November 22nd, 2019

Hunter College Graduate Program
Economics Department
695 Park Ave.
New York, NY 10065

Ms. Sherry Hazel
American Institute of Certified Public Accountants (AICPA)
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement on Auditing Standards, Auditing Accounting Estimates and Related Disclosures

Dear Members of the AICPA Auditing Standards Board (ASB):

The Advanced Auditing class (ACC 775) at Hunter College Graduate program in New York City appreciates the opportunity to comment on this exposure draft.

The class discussed the above proposed exposure draft and have attached our comments. If you would like additional discussion with us, contact Professor Joseph A. Maffia, at 212-792-6300 ext 404.

Sincerely,

Professor Joseph A. Maffia, CPA
COMMENTS TO PROPOSED STATEMENT ON AUDITING STANDARDS, AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

November 22, 2019

Principal Drafters
Jimmy Beltran
Alyssa Kaufman
Julianne Pisano
William Trang
Louis Villa-Larios

Hunter College Advanced Auditing Class
Juan Acosta
Alex Baharestani
Yu Bao
Hong Gun Cho
Shelby Dibbs
Jakub Dobryniewski
Aaron Gonzalez
Justyna Kleszczewska
Aaron Kwong
Jason Leong
Daniel Montes
Irina Natanova
Trang Phan
Leunice Roberts
Stylianos Stathakos
Altnay Sulaimanova
Altagracia Taversas Tiburcio
Maxine Yu
The Advanced Auditing Class has reviewed the above referenced Exposure Draft and offers the following comments for consideration by the Auditing Standard Board. Our comments relate to clarity and editorial changes, lack/insufficiency of examples, responses to specific questions ASB is seeking comment on, and general comments on Appendix A - Inherent Risk Factors.

Comments Pertaining to Clarity and Editorial Changes

A7. This paragraph talks about the relationship between estimation uncertainty, and the complexity and subjectivity involved in making estimates effect on the nature, timing, and extent of further audit procedures. We recommend revising the third sentence to state:

“For accounting estimates with low estimation uncertainty based on their nature, and low complexity and subjectivity involved in making such estimates, the risk assessment procedures and further audit procedures required by this proposed SAS would not be expected to be extensive.”

This allows auditors to more clearly understand the relationship and how to adjust the nature, timing, and extent of further audit procedures based on the degree of estimation uncertainty, complexity, and subjectivity.

A11. This paragraph discusses the effect inherent risk factors have on the importance of professional skepticism regarding accounting estimates. We recommend breaking up the first sentence into two separate sentences, and rewording the third sentence:

The exercise of professional skepticism in relation to accounting estimates is affected by the auditor’s consideration of inherent risk factors. The importance of professional skepticism increases for accounting estimates with a greater degree of estimation uncertainty, complexity, subjectivity, or other inherent risk factors. The importance of professional skepticism also increases when there is greater susceptibility to misstatement due to management bias of fraud.

This allows auditors to more easily see and understand the relationship between inherent risk factors and the importance of professional skepticism.

A12. This paragraph assesses the concept of the accounting estimates being reasonable. We believe that this intro sentence is not properly written and should be rewritten to be more easily understood by the reader. In addition, the first bullet point should be more elaborated on as it is references an unknown subject.

Staying in the context of the applicable financial reporting framework, other considerations that may be relevant to the auditor’s consideration of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework include whether:

• The data and assumptions used in making the accounting estimate are consistent with each other previous estimates done by an entity, and with those used in other accounting estimates or areas of the entity’s business
activities, and with estimates conducted by similar entities in a given industry.

A18. This paragraph refers to the outcome of an Accounting Estimate and does a decent job explaining it but can be shortened and stated clearer to further emphasize its purpose.

Some accounting estimates, by their nature, do not have an outcome that is relevant for the auditor's work performed in accordance with this proposed SAS. For example, an accounting estimate may be based on perceptions of actual market participants at a point in time. Accordingly, the price realized when an asset is sold or a liability is transferred may differ from the related previous accounting estimate made at the reporting date, with the passage of time, the market participants' perceptions of value have changed, because the passage of time may have changed the market's perceptions.

A21. This paragraph explaining scalability in accounting estimates can be stated more succinctly and therefore add greater clarity.

The nature, timing, and extent of the auditor's risk assessment procedures to obtain an understanding of the entity and its environment, including the entity's internal control, related to the entity's accounting estimates, may depend, to a greater or lesser degree, on the extent of the need for and number and complexity of transactions subject to estimation, to which the individual matters apply in the circumstances. For example, the entity may have few transactions or other events and conditions that give rise to the need for accounting estimates, including the applicable financial reporting requirements may be simple to apply, and/or there may be no relevant regulatory factors. Further, the accounting estimates may not require significant judgments, and the process for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors to a lesser degree, and there may be fewer controls relevant to the audit. If so, the auditor's risk assessment procedures are likely to be less extensive and may be performed primarily through inquiries of management with appropriate responsibilities for the financial statements and observation of management's process for making the accounting estimate.

A47. We think a portion of this clause seems redundant and could be better delivered with some grammatical changes.

The requirements of the applicable financial reporting framework may specify the approach to selecting management's point estimate from the reasonably possible measurement outcomes. Financial reporting frameworks may recognize that the appropriate amount is one that is appropriately selected from the reasonably possible measurement outcomes and, in some cases, the framework may indicate that the most relevant amount may be in the central part of that range.
A56. We find the structure of this paragraph is unclear and difficult to decipher. With different punctuation or wording, the point might be received more easily and thoroughly.

A retrospective review (review of the outcome or re-estimation of previous accounting estimates) assists in identifying and assessing the risks of material misstatement. This is useful when previous accounting estimates have an outcome through transfer or realization of the asset (or liability) in the current period, or are re-estimated for the purpose of the current period. Through performing a retrospective review, the auditor may obtain the following -

A73. This paragraph makes reference to the “use of unobservable inputs” required by the financial reporting framework, this language gives rise to ambiguity and confusion since it doesn’t give an example of such input and it’s unlikely that FASB would use such a vague term. “Assumptions that are based on unobservable data and, therefore, difficult for management to develop” is this sentence referring to forecasted data such as Macro or Micro data that could have an effect on the economy or the specific entity?

This paragraph also mentions the following: “Whether it is possible (or practicable, insofar as permitted by the applicable financial reporting framework) for management — to make a precise and reliable prediction about the future realization of a past transaction” and it gives other examples of decisions management may make, the judgments or estimates of expert staff of an entity should also be taken into account to have inputs from employees and members with a specific expertise in a field.

A74. Makes the false assumption that misstatements could only be misstated upwards, this in our opinion is incorrect because a misstatement can also be a downward estimate that reduces the amount of the estimate and that could unduly affect certain shareholders and the fair presentation of the Financial Statements.

A79-A80. Paragraph A80 repeats what is stated in paragraph A79. In addition, A80 is put into a separate bolded topic named Other Inherent Risk Factors. A79 and A80 should be merged to avoid repetitiveness of a related topic and to avoid confusing the reader.

A85. Paragraph A85 is mis-referenced in paragraph A7 under the topic of Scalability (Ref: par. 3).

A91. The punctuation of the bullet points of A91 should be changed slightly; adding a semicolon after the words “Examination” and “Recalculation” could improve the meaning of the terms that are being conveyed.

A92-A94. We recommend splitting up the paragraph into two sentences in order to make it more easily readable.

When the auditor’s further audit procedures include obtaining audit evidence from events occurring up to the date of the auditor’s report, the auditor should evaluate whether such audit evidence is sufficient and appropriate to address the risks of material misstatement
relating to the accounting estimate. The auditor should take into account changes in circumstances and other relevant conditions between the event and the measurement date that may affect the relevance of such audit evidence in the context of the applicable financial reporting framework.

A110. This paragraph clearly defines estimation uncertainty and measurement uncertainty, however by introducing measurement uncertainty later in the paragraph readers have to re-read the paragraph to understand the relationship between both estimation uncertainty and measurement uncertainty, which happen to be comparable definitions. To avoid confusion and make the reading more efficient, we suggest switching the second and third sentence and making minor changes to the original third sentence as follows:

Estimation uncertainty is the susceptibility to an inherent lack of precision in measurement. This arises when the required monetary amount for a financial statement item cannot be measured with precision through direct observations of the cost or price. The susceptibility to a lack of precision in measurement is often referred to as measurement uncertainty. In accounting frameworks, this is referred to as measurement uncertainty. This arises when the required monetary amount for a financial statement item cannot be measured with precision through direct observations of the cost or price.

The rest of A110, including the fourth sentence and bullet points a, b, and c, should remain the same as it perfectly describes the appropriate steps management should consider to understand and address estimation uncertainty.

A129. Changes are suggested for paragraph A129, specifically a portion of the paragraph located after bullet d, to eliminate irrelevant words and improve the flow of the sentence structure.

For derivative instruments and securities, if quoted market prices are not available, estimates of fair value frequently may be obtained from, for example, broker-dealers, or other third-party sources, from third-party sources, such as broker-dealers, such as broker-dealers, based on proprietary valuation models, or from the entity, based on internally or externally developed valuation models (for example, the Black-Scholes option-pricing model).
Comments Pertaining to Lack/Insufficiency of Examples

A135. Paragraph A135 explains and provides examples of indicators of possible management bias, but by mentioning that indicators of possible management bias do not constitute misstatements and stating that audit evidence may point to a misstatement rather than simply an indicator of management bias, without further elaborating on how to determine whether indicators of management bias are reasonable or misstated, readers will be confused as to when this is the case. The lack of examples makes the passage hard to follow as one is left wondering when an indicator of management bias is reasonable or misstated. Examples for each bullet located right under each bullet in paragraph A135 would be helpful.

Specifically Requested Comments

1. No, the examples and terminology used in proposed SAS does not result in lack of clarity when applying financial reporting frameworks commonly used in the U.S, such as U.S GAAP. ASB used ISA 540 (revised) as a base to draft the proposed SAS using a framework-neutral approach, making it applicable to a variety of estimates. ASB made certain changes to the language used in ISA 540 (revised) when constructing the proposed revisions in order to use terms and phrases that are more commonly used in the U.S, making it more clear and understandable for users.

2. These paragraphs make a clear presentation of the susceptibility of accounting estimates to misstatement due to the complex nature of factors that affect the valuation of events or transactions that business environments are prone to in the normal course of business. The interplay of the key topics and concepts of material misstatements and the inherent risk of complex events is conveyed in a clear manner to aid the understanding of auditors in evaluating the relevant facts and circumstances of economic events. These paragraphs make clear the key role that relevant financial reporting standards play in providing guidance to accountants and auditors in faithfully presenting economic events free of bias and misstatements to aid the users of accounting information. Putting a big emphasis on scalability and how different kinds of processes are affected differently by inherent risk will allow auditors to focus on those aspects most susceptible to financial misstatements. Understanding complexity and providing guidance for the auditor to exercise professional skepticism, in all stages of the audit, will enhance the approach auditors take in carrying out their assessments. Using an analytical approach in evaluating the risk of subjectivity with respect to judgments, regarding the evaluation and valuation of events, will provide the auditor with some powerful conceptual tools in carrying out their duties and in challenging circumstances and conditions that may raise doubts about their validity.

With respect to the interplay between this proposed SAS and other AU-C sections, the relationships and references pointed out do not give a complete picture of all the relevant sections mentioned from other AU-C. Such a task cannot be fulfilled in these opening paragraphs as those references and guidance are further connected to this SAS as the topics arise in the body of this proposed SAS. A minimal discussion avoids
confusing the reader as the topics would be too varied and covered briefly if mentioned in these short paragraphs.

3. This part of the AU-C section 501 refers to investments in derivative instruments and securities measured or disclosed at fair value as well as impairment losses. Referring to these topics, I agree with the proposed changed to AU-C that paragraphs .06-.10 should be eliminated because it is true that keeping the section would first copy what will be stated in the proposed SAS. Also, the guidance also refers to how to perform certain audit procedures instead of what AU-C is trying to explain, which is evaluating audit evidence. The paragraphs in question do not weigh in on audit evidence but only talk about what audit procedures to use which makes the information out of place.

4. Yes, the proposed date provides sufficient time for all affected parties to adopt the new standard. The effective date set for financial statements for periods ending on or after December 15, 2022 provides at least two full years for professionals to learn the new standard before they are required to begin implementing them into practice on the start of the third fiscal year. The lengthy allotted time is appropriate, as the material is complex and extensive in nature.

**General Comments on Appendix A - Inherent Risk Factors**

How do Inherent Risk and Estimation Uncertainty Relate?

We believe that the auditing standards board should look further into the relationship between “inherent risk” and “estimation uncertainty” to avoid confusion in this long exposure draft. The passages definition makes it seem as if inherent risk and estimation uncertainty mean the same thing, but they do not. Inherent risk “is the susceptibility of an assertion about the accounting estimate to material misstatement, before consideration of controls.” Estimation uncertainty is defined in this proposed SAS as “susceptibility to an inherent lack of precision in measurement.” Although the passage considers “estimation uncertainty” (referred to as “measurement uncertainty” in accounting frameworks) as an inherent risk factor which arises as a challenge in making accounting estimates, it is the constraints of the estimation uncertainty that should be considered inherent risk factors, not the susceptibility to lack of precision in measuring accounting estimates. The reason for this is certain constraints are capable of being eliminated during the measurement process if the right application of method is used. If such constraints are eliminated, this lack of measurement is defined as a potential misstatement and not estimation uncertainty. In addition, certain constraints are inherent because they cannot be eliminated from the measurement process. Consequently by classifying constraints as sources of inherent risk and not estimation uncertainty, the term “estimation uncertainty” can capture the general concept of lack of measurement in determining accounting estimates, whereas the term “inherent risk” can focus more on the reasoning as to why there may be possible uncertainty accounting estimates, relating to complexity, subjectivity, the selection and application of the methods, assumptions, data, the selection of management’s point estimate, and other factors that arise other than the failure of controls. The passage does a great job in mentioning these details, but fails to expand on this crucial information.