

AUDITING ESTIMATES AND FAIR VALUE MEASUREMENTS: INVESTOR PERSPECTIVES

OCTOBER 2, 2014



CFA Institute

WHY WE CARE ABOUT AUDITING ESTIMATES & FAIR VALUE MEASUREMENTS

SIGNIFICANT CONSUMERS OF ESTIMATES & FAIR VALUE MEASUREMENTS

Occupation	# of Members	% of Membership
Portfolio Managers	27,136	22%
Research Analyst	18,502	15%
Corporate Financial Analyst	6,167	5%
Investment Banking Analyst	4,934	4%
Chief Executive	8,634	7%
Consultant	7,401	6%
Risk Manager	6,167	5%
Relationship Manager	6,167	5%
Financial Advisor	6,167	5%
Accountant/Auditor	3,700	3%
Other	29,603	24%
Total	123,346	100%

24% (29,603) are Analysts

ALSO SPECIALISTS WHO ASSIST IN THE PREPARATION & AUDITING OF SUCH ESTIMATES & FAIR VALUE MEASUREMENTS

"Big 4" Accounting Firms	Charterholders
PwC	716
Ernst & Young	634
KPMG	538
Deloitte	493
Total	2,381*

* \approx 45% (1,516) are consultants
 \approx 20% (476) are accountants/ auditors
 \approx 2% of members worldwide

The ability to make high-quality, independent, objective, and reliable investment decisions depends not only on our expertise in the use of analytical and valuation techniques but also on the quality of the information available for us to collect, analyze, and incorporate into our valuation models.

WHY WE CARE ABOUT AUDITING ESTIMATES & FAIR VALUE MEASUREMENTS

SUPPORTERS OF INCREASED USE OF ESTIMATES & FAIR VALUE MEASUREMENTS

FINANCIAL REPORTING
in the 1990s
and BEYOND

1993

In 1993, CFA Institute observed:

*It is axiomatic that it is better to know what something is worth now than what it was worth at some moment in the past . . . Historic cost itself is in reality historic market value, the amount of a past transaction engaged in by the firm. . . . Historic cost data are never comparable on a firm-to-firm basis because the costs were incurred at different dates by different firms (or even within a single firm). **There is no financial analyst who would not want to know the market value of individual assets and liabilities.***

A Comprehensive
Business Reporting
Model

Financial Reporting for Investors

July 2007

In 2007, CFA Institute observed:

*Fair value measures reflect the most current and complete estimations of the value of the asset or obligation, including the amounts, timing, and riskiness of the future cash flows attributable to the asset or obligation. Such expectations lie at the heart of all asset exchanges. **In the last decade and a half, an increasing number of global financial reporting standards have been based upon fair values, a trend we would wish to see accelerate.***



INVESTOR CHALLENGES

LACK OF TRANSPARENCY INTO INPUTS, ASSUMPTIONS & METHODS



In 2014, CFA Institute observed:

CFA Institute has long advocated for more forward-looking measurements to enhance the “decision-usefulness” of financial statements for investors. Simultaneously, CFA Institute has sought better disclosures regarding management’s assumptions, judgments, and estimates included in forward-looking measurements as well as better cash flow information to assess both the reasonableness of such assumptions, judgments, and estimates and the organization’s ultimate realization of cash flows. *Put differently, CFA Institute has sought both forward-looking measurements and disclosures that make such measurements meaningful.*

VARIETY OF ESTIMATION METHODS & TECHNIQUES: WHAT DO THEY MEAN ECONOMICALLY & HOW DOES A USER ADJUST?



FAIR VALUE MEASUREMENTS



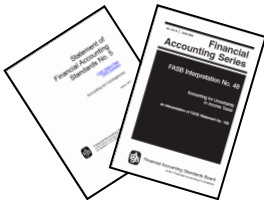
IMPAIRMENT OF FINANCIAL INSTRUMENTS
IMPAIRMENT OF INTANGIBLES & LONG-LIVED ASSETS



REVENUE RECOGNITION



INSURANCE LIABILITIES



LIABILITIES & UNCERTAIN TAX POSITIONS

THE STAFF CONSULTATION PAPER PROPOSAL

OVERALL OBSERVATIONS

SUPPORT INTEGRATING EXISTING GUIDANCE & PROPOSED STAFF APPROACH

BELIEVE THERE IS SUFFICIENT COMMONALITY TO MERGE GUIDANCE OF ESTIMATES & FAIR VALUE (ADDITION WITHOUT SUBTRACTION)

SHIFT CHART TO ILLUSTRATE THE CHANGES

DO PROPOSED CHANGES ADDRESS ROOT CAUSE OF AUDIT INSPECTION FINDINGS?



RISK ASSESSMENT

TWO ESSENTIAL ELEMENTS OF AUDITING ESTIMATES & FAIR VALUE MEASUREMENTS



ROBUST RISK ASSESSMENT



UNDERSTANDING CURRENT
ECONOMIC ENVIRONMENT
(CONTEXT)

ACCOUNTING & AUDITING EDUCATION

SHOULD ACCOUNTING & AUDITING EDUCATION INCLUDE STUDY OF VALUATION?

Completeness

Existence

Accuracy

Valuation

Ownership

Presentation & Disclosure

DOES ACCOUNTING CURRICULUM INCORPORATE VALUATION?



OVERALL

SUBSTANTIVE PROCEDURES & USE OF THIRD PARTIES = >
PROVIDE FEEDBACK IN COMMENT LETTER

SUFFICIENT COMMONALITY TO MERGE GUIDANCE OF ESTIMATES & FAIR VALUE

LINK TO ROOT CAUSES TO ASSESS COST VS. BENEFITS

RISK ASSESSMENT, CONTEXT & EDUCATION

INVESTORS SEEK GREATER DISCLOSURES RELATED TO ESTIMATES IN FINANCIAL STATEMENTS & EXPLANATION OF RISKS AND RELATED AUDIT WORK