November 17, 2019

Via Electronic Mail

Sherry Hazel
American Institute of Certified Public Accountants
1211 Avenue of the Americas, 19th Floor
New York, NY 10036-8775

RE: Response to AICPA Exposure Draft – Auditing Accounting Estimates and Related Disclosures

Dear Ms. Hazel:

The Office of the Washington State Auditor appreciates the opportunity to comment on this exposure draft. In our constitutional role as the auditor of public accounts for the state of Washington, our Office annually performs or reviews over 800 financial audits of the State, its agencies, and all types of local governments, along with their component units. Our responses to the questions asked by the Auditing Standards Board are included below:

Issues for Consideration:

1. *Given the approach by the ASB to draft the proposed SAS using a framework-neutral approach, are there any instances in which the use of certain examples or terminology in the proposed SAS would result in a lack of clarity when applying the financial reporting frameworks commonly used in the United States?*

   No.

2. *Are paragraphs 2-9 of the proposed SAS helpful in describing the key concepts of the proposed SAS, and do they adequately explain the interplay between the proposed SAS and other AU-C sections?*

   We found some of this content to be helpful. However, we found that duplication of the requirements of other AU-C sections was confusing. For example, when paragraph 4 states “this proposed SAS requires inherent risk and control risk to be assessed separately” it calls into question whether AU-C 330.07 somehow does not require this
already. We believe this assessment is already required; therefore, its inclusion in this standard is unnecessary.

It has not been the pattern of audit standards to fully duplicate general requirements for every application, but rather to expand on those requirements for certain specific applications (such as accounting estimates) and to use application guidance to identify examples of how the requirement should be applied. In this way, readers are not left guessing whether a particular requirement is the same as - or somehow different than - general requirements found elsewhere in standards.

If the Board is intending to clarify or expand on general concepts (such as the discussion of the spectrum of inherent risk in paragraph 4), then we would encourage the Board to do so by amending these concepts as they are described in standards that apply generally, such as AU-C 315 or AU-C 330.

3. Do you agree with the approach to the proposed changes to AU-C section 501?

Yes.

4. Does the proposed effective date provide sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments?

Yes.

Other comments regarding proposed amendments to AU-C 540

As discussed in paragraph 3, the degree to which an accounting estimate is subject to estimation uncertainty may be very low for certain accounting estimates. Paragraph 3 goes on to state that the nature, timing, and extent of the risk assessment and further audit procedures required by this SAS will vary in relation to the estimation uncertainty and assessment of related risks to material misstatement. However, this does not appear to be reflected in the requirements of the standard, which appears to reflect the presumption of high uncertainty. In order to allow for variability, we would suggest:

a. Adding the words “…as needed to respond to estimation uncertainty and the assessed risks of material misstatement” to precede the list of required procedures in paragraphs 21-25. While all 16 of the procedures described in these paragraphs may be relevant to an accounting estimate with high estimation uncertainty, subjectivity and complexity at a large organization, not all of the procedures may be relevant or necessary for every type of accounting estimate or situation (e.g. a straightforward estimate of the useful life of assets or an allowance for doubtful accounts at a smaller organization).

b. Limiting the understanding of internal control over estimates required by paragraph 12.e-j to only those estimates that are deemed significant to the financial statements (consistent with AU-C 315 paragraphs 13 and 21).

We agree that risk assessment procedures required by paragraph 12.a-d would be necessary to assess the relevance or significance of estimates. However, procedures to
understand the controls would only be needed to the extent that estimates give rise to risks of material misstatement, consistent with AU-C 315 paragraph 27.a.

c. Similarly limiting the requirement of paragraph 13 for a retrospective review to only those estimates that are deemed significant to the financial statements. Alternatively, this requirement for a retrospective review may be more appropriately identified as a response to assessed risks of material misstatement when performed by the auditor, or as an aspect of the entity’s internal controls to consider if performed as a risk assessment procedure. Currently, there appears to be an inconsistency between requirements of AU-C 240, which require a retrospective review as a substantive procedure only for “significant accounting estimates,” and the proposed requirements, which require a retrospective review as a risk assessment procedure for all accounting estimates.

Guidance in paragraph A154 includes a number of matters for auditors to consider communicating to those charged with governance regarding qualitative aspects of accounting estimates that appear to be very detailed explanations of the methodology. If an estimate and details about the methodology are so consequential, and management has not already communicated such matters to the governing body, then it may be more appropriate to communicate such matters as part of a control deficiency rather than as the auditor’s views about significant qualitative aspects of accounting practices.

Finally, as noted above, we found the repetition of other standards incorporated within AU-C 540 to be more confusing and complicating than it was beneficial. We have the following specific comments in this regard:

a. Footnote 1 is unique to this standard and implies that the standard is expected to be used by uninformed readers out of context of the rest of standards. If the AICPA is concerned about this possibility, we suggest a uniform preamble, note or disclaimer to be added to all published AU-C sections, rather than a footnote in only one of the standards.


c. We are unclear whether paragraph 29 is intending to impose a requirement or whether it is making a self-evident statement that requirements of AU-C 500 apply to audit evidence obtained for accounting estimates.

d. We are unclear whether paragraphs 36 and A113 are intended to impose an additional requirement or expectation above the requirement of AU-C 700 paragraph 16. For example, estimation uncertainty disclosures are not required by GASB or by most special purpose frameworks, and we would not expect auditors to impose them except in the rarest of circumstances. Moreover, these paragraphs are not consistent with the scope of the standard, which is in relation to the applicable financial reporting framework.

e. Paragraph 37 would be more appropriately located as application guidance in AU-C 260 (which, in fact, it already is), rather than a referenced requirement here, since this is not actually a requirement but simply an example of how the requirement in AU-C 260 might be applied.
f. Paragraph 38.b appears to expand on the general requirement of AU-C 330 paragraph 30.b. We are unclear why this expansion would only apply to accounting estimates. If the Board is intending to clarify the general requirement, then the clarification should be located in AU-C 330.

g. Paragraph A148 gives additional examples of deficiencies in controls which may be significant deficiencies or material weakness. These examples would be more appropriately located as part of the Appendix to AU-C 265, which they currently are not.

Other comments regarding proposed amendments to AU-C 200

We disagree with having different audit requirements for inherent and control risk for accounting estimates only. Inherent risk, control risk and the risk of material misstatement are concepts that are not unique to accounting estimates. It is inconsistent and confusing to have different requirements and discussion regarding these foundational concepts for a single application only.

Other comments regarding proposed amendments to AU-C 230 and AU-C 580

AU-C 580 extant paragraphs 6 and 8 already address the need for the auditor to consider whether it is appropriate to obtain representations from those charged with governance. We do not think it is appropriate to duplicate this consideration for a single item. If the Board wishes to emphasize this consideration for estimates, it should do so in the application material.

We would also encourage the Board to consider rephrasing AU-C 230 paragraph A12 and AU-C 580 paragraph 16 with the corresponding illustrative representation to read “…reasonable in accordance with the applicable financial reporting framework…” rather than “…reasonable in context of the applicable financial reporting framework…”

Other comments regarding proposed amendments to AU-C 240

As noted above, the provisions of AU-C 240 which require a retrospective review as a substantive procedure only for “significant accounting estimates” would seem to be nullified by and the proposed requirements which require a retrospective review as a risk assessment procedure for all accounting estimates.

Other comments regarding proposed amendments to AU-C 260

As noted above, the discussion of accounting estimates as examples of qualitative aspects of the entity’s significant accounting practices is most appropriately located in the application guidance and in the Appendix to this section, as proposed. This guidance renders it unnecessary to repeat in AU-C 540.

We have no comments regarding proposed amendments to AU-C section 700, 701 and 703.
Thank you for the opportunity to provide our comments. Any inquiries may be directed to me at (509) 527-4175.

Sincerely,

Scott Woelfle, CPA
Director for Quality Assurance