

Switch to fair value and the challenges facing the external auditors

Ahmed Abdel kader Ahmed

Accounting Department, Faculty of Commerce, Al-Azhar University, Egypt
Prof.ahmed60@gmail.com

Abstract: This study has illustrated the challenges that the auditor faced by in addressing to financial statements including items measured and disclosed in accordance with the fair value, from two perspectives “theoretical perspective and survey perspective”. The study has showed that auditors who address to auditing financial statements including items measured and disclosed in accordance with the fair value, are in face with many challenges that could be grouped under three dimensions. First challenge regarding the ability to checkout measurements used to estimate fair value for items included in financial statements, second domain is represented in the challenge regarding the awareness and understanding of auditor about the standards and guidance of fair value accounting and auditing., and third domain is represented in the challenge regarding the auditors’ abilities and competencies required for auditing of items measured and disclosed in financial statements in accordance with fair value.

[Ahmed Abdel kader Ahmed. **Switch to fair value and the challenges facing the external auditors.** *J Am Sci* 2014;10(1s):112-122]. (ISSN: 1545-1003). <http://www.jofamericanscience.org>. 17

Key words: fair value, challenges facing the external auditors

Study problem:

Over the last century, in the last years of 1980s and early years of 1990s, the reliance on the so-called fair value in accounting measurement and disclosure has become more widespread as a result of many criticisms faced the historical cost accounting. The international standards has adopted this value as a base for accounting measurement of many assets and liabilities such as financial instruments, including derivative financial instruments, real estate investments, intangible and vital assets and their products at the harvesting point.

In this context, most countries of the world have adopted the international accounting standards especially after the plans of coordination between the American Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in relation to making and issuing constant accounting standards and also after setting the decision made by the staff of International Accounting standards, that the movement from the historical cost towards the “Fair value” attains many benefits for the decision makers. (Barth, 2007; Elad, 2007; and Hitz, 2007) [1-3]

It is quite natural that this development of accounting measurement by movement towards the fair value has a reflection on the auditing process and auditor himself, and particularly on what is in relation to

audit risk which is the risk relevant to auditor’s view about financial statements, including items that have been measured and disclosed in accordance with fair value instead of being measured and disclosed in accordance with historical cost which is considered to be more conservative. The measurement of “Fair

value” often depends on a high degree of personal assessment because it is carried out in accordance with complex models and methods based on the assumptions that items were uncertain on the measurement date.

Thus, the movement towards the fair value measurement and disclosure has shed heavily over the auditor himself and leads him in face of challenges of fair value measurement and disclosure of some assets and liabilities in financial statements, which may be characterized by the following (PCAOB, 2009) [4]

- Increased degree of personal assessment that is used in admitting and measuring these values.
- High sensitivity of these value estimates for any slight change that may occur in the assumptions on which auditors rely to prepare these estimates.
- Tendency of valuation of these values to be manipulated by the management.
- Tendency of valuation of these values to be dominated by the internal controlling of management.
- Complexity of valuation techniques and models of these values.

Thus, providing the basic knowledge of the most important challenges faced by external auditor in auditing financial statements, including measured and disclosed items in accordance with the “fair value”, is considered to be the fundamental foundation upon which the study problem is discussed.

These challenges may have to do with the environment in which value estimates are estimated, or with the nature of duties undertaken by auditor in order to fulfill these estimates. In addition to the challenges that have to do with the personality of auditor.

This problem will be identified by reviewing a number of specialized accounting studies and research relevant to measurement and disclosure of what is known as "Fair value" as well as by conducting a survey study on a sample of financial statements' auditors of the Central Auditing Organization (CAO), particularly those who undertake auditing of banks, insurance.

Study Objectives:

Auditing financial statements including items measured in accordance with the "Fair value" has led the auditor in face of real challenge. This may particularly be the case, when auditor is faced with challenges in which auditing these values has not involved any kind of risk. To do so, awareness of the factors that pose a challenge faced by him is required to fulfill this objective.

Hence the main objective of this Study is to acquire the knowledge about the "Fair value" and to provide the critical knowledge of challenges in auditing fair value accounting estimates. Therefore, we can say that this Study is conducted to fulfill the following objectives:

- 1 – Briefly, acquire the knowledge about the fair value in items of its concept, usage development and justifications for its deployment.
- 2 – Provide the critical knowledge of the most important factors that pose challenges in auditing fair value faced by the auditor. These factors are determined via the realm of specialized academic accounting Studies and research.
- 3 – Provide the basic knowledge of awareness levels about the most important factors that pose a challenges faced by auditors of the Central Auditing Organization (CAO) in Egypt in auditing financial statements, including measured and disclosed items in accordance with fair value. This could be attained by conducting a survey on a sample comprising those who manage the process of auditing in banks, insurance companies and joint venture companies.

Study Limitations:

This study is addressed to identify the challenges faced by auditors in auditing financial statements, including items measured and disclosed in accordance with the "Fair Value", and provide the knowledge about how far auditors of the Central Auditing Organization (CAO) in Egypt are aware of these challenges.

Accordingly, the study is not addressed to know the methods and procedures relevant to audit fair value itself from theoretical or practical aspect. It is not also addressed to know how far auditors of private offices and entities are aware of understanding them because some auditors refrained while others excused for being

unable to participate, due to being busy at their work in the course of study preparation.

Study Significance:

Study significance stems from that it sheds light on challenges faced by auditors in auditing the fair value that constitutes the core of international accounting standards, from which the Egyptian accounting standards are derived, from intellectual and perspectives, which could be regarded as a contribution to academic knowledge among few literatures in this field.

Study Methodology:

The intellectual content of this study relies on inductive methodology of some specialized accounting studies and researches, especially those studies and research that investigated fair value in items of its concept, historical development and justifications for its deployment. In addition to those studies from which most important challenges faced by auditors in auditing financial statements, whose items depend on fair value, are concluded.

This study also relies on deductive methodology that is applied through a survey on a sample comprising auditors of the Central Auditing Organization (CAO) to identify the level of their awareness of challenges faced by auditors in auditing financial statements, including items measured and disclosed in accordance with the fair value

Study Scheme:

In order to fulfill objectives of the study and in the light of its limitations, the study content can be divided into three chapters:

- 1: Fair value, concept and historical development and usage justifications.
- 2: Challenges faced by External Auditor in auditing fair value.
- 3: A survey study

1. Fair Value

1.1 What is co-called fair value?

Study argues that in order to fully understand and actively address the challenges faced by external auditor in auditing financial statements, including items measured and disclosed in accordance with the so-called fair value, linguistic meaning and accounting meaning of fair value should be clearly understood.

In items of linguistic meaning, the fair value stems from saying " estimation of something means to assess what its value worth, it is said balance between two things and consider a thing existed instead of it as Justice means giving a person what he deserves and taking from him what he has to do (Moagam El - Wageez. 1993) [5]

Therefore, it is said that fair value linguistically means to determine the value of something impartially and accurately far from bias and error, which does not often confirm with the meaning, accounting that has no accounting approval either on the level of intellectual level or on the level of accounting standards that should be committed to upon application.

Regarding the intellectual level of accounting, there are such people who believe that the market value is the most widespread and commonly used value on determining the fair value with the condition of efficient market availability. Hence, the market value in a good financial market is the best indicator of fair value. Accordingly, fair value is "the price by which the property is transmitted between a willing seller and a willing buyer and a complete freedom is available for both of them for purchasing and selling and both parties are knowledgeable of the relevant facts. (Chris.,2001) [6]

A contradiction arises as the estimation of fair value based on the Market value and its disclosure at the heart of financial statements will lead to discard credibility provided by accounting estimation, or in other words, this will lead to unreliability of financial statements' data due to the following reasons: (Al-Awam, 1996) [7]

1 - Market value is affected by supply and demand factors in the stock market while fair value is determined according to an objective study of elements influencing the value of securities and shares.

2 - Market value is affected by some fabricated factors such as rumors while fair value is affected by the objective factors that are measured or able to be materially measured.

3 – Market value may not reflect the true value of the securities/shares since it is affected by personal and behavioral factors while the fair value is associated with true value of these securities and shares.

4 - Market value may not fit with true balance sheet of the entity that issued securities and shares due to the linkage existed between it and many factors while fair value should reflect true balance sheet of the entity that issued securities and shares.

In light of the previous factors, it can be said that fair value is the value that reflects true balance sheet of the entity that issued it and its expected returns whether in the form of announced dividends or in the form of capital increase in its value in light of economic variables affecting it.

According to what accounting standards encompass about the concept of fair value which was defined by the International Accounting Standards Board (IASB) - as mentioned in the International Financial Reporting Standards (IFRS) – as "the amount for which an asset

could be exchanged, or a liability settled, between parties that are knowledgeable and willing to enter into a transaction for the asset or liability based on a pure commercial exchange basis. (IASB, 2008) [8]

The Egyptian Accounting Standards, standard (25) has also defined Fair value as "the value for which an asset could be exchanged, or a liability settled between knowledgeable and willing parties, each of them are willing to exchange, knowledgeable about the facts and dealing with each other with free autonomy."(Egyptian Accounting Standards,2006) [9]

The American Financial Accounting Standards Board (FASB), standard 107 (regarding the necessity of fair value disclosure for all financial instruments), defined the fair value as "the present value upon which financial instruments can be exchanged among different parties. (FASB, 1991, No.107) [10]

The FASB has also issued a standard No. (157) which defined fair value as "the price that can be obtained as a result of selling an asset or paid to settle a liability in an orderly transaction between market participants on the measurement date." (FASB, 2006, No.157) [11] (ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

The American accounting standard No. (157) has identified three levels of fair value hierarchy within which a fair value measurement is categorized:

Level 1: Using quoted prices in an active market for identical assets or liabilities, that the entity can access at the measurement date, is presented at this level.

Level 2: Using quoted prices for similar assets or liabilities in active markets or markets that are not active is presented at this level.

Level 3: This level is applied in the absence of markets for similar or comparable assets. In this case the valuation depends on a wide range of personal estimations and judgments of the valuing entity itself. (Hitze, j. M, 2007; Chang and other, 2010) [12-13]

1.2 Appropriateness of Fair Value

Measurement and Disclosure

By the end of eighth decade and the beginning of ninth decade of the second millennium, and as a result of criticisms that are in face of applying historical cost principle in accounting, consensus have started to rise in favor of accounting based on fair value principle, particularly in favor of items of assets and financial investments whose fair value is usually called "market value". Applied Studies has focused on measuring fair value according to the market since it represents an appropriate value.

In the nineties of last century, many American studies had focused on disclosure of financial instruments owned by banks in accordance with market value. They supported the argument stated that

this value is the appropriate fair value of financial assets and liabilities of financial institutions (e.g., **Barth, 1994; Barth, Landsman, and Wahlen, 1995; Barth, Beaver, and Landsman, 1996; Eccher, Ramesh and Thiagarajan, 1996; Nelson, 1996; Venkatachalam, 1996**) [14-18]

Appropriateness means that accounting information disclosed in financial statements directly affects the decision taken by users of financial statements. The credibility of this characteristic depends on three factors. To ensure appropriateness of information, the following minor characteristics should be provided:

- Accounting information available to users in a timely manner
- The accounting information to be able to predict
- The ability to accounting information, it be able to feedback

One of recent studies that dealt with the appropriateness of fair value compared to historical cost, the study developed by **Mirza et al. (2008, p. 9-26)** [19] that explained that accounting provides most appropriate information for making a decision when it reflects the current market conditions. It also explained that the fair value which is estimated according to past events is still appropriate for decision makers, but a forecast of market future provides a convenient and reliable model. Fair value reflects the true value of economy for the current market information. It also offers the best information for forecasting. Its impact is optimized in the course of decision-making process. (**Carroll et al., 2003,**) [20]

Penman (2007,) [21] has summarized a number of justifications about appropriateness of fair value for making decision. The most important justifications were:

- 1 –Investors gave attention to value rather than to cost.
- 2 –Information about the balance sheet prepared in accordance with historical cost becomes irrelevant over the long term.
- 3 –Fair value is entity with economic vision of assets and liabilities, (i.e. fair value of accounting reports of assets and liabilities is equivalent to true economic substance).
- 4 –Fair value which reflects the measurement in accordance with market is non-biased measurement.

1.3 Reliability of Fair Value Measurement and Disclosure

In order to rely on information and attain its reliability, the following minor characteristics should be provided: (**Hendriksen, 1992**) [22]

- 1- Preparation of information such that it sincerely reflects the phenomena that are supposed to be expressed (validity to represent phenomena and events).
- 2- Ability of information to be proven and verified with respect with their integrity.

According to **Barth's** point of view (**Barth,2007**) [23] stated that the verification is considered a part or an element of sincere expression. From this point of view, people argued that accounting measurement and disclosure in accordance with fair value is more reliable than measurement and disclosure in accordance with historical cost. For example, the measurement and disclosure of real estate investments in the United Kingdom prepared in accordance with fair value, based on selling prices, are more reliable than measurement in accordance with historical cost (**Dietrich, Harris, and Muller, 2001**) [24]. This is in contrast to those who believe that sincere expression is related to verification. Consequently, the measurement and disclosure in accordance with historical cost is more reliable than that of fair value. (**McCarthy, 2004**) [25]

In brief, fair value may provide the feature of reliability of accounting information in case it is measured in accordance with active market. This value is also reliable in case there are no core significant differences upon the task of fair value valuation verification, this may not be provided in absence of active markets. Thus, the assumption of fair values in absence of market basics may lose the feature of reliability of accounting information.

2. Challenges in Auditing Fair Value That Faced Auditors

2.1 Introduction

Accounting estimates have constituted difficult numbers in financial statements. These statements cannot be prepared unless estimates of many assets and some liabilities are taken into action in order to represent them in a reliable value. During the past few decades, the degree of complexity and uncertainty of these estimates has increased dramatically. (**Brant Christensen & other, 2011**) [26]

It is noteworthy that most important challenges in auditing estimates in general and estimates of what is known as Fair value in particular faced with auditors, regarding the studies and research that have to do with these estimates, can be identified in three dimensions which are: uncertainty associated with auditing of accounting estimates in general and fair value estimates in particular, complexity of auditor's task in auditing of accounting estimates in general and fair value estimates in particular, and finally, competence and effectiveness the auditor owes.

2.2 Uncertainty of Fair Value Estimates

Auditor is faced with challenges in auditing fair value estimates as a result of uncertainty bounded generally in business and particularly in fair value estimates. Uncertainty refers to ambiguity around estimation of asset or liability value that is included in

financial statements. There is no doubt that the greater the degree of uncertainty in estimation of any asset or liability included in financial statements, the greater the risk of error in disclosure of these statements **(IAASB, 2008a) [27]**

The degree of uncertainty accompanying with measurement of fair value estimates for any of assets and liabilities depends on the diversity and multiplicity of models and the assumptions of items that constitute inputs of these models at the time of measurement. Fair value can be measured in accordance with market input or income input or cost input. These inputs often comprise many of models and assumptions relating to input of these models which are often associated with the degree of uncertainty **(IVSC, 2007) [28]**

It would be resorted to valuation based on income input or cost input due to lack of liquid markets for the majority of assets. According to cost input, fair value valuation depends on the futuristic cash flows, earnings, and discount rates linked with the present value. All of these items linked to a high degree of uncertainty. In case of reliance upon the cost input, fair value valuation will be based on determining the amount that is equivalent to the replaced cost which depends on assumptions of items that are often characterized by uncertainty as well.

In case of normal economy conditions, the management is provided with the freedom to choose between specific valuation models or compounded valuation models. The freedom to determine the related inputs and assumptions poses a challenge before auditor. Fair value valuation in the case of financial and economic crises causes the valuation to be more difficult and poses more challenge before auditor in regard to appropriateness and objectivity of fair value estimates in financial statements. **(IAASB, 2008b)[29]**

Eventually, it could be said that difficulty and complexity of valuation models for determining the fair value, resulting from uncertainty and occurrence of financial and economical crises, create challenges and problems before auditor about the following:

- Ability to test the assumptions used in measuring the fair value.
- Ability to value the appropriateness of valuation models for determining the fair value and its consistency with the International Valuation Standards.
- Ability to test the inputs of fair value measurement model, such as cash flow, discount rate, valuation period etc.....
- Ability to value market conditions and events in items of volatility after the balance sheet date.
- Ability to assess the remark list attached to financial statements. **(Melek Akgün; Davut Pehlivanlı and Meltem Gürünlü; 2011)[30]**

2.3 Difficulty in the Tasks of Auditing Fair Value Estimates

Uncertainty accompanying to fair value estimates increases the complexity and overlapping of auditing tasks of fair value estimates which delivers a bad impact on the auditor's performance.

Further, difficulty and complexity of auditing tasks of fair value estimates arise from uncertainty and economic volatility accompanying the models and assumptions upon which fair value estimates are based, ambiguity and incomplete Intellectual structure and appropriate guidance of auditing fair value estimates, and difficulty of verification of management bias when developing valuation of fair value. The researcher summarized all these difficulties as the following:

2.3.1. Uncertainty and Multiplicity of Models and Assumptions of Fair Value Estimates

There is no doubt that the aspects of uncertainty, economic violation, multiplicity of models and assumptions, upon which fair value estimates are based, increase the difficulty and complexity of the task of auditing fair value estimates. This difficulty affect negatively on the quality of decisions made by auditor **(Gaynor, et al., 2011) [31]**. The management also uses multiple and compound valuation techniques to measure the fair value which increase the difficulty of auditing task of fair value valuation. The greater the number and the more complexity the models are, the more the difficulty in understanding mechanisms of their application **(IAASB 2008; PCAOB, 2011)[32-33]**

Difficulty in the task of auditing fair value estimates arises from difficulty in understanding the models used for this purpose. Even if the auditor was able to understand the model or models which are used in estimation, his ability to identify and comprehend the assumptions on which these models rely will pose a powerful challenge faced by him, especially in case of dynamic market or in case of unavailability of independent data about markets. **(Humphrey et al. 2009; SEC, 2011)[34-35]** Moreover, the reliance of management on a specialized expert in measuring fair value also increases the difficulty in the task of auditing these estimates.

2.3.2 Ambiguity and Incompleteness of Application Rules and Guidance of Auditing Fair Value Estimates

There is no doubt that incompleteness of intellectual structure and guidance of fair value application is one of the obstacles that hinder the task of auditing fair value estimates. The ambiguity of application suited for auditing guidance also increases the difficulty in the task of auditing fair value estimates. The principles and guidelines of auditing fair value estimates and other estimates comprise equivalent or equal techniques, i.e., The presence of

two standards or two guidelines that could be applied on one thing and that's what increases the difficulties faced by auditor of financial statements that comprise measured and disclosed items in accordance with fair value. **(PCAOB, 2007,3) [36]**

Thus, the presence of two criteria which can be applied on a particular situation increases the difficulty in the task of auditor. Besides that their presence in auditing Fair value estimates will increase burden and complexity of his task in auditing these estimates **(Bonner, 2008)[37]** The absence of any details about how to determine fair value of assets among a list of similar assets, such as market's type, time and selected price, also increases the difficulty in the task of auditing fair value estimates.

2.3.3. Difficulties Referring to Management Bias :

Management bias is one of challenges faced by auditing fair value. This bias is stems from the concurrence of uncertainty nature that is accompanying with measuring fair value estimates with management drives. Estimation of fair value measurement increases the possibility of management bias and their personal judgment use. That is what calls some people for urging that Enron company's management abuse and bias in developing fair value estimates were responsible for its collapse **(Benston, 2006) [38]** and overthrowing of "Anderson & Co." that was considered as one of the largest certified auditing companies in the world.

Thus, the necessity to check out management bias in developing fair value estimates is one of the challenges faced by auditor in auditing these estimates. The complexity and uncertainty accompanying with fair value estimates throw a burden, over him, of taking courses of actions that may explain that estimates of fair value are not resulted from management bias which is the most important cause of material misstatement of the financial statements, **(PCAOB, 2011c, 10) [39]** which may aim at manipulating profits to protect personal bonuses for management.

In spite of this, the ability of auditor to check out management bias in auditing fair value estimates remains one of the difficult issues and this is not only due to complexity and uncertainty that imply these estimates but also due to features associated with auditor himself by which its interaction with other factors constitutes a dramatic impact on the quality of auditing process in general, and the quality of auditing fair value in particular.

2.4 Competency and Effectiveness of auditors for auditing the fair value

One of the challenges that auditor could be face by in auditing fair value estimates is that these estimates may be beyond the qualifications and competencies of auditor who addressed them in auditing fair value

estimates. For example, investigation about management intention and purpose from the models that are used to estimate fair value and its related assumptions and checking out of them are considered to be an extremely difficult thing

Generally, the auditor needs to understand how management calculates its fair value estimates and understands the data upon which the management relies in issuing these estimates and his may require specific skills and abilities to ensure that. It is worth to say that the auditor's competency and effectiveness is one of the key challenges the auditor is faced by in auditing fair value estimates since it requires specialized and intimate knowledge connected to the ways and methods of measuring fair value which may exceed Accountancy to Finance and Economics. **(Brian Bratten, Lisa Milici Gaynor, and Linda McDaniel) [40]**

The persistent debate of auditor in auditing fair value estimates is based on his ability to understand the models and assumptions that the management used to measure these estimates. This ability decreases as these models, which are used by management or by external specialist, develop with time. Thus the appropriateness auditing fair value estimates has become a difficult process that requires a comprehensive profession from the auditor. **(STEPHEN) [41]**

Among these accounting professions, there is Sheptical profession which is a unique characteristic that can be considered the most important basics of audit effectiveness. **(Hurt, 2010,) [42]**. If he needs to use professional skepticism in most cases, this need will be of utmost significance for him in auditing fair value and other estimates due to the increase regarding the degree of uncertainty and the difficulty of tangible evidences availability.

The lack of professional skepticism of auditor may pay for failure towards: (1) Conducting an adequate valuation of management's assumptions, (2) Conducting a test of the appropriateness of valuation model controlling, (3) Investigating the evidences contradicted with valuation, (4) Conducting a test of value use, and (5) Conducting a test of proceeding held by a specialist **(PCAOB, 2009) [4]**

Thus, the auditor's professionalism of skepticism represents utmost significance to him in order to reach the evidences in audits, check out them and be in face of complexity and uncertainty associated with fair value estimates the previous chapter has concluded that there is a number of challenges faced by auditors in conducting audits of financial statements including items measured and disclosed on the basis of fair value, their initiatives stem from Several sources where some of them are in connection with fair value estimates diversifying inputs, availability and accuracy

of data used in this estimation, some are in connection with accountants and management's ability to apply fair value inputs, in addition to management's objectiveness in the process of estimation itself. These challenges will inevitably lead to the increased information risk associated with financial statements and hence lead to the increased level of risk that auditor can stand as a result of issuing reports in auditing based on the same methods followed in case of issuing opinion about financial statements prepared in accordance with historical cost.

This increased level of risk is referred to that the fair value may permit management to manipulate profits and hence the risk of material misstatement of the financial statements due to fraud and interpolation will be higher, so the auditors are required to consider those challenges in audits of financial statements prepared in accordance with fair value in order to overcome them and thus reduce the degree of risk of material misstatement of the financial statements due to fraud and interpolation, and this is the objective of study in this chapter.

3.2 Objective of Survey Study

The survey study is aimed at identifying the views of auditors of Of the Central Auditing Organization (CAO) in Egypt about what was discussed in chapters 2 and 3 of this study through a questionnaire including a number of questions aimed at responding to the following:

- To what extent there is a consensus or disagreement among auditors Of the Central Auditing Organization

(CAO) in Egypt with those who view that using of fair value in preparing financial statements may provide benefits for their users more than those prepared in accordance with historical cost.

3. Survey study

3.1. Introduction

- To what extent there is awareness among auditors of the Central Auditing Organization (CAO) in Egypt about the standards, rules and guidance regarding the measurement and disclosure of fair value.

- To what extent there is awareness among auditors of the Central Auditing Organization (CAO) in Egypt about the challenges faced by them in auditing financial statements prepared in accordance with fair value.

- What are the procedures, which the auditors Of the Central Auditing Organization (CAO) in Egypt view that they should follow in order to face the challenges they met in auditing financial statements prepared in accordance with fair value.

3.3 Cluster of the Survey Study

The cluster of survey study comprises auditors Of the Central Auditing Organization (CAO) in Egypt who undertake auditing financial statements among banks, insurance companies and joint venture companies sectors where these sectors are the largest of their type that their financial statements comprise items measured and disclosed in accordance fair value. The following table illustrates the components of study cluster.

Table (1) the components of the study cluster

Occupation	Tasks	Banks & Insurance Companies Sector	Joint Venture Companies Sector
Trainee Auditors /Auditor	Undertaking Auditing	25	27
Head of Division	Developing and Following-up Auditing Programs	4	4
General Manager	General Supervision and Following-up	2	2
Total		31	33

The researcher has delivered questionnaires among subjects of survey cluster. the size of responses of the questionnaire was clarified as in the following table:

Table (2) the number and percentage of responses

Occupation	Banks & insurance companies sector		Joint Venture sector	
	Responses	Percentage	Responses	Percentage
Trainee Auditor / Auditor	22	88%	18	67%
Head of Division	4	100%	4	100%
General Manager	2	100%	2	100%
Total	28	90%	24	73%

3.4 Results of the Survey Study

The survey study comprises a number of dimensions represented as follows: The first dimension: The view about the benefits of financial

statements, prepared in accordance with fair value, for the users of financial statements. The second dimension: The view about understanding and awareness of standards and guidance of fair value

measurement and disclosure. The third dimension: Dealing with multiple aspects of challenges that are in face of auditors in auditing fair value with respect to:

- Checking out of fair value measurements for the items of financial statements.
- Awareness and understanding of standards and guidance of accounting and auditing related to fair value estimates.
- Qualifying auditor who addresses the audits of fair value.

The following are the results of survey study regarding each one of the three dimensions.

Table (3) The responses average about the benefits of financial statements, prepared in accordance with fair value, for their users

Items	Topic	Totally V.Agree	Agree	In Between	Disagree	Totally V.Disagree
1-8	Views about the benefits of financial statements, prepared in accordance with fair value, for their users	27.89%	52.88%	13,22%	5.05%	0.96%

Thus, It could be said that auditors Of the Central Auditing Organization (CAO) in Egypt are consistent with the view that the financial statements prepared in accordance with fair value provide more benefits for their users than those prepared in accordance with historical cost as the percentage of their agreement exceeds 80% (Sum average of totally agree and agree percentages).

3.4.2 Second Dimension Results

Table (4) The Responses Average about the Awareness and Understanding of Fair Value Standards and Guidance among Auditors of the Central Auditing Organization in Egypt

Items	Topic	Totally V.Agree	Agree	In Between	Disagree	Totally V.Disagree
9-16	Views about the Awareness and Understanding of Fair Value Standards and Guidance.	16.83%	39.67%	24.76%	15.87%	2.88%

Thus, it could be said that auditors Of the Central Auditing Organization (CAO) in Egypt do not have enough awareness and understanding of all standards and guidance of fair value where the percentage average of their agreement was 56.49% (Sum average of totally agree and agree percentages). This may indicate that auditors need to attend more sessions that stress on illustrating the standards and guidance of fair value either they are international or local ones.

3.4.3 Third Dimension Results

This dimension emphasizes on revealing the various challenges that are in face of auditors Of the Central Auditing Organization (CAO) in Egypt in their auditing financial statements including items measured and enclosed in accordance with fair value. This has been attained by a questionnaire including

3.4.1 First Dimension Results

This dimension emphasizes on revealing the view of auditors and managers Of the Central Auditing Organization (CAO) in Egypt that give rise to the question about to what extent there is a consensus or disagreement between these and those who view that using fair value in preparing financial statements provides many benefits for their users. This has been attained by a questionnaire including eight items (1 - 8) in which the responses average was shown as the following:

This dimension emphasizes on revealing to what extent there are awareness and understanding of the group of standards and guidance is regarding fair value measurement and disclosure among auditors of the Central Auditing Organization (CAO) in Egypt. This has been attained by a questionnaire including eight items (9-16), the responses average was shown as the following:

fourteen items (17-30), classified into three kinds of challenges which are as follows: The first challenge regarding the ability of auditors to checkout measurements used in fair value estimates for items included in financial statements they are auditing. The second challenge regarding the standards and guidance of fair value in items of the coverage and ambiguity of some of them. The third and last challenge regarding the ability of auditors to undertake the audits of financial statements including items measured and disclosed in accordance with the fair-val

3.4.3.1 First Challenge “Checkout of Fair Value Measurements” Results

Nine items (17-25) are included in the questionnaire has been allocated to investigate this

challenge where the responses average was as the following:

Table (5) The responses average about the challenge of the auditor's ability to checkout fair value measurements

Items	Topic	Totally V.Agree	Agree	In Between	Disagree	Totally V.Disagree
17-25	Views about the ability of auditors to checkout fair value measurements	31.41%	46.15%	11.97%	6.84%	3.63%

Thus, it could be said that the auditors Of the Central Auditing Organization (CAO) in Egypt view that their ability to checkout fair value measurements for the items they audit in the financial statements is considered their biggest challenge. The percentage average of respondents who recognize the enormity of this challenge was more than 77%. (Sum average of totally agree to agree percentages).

3.4.3.2 Second Challenge "Coverage and Ambiguity of Some Fair Value Standards and Guidance" Results

Two items (26-27) are included in the questionnaire has been allocated to investigate this challenge where the responses average was as the following:

Table (6) The responses average about the coverage and ambiguity of some fair value standards and guidance

Items	Topic	Totally V.Agree	Agree	In Between	Disagree	Totally V.Disagree
26-27	Views about the adequacy of standards and guidance of fair value and the extent of its clarity	25.01%	52.89%	14.43%	4.81%	2.88%

Thus, it could be said that the auditors Of the Central Auditing Organization (CAO) in Egypt view that there is a challenge faced by them in their auditing financial statements including items measured and disclosed in accordance with fair value regarding the inadequacy of standards and guidance of fair value besides that some of them have ambiguity. The percentage average of respondents who recognize the enormity of this challenge was nearly 80%. (Sum average of totally agree to agree percentages). This may arise the need to issue

standards and guidance about accounting and auditing of items measured and disclosed in financial statements in accordance with what is known as fair value. In addition to audit what has been issued to avoid any ambiguity they may have.

3.4.3.3 Third Challenge "Ability of auditors to undertake auditing fair value estimates" Results

Three items (28-30) are included in the questionnaire has been allocated to investigate this challenge where the responses average was as the following:

Table (7) Responses average about the ability of auditors who undertake auditing financial statements including items measured and disclosed in accordance with fair value

Items	Topic	Totally V.Agree	Agree	In Between	Disagree	Totally V.Disagree
28-30	Views about the ability of auditors to undertake auditing of items measured and disclosed in accordance with fair value	38.46%	46.80%	7.05%	3.84%	3.84%

Thus, it could be said that the auditors Of the Central Auditing Organization (CAO) in Egypt believe that there is a challenge faced by them in auditing financial statements including items measured and disclosed in accordance with fair value, regarding inadequate knowledge of the fundamentals and methods of fair value measurement. This may arise the need to a comprehensive professional training in this field since the percentage average of their agreement to this challenge was slightly more than 85%. This may give rise to the need to refine the auditors with knowledge and specialized training programs of

accounting and auditing about the measurement and disclosure and auditing of what so-called fair value.

Conclusions and recommendations:

Study has illustrated the challenges that the auditor faced by in addressing to financial statements including items measured and disclosed in accordance with the fair value, from two perspectives "theoretical perspective and survey perspective" and the concluded findings that can be summarized as the following:

1- The fair value is linguistically means determining the

value of something impartially and accurately, far from bias and error, which often does not conform

with accounting meaning, it does not have agreement

on accounting basis, either over the intellectual level

or over the accounting standards level, that should be complied with in application

a - First domain is represented in the challenge regarding the ability to checkout measurements used to estimate fair value for items included in financial statements

b- Second domain is represented in the challenge regarding the awareness and understanding of auditor about the standards and guidance of fair value accounting and auditing

c- Third domain is represented in the challenge regarding the auditors' abilities and competencies required for auditing of items measured and disclosed in financial statements in accordance with fair value.

2- Theoretical study has showed that auditors who address to auditing financial statements including items measured and disclosed in accordance with

the so-called fair value, are in face with many challenges, that could be grouped following

3-Survey study conducted on Auditors Of the Central Auditing Organization (CAO) in Egypt has emphasized on three domains which have been deducted from the theoretical study about the aspects of challenge that are in face of those who address to auditing of measured and disclosed items included in financial statements in accordance with above-mentioned fair value.

References

1. Barth, M., 2007, Standard-setting measurement issues and the relevance of research, *Accounting and Business Research*, Vol. 37, No. 3, pp. 7-15.
2. Elad, C., 2007, Fair value accounting and fair trade: An analysis of the role of International Accounting Standard No. 41 in social conflict, *Socio-Economic Review*, Vol. 5, pp. 755-777
3. Hitz, J., 2007, The decision usefulness of fair value accounting – A theoretical perspective, *European Accounting Review*, Vo. 16, No. 2, pp. 323-362. 21
4. Public Company Accounting Oversight Board (PCAOB). 2009. Auditing Fair Value Measurements and Using the Work of a Specialist. Standing Advisory Group Meeting. October 14-15. Washington, D.C.: PCAOB
5. Moagam El- Wageez, Arabic Language Archive, special edition for Ministry of Education, subject: (Value) and (Justice), 1993, p. 209-523.
6. Chris, B., "Agency valuation: which definition is best for you?", *American Agent & Broker*, Vol. 73, Issue 7, July 2001, P. 8.
7. Al-Awam, Attef Mohammed; "Accounting fair value for short-term financial investments in the framework of accounting standards and Egyptian stock market law", scientific journal for Economy and Commerce, Faculty of Commerce, Ein Shams University, 2nd Edition appendix, 1996, p. 1059-1064
8. International Accounting Standard Board, "International Financial Reporting Standards 2008 – IAS 39" financial instruments: recognition and measurement, London, united Kingdome, paragraph 9, p. 1945.
9. Egyptian Accounting Standards, Ministry of Investment, Arab Republic of Egypt, 2006
10. Financial Accounting Standards Board (FASB), statement of financial accounting standards no. 107, Disclosures about Fair Value of Financial Instruments, 1991.
11. Financial Accounting Standards Board (FASB), statement of financial accounting standards no. 157", Fair value measurements", Connecticut, 2006, p.6
12. Hitze, j. m., "The decision usefulness of fair value accounting – A theoretical perspective", *European accounting review*, vol. 16, 2, 2007, PP. 323 – 362
13. Chang joon song, Wayne Thomas, han yi, "Value Relevance of FAS 157 fair value hierarchy information and the impact of corporate governance mechanisms" *Accounting Review*, Vol. 85, No. 4, 2010, www.ssrn.com/abstract=1198142
14. -Barth, M., 1994, Fair value accounting: Evidence from investment securities and the market valuation of banks, *The Accounting Review*, Vol. 69, pp.1–25.
15. -Landsman, W., 2007, Is fair value accounting information relevant and reliable? Evidence from capital market research, *Accounting and Business Research*, Vol. 37, No. 3, pp. 19-30.
16. -Barth, M., Beaver, W. and Landsman, W., 1996, Value-relevance of banks' fair value disclosures under SFAS 107, *The Accounting Review*, Vol. 71, pp. 513–537.
17. -Nelson, K., 1996, Fair value accounting for commercial banks: An empirical analysis of SFAS No. 107, *The Accounting Review*, Vol. 71, p. 161–82.
18. -Venkatachalam, M., 1996, Value-relevance of banks' derivatives disclosures, *Journal of Accounting and Economics*, Vol. 22 p. 327–55
19. Mirza, A., Orrel, M. & Holt, G. (2008). *Practical Implementation guide and workbook*. 2nd Willey IFRS: Edition
20. Caroll, T., Linsmeier, T. & Petroni, K. (2003). *The reliability of fair value versus historical cost*

- information: evidence from closed-end mutual funds. *Journal of Accounting, Auditing & Finance*, 1-23
21. Penman, S., 2007, Financial reporting quality: Is fair value a plus or a minus?, *Accounting and Business Research*, Vol. 37, No. 3, pp. 33-44.
 22. Hendrickson, E. and Bred M. (1992), *Accounting Theory* 5th Ed. Irwin – Mc Graw – Hill U.S.A.
 23. Barth, M., 2007, Standard-setting measurement issues and the relevance of research, *Accounting and Business Research*, Vol. 37, No. 3, pp. 7-15.
 24. Dietrich, R., Harris, M., and Muller, K., 2001, The reliability of investment property fair value estimates, *Journal of Accounting and Economics*, Vol. 30, p. 125-158.
 25. McCarthy, P., 2004, Unnecessary complexity in accounting principles, *The CPA Journal*, Vol. 74, No. 3, p. 18-19.
 26. Brant Christensen, Steven Glover and David A. Wood; An Inconvenient Truth About Auditing Fair Value Measures; March 2011
 27. International Auditing and Assurance Standards Board (IAASB). 2008a. Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures. International Standard on Auditing (ISA) 540. New York, NY: IAASB
 28. The International Valuation Standards Committee (IVSC). (2007). *International Valuation Standards (IVS)*, USA
 29. International Auditing and Assurance Standards Board (IAASB). 2008b. Challenges in Auditing Fair Value Accounting Estimates in the Current Market Environment. Staff Accounting Practice Alert. New York, NY: IAASB.
 30. Melek Akgün; Davut Pehlivanlı and Meltem Gürünlü; A Process Design for Auditing Fair Value www.ccsenet.org/ijef International Journal of Economics and Finance Vol. 3, No.3; August 2011
 31. Gaynor, and T. L. Yohn. 2011. Fair value accounting for liabilities: The role of disclosures in unraveling the counterintuitive income statement effect from credit risk changes. *Accounting, Organizations and Society* 36 (3): 125-134:
 32. -International Auditing and Assurance Standards Board (IAASB). 2008b. Challenges in Auditing Fair Value Accounting Estimates in the Current Market Environment. Staff Accounting Practice Alert. New York, NY: IAASB.
 33. -Public Company Accounting Oversight Board (PCAOB). 2011b. Report on 2010 Inspection of PricewaterhouseCoopers LLP. November 8. Washington, D.C.: PCAOB
 34. -Humphrey, C., A. Loft, and M. Woods. 2009. The global audit profession and the international financial architecture: Understanding regulatory relationships at a time of financial crisis. *Accounting, Organizations and Society* 34 (6-7): 810-825
 35. -Securities and Exchange Commission (SEC). 2011. Disclosure and Corporate Governance: Financial Reporting Challenges for 2011. The Harvard Law School Forum on Corporate Governance and Financial Regulation. Available at: <http://blogs.law.harvard.edu/corpgov/2011/03/12/sec-disclosure-and-corporate-governance>.
 36. Public Company Accounting Oversight Board (PCAOB). 2007. Auditing Accounting Estimates and Fair Value Measurements. Standing Advisory Group Meeting. June 21. Washington, D.C.: PCAOB.
 37. Bonner, S. E. 2008. Judgment and Decision Making in Accounting. Upper Saddle River, NJ: Pearson Prentice Hall.
 38. Benston, G. (2006). Fair Value Accounting: A Cautionary Tale From Enron, *Journal of Accounting and Public Policy*, No:25, pp:465-484
 39. Public Company Accounting Oversight Board (PCAOB). 2011c. Assessing and Responding to Risk in the Current Economic Environment. Staff Audit Practice Alert No. 9. December 6. Washington, D.C.: PCAOB
 40. Brian Bratten, Lisa Milici Gaynor, and Linda McDaniel The Audit of Fair Values and Other Estimates: The Effects of Underlying Environmental, Task, and Auditor-Specific Factors, Electronic copy available at: <http://ssrn.com/abstract=2027492>
 41. STEPHEN P. ROWE, AUDITOR JUDGMENT UNDER UNCERTAINTY
 42. Hurtt, R. K. 2010. Development of a scale to measure professional skepticism. *Auditing: A Journal of Practice & Theory* 29 (1): 149-171

5/22/2014