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Proposed Statement on Auditing Standards – Auditing Accounting Estimates and Related Disclosures

Dear Ms. Hazel,

Ernst & Young LLP is pleased to submit this comment letter to the Auditing Standards Board (ASB or the Board) in response to the ASB's request for comment on its proposed Statement on Auditing Standards (SAS) on auditing accounting estimates and related disclosures.

As part of a global network of firms that uses one Global Audit Methodology (GAM) that is based on the International Standards on Auditing (ISAs), we support the ASB's efforts to converge its standards with those of the International Auditing and Assurance Standards Board (IAASB).

We believe the proposed SAS is generally in alignment with the Public Accounting Oversight Board (PCAOB) standards, which would reduce the risk of different conclusions being reached when audits are performed under PCAOB and AICPA standards. However, we recommend that the Board consider providing more guidance to address the use of specialists and third-party pricing information in auditing estimates.

Attachment A provides responses to the ASB's requests for comment, along with additional recommendations for your consideration if the Board decides to move ahead with the proposed SAS. Attachment B includes other editorial comments. We would be pleased to discuss our comments with members of the ASB or its staff.

Sincerely yours,

Ernst & Young LLP

Attachment A – Responses to requests for comments

1. Given the approach by the ASB to draft the proposed SAS using a framework-neutral approach, are there 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)?

The examples and terminology in the proposed SAS would not result in a lack of clarity when applying the financial reporting frameworks commonly used in the United States.

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 support the key concepts of the proposed SAS as outlined in paragraphs 2-9. To effectively audit estimates, including fair value measurements, auditors refer to many of the significant concepts of other AU-C sections. The complexity of auditing estimates may make the application of those AU-C sections more challenging and highlighting the nature of accounting estimates and key concepts of the proposed SAS is helpful to the reader.

We believe that the key concepts of the proposed SAS could be further enhanced by reiterating the point made in paragraph 1 that a fair value measurement is a form of accounting estimate. This could be accomplished by making the following amendment to the first sentence of proposed paragraph 3:

“Although this proposed SAS applies to all accounting estimates, ***including fair value measurements***, the degree to which an accounting estimate is subject to estimation uncertainty will vary substantially.”

Consistent with the PCAOB’s definition of an accounting estimate, we also recommend the following addition to the proposed definition of an accounting estimate in paragraph 11:

“Accounting estimate. A monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty. ***A fair value measurement is a form of accounting estimate.***”

We also recommend that the definition of an accounting estimate should be clarified to explain that an estimate may drive a decision not to recognize amounts in the financial statements. That is, we believe the definition should explicitly address estimates an entity uses in an analysis such as an asset impairment analysis, even if the entity does not recognize an impairment charge that relates to the estimates.

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 believe the proposed changes to AU-C section 501 are appropriate and would remove guidance that would be duplicative after the proposed SAS is finalized.

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 and conforming amendments would enhance the risk assessment process for accounting estimates, which may be performed by auditors early in the financial period (e.g., in the first six months of the financial period for many audits). Therefore, the effective date should be no less than 18 months after the approval of the final standard so auditors have sufficient time to implement it.

Attachment B – Recommendations for other edits and improvements

Proposed SAS	
Paragraph	Observation
Title	We recommend the following edit to the title of the SAS: Auditing Accounting Estimates, <u><i>Including Fair Value Measurements</i></u> , and Related Disclosures
A21.	<p>We recommend the following edit to paragraph A21 of the proposed SAS to recognize that auditors may perform procedures other than “observation” when they gain an understanding of management’s process for making the accounting estimate.</p> <p><i>The nature, timing, and extent of the auditor’s procedures to obtain the 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 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; the applicable financial reporting requirements may be simple to apply; and 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 <u>is likely to perform simple</u> risk assessment procedures are likely to be less extensive and which may be performed primarily through inquiries of management with appropriate responsibilities for the financial statements and <u>simple procedures to gain an understanding</u> observation of management’s process for making the accounting estimate.</i></p>
A22.	Paragraph A22 refers to procedures outlined in paragraph A20. But due to the changes in paragraph numbering from ISA 540, we believe this reference should be to paragraph A21.

AU-C Section 240, <i>Consideration of Fraud in a Financial Statement Audit</i>	
Paragraph	Observation
.15	<p>We recommend expanding the requirements of the discussion among the key engagement team members in paragraph 15 of AU-C Section 240 to include the following:</p> <p><u>f. how the financial statements could be manipulated through management bias in accounting estimates and related disclosures.</u></p> <p>We believe this additional requirement would be consistent with a key concept of the proposed SAS. Enhanced professional skepticism is important when there is a greater risk of misstatement due to management bias or fraud.</p>