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Dear IAASB,

Our response to the Auditing Accounting Estimates and Related Disclosures Exposure Draft is below.

1. Has ED-540 been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates?

   The ED notes that the update is necessary because of increasing complex estimates, in particular those for financial institutions. So it is appropriate that the auditing standards are being updated. However, we caution the IAASB to think forward in the cycle that they are perpetuating: users wanting more relevant financial reporting and more reliable estimates → accounting standard setters responding by trying to have shareholders' equity = market value of the firm → failures and criticisms of the audit profession when inherently subjective and unknowable estimates turn out to be wrong → even longer and more complex auditing standards → new expectations from users that auditors can somehow "prove" estimates are correct and a good basis for making investment or other decisions.

   In other words, the ED is trying to solve an accounting problem with an auditing solution.

   Instead, we suggest what may be needed is accounting standard setters recognizing the consequences that follow from the fact that accounting, even fair value accounting, can only partially predict the future, and that the best way to communicate the uncertainty that they are introducing in their quest for relevance is to communicate that reliability decreases when estimates are involved. Technical language on measurement uncertainty seems to not have narrowed the expectation gap, and possibly has expanded it because the auditor is expected to audit this uncertainty as well. Where there is a reasonable range of estimates, then perhaps accounting standards should require the entity to report this reasonable range of net income: multiple net incomes. Until accounting standards recognize this, perhaps the auditing standards could help move to the future by requiring modifications to the auditor's report in the form of scope limitations. To illustrate, the

ED, with consequential amendments to ISA700, 705 and 706, could provide guidance that would lead to audit reports that said something like "We obtained sufficient appropriate audit evidence that income is between $10 million and $12 million. Our audit's reports is not qualified with respect to this matter." Nevertheless, whether or not the auditing standards require a point estimate or range of reasonable amounts is not the problem and won't solve the problem; the fundamental problem is not with auditing but with the expectations created by reporting a single number, when many are equally reasonable.

We note that some financial reporting frameworks (for example public sector accounting standards) use the concept of "best estimate." The concept of a "reasonable estimate" is used throughout the ED. Guidance should be added to clarify that the auditor may need to adapt the standard in circumstances where the applicable financial reporting framework uses a concept other than "reasonable estimate" such as "best estimate." While many estimates may be reasonable, only one may be the best, and the auditor may need additional evidence that the estimate is the best.

2. *Do the requirements and application material of ED-540 appropriate reinforce the application of professional skepticism when auditing accounting estimates?*

Yes. We note that engagement quality control reviewer (EQCR) involvement may promote skepticism; consider adding specific guidance (or amending ISCQ-1) that where the financial statements contain estimates it is (rebuttably) presumed that an EQCR will be assigned. Note that it should not be only "where the risk of material misstatement due to estimates is other than low" because, in the logic of the new 540, it is itself a significant and difficult judgment what is the risk associated with estimates.

3. *Is ED-540 sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk?*

Scalability could be improved. It is useful to specifically communicate that estimates may be low risk. There is perhaps too much emphasis, caused in part by ISA 315, that estimates are automatically medium or high or significant risks.

Scalability would be better achieved by not being as proscriptive in paragraph 15 about what audit procedures the auditor shall do in low risk situations. For example, there may be procedures other than 15 (a) (i) (ii) or (iii) that would be as appropriate, such as comparing budget to actual results and investigating variances. As well, it is unclear how in practice 15(a)(ii) differs from paragraph 17.

Some auditors may interpret the two categories (low, other than low) as implying that auditors should not use more than two categories in assessing risk. But auditors may use different scales of risk (e.g. 5 scales: low, normal, medium, high, very high), or a numeric scale such as 1-10. Could auditors do only some of the procedures in paragraphs 17-20 if risk was other than low, or are they required via the wording in paragraph 15(b) to do all the procedures in paragraphs 17-20 if they, under their own methodology, conclude risk is “normal” or “medium,” and would do only every procedure in paragraphs 17-20 if risk was “high” or “very high”?

4. *When inherent risk is not low (see paragraphs 13, 15, and 17-20):*

   a) *Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?*

      As noted in response to question 3, the requirements may not be effective. Risk assessments are not necessarily binary (low, other than low) so the standard should not be written assuming they are. As well, there may be other procedures auditors perform, such as data analytics.

   b) *Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?*

      We agree.

   c) *Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?*

      The guidance is sufficient.

5. *Does the requirement in paragraph 20 (and related application material in paragraphs A128-A134) appropriately establish how the auditor’s range should be developed? Will this approach be more effective than the approach of “narrowing the range,” as in extant ISA540, in evaluating whether management’s point estimate is reasonable or misstated?*

   Yes. However as noted above if all amounts in the range are reasonable, it would be an advance for the profession to have the auditor include a scope limitation (that the auditor cannot determine which net income is correct because several net incomes from $X to $Y in a reasonable range are all equally correct).

6. *Will the requirement in paragraph 23 and related application material (see paragraphs A2-A3 and A142-A146) result in more consistent determination of a misstatement, including when the auditor uses an auditor’s range to evaluate management’s point estimate?*

We note that the auditor is required to evaluate "reasonableness in the context of the applicable financial reporting framework" but it is unclear what "in the context" means, without specific application guidance, and in particular "reasonable" may lead to auditors having to be held to a higher standard than what is their role – the auditor does not simply need to determine whether the estimate in the financial statements is presented in accordance with the requirements of the applicable financial reporting framework, but instead or in addition the auditor has to evaluate whether the estimate is "reasonable." Better wording is already in paragraph A2 and should be used the main text of the standard i.e. the auditor shall evaluate whether the estimates have been presented in accordance with the requirements of the applicable financial reporting framework.

The audit standard should not put auditors into the circumstance where the evidence is that the estimate is presented in accordance with the requirements of the applicable financial reporting framework, but it may not be considered "reasonable," unless that is the clear intent of IAASB. If that is the intent, the standard should state it, or perhaps indicate that "an estimate presented in accordance with the requirements of the applicable financial reporting framework is reasonable, unless the conditions in ISA700.18 apply: financial statements prepared in accordance with a fair presentation framework do not achieve fair presentation."

The introduction of the concept of "reasonable" has created a new category between "in accordance with the requirements of the applicable financial reporting framework" and "fair presentation."

7. *With respect to the proposed conforming and consequential amendments to ISA 500 regarding external information sources, will the revision to the requirement in paragraph 7 and the related new additional application material result in more appropriate and consistent evaluations of the relevance and reliability of information from external sources?*

We disagree. We believe it will further confuse the situation. A more straightforward approach that will result in "more appropriate and consistent evaluations" would be to amend ISA.A9, which states "Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors (benchmarking data)."

We suggest it should be expanded to say "Information from sources independent of the entity may be presumed by the auditor to be reliable. Because the auditor is using the information from the independent sources *<u>as audit evidence</u>*, the auditor normally does not need to obtain evidence *<u>about the information</u>* from the independent sources. Examples of sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, published stock prices, published interest rates and other economic data, and comparable data about competitors (benchmarking data)."

8. *In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:*
   a) *Translations*
   b) *Effective Date*

   We have no concerns regarding translations nor effective date, other than it may be useful to delay the standard until revisions, if any, are made to ISA 315.

Thank you for the opportunity to comment.

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