

Fair Value Auditing Guidance Task Force**Objectives of Agenda Item**

1. The objective of this agenda item is to agree whether further action by the IAASB is necessary on the topic of auditing fair values and, if so, which project(s) would best meet stakeholder needs in a reasonable timeframe.

Task Force

2. The members of the Task Force are:

John Fogarty (Chair)	IAASB Member
Doug Besch	External Member
Susan Koski-Grafer	External Member
Marc Pickeur	External Member
Tom Ray	External Member
Patricia Sucher	External Member
Chris Taylor	External Member

As work progresses on the various initiatives, the composition of the task force may be increased or modified depending on the expertise that is needed.

Further Actions that Could Be Taken

3. The Task Force had previously discussed a number of areas on which further work could be done and presented these to the IAASB and its CAG at their respective meetings in September 2008. At that time, the Task Force did not have a consensus view as to which activity or activities should be pursued and on what timeframe, with the exception of the Staff Audit Practice Alert.
4. Similar to the Task Force, the views expressed by the IAASB and the IAASB CAG at their September 2008 meetings did not indicate a strong consensus in any one particular area. It has been difficult to determine which activity, if any, should be pursued and presented to the IAASB in the form of a project proposal. A teleconference was also held with the Task Force on January 23, 2009 to obtain views as to the best course of action.
5. **With regard to a discrete project, based on the discussion of the Task Force, it is proposed that the IAASB develop guidance on auditing investments in private equity funds.** It was also suggested there was a need to revise IAPS 1012, *Auditing Derivative Financial Instruments*, however, it was acknowledged that this is not directly related to fair value.
6. The rationale for the selection of these 2 areas and the basis for the determination that formal projects are not necessary on other proposed initiatives is set forth below. It is suggested that, as the accounting in this area is currently evolving, the IAASB should continue to monitor the

developments in order to determine if more is needed on the proposed initiatives or new emerging issues from an auditing perspective.

Development of a Plain Man's Guide

7. One recommendation set forth in the meetings held with interested parties and discussed by the task force was the development of high quality basic information about credit markets, instruments, fair value concepts, pricing approaches, how pricing services work, terms and acronyms etc. should be developed and provided (known as a plain man's guide).
8. Initial contact was made with potential authors, primarily academics and member bodies. While the reaction was positive, it became apparent that the development of such a guide would take longer than anticipated, with some estimates of potential timing ranging from a year to two years.
9. Some thought had been given to how such a guide may be presented, with the view that it would be best for the plain man's guide to initially be focused on certain key areas. Further topics could be added in the future based on the need to do so and a prioritization of topics. It was suggested that there are a number of resources / other publications that could be linked into the guide that would serve as helpful references, such as work from the US Securities and Exchange Commission and others.
10. Since this initiative was first discussed, IFAC has developed a section on its website entitled "The Global Financial Crisis." This section of the IFAC website serves as an international clearinghouse of programs, articles, speeches, and other initiatives undertaken by IFAC, its independent standard setting boards, members and associates and others that are relevant to professional accountants and its many stakeholders. This webpage can be accessed at <http://www.ifac.org/financial-crisis/>.
11. As a result of the considerable changes in the landscape and the time that would be required to develop such a guide (as the IAASB does not have the knowledge or the resources internally to do so), it is proposed that the development of the plain man's guide not be undertaken. Rather, it is proposed that the IAASB work with IFAC's Communications team to assist in populating the IFAC website with guidance that is deemed relevant from other national standard setters, regulators, audit oversight bodies and financial resources so that the existing information can be more broadly disseminated. The Task Force supported this view.

Dialogue with Pricing Services

12. It was suggested that a dialogue between pricing services, brokers, preparers and auditors about how best to provide information about prices to enable preparers and auditors to have an adequate understanding of pricing of illiquid investments should be created.
13. The heads of the professional practices of the Big 4 have been asked to activate a group of their fair value experts to discuss how dialogue with the pricing services could be facilitated. A teleconference has been held to discuss the way forward; there does not appear to be strong support for a formal action in this regard. Rather, it may be better for the firms themselves to pursue this activity if it is felt necessary in the future.

14. Separately, Arnold Schilder, John Fogarty and IFAC Staff participated in a teleconference with representatives from Markit. Markit is a London-based company with the main business lines of Data, Valuation and Trade Processing. They offer pricing services for all financial instruments that don't trade actively on an exchange. They also publish daily consensus prices for the asset classes of CDS, bonds, ABS, CDS of ABS, loans, and LCDS. Markit also offers a price verification service called Totem, used in the monthly IPV process of market makers for exotic derivatives across all asset classes.
15. Markit requested the opportunity to speak to the IAASB, as they have also been in close contact with the IASB, the FASB, and the PCAOB. In their view, they have been working closely with users as well as with the auditors to help them understand how Markit generates their prices, how they ensure data quality, recent challenges and current initiatives.
16. It was noted that Markit is exploring whether it might be able to provide something similar to a U.S. SAS 70 report on controls surrounding its pricing services, similar to what would be contemplated under proposed ISAE 3402, "Assurance Reports on a Controls at a Service Organization." Any development in this area would be at the request of Markit engaging a service auditor and would not be an initiative the IAASB could likely influence.
17. The Task Force was of the view that there was further work that could be done to encourage pricing services to make more information publicly available about how they calculate prices; in addition, some task force members expressed concerns that it is not widely understood how auditors use pricing services in obtaining sufficient appropriate audit evidence and how pricing services fit into the fair value hierarchy. It is proposed that, given the indication that the Basel Committee on Banking Supervision intends to undertake further work in this area, opportunities to jointly collaborate in this area be explored.

Investments and the Use of Confirmations, Including Hedge Funds

18. The Task Force is asked to consider whether further consideration should be given to providing guidance similar to that issued by the US ASB on auditing investments in private equity funds through the use of confirmations and reporting on funds that do not disclose the individual investments they have made.
19. The Task Force had previously been briefed about auditing interpretations that had been issued by the AICPA that provide authoritative guidance about whether it is appropriate to obtain evidence about the valuation of investments through confirmations, and the auditor's actions when auditing financial statements of funds that do not disclose their individual investments. While not every financial reporting framework may require this type of disclosure, it may still be useful to auditors to alert them to the need to obtain sufficient appropriate audit evidence.
20. The Task Force had questioned whether there was anything in the ISAs at present that would address this point; in relation to the funds' financial statements, the point had previously been discussed in the context of modified opinions and the auditor's responsibility to include omitted disclosures in the auditor's report.
21. If such guidance were to be developed, it would likely need to be exposed for public comment. This could perhaps take the form of an IAPS, and would require approximately 18

months to be developed. Alternatively, since the IAASB is also considering whether it could develop a rapid response mechanism as a means for issuing authoritative and non-authoritative guidance outside of the typical due process, it may be possible that this topic would meet the criteria for something to be developed, as it is a practice issue on which there is limited guidance in the ISAs (See Agenda Item 7).

22. In the U.S., a practice aid for auditors had been developed to expand upon the interpretation relating to alternative investments. It was previously noted by a Task Force member that there is awareness that problems had been encountered in practice in this area.
23. While there was not explicit strong support for this initiative by the IAASB or its CAG, recent events in the U.S. regarding the investments funds run by Bernard Madoff highlight the importance that needs to be given to transparency in this area. The Task Force supported the development of guidance in this area, with the caveat that consideration would need to be given as to the appropriate form of such guidance. Given the need for more transparent information in relation to investment funds, the Task Force proposes that this matter be given priority and a formal project proposal be developed.

International Auditing Practice Statements

24. During the revision of ISA 540 (Revised and Redrafted)¹ and the IAASB's consultation on its strategy and work program, it was suggested that certain International Auditing Practice Statements should be revised.
25. As noted in the *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, IAPSs are issued to provide interpretive guidance and practical assistance to professional accountants in implementing ISAs and to promote good practice. The IAASB currently has on its work program a project to review the appropriateness of the content of all the IAPSs in order to determine whether they should be withdrawn or revised; and review the authority of IAPSs; this review has been tentatively scheduled for fourth quarter 2009.
26. The IAPS that may warrant revision as it relates to fair value or industries more affected by the use of fair value accounting are:
 - (a) IAPS 1004, *The Relationship between Banking Supervisors and Banks' External Auditors*;
 - (b) IAPS 1006, *Audits of the Financial Statements of Banks*; and
 - (c) IAPS 1012, *Auditing Derivative Financial Instruments*.
27. As IAPSs are considered IAASB pronouncements, they are subject to the same due process as an ISA and would take between 18 months to 2 years to develop.
28. In addition, it would likely be necessary that the IAASB draw on external resources to assist in the drafting of the revisions, as was done before with the development of IAPS 1006 with the Basel Committee on Banking Supervision.

¹ ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures."

29. The Task Force supported the consideration of whether the IAPSs be revised, with priority given to IAPS 1012. Should the IAASB determine not to do so at this time, it will be important that the project to review all the IAPSs move forward.

Liaison with IASB

30. The IASB Expert Advisory Panel, a group that includes representatives from the Big 4, industry and regulators, was given the task of determining whether practice guidance could be developed to address valuation methods for financial instruments when markets are no longer active, and also reviewed best practices in the area of valuation techniques. Mr. Kellas had attended a number of the Expert Advisory Panel meetings and their work was referenced in the IAASB's fair value alert.
31. In October 2008, the panel concluded their discussions with the issuance of the final guidance, which can be accessed at: http://www.iasb.org/NR/rdonlyres/0E37D59C-1C74-4D61-A984-8FAC61915010/0/IASB_Expert_Advisory_Panel_October_2008.pdf.
32. The IASB and the Financial Accounting Standards Board (FASB) recently established a Financial Crisis Advisory Group (FCAG). The FCAG is the high-level advisory group set up by the boards to consider financial reporting issues arising from the global financial crisis. The group includes recognized leaders from the fields of business and government with a broad range of experience in international financial markets.
33. IAASB Staff considered whether it would be appropriate for the IAASB to be represented on this panel, either as a full member or an observer. Because IFAC's former president, Fermin del Valle, is a member of the group, it was determined informal liaison with Mr. del Valle and a monitoring of the FCAG's activities would be appropriate. The Task Force urged the IAASB to continue to look for opportunities to work with the IASB, noting that it is important that, in setting accounting standards, the auditing implications are considered.

Other Possible Actions

34. As noted in the IAASB CAG minutes, a few Representatives noted that perhaps there was more that could be included in the auditor's report as it relates to fair value, including the levels of assurance reached with respect to fair values. As the IAASB intends to determine whether changes to the auditor's report may be necessary as a result of four academic studies that are currently in process, it is not proposed that work be undertaken specific to fair value in this area at present. Other topics which have been mentioned by CAG Representatives include:
- (a) The auditor's responsibilities in relation to disclosures – Staff notes ISA 540 (Revised and Redrafted) contains requirements and guidance relating to disclosures of accounting estimates, including fair value, but there could be a need for more general guidance within the ISAs.
 - (b) Assurance on sensitivity analysis and Value-at-Risk disclosures
 - (c) Guidance relating to the auditability of models.

Action Requested

35. Having considered the views set forth in this paper, the IAASB is asked to consider the recommendation that guidance on investment funds be developed, for its view as to whether IAPS 1012 should be revised as part of this Task Force's remit, and whether any of the other projects warrant further IAASB attention.