Organización Internacional de Comisiones de Valores
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April 29, 2005

Mr. James Sylph
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017

Re: Exposure Draft: Auditing Accounting Estimates and Related Disclosures (Other than Those involving Fair Value Measurements and Disclosures)

Dear Mr. Sylph,

IOSCO's Standing Committee No. 1 on Multinational Disclosure and Accounting appreciates the opportunity to comment on the Exposure Draft (ED) "Auditing Accounting Estimates and Related Disclosures (Other than Those involving Fair Value Measurements and Disclosures)". As securities regulators representing the public interest, we are committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards. Our comments herein reflect those matters on which we have achieved a consensus among members of Standing Committee No. 1 and are not intended to include all the comments that might be provided by individual members on behalf of their respective jurisdictions in the future.

The development of accounting estimates and related disclosures is one of the more subjective aspects of valuation in financial statements and as such, carries significant risk of misstatements. Given this risk, auditors need to be rigorous and skeptical in their audit of accounting estimates. We welcome the additional coverage of the subject in this ED and its emphasis on being alert for possible management bias in accounting estimates. However, we also have some concerns as noted below.

Clarity and structure of the ED

We continue to be concerned with language and drafting conventions that do not make clear what are the required actions and decisions of an auditor. We understand that the IAASB is undertaking to address this area in the Clarity project, but we are still concerned about the use of imprecise or unclear language and the status of requirements set out in the present tense. We believe that this results in ambiguity which could lead to inconsistent application of the ED and other ISAs. We

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urge the IAASB to resolve the language and drafting conventions for communicating requirements of audits in the Clarity project as a priority.

In this ED, we would prefer to see more explicit language regarding the actions the auditor should take to obtain an understanding of the controls and process by which management identifies and prepares estimates. We would also prefer to see greater prevalence of specific action words such as "evaluates, determines, assesses", and less use of imprecise or passive terms such as "is therefore alert to" or "considers".

We also have some concerns over the overall structure of the ED and the way in which it builds upon ISAs 315 and 330. There seems to be some lack of clarity in how the auditor requirements in the ED follow ISA 315 and ISA 330. In particular there does not seem to be enough emphasis on the identification of other accounting estimates that are not a significant risk. Paragraph 9 of the ED covers the auditor 'performing risk assessment procedures'. Following ISA 315, one would then expect to see coverage in this ED concerning the auditor performing work to identify accounting estimates where there is a risk of material misstatement (paragraph 100 of ISA 315), followed by work on those accounting estimates that are significant risks, followed by some work on estimates that have some risks but not significant risks. However, under the heading Assessment of the Risks of Material Misstatement, paragraph 24, and the subsequent paragraphs, focus solely on those accounting estimates that may be significant risks. There seems to be inadequate emphasis on auditing other accounting estimates that are not a significant risk.

Balance of coverage between management and auditor responsibilities

We believe the fundamental objective of the ED is to guide the auditor in discharging his/her responsibilities with respect to the audit of accounting estimates. We appreciate that there needs to be some discussion in the ED concerning management's role in accounting estimates. However, we believe there should be more emphasis on the auditor's responsibilities in an auditing standard. Moreover, we are concerned that Paragraphs 4, 15 and 16 seem to understate the auditor's responsibility regarding the "completeness" assertion in terms of estimates. While it is true that it is management's responsibility to identify the need for and then to make estimates, it is the auditor's responsibility to be satisfied that management has undertaken this appropriately. Liabilities are more susceptible to being understated if they are estimates, as such the auditor should look for items omitted from the financial statements. Paragraph 4 should have "completeness" added to the statement, as in "The auditor should obtain sufficient appropriate audit evidence to evaluate the completeness, i.e., that there are no omitted estimates of liabilities, and reasonableness of accounting estimates...etc."

Paragraphs 15 and 16 should be at least as focused on directing the auditor's responsibilities and procedures as on describing what management does. For example, the first sentence of paragraph 15 could outline how the auditor has to obtain an understanding of how management identifies accounting estimates (following from bold text requirement 9(b)). Then, there could be some detail on the areas where management needs to identify accounting estimates.

The requirement on the auditor in paragraph 16, that the auditor "inquires as to whether management has given consideration" should be more directly stated as matters that the auditor should assess for their impact on the need for estimates. As we read it now, it suggests that if the auditors "inquiry" of management results in the affirmative, then the auditor accepts that response as a representation unless something else arises to suggest that representation is open to question. We query whether this is really sufficient.

In paragraph 60, it is stated that if management does not perform the additional work requested by the auditor to support the accounting estimate, the auditor should consider the implications for the audit report. However, we are unsure what is intended here. If the auditor based on his/her own work, has obtained sufficient and appropriate evidence to support the accounting estimate, but management has not adequately supported its accounting estimate, what would be the appropriate actions and implications for the audit report?

Exclusion of fair value measurements and disclosures

There are some very similar auditing issues with accounting estimates and fair value measurements and disclosures, and some of our members have raised the question whether it is necessary or desirable to have two separate auditing standards on accounting estimates and fair values, as there may be unnecessary duplication of requirements and uncertainty of application when dealing with accounting estimates that are also fair values. At the very least, we would encourage the Board to ensure that the two standards are congruent. In particular, given the increased emphasis in this ED on responses to significant risk (paragraphs 47-63) and management bias (paragraphs 75 & 76), we would suggest ISA 545 is updated to bring it more fully into line with this ED in these areas.

Management bias

Paragraphs 75 and 76 of the ED state that the auditor should consider and be alert for possible management bias. In line with our previous comments, it would seem appropriate that rather than what seems to be a passive requirement, this should be restated as an active obligation. Thus it could be restated to read "the auditor should determine if there are instances of possible management bias" or "the auditor should evaluate the likelihood of possible management bias".

Given the likely importance of looking for possible management bias in accounting estimates and other estimates, we believe it would be helpful for the Board to add some additional references and explanations regarding estimates to ISA 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* and perhaps also to the ISA 220, *Quality Control for Audits of Historical Financial Information (Revised).*

Other points

In paragraph 17, the auditor may identify other areas of the business where management may have failed to identify the need for accounting estimates. There is a cross reference to ISA 315 concerning guidance on what to do when the auditor identifies material weaknesses in the entity's risk assessment procedures. However, we are unclear to which aspect of ISA 315 this is referring.

Paragraph 36 has a negative slant in emphasizing what the auditor cannot do and is not responsible for. If such statements are made, they should be accompanied by statements of what the auditor <u>can</u> do and <u>is</u> responsible for.

Paragraph 79 focuses on estimates that fall within a reasonable range but are outside (i.e., amounts are greater than) the limits the auditor has judged appropriate for materiality, and prescribes certain actions relating to disclosure. We believe the auditor has a general obligation to determine that disclosure is adequate regardless of whether an estimate is inside or outside a materiality limit. We therefore request that paragraph 79 be expanded or clarified.

We could find nothing in this ED about communicating about significant estimates with those charged with governance or even a cross-reference to that relevant ISA. We believe it would be useful to have some comment about the necessity of communicating the areas of significant risk concerning accounting estimates to those charged with governance.

Notwithstanding our points on how the ED could be improved, we recognize that this ED is covering a difficult area of audit work. We welcome the IAASB's work in grappling with this subject and the greater guidance included in this ED on accounting estimates.

This concludes our comments. Thank you for the opportunity to comment on this ED. If you have questions regarding any of our comments, please do not hesitate to contact me or Susan Koski-Grafer at (202) 942-4400.

Sincerely,

Scott Taub

Scott Taub
Chairman
IOSCO Standing Committee No. 1