent of the Board.

Respectfully Submitted,

Kay Tatum  
University of Miami  
Chair  
Auditing Standards Committee  
Auditing Section  
American Accounting Association

Brian Ballou  
Auburn University  
Vice Chair  
Auditing Standards Committee  
Auditing Section  
American Accounting Association

*Other ASC Members:*

Stephen Asare, University of Florida  
Karla Johnstone, University of Wisconsin-Madison  
Konrad Kubin, Virginia Polytechnic University  
Larry Rittenberg, University of Wisconsin-Madison  
Roger Simnett, University of New South Wales