Professional judgment framework

Faculty note:

The lecture notes will introduce the professional judgement framework to the students. Beyond lecture notes, supplemental curriculum materials allow students to apply the professional judgment framework to a variety of accounting and auditing scenarios (referred to as application scenarios).

These supplemental curriculum materials include an "application template" which serves as a tool to track, organize and evaluate considerations of the professional judgment framework. For each application scenario provided, this application template can be used by the students to support their judgment.

Note that a solution set is provided for each application scenario and each includes a completed application template along with a written memorandum. In substance, these two deliverables include the same content but are in different formats. It is your choice to require the completion of one or both of these formats. Documenting the rationale and support for important judgments made during the course of the audit is generally required by professional standards. In addition, for preparers, documentation helps support assertions made in the financial statements and supports an effective system of internal control. As such, requiring students to develop a written memorandum is encouraged to assist in reinforcing the concepts included in the judgment framework and the development of effective writing skills. The application template is a tool to help students generate the written memorandum. This tends to be an area where many young professionals struggle.

It is also very important to note that each solution set represents a possible approach to making the judgment rather than a "right" answer.

Prior to asking students to complete any of the supplemental application scenarios, as a class, you should complete the example, “Time to buy a new car?” This is a non-accounting-based scenario and includes three parts. This example will allow you to reinforce the learning of the lecture, with special attention to common biases, using classroom discussion. Completion of this example should enable students to get a hands-on experience and feel more comfortable with the professional judgment framework and the corresponding application template.

Finally, note that the lecture notes discuss that the overarching considerations for the professional judgment framework are to be continually readdressed throughout the overall judgment process. However, in completing the application scenarios, for simplicity purposes, students will only address the overarching considerations at the beginning of the judgment process.
Time to buy a new car? – a scenario where a new accounting professional, recently graduated, must make a judgment about buying a new car

- Part I: students identify and discuss the common biases relative to the scenario
- Part II: students apply the professional judgment framework to make a judgment relative to the scenario
- Part III: students prepare the final written memorandum of their judgment relative to the scenario

Allowance for doubtful accounts – a scenario where the student assumes the role of the controller for Wildcat Sporting Goods and must make a judgment about the allowance for doubtful accounts
Inventory: lower of cost or market – a scenario where the student assumes the role of the controller for JK, a technology company, and must make a judgment about the carrying value of its inventory considering the lower of cost of market.

Property, plant and equipment: impairment – a scenario where the student assumes the role of a junior accountant for Toyda, a car manufacturer, and must make a judgment about the need to impair its production facilities.

Useful life of copyright – a scenario where the student assumes the role of an audit senior of the client engagement team for RimStar Music Company and must make a judgment about the reasonableness of the client’s judgment for the useful life of a new copyright for its collection of a fusion genre of gospel songs and country music.
Debt modification or extinguishment – a scenario where the student assumes the role of the new controller of the Prescott Company, a commercial real estate developer, and must make a judgment about the potential refinancing of its mortgage loan

- Part I: students define the issues relative to the scenario
- Part II: students apply the professional judgment framework to make a judgment regarding three specified issues relative to the scenario
- Part III: students prepare the final written memorandum of their judgment relative to the scenario

Note: This application scenario requires students to apply more judgment in defining the issue and less in the remaining process steps as typical for most other application scenarios because multiple issues are present. As a result, this is why the scenario is broken into three parts so that the issues can first be identified before proceeding forward with the remaining process steps.

Environmental obligations – a scenario where the student assumes the role of the new controller of United Super Steel, a steel producer, and must make a judgment about recording an environmental obligation due to contamination of a production site over a multi-year period

- Part I: students apply the professional judgment framework to make a judgment regarding the scenario for year 1
Part II: student assumes a new role as the audit senior of the client engagement team for United Super Steel and must make a judgment about the reasonableness of the recorded environmental obligation for year 2
Application scenario

**Goodwill impairment** – a scenario where the student assumes the role of the controller for AKS, a consumer electronics company, and must make a judgment to determine possible goodwill impairment using a qualitative assessment over a multi-year period

- Part I: students apply the professional judgment framework to make a judgment regarding the scenario for year 1
- Part II: Students should be broken into groups to either assume the role of the assistant controller or audit manager. Each role will:
  - Review the partially completed application of the professional judgment framework (define the issue and gather the facts) to make the judgment regarding the qualitative assessment to determine goodwill impairment performed by the controller for year 2.
  - Complete the remaining application of the professional judgment framework (perform the analysis and make the judgment) to make the judgment regarding the qualitative assessment to determine goodwill impairment.

**Accounting for income taxes: valuation allowance** – a scenario where the student assumes the role of a junior accountant at Asbat, a leading pharmaceutical company, and must make a judgment about recording a valuation allowance against the deferred tax asset created by a net operating loss carryforward.
Application scenario

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Fraud risk assessment – This application scenario asks students to assume the role of an auditor and use their professional judgment to perform a fraud risk assessment as part of the audit planning process for Jameson Family Farms, a family-owned business that grows and sells peanuts. As a result of the assessment, students are then asked to modify select audit procedures to address the identified risk.

- The format of the case seeks to simulate a real-world experience by providing students a variety of sources of information to gain necessary insights, requiring students to directly reference auditing guidance, providing audit work paper documents for review and by including a diverse complement of case characters representing typical individuals they would encounter in the audit environment.

- Four videos are integrated into part I that do not require download. Closed-captioning functionality is available. A separate video transcript document is available for distribution to the students. However, to better simulate a real-world audit interview experience, students could be asked to take notes during the client interviews to force them to rely on information gathering in this manner alone.

Part I: students perform a fraud risk assessment as part of the planning process of the audit and evaluate possible risk factors. Information sources include company background, financial statements, client interviews (video), internal audit

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plan, audit working papers covering an analytical review of financial and nonfinancial information and an audit planning memorandum.

► Part II: students are told that the risk of material misstatement due to fraud has been assessed as high as compared to the prior year being assessed as low. Students are then asked to review prior year audit procedures related to revenue, accounts receivable and the allowance for doubtful accounts (provided) and make suggested changes to the nature, timing and extent of audit procedures based on this change in risk assessment. Prior to completing this step however, the students are first asked to identify the audit assertions that each audit procedure addresses.

Application scenario

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► Asset expropriation – a scenario where the student assumes the role of a junior accountant at Transcontinental Energy Company, an independently owned explorer and producer of oil and natural gas, and must make a judgment about recording a loss contingency regarding possible asset expropriation related to TEC’s assets in the country of Zing.