December 10, 2019

Ms. Sherry Hazel  
Audit and Attest Standards  
American Institute of Certified Public Accountants  
1345 Avenue of the Americas  
New York, NY 10036-8775

RE: Proposed Statement on Auditing Standards, *Auditing Accounting Estimates*

Dear Ms. Hazel:

We appreciate the opportunity to comment on the Proposed Statement on Auditing Standards, *Auditing Accounting Estimates* (the “proposed SAS”). We support the Auditing Standards Board’s (ASB) objective of convergence with the International Auditing and Assurance Standards Board (IAASB)’s revised ISA 540, *Auditing Accounting Estimates*. In determining what revisions to AU-C section 540 are necessary in the context of the US environment, we also support the ASB’s consideration of the Public Company Accounting Oversight Board (PCAOB)’s AS 2501 (Revised), *Auditing Accounting Estimates, Including Fair Value Measurements*. These standards are intended to improve audit quality by strengthening how auditors evaluate the methods, assumptions, and data used by management in developing accounting estimates.

The proposed SAS will be applicable to a wide range of accounting estimates. We appreciate the ASB’s efforts to embed concepts related to scalability within the proposed SAS. We encourage the ASB to consider, based on feedback to the exposure draft, whether additional guidance is necessary to demonstrate how the proposed SAS would be expected to apply to less complex estimates.

We also believe it will be important for the AICPA to develop a process to make timely updates to the various Accounting and Auditing Guides that contain incremental guidance on accounting estimates to ensure the guides are consistent with the proposed SAS.

The appendix contains our views on the specific issues set out in the explanatory memorandum, as well as views on other matters we believe are relevant to the ASB’s consideration in moving forward.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions you may have. Please contact Heidi Schuetze or Jay Brodish, Jr. at (973) 236-5000 regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP
Appendix

Request for Comment 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 (for example, U.S. GAAP)?

We agree that the proposed SAS should endeavor to be framework-neutral. While we have not identified any specific terminology that would be of concern, we believe it would be helpful to provide additional context to certain requirements in the standard as follows.

Fair presentation

Consistent with our feedback to SAS 134, we believe the ASB should ensure that any requirements to evaluate fair presentation in its standards are grounded in, rather than incremental or potentially inconsistent with, the applicable financial reporting framework. Any changes to AU-C section 540 should not result in the auditor’s responsibilities differing from what is required to evaluate whether the financial statements and related disclosures about accounting estimates are presented, in all material respects, in accordance with GAAP. The ASB cannot and should not establish disclosure requirements in auditing standards, so reference should be made more explicitly to US GAAP (in particular FASB and GASB standards), with guidance to explain what is expected to be achieved.

We therefore suggest the following language from SAS 134 and an appropriate cross reference to AU-C section 700, Forming an Opinion and Reporting on Financial Statements, be added as application material to paragraph 36:

The auditor’s professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the auditor would have no consistent standard for evaluating the presentation of financial position, results of operations, and cash flows in financial statements.

Management bias

Consideration of potential management bias, and whether such bias results in a material misstatement, is an essential component of the auditor’s evaluation of accounting estimates. As noted in paragraph 7 of the proposed SAS, the exercise of professional skepticism is important when there is greater susceptibility to misstatement due to management bias or fraud.

We believe the enhanced focus on judgments made by management in selecting the methods, assumptions, and data used in developing an accounting estimate is an appropriate way to prompt auditors to devote attention to addressing potential management bias in accounting estimates. However, it is important that the standard acknowledges that, given the subjective assumptions and measurement uncertainty inherent in many estimates, bias cannot be eliminated entirely.

Finally, we believe that the consideration of management bias is also relevant in the evaluation of information to be used as audit evidence. We encourage the ASB to consider whether any incremental changes are necessary to AU-C section 540 or its proposed revisions to AU-C section 500, Audit Evidence, to ensure the two standards take a consistent approach to considering whether there is a risk of bias in information to be used as audit evidence related to an accounting estimate.
Request for Comment 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 believe that the ASB’s inclusion of these paragraphs, which introduce the nature of accounting estimates and the key concepts of the proposed SAS, will be helpful to the auditor’s understanding in applying the proposed SAS. We agree that providing this upfront context to facilitate the auditor’s understanding of how the concepts within the proposed SAS build upon requirements in other AU-C sections can enhance the auditor’s ability to effectively apply these new or amended requirements.

Request for Comment 3 – Do you agree with the approach to the proposed changes to AU-C section 501? If not, please provide suggestions on a way forward.

We support the ASB’s decision to relocate material in AU-C section 501 related to obtaining sufficient appropriate audit evidence about the valuation of securities and derivative instruments to the proposed SAS. The ASB should consider whether the remaining material in AU-C section 501 remains relevant or if updates are necessary in light of its current projects to revise AU-C section 500 and AU-C section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.

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

The proposed SAS indicated that, if issued as final, it would be effective for audits of financial statements for periods ending on or after December 15, 2022. We believe that this effective date provides sufficient time for auditors to prepare for the adoption of the proposed SAS. We also believe it would be helpful to align the effective dates of the proposed SAS with the proposed changes to AU-C section 500. Doing so has the benefit of enabling firms to consider how best to update their methodologies and tools to take into account enhanced performance requirements related to auditing estimates and evaluating the results of those procedures and other information that may be used as audit evidence.

Other matters

Developing an auditor’s point estimate or range

Paragraph 27 of the proposed SAS requires the auditor, when developing a point estimate or range, to perform procedures to evaluate whether the methods, assumptions, or data used are appropriate in the context of the applicable financial reporting framework. This paragraph also explains that, regardless of whether the auditor uses management’s or the auditor’s own methods, assumptions, or data, further audit procedures should be designed and performed to address the matters in paragraphs 22–24 related to testing how management made the accounting estimate.

We are concerned that this requirement as currently drafted could be read as requiring the auditor to perform all the procedures in paragraphs 22–24 in addition to developing an independent estimate. Doing so would potentially be impractical and unnecessarily duplicative, in particular in circumstances when the auditor believes that developing an independent expectation provides more persuasive evidence than testing management’s process. We believe if not clarified, the proposed SAS could dissuade auditors from developing independent expectations to evaluate accounting estimates. Clarification of what type of procedures may be appropriate to address the matters in paragraphs 22–24 is therefore necessary to help practitioners appropriately apply the requirement.

The PCAOB’s standard more explicitly tailors the requirements related to developing an independent expectation to the different sources of the methods, assumptions and data used by the auditor. Those sources include (1) independent methods and assumptions of the auditor, (2) assumptions and data obtained from a third party, and (3) the company’s methods, data, and assumptions. Accordingly, we believe the PCAOB’s standard on accounting estimates better articulates what would be expected when
the auditor develops an independent expectation, and suggest the ASB leverage this approach to provide clarity within the proposed SAS. Specifically, we recommend the ASB develop additional guidance to paragraph 27 of the proposed SAS to incorporate the following concepts from AS 2501 (Revised):

- In developing an independent expectation, the auditor is required to take into account the requirements of the applicable financial reporting framework and the auditor’s understanding of the company’s process, including the significant assumptions used by the company, so that the auditor’s expectation considers the factors relevant to the estimate.

- If the auditor uses data produced by the company, significant assumptions used by the company, or the company’s methods in developing an independent expectation, the auditor is required to test the data, and evaluate the significant assumptions and methods in the same manner as when testing the company’s process used to develop the accounting estimate.

- When the auditor independently derives assumptions or uses the auditor’s own methods in developing an independent expectation, the auditor should have a reasonable basis for the assumptions and methods used.

- When the auditor’s independent expectation is developed using data and assumptions obtained from a third party, the auditor is required to evaluate the relevance and reliability of the data and assumptions.

**Documentation**

Paragraph A150 notes that “in documenting the linkage of the auditor’s further audit procedures with the assessed risks of material misstatement at the relevant assertion level, in accordance with AU-C section 330, this proposed SAS requires that the auditor take into account the reasons given to the risks of material misstatement at the relevant assertion level. Those reasons may relate to one or more inherent risk factors or the auditor’s assessment of control risk. However, the auditor is not required to document how every inherent risk factor was taken into account in identifying and assessing the risks of material misstatement in relation to each accounting estimate.” We suggest the following edit to give this guidance greater prominence and avoid unnecessary additional work.

38. The auditor should include the following in the audit documentation:

a. Key elements of the auditor’s understanding of the entity and its environment, including the entity’s internal control related to the entity’s accounting estimates

b. The linkage of the auditor’s further audit procedures with the assessed risks of material misstatement at the relevant assertion level, taking into account the reasons (whether related to inherent risk or control risk) given to the assessment of those risks. Documentation of how every inherent risk factor was taken into account in identifying and assessing the risks of material misstatement at the relevant assertion level is not required.

c. The auditor’s responses when management has not taken appropriate steps to understand and address estimation uncertainty

d. Indicators of possible management bias related to accounting estimates, if any, and the auditor’s evaluation of the implications for the audit, as required by paragraph 32

e. Significant judgments relating to the auditor’s determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated
Consideration of PCAOB standard-setting activities

We appreciate the ASB’s consideration of the PCAOB’s changes to its standard addressing estimates in developing the proposed SAS. In revising its estimates standard, the PCAOB concurrently amended other standards to better address the use of the work of company specialists and auditor specialists. We encourage the ASB to consider whether similar enhancements to its suite of standards would be appropriate.