




Significant Issues, Estimates, and Judgments: Management's Report to the Audit Committee

PURPOSE OF THIS TOOL: The audit committee needs to be proactive and consistent in its inquiries regarding significant issues, estimates, and judgments. At each meeting, the audit committee should inquire about current or unresolved issues or problems that have arisen in the financial, compliance, or operational control environment. Management should be encouraged to use this tool as the means to document and communicate these matters for discussion with the audit committee. Each matter should be prepared as a separate report. Statements should be clear and concise. Some items may carry over to subsequent meetings, in which case, any updated information should be included and highlighted.

Identifying Significant Issues, Estimates, and Judgments

As a first step to any discussion of this nature among the audit committee members, it is important for the audit committee to establish the threshold for a significant issue, judgment, or estimate. The following are some points that the audit committee should consider in its quest to identify a significant issue, estimate, or judgment.

A significant issue, estimate, or judgment is one that

1. creates controversy among members of the management team, or between management and the internal or external auditors.
2. has or could have a material impact on the financial statements.
3. is or could be a matter of public interest or exposure.
4. may be reported in an external release of financial information when management is unclear or undecided on its presentation. (This may include the annual report, federal, state, or local filings, funder reports, and any bond filings.)
5. relates to the application of an accounting standard in a way that is not consistent with general practice or represents the application of a new accounting standard. (The application of a new accounting standard may or may not be considered a significant issue, estimate, or judgment for the organization. However, the audit committee may ask management to use this format as the means with which to brief the audit committee on the application of the new standard.)
6. relates to key controls over financial information that are being designed or redesigned, have failed, or otherwise are being addressed by the organization.

The audit committee needs to be proactive and consistent in its inquiries regarding significant issues, estimates, and judgments. At each meeting, the audit committee should inquire about current or unresolved issues or problems that have arisen in the financial, compliance, or operational control environment. The highlights of the discussion and management's response should be documented in the meeting minutes.

Management's report to the audit committee concerning significant issues, estimates, and judgments should contain the following elements to provide a proper basis for discussion by the audit committee:

1. *Identification of the significant issue, estimate, or judgment.* In this section of the report, management should summarize the issue as concisely and clearly as possible.
2. *Management's position.* This section should address management's position on the issue. If a disagreement occurs among members of management, those disagreements should be detailed here as explicitly as possible, with brief explanations of each respective position.
3. *Relevant literature.* Both authoritative and nonauthoritative literature or regulatory requirements addressing this matter should be cited here. If no relevant literature is available, it would be appropriate to reference industry practice in this space. If this is a developing area, and no accepted industry practice or other source exists to support or refute these positions, this fact should be reported. If a choice exists regarding the accounting treatment, that should be disclosed here along with an explanation of how the choices of treatment were compared and the rationale for the treatment selected.
4. *Risks.* Management should discuss various short and long-term risks and opportunities associated with this matter.
5. *Federal or state agency or other regulatory disclosure.* Management must inform the audit committee of how it intends to address this matter in required filings.
6. *Auditor's position.* If management has consulted with the external auditors on this matter, the discussion should be summarized in this section. The discussion should include an indication of whether the external auditors agree with management's position and whether the auditors have addressed the audit issues that might be associated with it. If management has not consulted the external auditors on the matter, this should be indicated in this section.
7. *Other information relating to this issue, estimate, or judgment.* Management should use this section to highlight other related and relevant information that is not already included in the previous sections.