

August 1, 2017

Mr. Matt Waldron
Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
585 Fifth Avenue – 14th Floor
New York, NY 10017
U.S.A.

Dear Mr. Waldron,

Re: IAASB Exposure Draft Proposed ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures

The Canadian Auditing and Assurance Standards Board (AASB) is pleased to provide its comments on the proposed International Standard on Auditing 540, *Auditing Accounting Estimates and Related Disclosures* (ED-540).

In developing our views, we wanted to bring a practical perspective to our deliberations. We asked a selected number of firms of various sizes to choose accounting estimates from prior period audits and field test ED-540 as to whether it would enable them to make the judgments that will be needed in auditing accounting estimates. That insight, as well as feedback provided by Canadian stakeholders through written comments and roundtable sessions, has informed the views we express in this response. The **Appendix** includes a summary of the Canadian consultations on ED-540.

In our response, “stakeholders” refers to Canadian stakeholders who provided us with input. Also, “we” refers to the AASB.

Our comments are set out under the following main headings:

- A. Overall Comments;
- B. Request for Specific Comments; and

C. Other Comments on Specific Paragraphs or Matters of Interest.

A. OVERALL COMMENTS

We applaud the IAASB's significant effort to strengthen auditing of accounting estimates and related disclosures. We acknowledge that developing this exposure draft was a difficult task due to the complexity of the issues under consideration.

We are supportive of many of the proposals in ED-540. We feel, however, that for ED-540 to be operational, further improvements are needed. The results of field testing conducted by Canadian practitioners showed that many had significant challenges with operationalizing the requirements in paragraphs 15 and 17-19 in a manner that would achieve consistency of practice and appropriate use of the auditor's professional judgment. We agree with the views expressed by our stakeholders. In particular, we are concerned that:

- There is an implied requirement to identify and assess inherent risk as low or not low, which we believe should be made explicit. This requirement would be new to the ISAs, yet ED-540 provides little clarity as to how one makes such determination. As the classification of inherent risk as low or not low is key to determining the appropriate response to the assessed risks of material misstatement, we are concerned that lack of adequate clarity may lead to inconsistencies in practice.
- There is confusion as to whether the auditor can select one or a combination of approaches in testing accounting estimates when inherent risk is not low, such as those listed in paragraph 15(a). Participants of the field testing read paragraphs 17-19 as requiring the auditor to test how management made the accounting estimate and the data on which it is based. They were unclear as to why the auditor would be required to address these matters in the circumstance when the auditor decides to obtain sufficient appropriate audit evidence from events occurring up to the date of the auditor's report, or by developing a point estimate or range to evaluate management's point estimate.
- It is not practicable to ask the auditor to categorize accounting estimates into the three risk factors of complexity, judgment and estimate uncertainty. This is because the risk factors are not mutually exclusive and are not precisely defined. Also, categorizing accounting estimates into three discrete risk factors is inconsistent with management's process for making estimates. This inconsistency could be problematic, as the auditor may ask management to provide information for audit purposes that management has not considered as part of its own process.
- The relationship between the requirements in paragraphs 13, 15 and 17-19 is not clear. As a result, there is confusion as to whether the applicability of paragraphs 17-19 is

affected by the extent of complexity, judgment, and estimation uncertainty identified by the auditor in paragraph 13. For example, when the accounting estimate was considered to contain low complexity, some participants of the field testing believed that they did not need to apply paragraph 17, while others believed that they did need to apply paragraph 17.

- Further, when the auditor determines that paragraphs 17-19 do apply, it is not clear whether the work effort to address the matters in these paragraphs can vary depending on the extent to which an accounting estimate is affected by complexity, judgment, and estimation uncertainty, as determined by the auditor in paragraph 13. For example, when a reason for the assessed risks of material misstatement was complexity, some participants of the field testing interpreted paragraph 17 to require that all matters be addressed, while others believed they would use professional judgment to determine which matters are relevant.

We comment further on this in our response to question 4.

B. REQUEST FOR SPECIFIC COMMENTS

Q1. Has ED-540 been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates?

In part. We believe ED-540 has been appropriately updated to deal with International Financial Reporting Standard (IFRS) 9, *Financial Instruments*, as it relates to accounting estimates that are typical in entities such as financial institutions and those that trade complex financial instruments.

However, our stakeholders, particularly SMPs, made the observation that ED-540 is heavily skewed towards addressing considerations relevant to accounting estimates arising from IFRS 9. They believed that the standard needs to also focus on considerations relevant to accounting estimates in the non-financial sector and those that are more commonly included in financial statements. Such accounting estimates may include: goodwill, intangible assets, property valuations, asset retirement obligations, property plant and equipment impairments, inventory valuations, and acquisition valuations.

We believe that a more balanced coverage of material addressing accounting estimates of varying degrees of complexity and levels of risk would make ISA 540 more scalable and meaningful to a wide range of practitioners and applicable across entities of varying sizes.

Q2. Do the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates?

Yes - we believe that ED-540 appropriately reinforces the application of professional skepticism when auditing accounting estimates.

We support the inclusion of introductory paragraph 5 to emphasize, at the outset, the importance of the application of professional skepticism by the auditor. We believe that the application of professional skepticism is strengthened through the enhanced risk assessment requirements, and the requirements to “stand back” and evaluate the audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence.

Q3. Is ED-540 sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk?

We have identified some challenges in the scalability of certain proposals. Based on feedback provided by our stakeholders, we offer suggestions below as to how ISA 540 could be made more scalable.

Overall clarity and readability of ED-540

Many of our stakeholders found the application material in the proposed standard complex, resulting in readability and navigation difficulty. We believe that if certain requirements could be written to provide more clarity as to what is expected of the auditor, it would alleviate the need for extensive application material in the standard. As an example, we note paragraph 10(f) includes fourteen paragraphs of application material.

Further, stakeholders found the flowchart supplemental to ED-540 helpful in illustrating the work effort requirements. We encourage the IAASB to include this, or a similar flowchart, as an appendix to the Basis for Conclusions of ISA 540 (Revised).

Risk assessment procedures (paragraph 10)

Paragraph 10(b) requires the auditor to understand regulatory factors, if any, relevant to accounting estimates. While the wording “if any” recognizes that regulatory factors may not be present in all circumstances, our stakeholders questioned the extent to which the auditor would be required to search for regulatory factors that may be applicable to the estimate. Clarity around “how much is enough” would be helpful.

Paragraph 10(e) requires the auditor to understand how management makes accounting estimates, including sub-requirements to understand particular elements of management’s processes. We have a few suggestions as to how this requirement could be made more scalable, as follows:

- Adding clarity to explain the labelling convention used for “accounting estimate” and “accounting estimates” (plural). While we recognize that the IAASB’s intention in using the term “accounting estimates” (plural) was to refer to accounting estimates as a whole, that concept was not understood clearly by field testing participants. Some participants misinterpreted the requirements under paragraph 10(e) to apply more

granularly to individual accounting estimates.

- Amending paragraphs 10(e)(v), (vi) and (vii) to include the wording “whether, and if so, how” (new wording emphasized by underline). The added wording recognizes that some smaller entities may not have processes in place to deal with risk of management bias, address estimation uncertainty, or address the need for change in the inputs to the estimate(s) from the prior period.
- Expanding paragraph A44 to include discussion with the owner-manager about the need to use individuals with specialized skills and knowledge in accounting, in addition to the need to use an expert. Stakeholders felt that when management does not have the skills and knowledge in accounting necessary to make accounting estimates, it is important that this be identified early in the audit process so management can take appropriate action. Stakeholders also noted that the circumstances described in this paragraph can occur in entities of all sizes, and so this paragraph should not be under the heading “Considerations specific to smaller entities”.

Paragraph 10(f) requires the auditor to understand “each of the components of internal controls as they relate to making accounting estimates”. Auditors of smaller entities may face a specific challenge with the interpretation of such wording because certain controls in these entities, such as the direct involvement of the owner-manager, may be relevant to many components. We suggest the IAASB clarify the requirement to make it more scalable to a particular circumstance. For example, using the wording in paragraph 8(c)(ii) of extant ISA 540, which refers to “relevant controls” rather than “each of the components of internal control” may be clearer. This may also allow the application material to be streamlined, thus, improving readability.

Review the outcome of accounting estimates (paragraph 11)

Paragraph 11 requires the auditor to review the outcome of accounting estimates included in the previous period financial statements, or, where applicable, their subsequent re-estimation. We recognize that this wording comes from extant ISA 540, however, our stakeholders have indicated that there is varied interpretation in practice as to when this requirement applies. For example, some stakeholders have interpreted this requirement as not being applicable in circumstances when the accounting estimate does not have an outcome, such as in the case of stock-based compensation. We encourage the IAASB to revisit the wording of the requirement and the application material to ensure that it is clear that, while some accounting estimates may not have an outcome, a retrospective review of the results of the inputs used (such as, data and assumptions) in making the estimate, or management’s estimation process applied in prior periods, may also inform the auditor’s risk assessment and indicate possible management bias.

Response to risk (paragraphs 17-19)

We believe that the requirements in paragraphs 17-19 are not sufficiently clear as to whether, and if so how, they are meant to be scalable to the level of risk of material misstatement and the degree of complexity, judgment and estimation uncertainty associated with the accounting estimate. See response to question 4 below for further discussion.

Application material specific to smaller entities

Our stakeholders find the application material in ED-540 on considerations specific to smaller entities to be helpful in assisting the auditor in understanding and applying specific requirements, especially when it goes beyond issue identification by also discussing what the auditor may do differently. Accordingly, we encourage the IAASB to continue its focus on the applicability of ISA 540 to audits of entities of all sizes and to give careful and due consideration to matters specific to smaller entities.

We noted some application material in paragraphs A10 and A107 (last sentence) that refers to smaller entities, and therefore, we believe it should be identified with the title “Considerations Specific to Smaller Entities”.

Q4. 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?

In part. We support the consideration of the three risk factors (complexity, judgment and estimation uncertainty) in identifying and assessing the risks of material misstatement, as specified in paragraph 13. We also support the premise of setting a threshold for the detailed work effort based on the level of inherent risk associated with the accounting estimate, as specified in paragraph 15. With additional clarity, we believe that classification of inherent risk of low and not low can be operationalized in practice with success.

However, we believe that further improvement is needed to the proposed approach to responding to the assessed risks of material misstatement, when inherent risk is not low, under paragraphs 15(b) and 17-19. The results of our field testing showed that there may be significant issues with operationalizing these in a manner that would achieve consistency of practice and appropriate use of the auditor’s professional judgment.

We have identified the following key issues:

- Lack of clarity as to the work effort in classifying inherent risk as low and not low, under paragraph 15.

- Lack of clarity regarding the available approaches to test accounting estimates when inherent risk is not low, under paragraph 15(b).
- Difficulty categorizing accounting estimates into the three risk factors of complexity, judgment and estimation uncertainty, in complying with paragraphs 17-19.
- Lack of clarity regarding the relationship between the requirements in paragraphs 13, 15 and 17-19.
- Lack of clarity as to whether the work effort in paragraphs 17-19 can vary depending on the extent to which an accounting estimate is affected by the three risk factors.

Lack of clarity as to the work effort in classifying inherent risk as low and not low

Paragraphs A39 to A42 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, allow for a separate assessment of inherent risk. However, requiring such an assessment, as implied under paragraph 15, is new to the ISAs. Consequently, our stakeholders raised many questions and had varied interpretations around the application of this requirement. In the absence of additional guidance, we are concerned that the auditor may do either too much or insufficient work in classifying inherent risk as low or not low.

We believe that further clarity is warranted with respect to the following:

- How the auditor assesses whether inherent risk is low; for instance, whether all three of the risk factors need to be considered low or not applicable for inherent risk to be identified as low, and whether there are other considerations of conditions and events that should be considered.
- Inherent risk assessment of not low may encompass a range of possible risk levels, including risks assessed above low up to and including significant, which may impact the design of further audit procedures under paragraph 7(a) in ISA 330.
- Whether the auditor may assess or revise inherent risk as low when the outcome of an accounting estimate becomes known during the audit. Such guidance is provided in paragraph A75, but is not sufficiently clear and prominent to readers.

Further, paragraph 15 contains an implied requirement for the auditor to identify and assess inherent risk as low or not low related to accounting estimates, which we believe should be made explicit. An explicit requirement would provide clarity as to the work effort and a better logical flow to responding to the assessed risks of material misstatement. If the IAASB agrees, a new requirement could be placed immediately after paragraph 13 of ED-540, following the auditor's identification and assessment of the risks of material misstatement. Also, the second sentence of paragraph A95 would need to be amended to

remove the reference to ISA 540 not implying or requiring a separate assessment of inherent risk.

Lack of clarity regarding the available approaches to test accounting estimates when inherent risk is not low

Our stakeholders felt that it was unclear in ED-540 whether, in complying with paragraph 15(b) when inherent risk is not low, they have the same choice of further audit procedures as those set out in paragraph 15(a) when inherent risk is low.

Participants of the field testing read paragraphs 17-19 as requiring the auditor to test how management made the accounting estimate and the data on which it was based. There was confusion as to why the auditor would be required to test how management made the accounting estimate when the auditor decides that it would be more efficient or effective to obtain sufficient appropriate audit evidence from events occurring up to the date of the auditor's report, or by developing a point estimate or range to evaluate management's point estimate.

For instance, paragraph 19(a)(i) requires the auditor to obtain evidence about whether management has taken appropriate steps to understand and address estimation uncertainty. Our stakeholders interpreted this requirement as relevant to testing how management made the accounting estimate. They questioned why the auditor would be required to carry out this work in circumstances when it would be more effective and efficient, for example, to obtain audit evidence about events occurring up to the date of the auditor's report.

We believe that it is critical that ISA 540 (Revised) be clear that the auditor can select one or a combination of approaches in testing accounting estimates when inherent risk is not low, such as those listed in paragraphs 15(a). Moving material from paragraph A97 to 15(b) will give the available approaches to testing accounting estimates more prominence and address some of the confusion. Also, we suggest that the IAASB revisit paragraphs 17-19 with a view of providing clarity as to which requirements would apply to each of the available approaches to testing accounting estimates.

Difficulty categorizing accounting estimates into the three risk factors of complexity, judgment and estimation uncertainty

Our stakeholders noted that categorizing responses into three discrete risk factors is not consistent with management's process for making estimates. Often times, management considers accounting estimates more in terms of data, assumptions and methods / models. This potential inconsistency between how management determines accounting estimates and how the auditor is asked to audit those estimates could be problematic as the auditor may ask management to provide information for audit purposes that management has not

considered as part of its own process. The IAASB may look to the recently issued PCAOB Docket 43: *Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements*, which approaches the audit of estimates in a manner that appears to be more consistent with the way management makes their estimates.

Participants of the field testing had difficulty categorizing accounting estimates into the risk factors. The reasons cited were:

- The risk factors are not mutually exclusive items. For example, some participants viewed estimation uncertainty as always present in an accounting estimate, and judgment and complexity as factors that often influence estimation uncertainty.
- The risk factors are not precisely defined. The lack of precise definitions at the outset of the standard, makes it difficult for readers to assign a meaning to the terms as they encounter them in ED-540. Including definitions may enable streamlining the large amount of application material in relation to the three factors, thus improving readability.
- The discussions of the three risk factors each refer to data, methods, and assumptions which contributes to the difficulty in distinguishing the risk factors from each other.

We asked participants of the field testing why they chose a particular risk factor as a reason for the assessment given to the risks of material misstatement, and noted their judgments were not comparable. At times, the same reasons were provided to justify why an estimate was subject to high estimation uncertainty and why another was subject to judgment. This demonstrated the lack of clarity and varied interpretations in applying the requirements of paragraphs 15(b) and 17-19. We noted that it was mostly field testing participants dealing with less complex accounting estimates that struggled with categorizing the responses into the three risk factors.

We believe it is not practical to categorize the response to the assessed risks of material misstatement into the reasons given to that assessment (i.e., the three risk factors of complexity, judgment, and estimation uncertainty), as explained above. We encourage the IAASB to explore other ways to link the assessed risks of material misstatement to the further audit procedures required when inherent risk is not low.

Lack of clarity regarding the relationship between the requirements in paragraphs 13, 15 and 17-19

Results of the field testing demonstrated lack of clarity as to whether the risk factors are considered as having “all or nothing” conditionality, or on a spectrum (i.e., low to high), when determining the response to the assessed risks of material misstatement. Some

participants interpreted the factors as either applicable or not applicable to the estimate being tested, while others interpreted the three factors being on a spectrum of low to high. Also, when a factor was considered “low” in relation to the estimate being tested, there was inconsistent interpretation from field testing participants on whether paragraphs 17-19 applied. For example, some participants believed that when an estimate was affected by complexity, but complexity was considered low, they did not need to apply paragraph 17, while others believed that because there was some complexity they did need to apply paragraph 17.

We encourage the IAASB to provide clarity as to the relationship between paragraphs 13, 15, and 17-19, including how paragraphs 17-19 is affected by the extent of complexity, judgment, and estimation uncertainty identified by the auditor in paragraph 13.

Lack of clarity as to whether the work effort in paragraphs 17-19 can vary depending on the extent to which an accounting estimate is affected by the three risk factors

Participants of the field testing had difficulty in understanding whether the work effort to address the matters in paragraphs 17-19 can vary depending on the extent to which an accounting estimate is affected by complexity, judgment, and estimation uncertainty, identified by the auditor in paragraph 13. Participants had different interpretations of paragraphs 17-19. For example, some participants interpreted:

- all the matters in paragraphs 17-19 as relevant, while others indicated they would use professional judgment to determine which matters in paragraphs 17-19 are relevant;
- certain of the matters in paragraph 17 (such as paragraph 17(b) and (e) related to the relevance and reliability of the data and whether calculations are mathematically accurate and appropriately applied) to always apply regardless of the evaluation of inherent risk; and
- the matters in paragraph 19 to always be relevant because estimation uncertainty is always assumed to be present in estimates.

We encourage the IAASB to provide clarity as to whether, and if so how, the work effort in paragraphs 17-19 can vary depending on the extent to which an accounting estimate is affected by the three risk factors.

(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?

Yes - we support the proposed requirement in paragraph 13 with respect to identifying and assessing risks of material misstatement in relation to accounting estimates. We believe it appropriately directs the auditor to take into account the three factors (i.e., complexity, judgment and estimation uncertainty) that are most likely to influence the assessed risks of material misstatement. However, see response to question 4(a) for comments relating to the difficulty in identifying which of the factors (complexity, judgment and estimation uncertainty) were the reasons for the assessed risks, and whether paragraphs 17-19 can be applied proportionately to the level of risk of material misstatement.

(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?

Results of field testing indicated significant issues with the approach to responding to risks of material misstatement in paragraphs 17-19, as explained in the response to question 4(a). However, if the IAASB decides to retain the approach and the requirements, we have some suggestions for further clarity relating to the response when the reasons for the assessment given to the risks of material misstatement include *complexity* (paragraph 17).

Paragraph 17(d) requires the auditor to obtain sufficient appropriate audit evidence about whether the integrity of significant data and significant assumptions has been maintained in applying the method. Our stakeholders questioned what is meant by ‘integrity of significant data’ and ‘integrity of significant assumptions’. We believe clarity should be provided on these two phrases. For example:

- The “integrity of significant data” could be clarified by drawing from the application material in paragraphs A107 to A109 of ISA 315, which refers to the integrity of data or accounting records
- The “integrity of significant assumptions” could be clarified as to whether it is referring to aspects such as the judgment in the assumptions, the completeness of the assumptions, or the processes used in applying the assumption

Q5. 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 ISA 540, in evaluating whether management’s point estimate is reasonable or misstated?

In part. We agree that the requirement in paragraphs 19(b) and 20 appropriately establish how an auditor’s range should be developed. However, we do not agree with the wording in paragraph A128 that developing an auditor’s point estimate or range is a substantive analytical procedure. We believe the reference to the requirements and guidance in ISA 520, *Analytical Procedures*, introduces unnecessary confusion. For example, the inquiries of management about differences from expected values required by paragraph 7(a) in ISA 520 seem

inconsistent with the premise in paragraph 19(b) that management has not appropriately understood and addressed the estimation uncertainty.

We do not feel it is necessary to specify in a standard which type of procedure would be used in developing a point estimate or range. We note that ED-540 does not include guidance on the type of procedures to use in testing how management made the accounting estimate, and so we question why there would be guidance on the type of procedures to use in developing a point estimate or range. We recommend that paragraph A128 be removed.

Q6. 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?

Yes – we support the “stand-back” requirements in paragraph 23, but our stakeholders made the observation that its linkage with the broader requirement in paragraph 13(c) of ISA 700, *Forming an Opinion and Reporting on Financial Statements*, needs to be clarified.

For clarity, we suggest including a cross-reference in ISA 540.23 to ISA 700.13(c), with some guidance to explain the relationship. This would provide an appropriate lead-in to the important requirement that follows in the second sentence, which states “In making this evaluation, the auditor shall consider all relevant audit evidence obtained whether corroborative or contradictory.”

Further, we suggest clarifying whether paragraph 23 applies to all estimates, with inherent risk of low and not low. Results of field testing showed varied interpretations.

Q7. 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 information sources?

Yes, we believe the conforming amendments to ISA 500 will result in more appropriate and consistent evaluations of the relevance and reliability of information from external information sources. However, we have identified a few areas in application material that we believe need refinement.

Proposed paragraph 500.A33C - Other examples could be added

Paragraph A33C cites the central bank as an example of an external information source where the auditor may not be able to get access to the source controls and, therefore, consider the accuracy and completeness of the information. We believe that more examples should be added to acknowledge that there are other circumstances where this may occur. Other examples include valuers of real estate property or an actuary.

Proposed paragraph 500.A33F – 4th bullet is too narrowly focused on external information source relating to security prices

Paragraph A33F lists possible responses to obtaining evidence about the relevance and reliability of information from external information sources. We do not agree with the drafting of the fourth bullet point, which suggests that when the external information source relates to security prices, the auditor would obtain an independent price from a source that is different from that used by management. This bullet may be inappropriately read to mean that in the case of external information source relating to security prices the auditor can never use the same external information source as management. In practice, the auditor may consider it appropriate to use the same external information source as management when the sources are widely used and generally accepted to be of high quality, and when the nature of the item being valued is non-complex.

We believe that the wording in the fourth bullet should be amended to remove reference to “security prices” and “price” so it applies more broadly to all external information sources, consistent with the approach taken in drafting the three previous bullets in paragraph A33F.

Proposed paragraph 500.A33H – further clarification needed

Paragraph A33H does not have a logical flow. It starts with the situation where management and the auditor may use the same information source as management because there is only one provider. However, it ends with a suggestion for the auditor to access a different information source, when available, in obtaining audit evidence. Also, the third sentence starts with the words “in such cases”, but it is unclear what is being referred to.

We believe that there are two separate thoughts included in paragraph A33H. For clarity, we suggest breaking this paragraph into two separate paragraphs. One paragraph would deal with instances where the auditor uses the same information source as management because there is only one provider. The other paragraph would deal with instances when the information source used is determined not to be relevant or reliable, and the auditor would access a different information source from that used by management, when available. The guidance should also provide clarity on when the auditor would decide that it is appropriate to seek other audit evidence, when the auditor uses the same information source as management.

Clearer link to ISA 500 in ISA 540

Stakeholders indicated that it is not sufficiently clear in ED-540 that the auditor should refer to ISA 500 for more information relevant to external information sources. The reference to ISA 500 in the footnote to paragraph 17(b) does not seem to be sufficiently prominent to readers. The link to ISA 500 in ISA 540 could be made more prominent by including it within application material.

Q8. In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:

- a) Translations —Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-540.**

We have not identified any potential translation issues.

- b) Effective Date—Recognizing that ED-540 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods ending approximately 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.**

We are supportive of an effective date of 18 months after the approval of the final ISA. This is the typical implementation period for new or updated standards. We are also supportive that early application should be permitted.

C. OTHER COMMENTS ON SPECIFIC PARAGRAPHS OR MATTERS OF INTEREST

Linkage to existing requirements in ISA 315¹ and ISA 700²

Some of the proposed requirements in ED-540 appear to be built on other ISAs, such as ISA 315 and ISA 700. We believe that there is a lack of clarity as to how the broader requirements in the other ISAs interact with the related requirements in ED-540 and the auditor’s incremental work effort, if any. Examples where further clarification in ISA 540 may be appropriate are as follows:

- Paragraph 10 of ED-540 includes risk assessment requirements related to accounting estimates. Although the lead-in paragraph appropriately cross-references to the broader risk assessment requirements in ISA 315, our stakeholders questioned whether the requirements in paragraph 10 of ED-540 were incremental to ISA 315. To clarify, we suggest that the word “also” be added to the lead-in of paragraph 10 to state “...the auditor shall also obtain an understanding of the following...”
- Paragraph 21 of ED-540 includes a requirement to obtain sufficient appropriate audit evidence about whether the disclosures related to accounting estimates are reasonable in the context of the requirements of the applicable financial reporting framework, including in the case of a fair presentation framework and compliance framework. This

¹ ISA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*

² ISA 700, *Forming an Opinion and Reporting on Financial Statements*

requirement appears to be built on the requirement in paragraph 13(e) of ISA 700. However, there is no cross-reference nor clarification included as to how the two requirements interact.

We also highlight the importance of coordinating the revisions to ISA 540 with the revisions to ISA 315. ED-540 includes reference to general risk assessment concepts that will need to be consistent with, and may require further explanation in, ISA 315 as that project moves forward.

Disclosures Related to Accounting Estimates

Paragraph 21(a) requires the auditor, in the case of a fair presentation framework, to obtain audit evidence about “whether management has provided the disclosures beyond those specifically required by the framework that are necessary to achieve the fair presentation of the financial statement as a whole”. We believe that the requirement is unclear as to its intent and appears to go beyond the work effort in paragraph 14 of ISA 700 by suggesting that there would always be additional disclosures necessary to achieve fair presentation. We suggest that paragraph 21(a) be amended to caveat the reference to “beyond those specifically required by the framework”, with the wording “where appropriate”.

Communications with Those Charged with Governance or Management

Paragraph 26 requires the auditor to consider the matters, if any, to communicate to those charged with governance or management with respect to complexity, judgment and estimation uncertainty related to accounting estimates. Some of our stakeholders questioned the extent of such communication. For example, whether the auditor should communicate all estimates subject to complexity, judgment or estimation uncertainty, or only those identified with inherent risk assessed as “not low”. Additional clarity would be helpful.

We also believe that it would be helpful to remind readers that matters relating to accounting estimates discussed with those charged with governance may be considered a key audit matter under ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*.

Items that require definition or explanation

We have identified terminology used within ED-540 that we believe could be defined or further explained. Those are:

- “specialized skills and knowledge”;
- “further audit procedures”;
- “significant data”; and
- “significant assumptions”.

In regard to the use of the phrase “further audit procedures”, we recognize that it is meant to encompass procedures performed in response to assessed risks of material misstatement,

including tests of controls (if any), tests of details and analytical procedures. However, not all stakeholders were clear as to the intention of using this phrase. Some stakeholders interpreted the reference to “further” in paragraph 15(b) as further to what is required in 15(a). Therefore, they concluded that when inherent risk is not low, they would need to perform one of the procedures listed in paragraph 15(a), as well as perform procedures over the matters in paragraphs 17-19. While we recognize that the definition of “further procedures” is included in the Glossary of Terms, for clarity, we recommend that the definition also be included in ISA 540 (Revised).

** ** * * *

Editorial comments on ED-540 have been provided directly to the IAASB staff.

We hope that these comments will be useful to the IAASB in determining the appropriate next steps relating to this key project. If you have any questions or require additional information, please contact Eric Turner at (416) 204-3240 or eturner@asbcanada.ca.

Yours very truly,



Darrell Jensen FCPA, FCA
Chair, Auditing and Assurance Standards Board (Canada)

c.c. Canadian Auditing and Assurance Standards Board members

Ron Salole, member of the International Auditing and Assurance Standards Board

Appendix: Summary of consultations on the IAASB’s Exposure Draft of ISA 540 (Revised)

I. Groups consulted

- Advisory Group to the AASB on the project to Revise Auditing Accounting Estimates and Related Disclosures
- Regulators
- Large Firms
- Practitioners in small and medium-sized practices
- Auditors focusing on oil, gas, and mining entities
- Legislative auditors
- Provincial CPA body working group on assurance and reporting

II. Formal response letters received

- Three response letters from provincial and federal auditor general offices
- Two response letters from large public accounting firms
- One response letter from a provincial CPA body working group on assurance and reporting

III. Summary of field testing conducted by stakeholders in Canada

Exhibit I –Number of estimates tested across stakeholder and risk type

	SMPs	Large Firms	Oil / Gas / Mining*	TOTAL
Total estimates field tested	16	9	4	29
Low inherent risk	4	3	1	8
Not low inherent risk	12	6	3	21

*Oil / Gas / Mining was chosen as an industry to focus on as it is somewhat unique to Canada

Exhibit II –Types of estimates and industry coverage

Types of estimates field tested	Industries
Allowance for doubtful accounts	<ul style="list-style-type: none"> - Healthcare - Public sector - Wholesaler
Asset retirement obligation	<ul style="list-style-type: none"> - Chemical processing - Metal recycling - Mining
Employee Benefits	<ul style="list-style-type: none"> - Not for profit
Impairment	<ul style="list-style-type: none"> - Construction - Mining - Oil & gas
Inventory obsolescence	<ul style="list-style-type: none"> - Construction - Distribution
Landfill liability	<ul style="list-style-type: none"> - Municipal
Loan loss provision	<ul style="list-style-type: none"> - Large bank - Credit union
Fair value (investments or property)	<ul style="list-style-type: none"> - Distribution - Investment Fund - Mining - Oil & Gas - Real Estate
Revenue (including rebates / provisions / %age complete)	<ul style="list-style-type: none"> - Agriculture - Commodities - Construction - Healthcare - Municipal - Retail