Supplement A
to Agenda Item 9

RESPONSES RECEIVED ON THE EXPOSURE DRAFT

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED), *AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES*

GENERAL COMMENTS

Note: This supplement has been prepared for information only. A comprehensive summary of the significant comments received on the April 2017 Exposure Draft, Proposed International Standard on Auditing 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* (ED-540) and related analyses of significant issues will be presented at subsequent IAASB meetings. All comment letters on the Exposure Draft can be accessed here.

#	Respondent	Comments
Investors and Analysts		
1.	CFA	Another challenge for investors analyzing financial statement estimates is that they tend to have limited accompanying disclosures. Disclosures typically contain little information on the inputs and assumptions made with regard to estimates. In some cases, there is little information other than the number and some generic language with respect to how, in fact, the estimate was derived. Hence, we support ED 540's emphasis on consistent and robust disclosures. Below we outline our detailed comments on the significance of the stand back provision as well as the focus on professional skepticism and disclosures, the specific risk assessment requirements outlined in the ED, the importance of communication with those charged with governance, and the need to align standard setting with the US Public Company Accounting Oversight Board (PCAOB). Finally, we underscore the need for field testing the proposal in order for investors to assess whether the changes are economically worthwhile. **Stand Back** We support the enhanced risk assessment requirements and the requirements to "stand back" and evaluate audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence. Given the iterative nature of an audit, audit quality would be enhanced by requiring the auditor to take stock of the audit evidence obtained in relation to accounting estimates, particularly complex and challenging accounting estimates. We also support the guidance in the application material that notes when the auditor may conclude that an accounting estimate is reasonable and when then auditor should reconsider whether sufficient appropriate audit evidence has been obtained.

		CFA Institute believes that these are the two key provisions in the proposal. What these result in is the need for the auditor to take an independent view of the estimates rather than merely check the accuracy of management computations. To the extent that estimates are based on models, the auditor must consider whether there are other models and inputs that could have been used and whether other models or inputs would result in significantly different estimates. **Disclosures** CFA Institute supports paragraphs 21 (a) and A135 through A138 of ED 540 that requires that the auditor shall 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: "(a) In the case of a fair presentation framework, whether management has provided the disclosures beyond those specifically required by the framework that are necessary to achieve the fair presentation of the financial statements as a whole." With increasing use of accounting estimates it is important for users making investment decisions to understand the model, the inputs and the assumptions made by management, and the extent to which accounting estimates are subject to estimation uncertainty. As stated previously, it is a challenge for investors to understand what is behind these estimates, how they are derived, and what they mean economically. We believe such information should be provided through the disclosures in the financial statements. However, given that some financial reporting frameworks do not provide for specific disclosure requirements at a detailed level, from a user perspective, paragraph 21 (a) is necessary as it requires auditors to request additional disclosures when necessary to achieve fair presentation of the financial statements as a whole under the relevant financial reporting framework. Sufficient disclosures related to accounting estimates are essential for effective communication of key audit matters to investors. Disclosures are especially necessary whenever there is extreme measurement uncertainty[1] associated with the reported point estimates of assets and liabilities. We do, however, urge the IAASB to provide additional application guidance related to paragraph 21(a), such as examples of circumstances in which management might provide disclosures beyond those specifically required by the framework that are necessary to achieve the fair presentation. **Communication** CFA Institute agrees with paragraph 26, A155 and A156 of ED 540 whereby: "the auditor is required to communicate with those charged with governance or management about certain matters, including significant qualitative aspects of the entity's accounting practices and significant deficiencies in internal control, respectively. In doing so, the auditor shall consider the matters, if any, to communicate related to the extent to which the accounting estimates and their related disclosures are affected by, or subject to, complexity, the need for the use of judgment by management, estimation uncertainty, or other relevant factors." Investors and analysts seek more disclosures of accounting estimates, more information on how these estimates have been audited, and communication of key audit matters. Paragraphs 26, A155 and A156 place more emphasis on communication between auditors and those

[1] For example, estimation uncertainty occurs when the range of possible estimates is several factors of materiality.

		charged with governance regarding accounting estimates. For investors to effectively communicate with those charged with governance, it is essential that those charged with governance first discuss accounting estimates and key audit matters thoroughly with auditors. We welcome the discussion of the risk of management bias when auditing accounting estimates in the application material. But we believe the evaluation of management bias should be included through the entire audit process. We also believe the section on communication with those charged with governance should include a discussion of management bias. With respect to estimates there is a risk of confirmatory bias. Hence the need to challenge management, the application of professional skepticism, and the stand back provision are extremely important. As stated above, CFA Institute believes that investors need greater insight as to how estimates are derived. We also believe audit committees need to be more proactive in asking details regarding assumptions made by management. To provide these two important constituents with necessary information regarding the audit of accounting estimates, we hope the information is included in the new auditors reporting model. **Specialized Skills** We agree with the new objective-based approach to developing responses to risks of material misstatement. We believe it allows for the flexibility needed to address different types of accounting estimates, whilst driving more consistent and detailed work effort to obtain sufficient audit evidence. From an investor perspective, one of the most important questions is whether the auditor has the requisite skills, knowledge and experience to audit these estimates. Investors want auditors to make a robust risk assessment and to have an understanding of the current economic context and for auditors to use this in assessing estimates. For example, are implications of the low-interest rate environment being incorporated by the auditor into their assessments of the estimates and assumptions going into the financial statements. Therefore, the auditor at every stage of the audit should consider whether he/she has the requisite skills and competencies. The lack of appropriate skills to conduct the audit of accounting estimates we believe is the root cause of many of the problems we see today.[2] We welcome the requirement that the auditor needs to determine early in the audit process whether specialized skills or knowledge are required, in order to perform the risk assessment procedures, or to identify and assess the risks of material misstatement. However, the importance of the use of specialized skills and knowledge should be highlighted in all phases of the audit of accounting estimates such as planning, performing testing of controls and detailed testing. We also believe the ED should highlight any differences in audit procedures to be undertaken when the specialist is employed by the audit firm and when the specialist is employed by the audit firm's client. **PCAOB** In the Explanatory Memorandum, the IAASB outlines its extensive outreach activities, including with the PCAOB. We also note that the PCAOB issued *Docket 43: Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements*, on June 1,

[2] For example, a report, *Survey of Fair Value Audit Deficiencies* – by Atlanta-based valuation and litigation consultancy firm, Acuitas, Inc. – reviewed PCAOB inspection reports for 2008-2011 and reported that approximately one-fourth of all audit deficiencies reported by the PCAOB related to fair value estimate audit deficiencies. The study notes the primary causes of such deficiencies related to: pricing, failure to test, disclosures, risk assessment, prospective financial information, and other-than-temporary investments.

		2017 and that the PCAOB's proposed changes build on the existing approach to auditing estimates. We note various differences between the PCAOB's proposal and those of the IAASB. Close alignment between the IAASB and PCAOB standards on auditing accounting estimates is in the public interest and we urge the IAASB to continue its outreach activities with the PCAOB with the goal of achieving closer convergence. **ISA 315 *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*** It is unfortunate that the project to revise ISA 315 could not have taken place at the same time as the development of ED 540. ED 540 proposes a different risk model for risk assessment related to the audit of accounting estimates compared to extant ISA 315. ISA 315 broadly distinguishes between significant and non-significant risks. The ED on the other hand recognizes low and high inherent risk, in addition to significant risk. We urge the IAASB to clarify the relation of the risk model in the ED relative to the current requirements of ISA 315. Had the two projects been undertaken concurrently, the types of risks, including significant risk, could have been aligned. As it stands now, we are unable to determine whether further changes to the revised ISA 540 will be needed when future revisions are made to ISA 315. **Field Testing** The IAASB has invited auditors to participate in field testing of the proposals. We applaud this as it could provide helpful insights. Any issues identified by the auditors should be explored very carefully and any changes made in response should be done after following due process, having regard to the public interest. It is particularly important for investors as it is difficult for them to assess whether the changes are economically worthwhile and solving the issues they have faced. **International Auditing Practice Notes (IAPN) and Implementation Issues** We understand that the ISAs are principles-based. Consequently, the proposal does not address the many emerging accounting requirements. However, it would be useful to have separate guidance to apply the standard to different types of complex estimates. We believe this could be done perhaps through IAPNs. Areas that could be covered are estimates of expected credit losses under IFRS 9, as well as new accounting standards covering leases, revenue recognition and insurance contracts. Further, provisioning under the new Expected Credit Loss (ECL) model and auditing of these estimates under ISA 540 (Revised) might raise implementation issues. We, therefore, urge the IAASB to address issues that may arise and provide additional guidance, if necessary.
Those Charged with Governance		
2.	AICD	The AICD are concerned that the proposals will significantly increase the level of audit work undertaken and therefore increase audit costs, for no obvious benefit to stakeholders. We understand that the changes are a result of an increase in focus on the auditing of accounting estimates for financial institutions arising from concerns expressed by regulators. Further, we understand the application of the new IFRS 9 Financial Instruments from 1 January 2018 will have an impact on loan loss provisioning methodologies for some large and complex organisations in some jurisdictions. However, in our view these developments do not warrant a wholesale change to the audit methodology for auditing accounting estimates for all organisations, many of which are not large or complex or financial institutions and will not be overly impacted by the new loan loss provisioning requirements.

		Those areas where we see an increase in audit effort without commensurate benefits include: - the need for the auditor to re-perform estimates that have been undertaken by management. Specifically, this relates to the requirement of the auditor in certain cases to develop a point estimate or a range to evaluate management's point estimate. We consider the current requirements (assessment of the inputs to the model, being satisfied with the operation of the model itself, and testing controls around the use of the model) sufficient in the case of most accounting estimates; and - the application of the proposals to all estimates, irrespective of the extent of the risk of material misstatement to the financial report. We found the explanatory memorandum along with the standard and accompanying application guidance lengthy, repetitive and difficult to assess the impacts on preparers and directors. We recommend that the impact of future proposals on these particular stakeholders, along with costs and benefits, to be clearly articulated in non-technical language in the accompanying material and that the standard and application guidance is better integrated to avoid repetitiveness. Further, within these proposals there were several references to what management or those charged with governance may do or provide to the auditors. The AICD recommends that if there are additional requirements of management or those charged with governance, these requirements are placed in the relevant financial reporting standards and consulted on accordingly and not the audit standard. The auditing standards are not referred to by those stakeholders in their preparation of the financial report.
Regulators and Oversight Authorities		
3.	**BCBS**	The Committee's main interest in updating ISA 540 was to address the auditing challenges surrounding the new accounting standards on Expected Credit Losses ("ECL") promulgated by the IAASB and the Financial Accounting Standards Board. It has been acknowledged that the "complexity, variability, and materiality of the ECL provision, and the need for judgment regarding certain key data and assumptions, are likely to give rise to one or more significant audit risks". Thus, the IAASB set out to consider how ISA 540 could be further enhanced to drive appropriate audit procedures, taking into consideration the processes and controls in place at the entity, and reinforcing the application of professional judgment and professional skepticism for complex estimates, such as ECL. Accordingly, at the outset of the project to revise ISA 540, the Committee requested that the IAASB focus the revisions on issues for audits of financial institutions arising from the adoption of ECL frameworks. However, the ISA 540 ED instead addresses all estimates and maintains that the audit requirements and guidance in the ED are relevant for all accounting estimates, as this term is defined in paragraph 9(a). We would have preferred that the IAASB adopt the approach we suggested because that approach would have enabled the audit challenges for the audit of ECL frameworks to be fully addressed in sufficient detail. However, bearing in mind the decision the IAASB has taken as to its focus, we agree that the ED will improve the requirements and guidance for the audit of complex accounting estimates (in general) for all types and sizes of entities and we support it on those terms. We appreciate the significant efforts made by the IAASB and its ISA 540 Task Force to revise the standard to better support a high-quality audit of accounting estimates that are subject to complexity, judgment or estimation uncertainty. We further support the improvements made to the standard for enhanced risk assessments, the application of professional skepticism, and the requirement for the auditor to "stand back" and evaluate the audit evidence obtained. These improvements in the proposed standard address auditing challenges for estimates in increasingly complex business environments (such as approaches to models and data, obtaining an understanding of regulatory factors and additional internal control considerations) and go a long way towards enhancing ISA 540.

		Additionally, we recommend that the ISA 540 Flow Chart be included within the standard. This tool provides a strong and straightforward explanation of how the standard should be applied and clearly shows that, if an accounting estimate has complexity, management judgment or estimation uncertainty, the auditor must adhere to the Requirements of ISA 540. Furthermore, we strongly encourage the IAASB to finalise the standard expeditiously, with early adoption permitted, as it is important that auditors are able to apply the standard in the year that banks adopt an ECL accounting framework. As the primary global standard setter for the prudential regulation of banks, our focus is on the application of ISA 540 (Revised) to complex estimates in banks, including the audit of ECL estimates. Thus, the Committee's views, set out below, are on key aspects of the ED that could be further enhanced to address the auditing of complex estimates in banks. Internal control For banks, a robust internal control environment is critical to the strength of an entity's governance system, its ability to manage risk, and the fair presentation of its financial statements, including the related disclosures. Paragraph 10 in the ED contains a general reference to the Requirements for the auditor to obtain an understanding of internal control, including the components of internal control as they relate to making accounting estimates. Paragraphs 16 and 26 provide guidance on testing the operating effectiveness of the internal control framework, and reporting internal control deficiencies to those charged with governance ("TCWG") when the auditor intends to rely on internal control, respectively. We recommend that the references to ISA 315 in footnote 25 to paragraph 10 of the ED be expanded to include references to paragraphs 5–13 of ISA 315 (Revised), in addition to the current references to ISA 315, paragraphs 5–6 and 11. This will allow auditors to more completely identify the extent of the ISA 315 Requirements relevant to ISA 540, paragraph 10, with respect to risk assessment procedures and obtaining an understanding of the entity and its environment, including its internal control. The Committee believes that obtaining an understanding of internal control is critical for the audit of most estimates. Although we generally support the content of paragraphs 10, 16 and 26, we note the absence from paragraph 16 of an explicit reference to the design effectiveness of controls relating to accounting estimates. Accordingly, we urge that the standard be revised to clearly state the auditor's responsibility to evaluate the design and operating effectiveness of internal control, as required by paragraph 13 of ISA 315 (Revised), for processes that make extensive use of information technology and have a large number of estimates that are highly judgmental, complex or subject to high estimation uncertainty like those associated with the ECL estimate. For such estimates, we recommend that the standard state that the performance of substantive procedures alone will not be sufficient, except in limited circumstances. In our view, those limited circumstances will not exist within banks. Furthermore, examples of matters the auditor should consider when obtaining an understanding of the internal control framework are needed in the final standard to reinforce how auditors can meet these requirements, including emphasising that obtaining an understanding solely through management inquiry is insufficient. Audit of Disclosures We agree with the position set out in the Explanatory Memorandum to the ED that "disclosures relating to accounting estimates are critical to users' understanding of the accounting policies applied, the nature and extent of estimation uncertainty, key judgments and other matters relating to accounting estimates and more so when estimation uncertainty is high" (paragraph 44). We consider it essential that the auditor's evaluation of management's disclosures as required by ISA 540 be thorough enough to ensure that the disclosures help users to understand the nature and magnitude of the uncertainty affecting the estimates, the degree of complexity and the types of judgment made.

		Please refer to Annex 1 for our detailed comments on the above topics and other aspects of the ED. We have also provided, in Annex 2, the set of principles by which the Committee has been guided in evaluating the ED. These principles are derived from the Committee's March 2014 Guidance on External Audits of Banks. 2. Internal control A robust internal control environment is critical to the strength of an entity's governance system and its ability to manage risk, including the risk of materially misstated accounting estimates. We support the ED Application Material, in paragraphs A48–A60, for auditors to obtain an understanding of internal control over estimates for entities of all sizes, which largely clarifies the interplay between ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment; ISA 330, The Auditor's Responses to Assessed Risks; and ISA 540 (Revised). Our further suggestions include specific guidance on audit considerations and procedures for obtaining an understanding of internal control over estimates and aim to strengthen the link between ISA 315, ISA 330 and ISA 540. We agree with the text in paragraphs A30, A42, A43 and A49 that an entity's system of internal control should be commensurate with the nature, volume and complexity of its activities. A high-quality audit requires an auditor to first assess the risks of material misstatement of the estimate, taking into account the effectiveness of the entity's internal control framework (both design and operating effectiveness of internal control), and then to design audit procedures responsive to the assessed risk. We strongly agree that substantive procedures alone are often not sufficient for certain types of estimates, including estimates of ECL, and are rarely sufficient for banks. 2.1 Obtaining an understanding of internal control over estimates We support the inclusion of paragraph 10(f) in the ED and the related Application Material in paragraphs A48–A60, which require auditors to obtain an understanding of internal control components as part of the risk assessment. ISA 315 contains a number of examples of matters that auditors should consider when obtaining an understanding of an entity's internal control environment. In addition, we recommend including in ISA 540 the following examples of matters to consider when obtaining an understanding of an entity's internal control environment with regard to accounting estimates: (i) Knowledge of the entity's internal control over estimates obtained by the auditor during prior audits and other engagements performed by the auditor, as well as engagements performed by internal audit; (ii) Control deficiencies relevant to accounting estimates previously communicated to those charged with governance or management; (iii) Preliminary judgments about the effectiveness of internal control over financial reporting relevant to estimates; and (iv) The size and relative complexity of the entity's operations in general and the complexity of estimates in particular. Complexity will likely affect the risks of material misstatement and the controls necessary to address those risks. We propose the introduction of additional words (underlined below) to paragraph 15 to establish that an understanding of internal control is important for most audits and that the auditor needs to test controls when substantive procedures alone are not sufficient: • 15(a) - When inherent risk is low, as determined through the auditor's risk assessment procedures, the auditor shall determine whether one or more of the following further audit procedures would provide sufficient appropriate audit evidence regarding the assessed risk(s) of material misstatement in the circumstances.

		• 15(b) When inherent risk is not low, for example, as is the case with accounting estimates that make use of complex models or are highly judgmental, the auditor's further audit procedures shall include procedures to obtain audit evidence about the matters in paragraphs 17–20, when applicable. (Ref: Para A97) • Include at the end of paragraph 15 (before paragraph 16), "The results of the work that the auditor performs as part of their risk assessment procedures, which includes developing an understanding of relevant internal controls, shall inform the approach taken by the auditor to audit the estimate." Within the Application Materials, we recommend changes to describe the audit procedures necessary to obtain an understanding of the internal control over estimates, including for audits of smaller entities. In particular, in paragraph A10, we recommend adding that, in audits of smaller entities, the auditor may obtain an understanding of internal control over accounting estimates by performing walkthroughs. In our view, inquiry alone is not sufficient to obtain an appropriate understanding of internal control over accounting estimates. We are supportive of Application Material paragraph A30, which provides guidance on the factors auditors should consider as part of obtaining an understanding of models. In particular, we agree that additional controls around models are more likely to be relevant to the audit when the model used is complex, such as for ECL models. We recommend that the final standard include the following underlined edits in paragraph A49 to emphasise and clarify the need for the auditor to understand internal control when auditing most entities, and that obtaining an understanding of internal control is not limited to audits of entities with a wide range of estimates. A49. It is important for the auditor to understand the design and implementation of relevant controls to address the risks of material misstatement. This is true for most estimates, but its importance increases as the complexity of an estimate and the risks of material misstatement increase. Some entities may have a wide range of accounting estimates, some of which may be significantly affected by, or subject to, complexity, the need for the use of judgment by management, and estimation uncertainty. In such circumstances, there may be an increased need for the application of specialized skills or knowledge, and management may make extensive use of information technology in making the estimates. For such estimates, it is even more important for the auditor to understand the design and implementation of relevant controls, and also to test their design and operating effectiveness in addressing the assessed risks of material misstatements. We suggest adding a new factor and propose adding the two sentences below to paragraph A58 to emphasise the importance of understanding the precision applied by management in executing controls and whether controls are designed at a sufficiently precise level to prevent or detect a material misstatement on a timely basis: The auditor may consider the level of precision applied by management in executing these control activities. Controls should be designed to operate at a level of precision that would prevent or detect misstatements of one or more assertions regarding estimates. In addition we suggest that the following be added to paragraph A50: To understand the likely sources of potential misstatements and, as a part of selecting controls to test, the auditor may achieve the following objectives: (i) Understand the flow of transactions related to the relevant assertions; (ii) Identify the points within the entity's processes at which a misstatement, including a misstatement due to fraud, could arise;

		(iii) Identify the controls that management has implemented to address these potential misstatements; and (iv) Understand how information technology affects the flow of transactions. 2.2 Testing the design and operating effectiveness of internal control over accounting estimates We support the inclusion of paragraph 16 and the related Application Material in paragraphs A98–A100. However, these paragraphs (including paragraph 8 of ISA 330, which is referenced in the footnote to paragraph 16 of ISA 540) require auditors to test only the operating effectiveness of internal control relating to accounting estimates if auditors intend to rely on controls relating to accounting estimates or if substantive procedures alone cannot provide sufficient appropriate audit evidence. Given the complexity of many accounting estimates and the necessity of implementing appropriate controls from a risk management perspective, it is imperative that the auditor also evaluate the design of controls relating to estimates. Therefore, we urge the IAASB to enhance paragraph 16 by adding the following underlined language to the final standard, which in particular clarifies our expectations for audits of banks. In addition, the audit response should include consideration of control deficiencies identified and an assessment of the impact of such deficiencies on the audit. If the auditor intends to rely on controls relating to accounting estimates, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, as in the case of audits of entities (such as banks) that make extensive use of information technology and have a large number of estimates that are highly judgmental, complex, or subject to high estimation uncertainty, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to their operating effectiveness. The auditor shall test and evaluate the design and operating effectiveness of internal controls related to accounting estimates based on the assessed risk and perform such other procedures as the auditor considers necessary in the circumstances. In addition, the auditor shall evaluate the impact of any deficiencies in internal control on the assessed risk. (Ref: para A98–A100) We support the inclusion of paragraph 25 requiring the auditor to obtain written representations from management stating that they believe the methods, significant data and assumptions used in making the accounting estimates and their related disclosures are appropriate to achieve recognition, measurement and disclosures that are reasonable in the context of the applicable financial reporting framework. We believe the auditor should also obtain written representations from management acknowledging management's responsibility for establishing and maintaining effective internal control over financial reporting and suggest that this requirement be incorporated in the standard. We support the inclusion of paragraph A98, which explains circumstances where it is not possible or practicable for auditors to perform only substantive procedures, such as for banks that make extensive use of information technology and have a large number of estimates that are highly judgmental or complex. We agree that substantive procedures alone may not provide sufficient audit evidence. This will be the case where there is a large volume of transactions, significant information is produced electronically, complex models are used or information is used across systems, which is the case for ECL estimates that integrate the entity's risk management and financial reporting systems. This situation will also arise for reasons that are not principally driven by information technology, such as the nature of the accounting methods being applied. It would be further helpful if paragraph A98 began by providing guidance on those aspects that drive the decision to rely on controls, followed by examples of the limited circumstances that may support relying only on substantive procedures to provide sufficient appropriate audit evidence. 2.3 Auditor's responsibility to report significant deficiencies in internal control We support the inclusion of paragraph 26 which clarifies the application of ISA 260 (Revised), Communication with Those Charged with Governance and ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management, with

		respect to the requirement that auditors report to TCWG on significant deficiencies in internal control, among other matters. Given the nature of accounting estimates and the impact of control deficiencies on estimation uncertainty, we recommend addressing the timing of communicating with management and TCWG. This is especially important for banks that rely heavily on information technology and have complex internal processes. In these cases, early identification and communication of internal control deficiencies provides an opportunity for a bank's management to take steps to remediate the control deficiencies and correct any resulting misstatements on a timely basis. 4. Audit of Disclosures We consider it essential that the auditor's evaluation of management's disclosures, as required by ISA 540, be thorough enough to ensure that the disclosures help users to understand the nature and magnitude of the uncertainty affecting the estimates, the degree of complexity and the types of judgments made. Therefore, we support the alignment of the audit objective for disclosures with the objective for the other aspects of the audit of the related accounting estimate, so that "reasonable" is the benchmark (paragraph 8 of the ED). We are concerned that references to audit considerations on disclosure are dispersed throughout the ISA 540 Requirements and Application Material. For example, guidance on disclosure is addressed in paragraphs (including, but not limited to) A2, A16, A57, A88, A123–125, A136, A137 and A153. This reduces the cohesiveness and understandability of this guidance and could undermine the importance attached to the auditor's responsibilities for disclosures. As such, we recommend that the IAASB bring this guidance together in one place. If this is not possible, we recommend increasing the cross references between the paragraphs noted above. Because of the high degree of judgment involved in making ECL estimates, clear disclosure around where in the range a point estimate is, why the point estimate is appropriate, and what the point estimate is sensitive to, are especially important in assessing the reasonableness of an estimate. We therefore support the change outlined in paragraphs 43–45 of the Explanatory Memorandum to the ED that expands the requirement for auditors to consider disclosures that describe estimation uncertainty when it relates to risks other than just those regarded as significant (paragraph 19a(ii)). We also support the inclusion of paragraph A134 and agree that the auditor's evaluation of the reasonableness of disclosures becomes increasingly important as estimation uncertainty increases. We further recommend paragraph A2, which includes important expectations on disclosures, be included in the standard's Requirements, along with the material in paragraphs A123–A125. The following principles are derived from the Committee's March 2014 Guidance on External audits of banks. Loan loss provisioning is generally material for a bank's financial statements and the calculation of capital and key performance metrics. The measurement of loan loss provisions involves complex judgments which are subjective in nature. 1. External audits of financial statements performed in accordance with the relevant auditing standards should enhance the confidence of all users, including supervisors, in the reliability of the audited financial statements and the quality of the information provided. 2. Commensurate with the size, complexity and diversity of banking activities, and the legal and regulatory framework in which banks operate, the external auditor of a bank should have specialised knowledge and competence in auditing banks. Knowledge and competence are particularly important in an external auditor's ability to exercise professional judgment and carry out key aspects of the audit, such as identifying and assessing the risks of material misstatement and designing and implementing appropriate responses to those risks. 3. The external auditor should exercise professional skepticism when planning and performing the audit of a bank, having due regard to the specific challenges in auditing a bank. Professional skepticism should manifest itself not only through the auditor obtaining

		corroborating evidence for management's assertions, but also challenging management's assertions, considering whether there are alternative accounting treatments that are preferable to those selected by management, and documenting the auditing approach, the evidence obtained, the rationale applied and the conclusions reached. Throughout the audit, the auditor "adopts a questioning approach when considering information and in forming conclusions". 4. External auditors should be satisfied that the bank's system of internal control is commensurate with the nature, volume and complexity of the bank's activities and is organised in accordance with regulatory and legal requirements. The internal control structure of a bank must be robust and reliable in order to cope with stressed environments. 5. ISAs require the external auditor to obtain an understanding of control activities relevant to the audit (those activities necessary to assess the risks of material misstatement and to establish the audit strategy). The external auditor of a bank should identify and assess the risks of material misstatement in the bank's financial statements, taking into consideration the complexities of the bank's activities and the effectiveness of its internal control environment. 6. The external auditor of a bank should respond appropriately to the significant risks of material misstatement in the bank's financial statements.
4.	CEAOB	1. The CEAOB appreciates the opportunity to comment on the IAASB's ("Board") exposure draft on proposed International Standard on Auditing (ISA) 540 Revised – Auditing Accounting Estimates and Related Disclosures, issued in April 2017. 2. As a body of European audit regulators, the CEAOB considers it is important to pursue continuing improvement of standard setting for the audit profession. 3. The content of this letter has been discussed and agreed upon by its members. The comments in this letter reflect matters of consensus within the CEAOB. Nevertheless, the comments hereafter are not intended to include all comments that might be provided by the individual regulators that are members and their respective jurisdictions. General support for revising ISA 540 4. We support the project to revise ISA 540 to foster better audit quality in respect of accounting estimates. The database maintained by the audit regulator members of the CEAOB includes a high number of inspection findings on this topic. We support revisions to the ISAs which have the potential to drive better audit quality and consistency in its application by auditors. 5. The main areas of findings in relation to ISA 540 highlighted in a survey conducted by European audit regulators based on data collected in the European database were (i) insufficient challenge of management assumptions (ii) insufficient audit procedures performed by the auditor and (iii) weaknesses in testing internal control related to preparing accounting estimates. *Support for the balance achieved in the revised standard* We support the efforts of the Board to improve the standard in order to meet the challenges of auditing increasingly complex estimates. We support and encourage the Board's efforts to avoid adding unnecessary requirements and application material to the standard. *Enhancement in the standard through the proposed revisions*

		7. We, in general, believe that several proposals in this exposure draft are steps in the right direction, and can help achieve better quality in the audit of accounting estimates. We support the: a. proposal to adapt the level of work effort required to the level of risk and to the factors inherent to the risk, b. inclusion of a provision (in par. 16 of the proposal) which highlights a requirement stemming from ISA 330, to perform tests of controls to ensure their operating effectiveness before relying on them or when substantive procedures alone are not sufficient, c. inclusion of the "stand back" requirements in par. 22 and 23, which encourage the auditors to take into account all information gathered and to investigate contradictory evidence obtained. 8. We nevertheless recommend to the Board to consider various additional enhancements as mentioned hereafter: *Increased focus on disclosures related to estimates* 11. We support the IAASB's effort to enhance the focus of the auditor on the quality of disclosures provided by the audited entity and agree that disclosures are a key aspect in the audit of accounting estimates. Regarding the proposal to move the objective to check the fact that disclosures are "reasonable" rather than "adequate", we encourage the Board to provide further explanations regarding the notion of "reasonable" compared to the former terminology "adequate" in order to achieve consistency in application. 12 In addition, we believe that the revised ISA should more clearly require the auditor to understand the risks (and internal controls) relating to the preparation of disclosures by management, in addition to the provisions in par. 10(a) and 10(e). Meaning of the notion of outcome of an estimate We encourage the Board to check the consistent use all over the standard of the notion of "outcome of an accounting estimate" which has been defined in the standard (par. 9 f). Further clarity around the meaning of "outcome" in different situations would be useful to drive further consistency in application. Alternative evaluations by management In par. 19(b), we suggest changing the proposed requirement, by integrating an additionalstep, so that the auditor asks the entity's management to provide alternative evaluations before requesting the auditor to develop its own estimate. This would mean elevating the application material described in par. A126 into the requirements. Use of experts In addition to the requirements of par. 12, we believe that it is important to further highlight in the guidance that an involvement of specialized skills might be necessary to inform or confirm the evaluation, by the auditor, of level of estimation uncertainty in cases where only a specialist has the necessary level of understanding of the potential impact of the accounting estimate. Such involvement could either lead to the specialist performing audit procedures but could also end with his involvement in the risk assessment. Impairment indicators

		Par. A22 indicates that the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify, in relation with ISA 315. We believe that missing indicators of impairment, that management failed to identify, should also be referred to in this paragraph, so that the auditor remains alert to any impairment indicators. Weakness in internal control design or operation In addition, we believe that further clarity about the actions to be taken by the auditor when internal control is not appropriately designed or is not operating well, in the context of an accounting estimate, would be welcome. A reference to ISA 330 could be added in this regard. Post implementation We also would like to encourage the Board to perform a post implementation review after implementation of the revisions to evaluate whether the revisions have led to the positive changes expected.
5.	EBA	The EBA welcomes the IAASB efforts at enhancing the requirements for the audit of accounting estimates. Accounting estimates affect most of the components of the financial statements of financial institutions and their importance will increase further in the context of the implementation of the expected credit losses (ECL) requirements of IFRS 9, Financial Instruments (IFRS 9), where accounting estimates are likely to become more complex, require the use of more judgement and be more uncertain compared to the current accounting estimates under incurred loss frameworks. The EBA supports the principles-based approach of the ED, which focuses on the requirements of the audit approach in order to address the risks of material misstatements arising from accounting estimates. This principles-based approach should ensure that the auditor's responses to the risk of material misstatement are effective, avoiding any so called 'bright lines' when audit procedures are prescribed for each reason underlying the assessed risk of material misstatement. However, we believe that the enforceability of the standard could be further improved, among others by improving the application guidance and thus helping auditors to meet the objectives of the ED and by including some of the application guidance of the ED as requirement at standard's- level. The EBA welcomes also the increase in the references in the ED to the audit of internal controls. An appropriate internal control framework will be key to ensuring the reliability and correctness of accounting estimates in general. Having said that, the ED could benefit from placing more emphasis on the importance of the audit of internal controls and making it clear that in the context of the audit of ECL, in most cases, these controls will need to be tested and that substantive procedures alone will not be sufficient. Use of specialised skills or knowledge Paragraph 12 and the related application guidance requires the auditor to determine early in the audit process whether specialised skills or knowledge are necessary to perform the audit engagement. In addition, paragraph 14 of the ED requires the auditor to determine whether specialised skills or knowledge are required in order to respond to the risks of material misstatement related to accounting estimates. We are supportive of these requirements and we also welcome the explicit clarification in paragraph A69 that for the audit of ECL of internationally active banks the auditor is likely to conclude that the use of experts will be necessary. In addition, we suggest that paragraph A69 refers to all banks instead of internationally active banks only as the audit of ECL is likely to be relevant to all banks and hence the auditor is likely to conclude that the use of experts will be necessary. Risk assessment - understanding of regulatory factors

		For regulated entities like banks, more specific regulatory expectations may exist to guide the implementation of financial reporting requirements related to accounting estimates (e.g. EBA's 'Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses 'EBA GL on ECL' issued in May 20174). In such cases, the auditor should take due consideration of the relevant regulatory expectations and should obtain an understanding of how these expectations have been met. We therefore very much support the inclusion of paragraphs 10(b) and A14-A15 referring to regulatory factors as part of the risk assessment, particularly in the context of the audit of banks. On the other hand, in terms of the application of principles-based accounting frameworks where judgement is required, paragraph A15 highlights that regulatory requirements may 'not be consistent' with the requirements of the applicable financial reporting framework, which may indicate 'potential risks of material misstatement'. However, we believe that the example provided in this paragraph does not present the issue in a clear and holistic way and we suggest replacing this example by referring to the valuation rules for accounting and prudential purposes and bringing to the auditor's attention that differences between the objectives in the valuation of financial instruments for prudential and accounting purposes may exist and which can lead to different requirements and inputs used for each of them. In addition, we suggest changing the text of paragraph A15 by replacing 'not consistent' with 'not fully aligned', and 'potential risks of material misstatement' with 'bias' as the objectives of regulatory and accounting requirements have both similarities and differences. Risk assessment - understanding of how management makes accounting estimates Methods used to develop accounting estimates As also indicated in the EBA GL on ECL6, the use of (temporary) adjustments to model results, often referred to as 'overlays', requires the application of significant judgement and creates the potential for bias. Therefore, it is important that the auditor pays particular attention to such adjustments applied by management and challenges their appropriateness with regard to the financial reporting requirements. In this sense, we agree with the application guidance provided in A26-A31 and with the explicit reference in A30 for the auditor to consider whether adjustments are made to the output of models used. But to give the related audit requirements in the application guidance more prominence, we suggest that besides paragraph 18(c) on the auditor's responses to the assessed risks of material misstatement, overlays are also mentioned in the main text of the standard in the risk assessment procedures of the auditor in paragraph 10 (e)(i). In addition, the ED already recognises in A54 that those charged with governance have a strong role to play where accounting estimates require significant judgement, have high estimation uncertainty or are complex to make. We believe that the list of factors under A54 should be extended to include as an additional factor the use of overlays by management, together with a link to A30. Significant data We note that the definition of 'significant data' is included in A35. We therefore suggest a reference to paragraph A35 is included in paragraph 10 (e)(iii). Internal controls We welcome that the ED requires the auditor to obtain an understanding of the design and implementation of internal controls as they relate to making accounting estimates. An appropriate internal control framework will be key in ensuring the reliability and correctness of accounting estimates in general, by virtue of their inherent characteristics. The more judgement, estimation uncertainty and complexity is involved in the determination of accounting estimates, the greater the need will be for robust governance procedures and a strong control framework. ECL accounting estimates for the financial statements of a bank

		are in our view a key example of an area where effectively operating internal controls will be of particular importance. Therefore, we expect that in the case of ECL, the effectiveness of controls is more likely to be subject to audit. Having said that, we suggest to explicitly mention this in paragraph 16 and that for the audit of ECL, the relevant controls are likely to be tested while substantive procedures alone will not be sufficient. Alternatively, paragraph A98 could be moved from the application guidance to the main text of the standard to supplement paragraph 16. Other comments The EBA notes that the audit of accounting estimates has been a recurring finding in audit inspections, particularly for financial institutions. In this regard, the EBA supports the continued engagement by the IAASB with the International Forum of Independent Audit Regulators (IFIAR) and Committee of European Auditing Oversight Bodies (CEAOB) to enhance the enforceability and effectiveness of the revised ISA 540. The EBA supports the proportionate approach in the ED regarding the application of the requirements which aims to meet the objectives of the ISA 540 without undue cost and effort through the introduction of additional application material with considerations specific to smaller entities. These proposals are mainly in the form of reducing the requirements in the case of the audit of smaller entities. However, considering that the audit of smaller entities includes different challenges to the audit of larger ones, we would welcome specific guidance in the ED in this respect. In addition, the EBA agrees that both the accounting estimates and the disclosures around them are important and supports auditors obtaining audit evidence to assess whether disclosures are reasonable in the context of the applicable financial reporting framework (paragraph 19 of the ED). We also suggest that the ED emphasises further the importance of complete and focused disclosures, which should be subject to appropriate audit procedures, by moving some of the application guidance in A120-A122 into the main requirements of the standard. We welcome the guidance in the ED on the audit of financial instruments in inactive or illiquid markets in paragraphs A36-38, which has been frequently requested in the past as it is an area of concern from a prudential perspective. We would suggest that the ED is further amended to refer to the audit work related to the disclosures for those financial instruments in inactive or illiquid markets, as it is expected that the relevant accounting estimates for these financial instruments will be accompanied by certain disclosures and auditors would need to perform additional audit procedures in this respect. Finally, we welcome the reference in paragraph A157 of the ED regarding the usefulness of the communication between supervisors, regulators and auditors during the audit, which is also consistent with the EBA Guidelines on the communication between competent authorities and auditors7. We would suggest also that this paragraph is strengthened by encouraging auditors to initiate communication directly with the supervisors and regulators and where permitted to share information about the audited bank which is relevant to their respective functions. The EBA welcomes the IAASB efforts at enhancing the requirements for the audit of accounting estimates. Accounting estimates affect most of the components of the financial statements of financial institutions and their importance will increase further in the context of the implementation of the expected credit losses (ECL) requirements of IFRS 9, Financial Instruments (IFRS 9), where accounting estimates are likely to become more complex, require the use of more judgement and be more uncertain compared to the current accounting estimates under incurred loss frameworks.

		The EBA urges the IAASB to finalise the ED as soon as possible and in a way that delivers a high quality auditing standard. Understanding that the final standard will not be available at the time of initial application of IFRS 9, we encourage the IAASB to promote early adoption of the standard where it believes it to be practicable for auditors. Timely publication of the revised ISA 540 will help to enable early adoption. The EBA supports the principles-based approach of the ED, which focuses on the requirements of the audit approach in order to address the risks of material misstatements arising from accounting estimates. This principles-based approach should ensure that the auditor's responses to the risk of material misstatement are effective, avoiding any so called 'bright lines' when audit procedures are prescribed for each reason underlying the assessed risk of material misstatement. However, we believe that the enforceability of the standard could be further improved, among others by improving the application guidance and thus helping auditors to meet the objectives of the ED and by including some of the application guidance of the ED as requirement at standard's- level. In addition, although we recognise that a Professional Skepticism Working Group1 has been established by the IAASB, we believe that professional skepticism should also be addressed in the revised ISA 540 as we consider that professional scepticism should underpin the performance of an audit at all times and it is key in ensuring high quality audit of ECL. We also believe that the ED could include stronger requirements on auditors to challenge management and to obtain specific audit documentation to demonstrate how they have exercised professional scepticism in their audit of accounting estimates. The EBA welcomes also the increase in the references in the ED to the audit of internal controls. An appropriate internal control framework will be key to ensuring the reliability and correctness of accounting estimates in general. Having said that, the ED could benefit from placing more emphasis on the importance of the audit of internal controls and making it clear that in the context of the audit of ECL, in most cases, these controls will need to be tested and that substantive procedures alone will not be sufficient. In this regard, as part of the audit of internal controls and other audit procedures to be performed, we support the requirement in the ED for the auditors to develop their own point estimate or range for other than low risk estimates to evaluate the reasonableness of management's point estimate, and the related disclosures in the financial statements, when possible and appropriate. However, we understand that in the context of the audit of ECL which may include complex models and several assumptions, auditors may not always be able to develop an independent point estimate or range. Therefore, the ED could include more guidance on the circumstances (and criteria) under which the auditors should develop their own point estimate or range and an additional step of requiring auditors to first request management to consider alternative assumptions or to provide additional disclosures related to the estimation uncertainty before requesting auditors to develop their own estimates. Finally, we also suggest that some of the elements of the ED could be strengthened and further clarified. In particular, with regards to the auditor's response to the risk of material misstatement, it is important that more guidance is provided on how the outcome of the use of an auditor's own range or point estimate interacts with the level of the materiality applied in the audit and how this may be reflected in the audit report.
6.	ESMA	ESMA is of the view that the ED can be improved regarding the balance between the requirements and the application guidance, which do not have the same authoritative status. We are of the view that part of the application guidance should be transformed into binding requirements in order to ensure that the relevant provisions can be applied and enforced consistently. At the same time, ESMA is of the view that the application guidance should be as clear and concise as possible and therefore should avoid to the extent possible unnecessary repetition. Examples of both type of provisions are included in the Appendix to this letter.

Furthermore, ESMA would like to highlight a number of areas where further development of the auditing framework is necessary to ensure proper audit of accounting estimates, notably from an investor protection perspective:

- application of professional scepticism
- assessment and evaluation of management bias
- testing of effectiveness of internal controls
- response to the risk of material misstatement
- audit documentation
- interaction with key audit matters.

ESMA welcomes the IAASB's efforts to address in the ED the consequences of the evolution of the financial reporting framework on the audit of accounting estimates. ESMA has previously argued that the IAASB should address the relevant application issues in relation to the audit of accounting estimates. Over the last decade, financial reporting frameworks have progressively increased the importance of unbiased, comprehensive and clear disclosures on assumptions and judgments made by management when developing accounting estimates. Furthermore, ESMA notes that the recent accounting standards such as IFRS 9 Financial Instruments and IFRS 17 Insurance Contracts increase significantly the use of, and the reliance on management judgement when making accounting estimates, often requiring long forecast periods and reliance on complex modelling.

Consequently, ESMA strongly believes that audit standard setters need to consider these developments and ensure comprehensive and rigorous audit requirements for accounting estimates and the underlying judgements made by management. Furthermore, ISA 540 (Revised) should include requirements on audit of disclosures on these estimates and judgements as well as on appropriate documentation of the audit procedures performed. ESMA believes that the requirements of the ED represent an important step into the right direction and have the potential to improve audit quality. However, ESMA is of the view that ISA 540 (Revised) should include specific provisions on audit of selected accounting estimates, such as those made when auditing expected credit losses (ECL), fair value measurement or goodwill impairment. With respect to the newly introduced ECL model, ESMA calls on the IAASB to scrutinise carefully issues arising from auditing of the new ECL model, and, if necessary, provide additional guidance on a timely basis as a matter of priority. Detailed scrutiny is especially relevant for the implementation and auditing of complex ECL models, e.g. in the financial sector.

ESMA is of the view that the ED can be improved regarding the balance between the requirements and the application guidance, which do not have the same authoritative status. We are of the view that part of the application guidance should be transformed into binding requirements in order to ensure that the relevant provisions can be applied and enforced consistently. At the same time, ESMA is of the view that the application guidance should be as clear and concise as possible and therefore should avoid to the extent possible unnecessary repetition. Examples of both type of provisions are included in the Appendix to this letter.

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- application of professional scepticism
- assessment and evaluation of management bias

		• testing of effectiveness of internal controls • response to the risk of material misstatement • audit documentation • interaction with key audit matters. Finally, ESMA would like to ask the IAASB to finalise the revised standard on auditing of accounting estimates on a timely basis. In our view, the IAASB should enable and promote early application of the standard after its publication and facilitate the audit of ECL requirements, which are applicable from 1 January 2018. Details on our suggestions where the framework for audit of accounting estimates could be further developed, together with our comments on some of the questions from the ED are set out in the Appendix to this letter Management bias ESMA welcomes that the discussion on the risk of management bias when auditing accounting estimates is included in the application guidance. As we believe that the risk of management bias related to accounting estimates should be embedded into the auditors' work during the whole audit process, we believe that the result of the assessment and evaluation of the management bias should be included in the on-going communication with those charged with governance. Furthermore, where appropriate, due to significant risk of material misstatement, results of such evaluation should be included as a key audit matter in the auditor's report. Consequently, we are of the view that the notion of management bias should be incorporated throughout ISA 540 (Revised). This could be done e.g. through clarification that the definition of reasonable in paragraph A2 of the ED should include an attribute being "free from bias", specifying that assumptions, as referred to in paragraph A32 of the ED, should be "free from bias" and including evaluation of management bias as one of the consideration required in paragraph A33 of the ED. Furthermore, ESMA believes that the guidance on the assessment of management bias in paragraph A7 of the ED should be explicitly linked to the assessment of the outcome of an accounting estimate. Finally, ESMA is of the view that the ED could include additional examples on specific considerations pertinent to the evaluation of the management bias linked to auditing accounting estimates, e.g. related to ECL models, recognition and measurement of deferred taxes as well as goodwill impairment Risk assessment (Q4-Q6 of the Request for comments) 20. The ED proposes a different risk model for risk assessment related to audit of accounting estimates compared to extant ISA 315. While ISA 315 broadly distinguishes between significant and non-significant risks, the ED acknowledges low inherent risk and non-low inherent risk in addition to significant risk. In our view, the ED does not describe and explain clearly and unequivocally (i) the risk level not being low and (ii) significant risk(s) and does not explain the relation between them. Consequently, ESMA encourages the IAASB to clarify further the risk model in the ED and its relation to the existing requirements of ISA 315. 21. ESMA agrees with the proposed risk assessment procedures and related activities in paragraph 10 of the ED. However, ESMA believes that the IAASB should consider that understanding of risk and related internal control related to (i) the preparation of accounting estimates and related disclosures by management as required by the respective financial reporting framework and (ii) the completeness of the estimates made by management should be explicitly considered as part of the understanding of the entity and its environment.

		22. ESMA emphasises the importance of using specialised skills when auditing accounting estimates, notably when those estimates rely on complex modelling. Therefore, we welcome the requirement that the auditor needs to determine early in the audit process whether specialised skills or knowledge are required, in order to perform the risk assessment procedures, or to identify and assess the risks of material misstatement. However, we are of the view, that the importance of the use of specialised skills and knowledge should be highlighted in all phases of the audit of accounting estimates not only as part of the risk assessment. Use of specialised skills might be indispensable also during the planning stage, during performing testing of controls or substantive testing, notably in complex environment. Testing of effectiveness of internal controls (Q4 and Q6 of the Request for comments) 24. ESMA welcomes the application guidance in the ED on the testing of effectiveness of internal controls over the accounting estimates and over the process of their preparation. In order to ensure that the auditors are required to test internal controls over the ECL in all appropriate circumstances (such as for financial institutions), guidance currently proposed for paragraph A98 should be further expanded and incorporated in the requirements section of the standard. 25. ESMA also believes that the importance of the testing of internal controls over the accounting estimates should be highlighted when performing procedures related to risk assessment and responses to the assessed risk of material misstatement. In reference to the latter, ESMA suggests that the relevant guidance in paragraphs A48-A60 of the ED related to auditor obtaining an understanding of internal controls (paragraph 10(f) of the ED) could be linked and emphasised in the requirements related to the auditor responses to the assessed risk of material misstatement (notably to paragraph 16 of the ED). Audit documentation 32. ESMA is disappointed that the requirements related to the documentation of the auditing of accounting estimates do not seem to be sufficiently developed in the ED. ESMA is of the view that it would be appropriate to expand and define the documentation requirements included in the paragraph 27 of the ED as well as cross-refer them to the requirements of paragraphs 8 and A10 of ISA 230 - Audit Documentation. While ESMA does not support repetition of the requirements of other auditing standards, ESMA is of the view that the IAASB should consider transforming the relevant part of the application guidance specifically related to documentation of the audit of accounting estimates currently included in paragraph A158 into requirements within paragraph 27 of the ED. 33. We are of the view that estimation uncertainty, use of judgement and complexity of accounting estimates warrant additional documentation of the work of the auditors in this area than currently proposed by the ED. While we agree with the general intention of paragraph 27 of the ED, ESMA is concerned that the requirement of paragraph 27(a) of the ED is not sufficiently specific to ensure documentation of all substantial judgements and procedures when auditing this complex and judgemental area of financial reporting. 34. Therefore, ESMA suggests that the auditor should be required to document, with regards to all significant accounting estimates, as a minimum: a. the basis for the auditor's conclusions on the reasonableness of areas of subjective judgement (as included in paragraph 27(a) of the ED); b. assessment and evaluation of the accounting estimates, including their specific risk factors; c. significant judgements made by the auditor when assessing the accounting estimates;

		d. how professional scepticism in auditing accounting estimates was ensured; and e. assessment and evaluation of the factors driving potential risks related to the accounting estimates. ESMA is of the view that specific requirements for audit documentation of accounting estimates in ISA 540 (Revised) would specify the generic requirements in paragraph 32 of ISA 315. 35. Finally, ESMA notes that the documentation requirements should be extended by specific requirements related to the documentation of the identification and assessment of the risk of material misstatement in relation to the accounting estimates by the auditor. This is because in our view, the reference to ISA 315 in paragraph 13 of the ED seems to be overly restrictive and might not capture documenting auditors' identification and assessment of the individual relevant factors, which the accounting estimate is subject to. In our view, such documentation requirement is even more relevant when the auditor assesses the inherent risk of misstatement as low. Key audit matters 36. ESMA appreciates the reference to the link between certain aspects of the audit of accounting estimates related to estimation uncertainty and the key audit matters in paragraph A125 of the ED. However, ESMA strongly believes that the interaction between the audit of accounting estimates (and notably the auditor work on assessment of its elements of estimation uncertainty, management judgement and complexity) and key audit matters should be further developed in the requirements section of ISA 540 (Revised). Disclosures 37. ESMA welcomes the requirements of paragraph 21 on the audit of disclosures related to accounting estimates. ESMA highly appreciates the requirements of paragraph 21(a) and strongly supports the requirement that the auditor should evaluate whether the management has provided all the disclosures that not only meet the objective of the disclosure requirements but also ensure fair presentation of the financial statements as a whole. However, ESMA is of the view that this requirement could be better explained (e.g. by building on the description provided in paragraph A120 that seems to be more clear and explicit as the requirements) and further exemplified in the application guidance. Other comments 39. ESMA is of the view that paragraph 3(c)(ii) of the ED should be split into two separate considerations one focusing on management point estimate and one on disclosure. In our view it remains unclear why the IAASB decided to combine these two factors, as the susceptibility to misstatement with respect to estimation uncertainty may increase because of each these factors independently. 40. The term "outcome" defined in paragraph 9(f) of the ED should be used consistently throughout the standard. In this respect, the IAASB should distinguish whether the term outcome refers to the ultimate cash flows resulting from the estimate or to the final calculation of the amount, which was estimated. 41. While ESMA accepts the use of the term "reasonable" for the audit of disclosures related to accounting estimates for the reasons included in paragraph 11 of the explanatory memorandum to ISA 540 (Revised), ESMA is of the view that the explanation of the term in relation to the audit of disclosures should be included directly in ISA 540 (Revised).
7.	**IAIS**	Overall, the IAIS believes the revisions will improve the requirements and guidance for the audit of accounting estimates, including estimates of insurance contract liabilities, and that it is an important step in the right direction with respect to the overall objective of enhancing audit quality in the public interest.

8.	**IFIAR**	3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all, of the members of IFIAR. However, the comments are not intended to include, or reflect, all of the views that might be provided by individual members on behalf of their respective organisation. 4. Where we did not comment on certain specific matters this should not be interpreted as either approval or disapproval by IFIAR. 5. We support a holistic revision of ISA 540. Auditing accounting estimates is an area of recurring inspection findings across jurisdictions. The recent IFIAR inspection survey1 continues to indicate that the most pervasive inspection finding within engagement performance relates to the audit of accounting estimates. The survey findings point to difficulty auditors face when assessing the reasonableness of assumptions, performing sufficient risk assessment procedures, testing the accuracy of data used, or taking relevant variables into account in the audit of accounting estimates. 7. The ED emphasizes the importance of risk assessment being performed by auditors and moves away from the concept of additional procedures to be performed only in the event of a significant risk. We support this approach and believe it is likely to lead to a more appropriate audit response being developed, even if further clarifications still would be helpful in this regard (see following paragraphs). 8. We support the inclusion in the ED of paragraph 16 that echoes the requirement of ISA 330, paragraph 8 on the need to test internal controls when the auditor intends to rely on those internal controls or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. We believe this will raise auditor awareness of the requirement to consider the importance of internal controls in designing an audit response. Risk assessment 10. The inherent risk assessment is a key element in the determination of the work effort to be performed in the audit of the estimates. As mentioned in paragraph 7 of this letter, we support the focus placed on an improved risk assessment regarding the audit of accounting estimates. We nevertheless believe the relationship, if any, between the different types of risk factors and the risk levels used in the ED should be further explained in the standard. 11. There is a need to further align and revise provisions of the extant ISA 315 dealing with risk assessment to ensure a proper understanding of how to assess low inherent, non-low inherent and significant risks in order to ensure consistency in application by auditors. Terminology 19. We note that the ED requires the auditor to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework. However, as acknowledged in the Explanatory Memorandum to ED, ISA 700 uses the terms “appropriate” and “adequate”, not “reasonable”, in relation to disclosures. We have concerns about how the inconsistencies in terminology would be applied in practice and encourage the IAASB to give this further consideration. Need for post-implementation review 23. We encourage the IAASB, following completion of this project, to gather stakeholder input via a post-implementation review in order to assess whether the changes have achieved the desired effects (e.g. whether the goals have been met and whether some challenges remain).

9.	**IOSCO**	Overall Comments We support the Board's efforts to improve the requirements and guidance for auditors in auditing accounting estimates and related disclosures. In this letter, we have identified instances where we believe the final standard could be improved. We are disappointed that the ED does not address key issues with the extant standard and that the testing objectives required to be met are unclear. We believe it is important that the matters outlined in this letter are addressed in the final standard. However, if the Board decides to proceed with a standard without dealing with the key matters that are outlined in the following three sections of this letter, we believe the Board should give priority to follow up projects to address the matters we discuss later in • “Sampling, identification of differences to investigate and evaluate errors”; • “Use of the auditor’s own experts”; and • “Specific guidance on financial instrument valuation and related areas”. We believe it is important that, as a minimum, all other matters outlined in this letter should be addressed in the final standard. Sampling, identification of differences to investigate and evaluating errors We are concerned that the ED does not address key methodology issues in testing estimates such as values of financial instruments. We believe that the Board should give priority to a further project to develop additional guidance in this area. While some of these issues might be also relevant to a project on data analytics, they should not be delayed pending such a project. While sampling and error evaluation should be addressed more generally, there are specific issues for estimates such as the valuation of financial instruments that require the Board’s attention. Examples of those issues are discussed in the next several paragraphs. We believe that ISA 530 Audit Sampling does not provide sufficient requirements or guidance to address these matters. Where an auditor develops his or her own estimate to test the values of financial instruments in a portfolio, guidance is needed for setting sample sizes, setting thresholds for investigating differences, reviewing and investigating differences, identifying errors, and extrapolating and evaluating errors. For example, while paragraph A128 of the ED refers to ISA 520 Analytical Procedures in setting point estimates and ranges, the guidance on determining which differences do not require investigation in paragraph A16 of that standard is too general and is not sufficient to promote consistent application by auditors in practice. ISA 520 does not address fundamental questions such as: (i) how to set thresholds having regard to materiality, the precision required and the nature of the population; (ii) whether to address assessed risks by seeking greater precision in setting thresholds; and (iii) how to set thresholds for disaggregated populations. There is a risk that the auditor sets thresholds that are large enough to allow for differences caused by the auditor using different pricing sources from those used by management, rather than setting thresholds for the precision required. Similarly, if the auditor attributes differences identified to using different pricing sources, this would defeat the purpose of testing client values by using different pricing sources. For example, where an auditor is unable to find a suitable pricing source to capture inputs in the same time zone or on the same date as used for valuation by management, it would not be appropriate to compensate by increasing the acceptable thresholds to allow for the volatility in inputs or values over time, rather than focusing on the level of precision required.

		To address issues in practice, the standard should specifically state that it is not appropriate to set thresholds based on tolerable differences in individual inputs (e.g. point differences in interest rates) without also quantifying and evaluating how those tolerable differences would impact point estimates and ranges used by the auditor to evaluate amounts in the financial statements. Auditors may also be uncertain as to how to extrapolate and evaluate errors. This may include cases where values of an instrument recorded in the financial statements could be positive or negative (e.g. interest rate swaps) and errors identified from sample selections could be in opposite directions. This matter is not addressed in ISA 520 or in ISA 530. If these matters are not dealt with in the revised ISA 540, they should be given high priority in a separate project. Evidence to support an estimate and disclosures Paragraph 19(a)(ii) of the ED says that the auditor's evaluation of whether an accounting estimate, and related disclosures, are reasonable in the context of the applicable financial reporting framework includes obtaining sufficient appropriate audit evidence to support the reasonableness of management's conclusions. To the extent the auditor is unable to obtain sufficient appropriate audit evidence, there should be application guidance on potential impacts to the audit opinion and whether reporting the matter to those charged with governance is necessary. Given practice issues noted by some members, we believe that it is important to remind the auditor to consider the impact on their opinion in ISA 540 rather than to rely on the general requirements in paragraph 17 of ISA 700 Forming an Opinion and Reporting on Financial Statements. Specific guidance on financial instrument valuation and related areas The project to develop a revised ISA 540 was originally intended to result in guidance on auditing financial instrument values and loan loss provisioning under the expected credit loss model. While there is some guidance in the proposed amendments to ISA 500, the ED does not contain specific requirements or guidance in these areas. We appreciate the imperative to issue a revised version of ISA 540 before IFRS 9 Financial Instruments is in effect for years commencing on or after 1 January 2018, and that the ED provides high level requirements and guidance for audit work across a broad range of accounting estimates. However, we believe it is important to provide specific guidance on the audit of accounting estimates in areas such as financial instrument valuation, loan loss provisioning under an expected loss model, impairment of non-financial assets, tax balances, and valuation of insurance policy liabilities. We encourage the Board to provide supplemental guidance in these areas as a high priority after the release of the revised ISA 540. Stand back provisions The stand back provisions in paragraph 22 currently only refer to paragraphs 17 to 19 relating to situations where risk has been assessed as 'not low'. The stand back provisions should apply whether risk is assessed as 'low' or 'not low'. It is important to review whether the risk assessment at the assertion level remains appropriate when the assessment was 'low' given that the nature and extent of work may have been insufficient (paragraph 22(a)). It is also relevant to assess whether sufficient audit evidence has been obtained (paragraph 22(b)) and to review management's decisions under the reporting framework (paragraph 22(c)) even where risk was assessed as low. The stand back provisions in paragraph 22(a) should also require the auditor to reassess the appropriateness of any reliance on controls, and the effect of any changed assessment on the nature, timing and extent of audit procedures.

		Paragraph 23 requires the auditor to consider all relevant audit evidence obtained whether "corroborative or contradictory" when evaluating whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework. While recognizing that paragraph 22(b) would require the auditor to evaluate whether sufficient and appropriate audit evidence has been obtained, paragraph 23 should be amended to focus on whether the auditor has exercised sufficient professional skepticism. Professional skepticism involves challenging management's estimates and assumptions, rather than mere corroboration. The auditor should consider whether to obtain more evidence to challenge rather than corroborate accounting estimates and related disclosures, and whether the auditor has sufficiently challenged the accounting estimates. This is in addition to considering contradictory evidence. For example, the auditor might benchmark assumptions against other entities in the industry, consider legislative changes that affect future cash flows, or have regard to whether asset values are consistent with the entity's market capitalization. Documentation Paragraph 27 would require, among other matters, documentation of the auditor's evaluation of the reasonableness of the accounting estimates and related disclosures and indicators of possible management bias. Despite the general nature of this requirement, it does not capture other important matters that we believe should be documented. Given that the revised ISA 315 on risk assessment has been delayed, the revised ISA 540 should specifically require documentation on the process for assessment and classification of inherent risk ('low' or 'not low'), the reasons for that classification and responses to the assessed risks of material misstatement. Further, where an accounting estimate involves the use of complex models (e.g. impairment testing of non-financial assets), the auditor should retain a copy of management's model and any model prepared by the auditor or their expert in a readily reviewable format (e.g. Excel) to enable another experienced auditor having no previous connections with the audit, to understand the model and how it works, the work performed and the reasons for the conclusions reached. However, the Board may need to provide guidance to address the impact of proprietary models. Where there are a large number of complex valuation models for different items (e.g. life insurance policy liabilities or financial instruments), the auditor should perform testing using his or her own independent models, or clearly document management's models tested and the testing performed. Reference should also be made to the general requirements in ISA 230 Audit Documentation. Definitions The Board should provide further clarification on the following definitions: • Accounting estimate: Paragraph 9(a) includes the term 'monetary amount.' It is not clear whether this encompasses an estimate of zero and whether it includes disclosures of non-monetary amounts. • Fair presentation framework and compliance framework: These terms are used in paragraph 21 and should be cross referred to the definitions in ISA 200 Overall Objective of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.
10.	IRBA	General comments 1. The IRBA welcomes the IAASB's holistic revision of ISA 540, through its issue for comment on ED-540, for the following reasons:

		a. Globally, through the International Forum of Independent Audit Regulators (IFIAR), and in South Africa inspection findings relating to the audit of accounting estimates remain one of the key inspection findings on the inspection of individual audit engagement files; and b. The increasing complexity of financial reporting standards, for example, the recent issue of International Financial Reporting Standard (IFRS) 9, Financial Instruments. 2. There are several matters discussed in the "request for specific comments and responses" and "other matters" sections below that the IRBA would like to bring to the IAASB's attention where ED-540 could be further strengthened. This strengthening is necessary to close the gap between the proposals and need to address shortcomings in audit quality in the audit of accounting estimates. We see this as an important opportunity for the IAASB to be alert to the potential that a suitable ED-540 could have on audit practice. This would be a missed opportunity and would further widen the expectation gap between users and auditors if the IAASB falls short in its efforts to enhance extant ISA 540. 3. We also request that the IAASB be alert to feedback received from the pilot testing of ED-540 and comments received from practitioners about how ED-540 can be practically implemented. Other matters Documentation 32. Audit documentation that meets the requirements of ISA 230 and the specific documentation requirements of other relevant ISAs provides: a. Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and b. Evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements. 33. Despite the purpose of audit documentation described in paragraph 32 above, the lack of preparation of sufficient audit documentation is a key inspection finding in South Africa . 34. As such, despite the audit documentation requirements set out in ISA 230, ED-540 documentation requirements should be enhanced, as follows: a. Paragraph 1 of ED-540 should include ISA 230 as one of the standards ED-540 expands upon. (Refer to the "editorial comments" section below.) b. Paragraph A158 of ED-540 should be elevated and included as a requirement of the standard. In addition, paragraph A158 should be re-constructed as part of the requirements to clearly articulate that the auditor shall document (refer to the "editorial comments" section below): … iv. The auditor's judgments about the assessed risk of material misstatement related to accounting estimates, and the auditor's response;

		v. Procedures performed to address matters in paragraphs 17-21, including the auditor's judgment about management's selection of methods, significant data and significant assumptions; vi. The overall evaluation required by paragraphs 22-23; vii. Communications with those charged with governance and management; and viii. Professional judgments on the basis for the auditor's evaluation of whether accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework. c. More specifically, incorporating or referencing the relevant documentation requirements contained in ISA 315 (Revised) and ISA 330 . 35. In addition, the last three sentences of paragraph A10 of ED-540 should be moved to the application material on documentation. (Refer to the "editorial comments" section below.) 36. A few technical and lead partners of banks from firms also commented on documentation where they suggested that more guidance be provided on documentation, especially as it relates to the audit of the expected credit loss model used in developing impairment provisions. 37. A key consideration of the IAASB in considering this input must be the heavily increased requirements introduced in this standard, and the ability of the audit file to stand up to scrutiny by internal and external inspections. It would be contrary to the objective of the standard, and the goals of the IAASB to enhance quality, if auditors perform the work, but are unable to demonstrate through documented evidence that such work has been performed. A spike in unsatisfactory external inspection findings, beyond the current high level, is unsustainable, and will serve to undermine the public confidence in the audit. Stand-back requirement, paragraph 22 38. ED-540 recognises in paragraph A78 that there may be other relevant factors that the auditor may consider in identifying and assessing the risks of material misstatement other than the three relevant factors identified in paragraph 13. 39. Paragraph 22 of ED-540 requires the auditor, for each accounting estimate for which the auditor's further audit procedures were required, to address the matters in paragraphs 17-19 to evaluate certain matters set out therein. 40. As such, paragraph 22 of ED-540 appears to only require the auditor to evaluate certain matters in relation to the further audit procedures performed on each accounting estimate that is subject to, or affected by, one or more of the three relevant factors. 41. Paragraph 22 of ED-540 should be enhanced to require the auditor to evaluate certain matters in relation to the further audit procedures performed on each accounting estimate in response to any other relevant factor identified by the auditor. 42. In addition, paragraph 20 forms part of the work-effort that the auditor performs in response to the assessed risk of material misstatement and therefore should be referred to in the first sentence of paragraph 22 along with paragraphs 17-19 that are already referenced. Likewise, paragraph A139 should also make reference to paragraphs 17-20. Communication with regulators or prudential supervisors

		43. We support the inclusion of paragraph A157 in ED-540, which recognises that direct communication with regulators or prudential supervisors may be permitted or required. Communication between auditors and regulators or prudential supervisors, particularly in the banking industry, is especially important and useful.
11.	UKFRC	The emphasis on determining whether specialised skills or knowledge are required and the extension from the current requirement to include this in relation to the identification and assessment of the risks of material misstatement. We believe that the proposals could be further enhanced in a number of important respects, including in particular: We note that the IAASB has invited auditors to participate in field testing of the proposals. We commend this as practical experience can provide helpful insights. We highlight that there may be limitations in the effectiveness of such testing. For example, some of the new accounting requirements that the proposed revisions to ISA 540 are intended to help address have yet to come into effect. As a result auditable examples may not exist. Such field tests will be performed by auditors in isolation from other stakeholders'. Accordingly, any difficulties identified in the feedback from auditors should be explored very carefully and any changes made in response should have regard to the public interest by following appropriate due process and having regard to other stakeholders' views. Inconsistency with ISA 700 The Explanatory Memorandum notes a degree of inconsistency with ISA 700 that will result from the change to 'reasonable' from 'adequate' for disclosures and suggests that this can be addressed during the post-implementation review of the auditor reporting standards. We believe such inconsistency is unhelpful and confusing and it is not appropriate to wait, potentially several years, to address it through revision of ISA 700, which may follow the post-implementation review of that standard. We recommend that the inconsistency is addressed as part of the finalisation of the revision of ISA 540 by making conforming amendments to ISA 700 at that time. In particular, it is important to amend paragraph 13(e) of ISA 700 to the effect that the auditor is required to evaluate whether disclosures are 'reasonable' rather than 'adequate'. As noted in the Explanatory Memorandum, continuing to use 'adequate' may inappropriately suggest that disclosures are less important than the accounting estimates themselves. Risk assessment procedures Paragraph 10(c) requires the auditor to obtain an understanding of "the nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements." Related application material in paragraph A17 refers to how this may assist in understanding the three specific qualitative inherent risk factors given most prominence in the ED, but within the requirements those factors are not referred to until paragraph 13. We recommend that a requirement is added to paragraph 10 to obtain a sufficient understanding of the extent to which making the estimates would be subject to, or affected by, the inherent risk factors, including the three given most prominence. This would help set up paragraph 13 which, in effect, requires taking such an understanding into account when identifying and assessing the risk of material misstatement. One way to achieve this would be to move points (a) to (c) of paragraph 13 to be sub-points of paragraph 10(c), and shorten the references to the factors in paragraph 13. Review of outcome of previous accounting estimates Paragraph 11 of the ED requires the auditor to review the outcome of accounting estimates included in the previous period financial statements or, where applicable, their subsequent re-estimation to assist in identifying and assessing the risk of material misstatements in

		the current period. The related application material in paragraph A62 identifies that a retrospective review may also be performed for accounting estimates made over several periods or a shorter period (such as half-yearly). We believe that, as recognised by the application material, reviewing the outcome of previous accounting estimates other than those just in the previous accounting period can help provide a better understanding of management's effectiveness in making accounting estimates. This is particularly relevant for estimates that involve judgments and projections extending more than one year (e.g. the outcome of management's credit loss projections over a cycle). Accordingly, we recommend that the requirement should be amended along the following lines: "The auditor shall review the outcome of previous accounting estimates included in the previous period financial statements, or, where applicable, their subsequent re-estimation, when it will assist in identifying and assessing the risk of material misstatement in the current period. The auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review. The review is not intended to call into question judgments about previous period accounting estimates that were appropriate based on the information available at the time they were made." In relation to some accounting estimates, paragraph A65 of the ED clarifies that the estimate itself will not have an outcome. We recommend that this guidance is extended to explain that while this may be the case for the overall estimate, some of the valuation attributes used in making the estimate may nonetheless have an outcome that can be reviewed. For example a Level 3 fair value could be based on a Level 3 input such as a projected cash flow derived from an asset or liability, and that cash flow may have an output that can be back-tested in subsequent periods. Specialised skills or knowledge Paragraph 12 requires the auditor to "determine whether specialised skills or knowledge are required, in order to perform the risk assessment procedures, or to identify and assess the risks of material misstatement." Saying "or to" identify and assess the risks of material misstatement may imply that risk assessment procedures are separate from identification and assessment of risk, whereas they are related as defined in ISA 315 (paragraph 4(d)). Evaluating the reasonableness of disclosures Paragraph A123 sets out "Matters that may be relevant in obtaining sufficient appropriate audit evidence about the reasonableness of management's point estimate and related disclosures include, when applicable:" We believe that, when applicable, these matters "will" be relevant in obtaining sufficient appropriate audit evidence. Accordingly, as stated in the main letter, we recommend that paragraph A123 should either be incorporated in the requirements or, at the least, amended to remove the "may" by for example changing it to: "…. Matters that may be relevant to obtaining sufficient appropriate audit evidence about the reasonableness of management's point estimate and related disclosures include, when applicable:" This would be an approach similar to that used in ISQC 1 to avoid overly detailed requirements. Further, paragraph A123 is cross referred to paragraph A2 which describes what is meant by "reasonable", including that all relevant requirements of the applicable financial reporting framework (AFRF) have been applied "appropriately". If paragraph A123 remains as application material, it would be helpful to move it up to follow paragraph A2. We also recommend that more emphasis is given to the importance of the presentation of disclosures in the financial statements and the need for them to be understandable by the users. This could be included in paragraph A136.

Overall evaluation

Paragraph 23 establishes a requirement for an evaluation whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated. In making this evaluation, the auditor is required to consider all relevant audit evidence obtained whether corroborative or contradictory.

There are some ambiguities in this requirement. The auditor detects misstatements "at the assertion level" (i.e., at the level of an assertion about a class of transactions, an account balance or a disclosure) through performing substantive tests. This requirement should, therefore, logically be read as applying to each accounting estimate (or at least classes of them tested together). However, the requirement (as in extant ISA-540) refers to "estimates", unlike the requirement in paragraph 22 (which refers to "each accounting estimate"). It also does not say that it applies only to those estimates referred to in paragraph 15(b) and therefore paragraph 22. By inference, it therefore also includes estimates referred to in paragraph 15(a), although that is not clear. Similar ambiguities exist for paragraph 21, which requires obtaining sufficient appropriate audit evidence about whether the disclosures related to accounting estimates are reasonable.

We recommend these ambiguities are resolved and the wording clarified.

Communication with those charged with governance

Paragraph 26 cross refers to communication requirements in ISAs 260 and 265. However, the related application material in paragraph A155 is worded in a manner that suggests this is optional. We recommend that paragraph A155 is amended, by deleting "may" in the second sentence, to be clear these are requirements and not optional.

A new requirement in paragraph 26 is for the auditor to "consider the matters, if any, to communicate related to the extent to which the accounting estimates and their related disclosures are affected by, or subject to, complexity, the need for the use of judgment by management, estimation uncertainty, or other relevant factors." We believe a requirement to "consider" is weak and may give rise to inconsistency in communication by different auditors. We recommend that this be strengthened, for example along the lines of:

"When relevant to the understanding of those charged with governance, the auditor shall explain the matters, if any, related to the extent to which …."

Accounting Estimates (ED-540)

How Estimation Uncertainty, Complexity and Judgment affect susceptibility to Misstatement and the relationships between these factors

Price, cost or value on specified measurement basis is not directly observable	➔	Use of valuation attributes, and a method to relate data and assumptions for these attributes to a measurement outcome(s)	➔	Increased complexity, need for judgment and other qualitative inherent risk factors
		↓		↓
		Estimation uncertainty (inherent variability in measurement outcomes when there are limitations in available knowledge and information)		Susceptibility to variability in measurement outcomes that is not inherent

↓		↓
Susceptibility to misstatement through inappropriate selection, from appropriate amounts for reasonably possible measurement outcomes, of an inappropriate point estimate or inappropriate disclosures	←	Susceptibility to misstatement through inappropriate amounts being treated as reasonably possible measurement outcomes
↓		↓
Misstatement of depiction		**Misstatement of measurement**

Estimation uncertainty arises from factors that give rise to an inherent lack of precision in the measurement of an accounting estimate. The inherent variation in such measurement that results from estimation uncertainty is not in itself a misstatement. However, misstatements may arise in the presence of estimation uncertainty, from factors that result in the inherent variation (estimation uncertainty) not being appropriately depicted in the financial statements (referred to above as misstatements of depiction).

Other factors, such as complexity and the need for judgment in making accounting estimates, may give rise to additional variation in the measurement of an accounting estimate that is not inherent and therefore does not represent estimation uncertainty. Such variation in the measurement of an accounting estimate would, if reflected in management's point estimate or related disclosures, be a misstatement (referred to above as misstatements of measurement).

When different qualitative inherent risk factors are present, they increase the susceptibility to different types of misstatements of depiction or measurement. For example, when there is complexity in making an accounting estimate, misstatements may occur because inadequate skills and knowledge are applied in making the accounting estimate. When there is a need for management judgment in making an accounting estimate, such judgment may result in misstatements because of inherent or motivated management bias.

Identifying the factors that are present therefore enables the auditor to identify the types of misstatement that may be present and to better identify and assess the related risks of material misstatement. It also enables the auditor to design more tailored responses to those risks.

Whilst each of these three factors may give rise to different types of misstatements, they are also inter-related because they all have the same root cause, the need to develop an estimate using information, about relevant valuation attributes, which, though it is the best available information, may nonetheless be incomplete or subjective.

Complexity and the need for management judgment are therefore inherent to the process of making an accounting estimate, though they may affect different accounting estimates to a greater or lesser degree. However, when there is high estimation uncertainty, not only is there a greater likelihood that the estimation uncertainty will be inappropriately depicted in management's point estimate and related disclosures, but there is also more likely to be greater complexity, and a greater need for management judgment, in making the estimate.

National Auditing Standard Setters		
12.	AUASB	In formulating its response, the AUASB has sought input from its constituents in three principal ways. The first was from hosting a roundtable meeting with stakeholders in three of the large Australian cities - stakeholders that represent a broad range of backgrounds including assurance providers from medium and large audit firms, audit regulators, professional accounting bodies, directors, preparers and users of financial statements. The second was through an open invitation to provide comments placed on the AUASB website; and the third was by way of subsequent formal discussions by the AUASB members at recent board meetings. The AUASB is supportive of the intentions behind the IAASB's proposed extensive revisions to ISA 540 and plan to improve audit quality by keeping the auditing standards relevant in the face of continually evolving business environments and pending accounting standard changes (in particular IFRS 9). However, we consider that ED ISA 540 requires further consideration as the AUASB believes that the ED does not achieve its intended objectives for revision, those being: 2. Do the revisions achieve the IAASB's desire for standards to be principles based? The ISAs are a set of principles based standards that focus on the exercise of auditor's professional judgement, meaning that the standards should be able to deal with evolving business environments and financial reporting frameworks. While the AUASB is supportive of the need to revise ISA 540, the AUASB considers that ED ISA 540 is overly prescriptive and rules based. This could lead to increased application of a 'checklist mentality' by the auditor, resulting in a diminution of professional judgement and scepticism and a subsequent unintended decline in audit quality, as well as a standard that is not able to deal with evolving business environments and financial reporting frameworks (refer response to question 2 of the detailed submission). We encourage the IAASB to return to a more principles based standard, characterised by providing the auditor with the capacity to exercise their professional judgement in achieving the principle. This may mean there are multiple acceptable methods to achieving the principle, avoiding the checklist mentality. We also encourage the distinction between application paragraphs versus illustrative guidance material. Where material is added to ISA 540 which may be considered specific to certain types of estimates or industries, such as financial services, these may be better placed outside of the standard in industry-specific illustrative guides. The AUASB is concerned that the designation of responsibilities between the auditor and management is sometimes unclear. This may lead to confusion and potentially an increase in scope of auditor's responsibilities when applied in practice. The AUASB considers that the standard is inappropriately tending to shift the onus from preparer to auditor (refer 2.2 and 5 of the detailed submission), without a clear pathway for when the auditor determines material non-compliance with the accounting standards and therefore modifies the audit report.
13.	CAASB	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. <u>Linkage to existing requirements in ISA 315 and ISA 700</u> 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 <u>also</u> 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 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. <u>Disclosures Related to Accounting Estimates</u> 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". <u>Communications with Those Charged with Governance or Management</u> 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*. <u>Items that require definition or explanation</u>

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).

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	- Healthcare - Public sector - Wholesaler
Asset retirement obligation	- Chemical processing - Metal recycling - Mining
Employee Benefits	- Not for profit
Impairment	- Construction - Mining - Oil & gas
Inventory obsolescence	- Construction - Distribution
Landfill liability	- Municipal
Loan loss provision	- Large bank - Credit union
Fair value (investments or property)	- Distribution - Investment Fund - Mining - Oil & Gas

		<table><tr><td></td><td>- Real Estate</td></tr><tr><td>Revenue (including rebates / provisions / %age complete)</td><td>- Agriculture - Commodities - Construction - Healthcare - Municipal - Retail</td></tr></table>
14.	CNCC-CSOEC	We support the IAASB's decision to explore this topic. The revision of ISA 540 Is crucial to ensure the standards to flt for purpose in light of today's evolving and complex business environment. We would also like to draw your attention on the fact that In order to deal with the practical issue arising from the first time application of IFRS 9, the CNCC has felt the need to develop a professional guidance in French and English addressing the statutory audit procedures relating to loan provisioning under IFRS 9 for credit Institutions. This guidance •a guide to statutory audit procedures on expected credit loss provisioning under IFRS 9 in credit Institutions• is attached to the present letter and is available at the following web address: https://doc.cncc.fr/docslnoterelative-aux-diliQences-v2/attachment s/engllsh- version-note-dlligences-provisionnement-credit-ifrs-9january-2017
15.	HKICPA	We support the IAASB's commitment in revising the standard such that it stays relevant in the face of continually changing circumstances.
16.	IDW	Given the fundamental changes in some financial reporting frameworks for certain kinds of estimates (e.g., IFRS 9) and the overall concerns expressed by stakeholders about how auditors deal with accounting estimates, we agree that a fundamental revision of ISA 540 needed to be on the IAASB's agenda. However, we are concerned about how the IAASB decided to progress this matter, which accounts for some of our comments of a more fundamental nature. That being said, given the strictures within which the IAASB operated based upon the decisions that it had made prior to drafting the standard, the standard appears to work well but for the issues we address in this comment letter and its appendices. General Comments Progression of the /SA 540 Project and its Impact on Scope and Scalability However, given the current project on ISA 315, we are concerned that the IAASB has placed the "cart before the horse" by seeking to overhaul ISA 540 generally before having a clear indication of where ISA 315 might land on a series of key issues and concepts, even though the resolution of these matters will have a major impact on ISA 540. Consequently, we believe the IAASB should have considered to first issuing, in a shorter period of time, limited amendments to ISA 540 to deal with the issues around estimates with the characteristics of expected loss models. In a second step, once the project on ISA 315 has been completed, it would have then been appropriate for the IAASB to engage in a general overhaul of ISA 540 based upon a revised

		ISA 315 . The current approach of dealing with ISA 540 first involves the dangers of either ISA 540 needing fundamental revision a few years down the road due to changes in ISA 315 - or worse - having the ISA 540 "tail" wag the ISA 315 "dog" such that decisions made on ISA 540 limit options on where ISA 315 lands on key issues and concepts (also see our comments to paragraph 15 in Appendix 2). The relationship between ISA 315 and ISA 540 also engenders some of our concerns with respect to the scope of the standard (see our comments to paragraphs 1 and 9 (a) in Appendix 2) and the scalability of proposed risk assessment requirements (see our comments to paragraph 10 in Appendix 2). In our view, this indicates that some issues need resolution within ISA 315 before addressing them in ISA 540. We acknowledge that at this stage after the issuance of the exposure draft, the IAASB cannot reverse its decision on this matter. However, it seems to us that the IAASB did not appear to adequately consider the potential longer term implications as to how it progresses this standard. This suggests to us that potential implications of standard setting options need greater attention when considering a project proposal. Application Material We are rather concerned with the length of the application material and the appendices. The material and appendices read very much like a textbook on how to deal with accounting estimates in an audit. We do not believe it to be the role of the IAASB to educate auditors, but to issue standards that contain requirements and application material to assist in the application of those requirements. This means that application material should not include matters that involve educating auditors about issues in which they need to be competent before accepting an engagement. We therefore recommend that the IAASB seek to rationalize the content of the application material. Drafting We note that the word "includes" or "including", which has always been a part of the drafting repertoire of the IAASB, is being badly overused. We first noticed this tendency in the application material of ISA 701, in ISA 720, and in the disclosures project, but this tendency has reached new heights in ISA 540. In some cultures, the overuse of this word is indicative of sloppy thinking. We recommend that the IAASB seek to redraft some of the wording so that this overuse is ameliorated. 10. We have a major concern with the applicability of paragraph 10 to all accounting estimates in conjunction with our concerns about the definition of an accounting estimate in paragraph 9 (a) as noted above. We surmise that this paragraph seeks to provide the additional considerations applicable to accounting estimates when performing risk assessment procedures and related activities in accordance with ISA 315. To this effect, the requirements in 10 (a) to (d) and in paragraphs 11 and 12 appear reasonable as long as the definition of an accounting estimate is narrowed as we describe in our comments on paragraph 9 (a). However, it seems to us that the order ought to be changed. For example, it seems to us that (c) and then (d) ought to be done first, because (a) only ought to apply to those kinds of estimates that are expected to be in the financial statements: there is no point to obtaining an understanding of the requirements in the financial reporting framework for certain kinds of estimates if those kinds of estimates are not expected to be included in the financial statements. For these reasons, we suggest that the order be changed as follows: (c), (d), (a) (b), 11 and 12. Our major concern relates to (e) and (f). These requirements have been expanded considerably in granularity compared to the corresponding requirement in extant ISA 540.8 (c). If the definition of an accounting estimate is not narrowed as we describe in our comments on paragraph 9 (a), then these requirements are clearly disproportionate for estimates with insignificant estimation

		uncertainty. Furthermore, were the definition of an accounting estimate to be changed as we suggest, even for estimates with significant estimation uncertainty but whose measurement is not complex, the nature and extent of the granularity of these requirements exceeds that needed to deal with those simple estimates that might be addressed through the requirement in paragraph 15 (a) of the draft. Many of the issues addressed appear to us to apply to estimates whose measurement is complex only. It seems to us that there ought to be a requirement as part of the risk assessment procedures to determine whether the measurement of any of the accounting estimates expected in the financial statements is likely to be complex. If such accounting estimates with complex measurement are identified, then a conditional requirement including some of this granularity for the risk assessment procedures in relation to those estimates appears to be appropriate. A2. We found the attempt to provide a description of the term "reasonable" in the context of measuring accounting estimates and making the related disclosures to be helpful. We note, however, that the first three bullet points in A2 apply only when the applicable financial reporting framework actually addresses these bullet points: if the applicable financial reporting framework does not address these, then the bullet points do not apply and the description of reasonableness ceases to be useful. Perhaps consideration ought to be given as to the meaning of reasonableness when the financial reporting framework does not address these three bullet points. The other considerations, however, were helpful in this respect. A3. We did not find the description of the term "appropriate" to be helpful, as the description appears not to articulate with the use of the term "appropriate" in the second sentence of A2. Furthermore, it is unclear to us how "reflects judgements that are consistent with the measurement basis in the applicable financial reporting framework" adds to the concept "complies with the applicable financial reporting framework": it just seems to be conceptually redundant. Furthermore, if the financial reporting framework does not address the first three bullets in A2, what is the difference between the description of appropriate and reasonable in A2 and A3? Overall, we believe that either the description of appropriate can be deleted, or a better description that articulates with the description of reasonable in A2 is needed.
17.	JICPA	The increasing complexity of business environments has raised estimation uncertainty in accounting estimates. In response to it, the financial reporting frameworks developed by each accounting standard setter have been continuously evolving. The role of the disclosures relating to estimates in the financial statements has accordingly been becoming ever more important in assisting users' understanding of estimation uncertainty. We recognize that the revisions relating to the disclosures (Objectives (paragraph 8), Requirements (paragraphs 19(a) (ii), (b) and 21) and relevant Application Materials) are very important which reflect this growing importance of disclosures. At the same time, we believe there are areas where just changing auditing standards will not necessarily be sufficient to achieve the aim of the revisions. For example, for additional disclosures to be provided for users' understanding even when the disclosures of estimation uncertainty are in accordance with the applicable financial reporting framework (paragraphs A124 and A125), not only the auditor but also management and those charged with governance themselves, need to have an attitude of being willing to make such disclosures. In addition, it is necessary that users proactively demand such information from the entities, and that regulators and accounting standards setters establish an environment that encourages such additional disclosures. Therefore, in order to achieve the aim of the revisions, it is essential that each stakeholder in the financial reporting supply chain, including users, management, those charged with governance, auditors, accounting standard setters and regulators, commits themselves toward better financial reporting, and fulfills their responsibilities. We will continue our efforts on outreach and dialogue with relevant stakeholders toward better financial reporting, in conjunction with our commitment toward improvement of audit quality.
18.	MAASB	

19.	NBA	General Comments We support the effort of the IAASB to revise ISA 540. Estimates are increasingly relevant in financial statements and therefore an updated standard is needed. An example of the increasing relevance is the implementation of IFRS 9. We therefore understand the need to move quickly in the public interest. At the same time we encourage the IAASB to take the time needed to make sure that the standard is not only technically sound but that it is also easy to understand. This standard should change auditor behavior for the audit of small entities and large enti-ties. We would encourage the IAASB to take an extra three months to finalize the standard if the IAASB felt that that time would improve understandability of the standard for large firms and for SMP's. It is Royal NBA's experience that Mark Twain's words "I didn't have time to write a short letter, so I wrote a long one instead" also applies to ourselves as standard setters and that it is not only relevant with regards to the length of our pub-lications but also with regards to the clearness of the publications. Structure and content The ED is very extensive, primarily in the application material. Especially the paragraphs about risk assessment and internal control are very comprehensive. This does not help the user to easily understand the standard. This is a pity given the fact that the flow chart that was provided shows shows clearly the simplicity of the process described in the ISA. We therefore strongly suggest to at least add the flow chart as an appendix to the standard. In addition we have the following suggestions to improve the accessibility to the ISA: • The ISA includes in the application material educational material, that explains for instance on what a model is (A26 – A29), which might be helpful to certain auditors whilst others are aware of this information. We wonder if as a general principal for this and other ISA's application material that is educational should not be moved to appendices. Real application material should focus on applying the requirements not on educating the auditor on more broader issues. In our opinion this would improve the accessibility of this ISA and the ISA's in general. • With regards to applying ISA 315 the ED provides 4 requirements and 85 para-graphs of application material. We feel that a lot of this material could be integrated in ISA 315. We fully accept that ISA 315 is a separate project and that it is too early to update ISA 315 with the material in ISA 540. At the same time we wonder whether it wouldn't be a better solution to create a temporary solution (for instance ISA 315 A) thus creating a clean ISA 540. • We suggest to use more plain English and easier constructs. For instance para-graph 8(the objective) states: The objective of the auditor is to obtain sufficient appropriate audit evi-dence about whether: (a) Accounting estimates, whether recognized or disclosed in the financial statements; and (b) Related disclosures in the financial statements, are reasonable in the context of the applicable financial reporting frame-work. We do not understand why we need the underlined text. Paragraph A2 provides an abridged version of the objective without this construct. • Paragraph A2: The first sentence repeats paragraph 8 and could therefore be re-moved. We do not understand where the other considerations come from, espe-cially the second bullet. The second bullet could be moved upwards to the "nor-mal" considerations. • Paragraph A71 is a repetition of paragraph 13 and can therefore be removed.

		• References between the paragraphs in the application material make the ED also complex. We recommend limiting this as much as possible. • Appendix I is very theoretical and explains the techniques. We recommend con-sidering to make this more practical and explain how the auditor should deal with the various measurement bases.
20.	NZAuASB	Overall comments The NZAuASB is supportive of the intentions of the IAASB in its efforts to revise ISA 540. Such efforts are necessary to address this highly judgemental area and are timely in light of the recent changes in the accounting environment. However, we have a number of fundamental concerns with ED- 540 as currently drafted, as discussed in the paragraphs that follow and in our responses to the IAASB's specific questions. ED-540's focus on Financial Instruments A key driver in the proposed revision to ISA 540, as indicated by the IAASB's outreach with regulators and auditors, was the need to focus on the issues for audits of financial institutions arising from IFRS 9 . The focus of ED-540 therefore is on auditing of complex accounting estimates. This complexity is reflected in the content and drafting style of the exposure draft. Many of our constituents noted ED-540 needed to be read several times before its application was understood. Such complexity of subject matter coupled with complexity of drafting is likely to confuse the reader and result in the key concepts not being clearly understood and applied. Many of our constituents also noted that, throughout ED-540, the application material and examples focussed on issues for audits of financial institutions. In our view, ED-540 would be enhanced by considering audit issues particular to other sectors, for example, the public sector. An issue of concern to our public sector constituents is the valuation of assets, particularly those with estimation uncertainty, such as valuation of heritage assets and infrastructure assets. The NZAuASB found the flowchart supplement to ED-540 to be very helpful in explaining the overall approach of the standard, and recommends that the IAASB consider incorporating such a flowchart in the introductory material to the standard. Objectives-based vs Rules-based Standard The NZAuASB fully supports the auditor's consideration of, and responses to, the extent to which the accounting estimate is subject to, or affected by, complexity, the need for the use of judgement by management, including the potential for management bias, and estimation uncertainty. However, the NZAuASB is concerned that paragraphs 17-19 are not sufficiently objectives-based and, accordingly, due to the granularity of the requirements, will drive a compliance mentality rather than auditors using their judgement in addressing the specific risks resulting from each of the factors. Unnecessary content There are a number of sections within ED-540 that, in our view, contain unnecessary content. Either because they • state the obvious; • discuss fundamental concepts which in our view should be well understood by the auditor and are not specific to auditing accounting estimates; or • repeat issues already addressed in the exposure draft.

		The appendices to ED-540 are an example of content which in our view is unnecessary. This has the effect of making the standard longer than it needs to be (ED-540 includes 17 requirements and 211 application paragraphs). It also potentially detracts from the expectation that the auditor should be applying professional judgement to each engagement based on the auditor's knowledge and understanding of the entity subject to audit and its operating environment. In addition, we consider that the role of the auditing standard is to guide the auditor. While we acknowledge that it is sometimes helpful to include information about the responsibilities of management and those charged with governance, in our view, such references should be limited to essential explanatory material. Accordingly, the NZAuASB recommends that the IAASB carefully consider the relevance of each of the 211 application paragraphs to ED-540 with a view to determining whether the guidance is essential. • The NZAuASB found the flowchart supplement to ED-540 to be very helpful in explaining the overall approach of the standard, and recommends that the IAASB consider incorporating such a flowchart in the introductory material to the standard. • The terms "significant assumptions" and "significant data" are key to understanding and appropriately applying ED-540. The NZAuASB notes that the meaning of significant assumptions and significant data is described in paragraph A35. However, such description is lost in the extensive application material. The NZAuASB believes that definitions of these terms would be helpful. • Paragraph A1 – To illustrate the breadth of accounting estimates, the NZAuASB suggests adding the following additional examples provided by practitioners to paragraph A1: o Biological assets o Investment properties
Accounting Firms		
21.	BDO*	BDO International Limited (BDO) is pleased to have the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB) Exposure Draft (ED) in respect of ISA 540 (Revised) Auditing Accounting Estimates and Related Disclosures (ED-540).We are supportive of the IAASB's overall approach of proposing revisions to ISA 540 Auditing Accounting Estimates and Related Disclosures in order to modernise the International Standard on Auditing (ISA) for evolving business environments and foster an appropriately independent and skeptical mindset of the practitioner. Field Testing Results Please find below results from field testing the proposed requirements under ED-540 based on the questions posed in Proposed ISA 540 (Revised): Field Testing Information Package. Accounting estimates tested include impairment of long-lived assets (goodwill, property, plant and equipment), asset retirement obligation, credit loss related to accounts receivable and bond valuation. 1. Did the new risk assessment requirement (paragraph 10), provide you with sufficient guidance to identify and assess the risks of material misstatement? We consider that paragraphs 10 and A11 – A70 of ED-540 provide sufficient guidance on the risk assessment procedures and related activities around understanding the entity and its environment with respect to auditing the accounting estimate.

		2. With respect to the revised requirement to identify and assess the risks of material misstatement (paragraph 13), how capable were you of thinking about the accounting estimate in terms of the risk of factors, complexity, the need for use of judgment and estimation uncertainty? The requirements under ED-540 provide the auditor with a greater understanding of the risk by considering the three factors inherently present in the estimate. When assessing the risk factors, we noted that at least two of the factors (judgment and estimation uncertainty) have a strong correlation due to management having to make key assumptions. For example, when testing impairment, management was required to make several key judgments about revenue and margin growth rates. These judgments resulted in inherent uncertainty as changes in the judgment would change the estimate. As stated previously, additional guidance with examples on differentiating the three factors would be helpful in assessing the risk related to the accounting estimate and designing appropriate procedures to respond to these risks. 3. In addition to risk factors of complexity, the need for the use of judgment and estimation uncertainty, did you identify any other relevant risk factor(s) in the identification and assessment of the risk of material misstatement (paragraph 13)? We did not identify any additional factors. 4. When inherent risk was considered to be ‘not low’, was it sufficiently clear to you what procedures you would need to perform to obtain evidence about the matters in paragraphs 17-20, as applicable? When inherent risk is ‘not low’, ED-540 needs to provide clarification as to whether all objectives listed under each of the three factors are to be met or whether the auditor is able to use judgment to select which objectives are the most relevant/appropriate. 5. What challenges did you encounter in dealing with estimates which had more than one risk factor (complexity, judgment, estimation uncertainty)? As noted above in question 2 of the field testing, we found it difficult to differentiate the three factors in assessing and responding to the risk as we believe the factors are all interrelated. For all the accounting estimates in the field testing, we noted that at least two of the factors were present. This led to some difficulties in assessing risk when one of the factors was considered low inherent risk and another factor was assessed as not low. With respect to estimation certainty, one of the challenges we encountered was whether the level of estimation uncertainty should be influenced by whether the accounting estimate is eventually recognised in the financial statements. For example, when assessing goodwill impairment, since the estimate (which is the value-in-use or VIU of the cash generating unit or CGU) is determined for the purpose of goodwill impairment and given that the VIU is higher than the carrying amount of the goodwill, the estimate has not been recognised in the financial statements as no impairment of goodwill has been recorded. Our preliminary assessment is that although the estimate is not recognised in the financial statements, there will still be a high level of estimation uncertainty if changes to the key assumptions would result in significant changes to the estimate. We suggest the IAASB provide further clarification and guidance in this area. Considering the results of the field testing and that these three risk factors are likely to interact and influence one another in practice, we are of the view that it may not be necessary to perform a risk assessment of these risk factors independently, and then requiring distinct audit responses to be carried out. We also noted that some of the requirements in ED-540 paragraphs 17-20 overlap in certain respects, for example paragraphs 17(a) and 18(a)(i), and paragraphs 17(a) and 18(c). We are concerned that the risk

		assessment process may become unduly complex while not substantially changing the underlying audit procedures performed to address the risk. 6. Recognising that risks exist along a spectrum, were you able to tailor the procedures you would perform to the level of assessed risk? If you identified a significant risk, based on the work effort you think would be needed to comply with paragraphs 15-20, would you expect to do anything different/additional as a consequence of the risk being determined as significant? We found that providing a list of objectives for each factor was more helpful than a list of procedures in tailoring the response. However, we feel that providing additional guidance on the level of work effort in ED-540 would be helpful as currently it is not clear as to whether the level of work effort would be different for accounting estimates assessed as 'not low' inherent risk versus those assessed as significant risk. 7. Regarding misstatements, did you find the application material in paragraphs A142-A146, together with ISA 450, clear in determining what constitutes a misstatement? We found the application material, together with ISA 450, clear in determining what constitutes a misstatement.
22.	CHI*	Risk Assessment Procedures Paragraph 10 references to performing risk assessment procedures over estimates when assessing risk under ISA 315 (revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment; however, we are particularly concerned that as presented, the procedures listed in the Exposure Draft could be viewed as a secondary risk assessment performed subsequent to the assessment under ISA 315 (revised) and not as one cohesive risk assessment process. This potential confusion could increase auditor effort by performing multiple risk assessments or it could lead the auditor to not consider the risk assessment procedures in the Exposure Draft when performing the assessment under ISA 315 (revised) resulting in a deficiency in the audit. We agree with the Board that additional considerations are needed when assessing the risk of material misstatement in estimates; however, we believe these procedures would be better linked to the required procedures in ISA 315 (revised). For example, paragraph 10(e) and 10(f) of the Exposure Draft requires the auditor to understand how management makes accounting estimates and the internal controls surrounding those processes. It is unclear the extent in which the auditor could apply professional judgement in determining the extent of understanding related to how management makes estimates. Additionally, it is not clear if the auditor would apply the procedures of 10(e) and 10(f) at the entity level (evaluating of management's processes and controls over estimates as a whole) or at the individual estimate level. Also, it is not clear whether the risk assessment procedures in paragraphs 10-12 of the Exposure Draft would apply to all estimates or to estimates where the likelihood of the potential misstatement could result in a material misstatement. In applying ISA 315 (revised), the auditor applies professional judgment in the risk assessment process to reach a conclusion as to whether an estimate is a significant estimate. For those estimates determined to be significant estimates the auditor is then required to obtain an understanding of management's processes. Specifically, paragraph 18(e) of ISA 315 (revised) requires an understanding of the financial reporting process used to prepare the entity's financial statements, including significant estimates (ISA 315.18(e)). The Exposure Draft removes the concept of significant estimates thus appearing to imply that the auditor needs to understand management's process and components of internal controls related to all estimates at the individual level, regardless of the potential risk of material misstatement, whereas, under existing requirement the auditor would perform these procedures only for significant estimates. While understanding risk is a critical aspect of designing and performing an audit, the additional requirements imposed by paragraph 10 of the Exposure Draft would appear to meaningful increase the time related to

		understanding risks related to estimates that do not present a likely potential for material misstatement thereby increasing the cost of the audit without a corresponding increase in audit quality Identifying and Assessing the Risks of Material Misstatement We support the Board's requirement 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, use of judgement, including the potential for management bias, and estimation uncertainty. However, due to how closely related these factors are to each other, there appears to be an inherent difficulty in separating the risks related to each individual factor. We see benefit in including these as relevant factors when evaluating the risk of misstatement in an estimate, however, we believe there should not be a specific requirement to associate the risk with one or more than one factor but rather allow the auditor to apply professional judgement in determining the response to the risks identified. See further discussion in the Responses to the Assess Risks of Material Misstatement below. While we support the introduction of the risk factors, it is unclear to us how to apply ISA 315 and 330 with respect to identifying and responding to significant risks. Specifically, it is not clear if the required procedures in paragraphs 15 and 16, including the additional response in paragraph 17-20 for inherent risks assess as not low, of the Exposure Draft would comply with the requirements of ISA 330.21 to design audit procedures that are specifically responsive to that significant risk or if additional procedures beyond those required would still need to be documented. These paragraphs of the Exposure Draft appear to pre-determine the auditor's response to all risks of material misstatement, including significant risks. Thus an auditor might interpret that the required procedures in paragraphs 15 through 20 are the procedures to address the significant risk identified with respect to estimates, which may result in the auditor only performing those procedures to meet the requirements of paragraphs 17-20 which may not be responsive to the significant risk identified. Further an unintended consequence of the exposure draft is that auditors may cease to identify significant risks over estimates since an identified risk no longer meets the definition of a significant risk as defined in paragraph ISA 315.4(e) "An identified and assessed risk of material misstatement, in the auditor's judgement, requires special audit consideration." Since the exposure draft now contemplates the response to all risks of material misstatement, it appears no risk related to an estimate would require special audit consideration under ISA 315 and ISA 330. This could cause poor audit quality; therefore we believe further clarification is necessary on how the auditor's response will differ for significant risks. Conversely, one could further interpret the Exposure Draft to imply that all estimates with inherent risk of not low are treated as significant risks further indicating a need for clarification on how the auditor's response differs for significant risks. Paragraph A72 and A73 of the exposure consists of examples of estimates which may have an inherent risk of low or not low based on the auditor's identification and assessment of the risk. While presenting examples are helpful, we are concerned that as presented the examples may lead to auditor bias in that the auditor may conclude that all examples in A72 are considered to be low inherent risk and all examples in A73 are to be assessed as not low. We recommend including language to make it clearer that other factors could result in the example estimates moving from the low to not low bucket and vice versa. Responses to the Assessed Risks of Material Misstatement Paragraph 15 of the Exposure Draft establishes further audit procedures for risks of material misstatement based on the assessed level of inherent risk of low or not low. Introducing audit responses to risks of material misstatement based on an assessed level of inherent risk seems to imply that a separate assessment of inherent risk is required under the Exposure Draft, which is inconsistent with the Board's intention as indicated in paragraph A95 of the Exposure Draft. For example, if the auditor assesses the risk of material misstatement as low based on one assessment of combined inherent and control risk (control risk reduced from the maximum due to performance of tests of controls), under the exposure draft, the auditor is required to separately assess inherent risk to properly evaluate whether the auditor is

		required to apply the procedures in paragraph 17-20 of the Exposure Draft. The introduction of performing audit procedures based solely on inherent risk is inconsistent with ISA 330 (revised), as the auditor would design further audit procedures based on the risk of material misstatement (combined inherent risk and controls risk). As indicated in the section above, we support the Board's recognition that the risk in an estimate is impacted by the complexity, level of management judgment including bias, and estimation uncertainty. However, we see challenges in being able to differentiate between the three factors, particularly with respect to complexity and judgement. The inability to distinguish between the factors will result in the need to design procedures to meet all objectives in paragraphs 17-20 potentially resulting in unnecessary audit procedures without resulting in improved audit quality. We believe the auditor should be able to exercise judgement to determine if the individual objectives for each factor represents the risk of material misstatement and then to subsequently design audit procedures to meet those identified objectives. Paragraph 19 of the Exposure Draft addresses objectives for when inherent risk is not low due to estimation uncertainty. Specifically, paragraph 19 (b) indicates "When, based on the audit evidence obtained, in the auditor's judgement, management has not appropriately understood and addressed the estimation uncertainty, the auditor shall, to the extent possible, develop an auditor's point estimate or range to evaluate the reasonableness of management's point estimate and the related disclosures in the financial statements that describe the estimation uncertainty." We believe that further clarification is needed to expand on the impact of when management has not understood estimation uncertainty. As currently drafted, an auditor could infer the only response necessary when management has not understood estimation uncertainty is to perform an auditor's point estimate/range. Specifically, we would recommend adding application material indicating the auditor should consider whether an internal control deficiency exists and to respond accordingly. As part of that response, if the auditor determines that management's failure to appropriately understand estimation uncertainty is a significant risk, further clarification would be required on how to apply paragraph 21 of ISA 330 which states that "…When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details". Since paragraph 19(b) of the Exposure Draft response is defined to be a substantive analytic in paragraph A128 of the Exposure Draft it appears an auditor's point estimate/range would not be a sufficient audit response in accordance with ISA 330. Management's Expert As the complexity of accounting estimates increases, the need to rely on management's experts becomes increasingly important to obtaining sufficient audit evidence. Further clarification is suggested on how to apply the ISA 500 requirements and guidance on management's experts with respect to estimates. Paragraph 8 of ISA 500 requires the auditor to evaluate the competence, capabilities and objectivity of the expert, understand the work of that expert, and evaluate the appropriateness of that expert's work. In the evaluation of the expert's work, paragraph A48 of ISA 500 indicates that procedures may include the relevance and reasonableness of the expert's findings, appropriateness of the significant assumptions, and the relevance and accuracy of significant source data. The exposure draft appears to be consistent with ISA 500 from the perspective of requiring the auditor to evaluate the appropriateness, including the relevance and reliability, of significant assumptions and data. However, the Exposure Draft could further address how the auditor would modify the nature, timing, and extent of the procedures performed to address the complexity factors in paragraph 17 of the Exposure Draft when a management expert is relied upon. For example, management generally will hire an actuary to develop the pension liability estimate, as the estimate requires a complex model that involves specialized skills and knowledge. Subject to the requirements of ISA 500, the auditor would rely on the results of the modelling after determining the competence and objectivity of the specialist, obtaining an understanding of the methods and assumptions utilized by the

		specialist, and making appropriate tests of the data provided to the specialist. The auditor is not required to re-perform the modelling in order to rely on the expert. However, in the Exposure Draft it is unclear as to whether the auditor would be required to re-perform the model in order to be able to rely on management's expert. For example, paragraph 17(e) indicates that the auditor shall obtain sufficient audit evidence about whether the calculations are mathematically accurate and appropriately applied. Paragraph 17(e) and the related application material is not clear as to the impact of the auditor's evaluation of the competence and objectivity of company specialists if the auditor is always expected to test the mathematical accuracy and appropriateness of the model. For example, a pension liability for which management engaged an outsider actuary as an expert. An auditor would likely need to engage a third party expert (actuary) to develop a separate estimate or assist in evaluating the model used by management's expert, if it was provided. This additional cost may outweigh the benefits based on a risk assessment process since paragraph 17(e) does not appear to consider the competency and objectivity of management's expert. We believe further clarification is required in this area. Scalability We are supportive of the Board's consideration of scalability in all audit requirements. However, we believe that the scalability requirements should be driven based on the risk of material misstatement and the audit evidence needed to address the risk and not based on the size of the entity or audit firm.
23.	DTT*	DTTL appreciates and commends the IAASB's substantial endeavors in the development of ED-540, and the Board's concentrated and expansive efforts to solicit input from regulators and other key stakeholders, which, DTTL believes, were instrumental in providing the appropriate direction and input for the project. DTTL understands the sense of urgency with which the project was undertaken, given the impending effective date of International Financial Reporting Standard (IFRS) 9, Financial Instruments, and the resulting challenges related to auditing expected credit losses. DTTL acknowledges that the auditing of accounting estimates is often one of the most difficult aspects of an audit, especially if the accounting estimates are more complex, involve more use of judgment by management, and have higher levels of estimation uncertainty; however, many of the difficulties are not unique to the auditing of expected credit losses. DTTL therefore concurs with the Board's call for prompt action to further re-focus the auditor's attention on the important topic of auditing accounting estimates. DTTL also supports the fundamental approach taken in ED-540 to enhance and expand the requirements and guidance pertaining to the auditor's identification and assessment of risks of material misstatement for accounting estimates, as well as the related auditor's work effort. Impact on Audit Quality DTTL believes that the positive direction taken by the IAASB in enhancing and providing for a more granular risk assessment process in ED-540 will support the auditor's efforts to drive further quality improvements related to the auditing of accounting estimates. Targeting the auditor's work efforts on the risk assessment process, in particular focusing the auditor's attention on those matters that are the most difficult to audit and particularly unique to the auditing of accounting estimates, is the appropriate way forward. This approach will better encompass the anticipated changes resulting from new accounting standards that increasingly involve difficult or complex accounting estimates , as well as address the related scrutiny and continued interest by regulatory and audit oversight bodies and other key stakeholders in this area. DTTL notes that challenges pertaining to the auditing of accounting estimates cannot be resolved via the standard-setting process alone. Appropriate execution by auditors of the requirements in the standards, taking into account the specific facts and circumstances relevant to the engagement and the specific estimate involved, is equally important. Auditors need to be diligent and careful in considering the nature and circumstances relevant to each individual estimate, and in planning and performing procedures that will be specifically responsive to

		the related risks. However, it is also the opinion of DTTL that tangible improvements in audit quality are most readily realizable when the auditing standards provide for clear, executable requirements that are capable of being understood and operationalized when auditing any type of accounting estimate. As such, DTTL is concerned that ED-540, as currently drafted, may not achieve the ultimate objective of driving improvements in audit quality due to the perceived complexity of the proposed standard and lack of clarity as to how its requirements should be adapted and applied to different types of estimates. DTTL's specific concerns in this regard are discussed below and in Appendix I where the responses to the questions in the IAASB's Explanatory Memorandum accompanying ED-540 are addressed. Risk Assessment Process DTTL concurs with the renewed emphasis and focus on the risk assessment process for accounting estimates in the proposed standard; however, DTTL does not believe that ED-540 provides the auditor with a sufficiently clear "roadmap" that sets out how to apply requirements to the various accounting estimates recognized or disclosed in the financial statements, and in the related disclosures to the financial statements. In addition to the more specific details provided in Appendix I (see response to question 4), DTTL would like to draw attention to the following overall comments: Risk Assessment Procedures DTTL agrees with the enhanced requirements in paragraph 10 of ED-540 that set forth the specific areas of focus relating to accounting estimates that should be addressed when obtaining an understanding of the entity and its environment, including internal control over financial reporting. This detailed and thorough understanding is instrumental in "setting the stage" for the auditor to effectively identify and assess risks of material misstatement (including as applicable, taking into account the effect of complexity, use of judgment by management, and estimation uncertainty (the "three factors")). The proper identification and assessment of risks of material misstatement is critical to effectively auditing accounting estimates, and also to scaling the necessary audit responses to be commensurate with the risks and their relative significance. In order to reinforce the scalability aspects of this requirement, DTTL believes that application material may be appropriate to clarify for the auditor that this understanding as required by paragraph 10 of ED-540 may be effectively performed at the entity-level and not necessarily at the individual estimate-level. Complexity, Use of Judgment by Management, and Estimation Uncertainty DTTL concurs and supports the approach taken in ED-540 that the three factors identified are necessary to be taken into account when identifying and assessing risks of material misstatement for all accounting estimates. The definition of an accounting estimate notes that "the measurement of [the monetary amount] is subject to estimation uncertainty." Consequently, by definition, estimation uncertainty is present in all accounting estimates and this factor should therefore likely be relevant for the identification and assessment of risks of material misstatement for all accounting estimates and the related further audit procedures. However, the relevance and significance of these factors will vary from one estimate to another; for example, they may be of lesser importance when dealing with simple accounting estimates. DTTL also believes that the three factors are interrelated and inextricably linked, and considering them in isolation will likely not be the most efficient or effective approach to identifying and assessing risks of material misstatement. As currently structured, ED-540 does not clearly articulate the interplay of all the factors throughout the risk assessment process, and this is exacerbated by the requirements in paragraphs 17-19 of ED-540 being focused on each factor in isolation. In an effort to draw out the interplay between the factors, DTTL believes that it would be beneficial to more clearly indicate that the factors addressed by paragraph 13 are to be considered collectively. DTTL further suggests that the strict delineation between each of the factors as separately described in paragraphs 17-19 of ED-540 be eliminated, as in practice, auditors often do not necessarily consider the characteristics attributed to the three factors and the related responses (as

		described in and required by ED-540) in a strictly linear manner (e.g., paragraph 17c attributes the interpretation of contractual terms to the factor of "complexity"; however, the interpretation of contractual terms may also in practice be viewed as "use of judgment by management"). In addition, ED-540 is unclear as to how the three factors are "taken into account" when assessing whether "inherent risk is low" or "inherent risk is not low." It is also unclear that once the determination of inherent risk is made, whether this determination needs to apply to all risks of material misstatement associated with the accounting estimate, or whether it is possible that there could be varying assessments of risks of material misstatement for a single accounting estimate (and if so, how the requirements of the proposed standard would then be applied). In practice, it is often the case that there are multiple risks of material misstatement relating to an accounting estimate and some will be assessed on the lower end of the spectrum, while others may be higher or significant risks. Furthermore, when there is more complexity, more use of judgment by management, and higher levels of estimation uncertainty surrounding the making of an accounting estimate, these factors directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately the persuasiveness of the audit evidence needed. DTTL believes, therefore, that it is very difficult to prescribe required further audit procedures in order to consistently result in sufficient appropriate audit evidence about whether the accounting estimates are reasonable in the context of the applicable financial reporting framework, as this determination will always be a matter of professional judgment. Therefore, paragraphs 17-19 of ED-540 may also be viewed as limiting further audit procedures only to risks of material misstatement that result discretely from the three factors, given the construct of the paragraphs and the seemingly narrow focus of each one. It is also important for the auditor to be aware that these three factors are not necessarily the only relevant factors to be considered when identifying risks. Paragraph 13 of ED-540 makes reference to "relevant factors, including" complexity, use of judgment by management, and estimation uncertainty, thereby implying that there are other factors that may be applicable when identifying and assessing risks of material misstatement. Similarly, there is a specific reference in paragraph 26 of ED-540 to "other relevant factors" when communicating with those charged with governance. Although the guidance in paragraph A78 of ED-540 provides some indication of the other relevant factors, these may be overlooked given the emphasis that is placed on the three factors throughout the requirements of the proposed standard. Given the circumstances of the engagement, it may well be possible that the relevant factors addressed in paragraph 78 of ED-540 could be aligned with, and may need to be considered equally with, the factors of complexity, use of judgment by management, and estimation uncertainty. Consequently, based on the matters highlighted above, DTTL believes that ED-540 should be amended. In particular, DTTL recommends a two-pronged approach to re-drafting paragraph 13 of ED-540 that will appropriately achieve the additional focus on the auditing of accounting estimates when applying ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment (ISA 315 (Revised)). First, paragraph 13 of ED-540 should be revised to allow for a more holistic and complete approach to identifying and assessing risks of material misstatement for all accounting estimates. The purpose of the enhanced requirement paragraph will be to identify risks of material misstatement at the right level and assess them appropriately, such that the further audit procedures are responsive and result in sufficient appropriate audit evidence. This paragraph and related application material should also make it more clear that for difficult or complex accounting estimates, there will likely be more risks of material misstatement and also that they are likely to be assessed as higher or significant. For simple accounting estimates, there will be fewer risks of material misstatement and they may be assessed as lower or low. Second, DTTL suggests making it clearly apparent that the auditor has overall strategies to use when auditing all accounting estimates, not just for those where inherent risk has been assessed as "low." DTTL strongly believes that these strategies are conceptually sound and intuitive and should be used for providing the overall approach to auditing accounting estimates, regardless of the assessed risk (see response to question 4 in Appendix I). By directing the auditor to perform a thorough and complete risk assessment for all accounting estimates and to design responses to the risks in the context of an overall strategy for the accounting estimate as a whole, it will not be necessary to further categorize assessed risks of material misstatement into

		the categories of "inherent risk is low" or "inherent risk is not low." This approach will also better align with ISA 315 (Revised), and DTTL believes it is also consistent with the revisions to ISA 315 (Revised) that are currently being contemplated by the IAASB. Data and Assumptions Similar to the delineation of the presentation of the three factors, the descriptions of data and assumptions have also been separated in the proposed standard. In practice, auditors often refer to and think of "data and assumptions" as a combined concept, and do not necessarily strictly bifurcate the two items. Different auditors may even have different views on whether an item is considered data or an assumption (e.g., different views may exist as to whether terms of a contract are to be viewed as "assumptions" rather than "data" in the context of a particular accounting estimate or for different types of estimates). The nature of an estimate might cause a particular item to be viewed as data in some situations, but as an assumption in others. DTTL acknowledges that the application material describes both data and assumptions; however, given the longstanding history of auditors considering these items together and the practical challenges in consistently determining their discrete categorization, DTTL believes that this application material will not adequately address the risk that the work effort requirements of ED-540 are inappropriately applied (e.g., due to inconsistencies in views as to whether an item is either data or an assumption, or both). In addition, DTTL notes that the concepts of both data and assumptions are inconsistent in how they are discussed in paragraphs 13, 17, and 18 of ED-540. For example, paragraph 13(a) of ED-540 (which addresses complexity) does not address assumptions; however, paragraph 17 of ED-540 (which also addresses complexity) does address data and assumptions in sub-bullets (a) and (d), but sub-bullets (b) and (c) only address data. As there appears to be a disconnect between paragraphs 13(a) and paragraph 17 of ED-540, DTTL suggests that alignment of the concepts in 13(a)/17, 13(b)/18, and 13(c)/19 of ED-540 be reconsidered (and that both data and assumptions are consistently addressed) in conjunction with DTTL's suggestions for modifying these paragraphs (see response to question 4 in Appendix I). DTTL also notes that the concept of "significant data" is introduced in paragraph 10(e)(iii) of ED-540. Unlike "significant assumptions," the term "significant data" is not used in financial reporting frameworks and therefore will not have the same level of general understanding as to what it means. DTTL does not believe that the application guidance in paragraph A35 of ED-540 provides sufficient direction to auditors as to how to identify "significant data". DTTL also notes further that the revised management representations proposed by ED-540 would require management representations about significant data. Absent a very clear definition, this would be a very challenging, if not impossible, representation for management to provide. DTTL does not believe that the concept of "significant data" is necessary for the application of ED-540. When performing procedures, the auditor should consider the data used by management to make the accounting estimate based on its nature and source, including considerations related to the relevance and reliability of the data. DTTL therefore recommends the deletion of "significant" as a qualifier to data throughout the proposed standard. Linkage to Existing ISAs In an effort to further emphasize that the requirements relating to the risk assessment process in ED-540 are in addition to those already encompassed in ISA 315 (Revised) and ISA 330, The Auditor's Responses to Assessed Risks (ISA 330), thought should be given by the IAASB to using consistent messaging when certain ISAs are "supplemental" to foundational auditing standards. For example, using the phrase "special considerations," or providing a more comprehensive lead-in to the additional requirements in ED-540, drawing more extensively from concepts in ISA 315 (Revised) and ISA 330, may be ways of more clearly emphasizing the linkage between ED-540 and other ISAs. Consistency of Global Standards

		Consistency of global auditing standards serves to enhance audit quality, and therefore serves the public interest. To that end, DTTL is aware of the recent release by the Public Company Accounting Oversight Board (PCAOB) of Proposed Auditing Standard, Auditing Accounting Estimates, Including Fair Value Measurements and Proposed Amendments to PCAOB Auditing Standards (PCAOB Release No. 2017-002, June 1, 2017; PCAOB Rulemaking Docket No. 043). DTTL acknowledges the efforts of the IAASB to engage with the PCAOB, but notes the differing approaches taken to the proposed revisions to the standards addressing the auditing of accounting estimates. DTTL believes that such diversity will make it increasingly difficult to develop global audit methodologies and related implementation guidance on a consistent basis and will lead to practical challenges. In finalizing ED-540, DTTL recommends the IAASB consider the PCAOB proposal, as well as the related responses, and continue to engage with the PCAOB in order to attempt to align the final standards to the greatest extent possible. Conclusion While DTTL is supportive of the general direction the IAASB has taken, DTTL does believe that aspects of ED-540 should be re-visited to clarify the risk assessment and work effort to be performed by the auditor. DTTL appreciates the wide array of issues relating to the auditing of accounting estimates being addressed by the IAASB, especially in those areas most affected by complexity, the use of judgment by management, and estimation uncertainty. DTTL believes that the comments articulated in this letter will assist the IAASB as it continues its deliberations. DTTL strongly encourages the Board to continue to move forward with revisions to ED-540 as a matter of urgency. **Other Areas** Applicability of ED-540 to All Estimates (paragraphs 2 and 3) DTTL believes that enhancing the special considerations pertaining to the auditing of accounting estimates in ED-540 is responsive to dealing with evolving financial reporting frameworks. DTTL notes, however, that a more balanced approach needs to be struck in the introductory paragraphs in ED-540 so as to clarify to auditors that ED-540 is applicable across both different types of entities and accounting estimates; that is, neither the size of an entity nor the nature of the accounting estimate is the determining characteristic in how to audit an accounting estimate. ED-540 encompasses those accounting estimates that are perceived to be “simple” as well as those accounting estimates where the three factors highlighted in ED-540 of complexity, use of judgment by management, and estimation uncertainty play a greater role in the determination of risks of material misstatement. To that end, DTTL proposes that paragraph 2 of ED-540 be amended as follows to more directly focus on what an accounting estimate is, and introduce the concept of the three factors to the auditor. DTTL also suggests that the 4th and 5th sentences (which DTTL is suggesting be deleted from paragraph 2 of ED-540) be included as application material to paragraph 13 of ED-540. **2.** Many financial statement items are susceptible to an inherent lack of precision in their measurement, which is referred to as estimation uncertainty. In the ISAs, such financial statement items are referred to as accounting estimates. Accounting estimates vary widely in nature, and their measurement may also be subject to, or affected by, complexity and the need for the use of judgment by management**,** **as well as**~~. The extent to which they are subject to or affected by complexity and judgment is often related closely to the extent to which they are subject to or affected by estimation uncertainty. Accordingly, the auditor’s identification and assessment of the risks of material misstatement relating to accounting estimates, and the auditor’s responses to those assessed risks are affected by these three factors, and~~ the interrelationship among ~~them~~ **these three factors**.~~(Ref: Para: A1, Appendix 1, Appendix 2)~~ DTTL suggests the insertion of paragraph 2A of ED-540 that would clearly highlight to the auditor that ED-540 is also relevant for those accounting estimates that are not as susceptible to the three factors identified in paragraph 2 of ED-540.

		2A. <u>Certain accounting estimates are subject to less complexity, the use of less judgment by management, and lower levels of estimation uncertainty. This ISA is also applicable when the auditor identifies and assesses risks of material misstatement, and develops the appropriate responses, relating to these accounting estimates.</u> In an effort to more <u>succinctly</u> describe the nature of those more difficult or complex accounting estimates, DTTL also recommends that paragraph 3 of ED-540 be pared down to focus attention on those underlying concepts that drive the auditor's work effort as it relates to responses to the risk assessment procedures. Much of what is highlighted in paragraph 3 of ED-540 is repeated in the requirements and will therefore already be considered by the auditor (and is therefore not necessary to also discuss in paragraph 3 of ED-540). **3.** When an accounting estimate is being made, its susceptibility to misstatement may increase because of ~~the need to:~~ **<u>considerations relating to complexity, use of judgment by management, and estimation uncertainty, or any combination thereof. In identifying and assessing risks of material misstatement for those accounting estimates that are affected by more complexity, use of more judgment by management, and higher levels of estimation uncertainty, the nature, timing, and extent of the further audit procedures designed and performed would likely be affected. In such circumstances, the further audit procedures would be designed to obtain more persuasive evidence thereby being appropriately responsive to the assessed risks of material misstatement at both the account and assertion level.</u>** ~~With respect to complexity:~~ ~~Apply appropriate specialized skills or knowledge in the selection, design or application of the method used to make the accounting estimate, including when the method involves complex modelling.~~ ~~Appropriately consider the relevance and reliability of the data used, whether the data is obtained from internal sources or from external information sources.~~ ~~Maintain the integrity of the data used.~~ ~~With respect to the use of judgment by management:~~ ~~Appropriately take into account available information when selecting methods, assumptions, or data.~~ ~~Mitigate the risk of management bias.~~ ~~With respect to estimation uncertainty:~~ ~~Take appropriate steps to address estimation uncertainty.~~ ~~Select an appropriate management point estimate or make appropriate related disclosures in the financial statements.~~ <u>Objective (paragraph 8)</u> DTTL notes that one of the objectives when auditing accounting estimates is to "obtain sufficient appropriate audit evidence about whether the related disclosures in the financial statements are *reasonable* in the context of the applicable financial reporting framework." DTTL believes this creates an inconsistency with the rest of the ISAs and in particular with requirement paragraphs 13(a) and (e), 15, 38(iv) of ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, as the IAASB has previously used the term *adequate* to describe the auditor's work effort in the context of disclosures. DTTL recommends that the Board revert to the use of adequate as it relates

		to disclosures, especially considering the IAASB recent project to address disclosures in the ISAs, where this matter was not highlighted as an area to be addressed at that time. This recommendation would necessitate additional changes being made throughout ED-540. <u>"Stand Back" (paragraph 22)</u> DTTL believes the inclusion of the "stand back" as described in paragraph 22 of ED-540 is not required, as the underlying concepts are already embedded in paragraphs 25 and 26 of ISA 330. Further, it is not clear if these requirements are to be performed at the assertion level, the individual accounting estimate level, or when accounting estimates are considered more broadly when evaluating whether they are reasonable in the context of the applicable financial reporting framework. However, the "stand back" in paragraph 23 of ED-540 pertaining to the auditor's evaluation of accounting estimate misstatements based on the audit evidence gathered is appropriately included in ED-540. <u>Written Representations (paragraph 25)</u> DTTL believes that the written representations required by paragraph 25 of ED-540 to be obtained from management (and when appropriate, those charged with governance) should cover data and assumptions used in making accounting estimates and related disclosures in accordance with the requirements of the applicable financial reporting framework more generally (that is, as opposed to being limited to significant data and significant assumptions). Even though the term "significant assumptions" may currently be more generally understood by management and auditors, as pointed out above, the term "significant data" will likely not be, and this will lead to practical difficulties, inconsistencies, and challenges with respect to obtaining appropriate written representations. It is for the auditor to determine, using professional judgment, what is significant as it pertains to the data and assumptions. <u>Communication with Those Charged with Governance or Management (paragraph 26)</u> DTTL requests further clarity as to whether the communication requirements outlined in paragraph 26 of ED-540 should be limited to certain types of accounting estimates (e.g., based on materiality), or if the auditor should be communicating the required information for <u>*all*</u> estimates. For example, as drafted, ED-540 indicates that such communication includes "…the extent to which [all] the accounting estimates, and their related disclosures, are affected by, or subject to, complexity, the need for the use of judgment by management, estimation uncertainty, or other relevant factors." DTTL notes that providing this additional clarity will be useful, as it is the matters that have been communicated with those charged with governance, and to which the auditor has devoted significant attention, that provide the basis for ultimately determining key audit matters (and in making such a determination, the auditor is required to take into account, among these matters, those accounting estimates that have been identified as having high estimation uncertainty). As such, DTTL believes that the requirement in paragraph 26 of ED-540 should be more closely aligned with that in paragraph 9 of ISA 701. <u>Terminology (paragraphs A2 and A3)</u> While DTTL understands the attempts by the IAASB to try and ensure that all users of ED-540 have a common basis for the application of the requirements and guidance by explaining and elaborating on the intended use of certain terminology, DTTL believes that in some instances the guidance provided is redundant and has made paragraphs long and overly complicated. In particular, DTTL does not agree with the attempt to describe the key concept of *appropriate* in paragraph A3 of ED-540 of the application material and that the description does not connect well with the content of paragraphs 6 and 23 of ED-540. The appropriateness of audit evidence is already defined in paragraph 13(b)(ii) of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in*

		Accordance with International Standards on Auditing, and as such DTTL recommends deleting paragraph A3 of ED-540. DTTL is of the opinion that such a concept is used throughout the ISAs and already has a meaning that is understood by auditors. Professional judgment plays a part in the auditor's approach to what is reasonable and appropriate, and to attempt to describe these concepts as they relate uniquely to ED-540 may call into question the intent and meaning of those terms with respect to other ISAs. <u>Internal Control Focus</u> DTTL supports the increased focus on internal control in ED-540, including the application material associated with paragraph 10 of ED-540 that elaborates on how controls may be considered when auditing accounting estimates. DTTL continues to believe, consistent with ISA 330, that the auditor should have the ability to select a substantive-only approach, as dictated by the circumstances of the engagement (and when the requirements in paragraph 8 of ISA 330 are not applicable). DTTL also supports the focus in the proposed standard on considerations by the auditor of regulatory requirements or expectations for when controls are to be tested (or at least identified as relevant such that design and implementation procedures are performed). <u>Appendix 1</u> While there is no explicit reference to IFRS in Appendix 1, DTTL believes that Appendix 1 is IFRS-measurement focused. Some of the statements made in Appendix 1 can only be accurate in the context of a particular financial reporting framework (for example, when using the leveling terminology for fair value, it may make sense in the context of IFRS and U.S. Generally Accepted Accounting Principles that both have the concept of level guidance; however, if another financial reporting framework does not use leveling, then the context of the statements would not be factual). Consequently, Appendix I as drafted may create confusion as to the accounting concepts used in the context of a particular financial reporting framework being used. DTTL recommends that Appendix 1 be drafted in a more framework-neutral manner. In doing so, this will reduce the risk of Appendix 1 becoming obsolete when there are changes to a financial reporting framework, such as IFRS or U.S. GAAP. Accordingly, DTTL has made certain drafting recommendations to Appendix 1, and these are reflected in **Appendix II** of this comment letter.
24.	EYG*	Overall, we believe the IAASB has identified and understood the relevant issues in practice related to auditing accounting estimates in the current environment. We have focused our analysis of ED-540 on its capability of being implemented appropriately and consistently in practice. Our comments are informed by our practical experiences, including enhancements we have made in recent years to our EY Global Audit Methodology related to auditing estimates, and the input from our auditors, including those experienced in the audits of financial institutions. Our significant views and areas of concern related to ED-540 are summarized as follows: • We believe several enhancements have been made to reflect the evolving nature of financial reporting standards, but we have further suggestions. In particular, we believe that the auditor's risk assessment procedures and the resulting design of responsive audit procedures need to specifically take into account whether management's process to make the accounting estimate represents the appropriate application of the requirements of the applicable financial reporting framework (see our response to Q1). • We support the risk-based differentiation of accounting estimates between those for which inherent risk is "low" and "not low". However, we believe that the testing approaches that have been identified as only being applicable to estimates with "low" inherent risk are also applicable to estimates with "not low" inherent risk, and this applicability needs to be clarified in ED-540. In our view, the objective-based requirements in paragraphs 17-19 (a) that address procedures for estimates with "not low" inherent risk equate to an audit approach to test how management made the accounting estimate (see our response to Q4 (c)).

		• We agree that complexity, management's use of judgment and estimation uncertainty are relevant drivers of risks related to accounting estimates, and we support the specific consideration of these factors in the auditor's risk assessment as well as in the design of responsive audit procedures. However, we believe that the approach to the related work effort (i.e., requiring each of these factors to be addressed separately) in paragraphs 15 and 17-19 is unnecessarily complicated and does not reflect the approach that is taken, or should be taken, in practice to designing and developing audit procedures for accounting estimates (see our responses to Q3 and Q4). • With regard to the enhancements to the auditor's work effort for disclosures related to accounting estimates, we have the following specific concerns: • We are concerned about changing the criterion for the auditor's evaluation of disclosures related to accounting estimates to "reasonable" from "adequate". The rationale for the change included in the explanatory memorandum is not consistent with our understanding of the rationale for the existing differentiation in the criteria for the evaluation of estimates v. disclosures, and how we apply these criteria in practice. Although we can conceptually agree with the revised explanation of "reasonable" provided in paragraph A2, we believe such a definition leads to the need for the IAASB to further consider whether "reasonable" is the most appropriate term. Further, we believe there may be implications from this change for the auditor's evaluation of disclosures not related to accounting estimates, including the auditor's evaluation of misstatements in those disclosures (see Appendix 2 to our letter for further detail). • Paragraph 23, which has been extended to include specific evaluation of disclosures related to accounting estimates, does not provide any application material related to the auditor's identification and evaluation of misstatements in qualitative disclosures. Qualitative disclosures are particularly prevalent in management's disclosures about accounting estimates and such disclosures can be challenging to evaluate (see our response to Q6). • We do not support including in the requirements of ED-540 the auditor's evaluation of whether disclosures beyond those required by the applicable financial reporting framework are necessary (see our response to Q6). • We support the proposal to include guidance for the auditor's consideration of the relevance and reliability of external information sources used by management in the preparation of accounting estimates, but we do not believe that incorporating such guidance into ISA 500 (instead of ISA 540) will result in appropriate and consistent evaluations of such sources by the auditor (see our response to Q7). We recognize that the US Public Company Accounting Oversight Board (US PCAOB) has issued a proposal to enhance its standards as it relates to auditing accounting estimates. We encourage the IAASB to proactively engage with the US PCAOB, to the extent possible, to reduce the risk of having two different internationally-applicable approaches to auditing estimates that may be difficult to reconcile and may lead to differing work efforts and documentation requirements, which would not be in the public interest. As financial reporting standards continue to increase in their complexity, management's processes to prepare accounting estimates also increase in complexity. Consequently, we believe it is appropriate for the IAASB to consider how International Standard on Auditing (ISA) 540 can be enhanced to reflect the evolving nature of financial reporting standards that address accounting estimates, as well as the auditing challenges that arise therefrom. We support the IAASB's initiative to prioritize the enhancements to ISA 540 to be responsive to, in particular, the impending effective date of IFRS 9 , which presents heightened challenges to both management and auditors as it relates to the preparation and auditing, respectively, of estimates related to expected credit losses. Nevertheless, some of the same auditing

		challenges identified in respect of IFRS 9 exist in practice today for other complex accounting estimates, to varying degrees, including across industries. Therefore, we support the IAASB's approach to enhance ISA 540 for the audit of all accounting estimates, not just those related to IFRS 9 or the audit of financial institutions. Overall, we believe the IAASB has identified and understood the relevant issues in practice related to auditing accounting estimates in the current environment. We have focused our analysis of ED-540 on its capability of being implemented appropriately and consistently in practice. Our comments are informed by our practical experiences, including enhancements we have made in recent years to our EY Global Audit Methodology related to auditing estimates, and the input from our auditors, including those experienced in the audits of financial institutions. With regard to the enhancements to the auditor's work effort for disclosures related to accounting estimates, we have the following specific concerns: • We are concerned about changing the criterion for the auditor's evaluation of disclosures related to accounting estimates to "reasonable" from "adequate". The rationale for the change included in the explanatory memorandum is not consistent with our understanding of the rationale for the existing differentiation in the criteria for the evaluation of estimates v. disclosures, and how we apply these criteria in practice. Although we can conceptually agree with the revised explanation of "reasonable" provided in paragraph A2, we believe such a definition leads to the need for the IAASB to further consider whether "reasonable" is the most appropriate term. Further, we believe there may be implications from this change for the auditor's evaluation of disclosures not related to accounting estimates, including the auditor's evaluation of misstatements in those disclosures (see Appendix 2 to our letter for further detail). We recognize that the US Public Company Accounting Oversight Board (US PCAOB) has issued a proposal to enhance its standards as it relates to auditing accounting estimates. We encourage the IAASB to proactively engage with the US PCAOB, to the extent possible, to reduce the risk of having two different internationally-applicable approaches to auditing estimates that may be difficult to reconcile and may lead to differing work efforts and documentation requirements, which would not be in the public interest. Appendix 2: Comments on other matters related to ED-540 Adequacy v. reasonableness of disclosures related to accounting estimates Paragraph 11 of the explanatory memorandum explains that "the IAASB concluded that both the accounting estimate and the related disclosures should be 'reasonable' in the context of the applicable financial reporting framework, as continuing to use 'adequate' may inappropriately suggest that disclosures are less important than the accounting estimate itself." Although we acknowledge that this may be a possible interpretation of the extant objective of ISA 540, we do not share this view. In practice, the current use of the term "reasonable" as it relates to evaluating accounting estimates is understood to mean that the auditor is to specifically consider estimation uncertainty inherent in the accounting estimate and whether the resulting valuation is appropriate. We note that the ISAs currently only use the term "reasonable" in the context of evaluating fair presentation as a criterion for accounting estimates, and we have always believed this to be intentional and appropriate. It follows that, in practice, because disclosures related to accounting estimates are not subject to estimation uncertainty, the auditor's evaluation objective has been intentionally different, and that is to determine whether such disclosures are "adequate" in the context of the requirements of the applicable financial reporting framework. We note that paragraph A2 of ED-540 puts forth a definition of "reasonable, in the context of the financial reporting framework" that "all the relevant requirements of the financial reporting framework have been applied appropriately", and that this definition applies to both

		accounting estimates and related disclosures in the financial statements. We can support this new explanation, particularly that both estimates and disclosures are evaluated using the context of the requirements of the applicable financial reporting framework. In fact, in our view, this definition is clearer than the term that is being defined (i.e. "reasonable"). In light of this revised explanation, we would support, and strongly encourage the IAASB to consider, replacing the term "reasonable" with a phrase that explains that the relevant requirements of the applicable financial reporting framework have been appropriately applied. We believe this would be a useful clarification for ED-540 to achieve consistency in both the auditor's evaluation of estimates and in stakeholder expectations regarding how estimates and related disclosures are evaluated by auditors. Regardless of whether the IAASB changes the criterion for evaluation of estimates and related disclosures in ISA 540 to "reasonable" as proposed and newly defined, or in line with our recommendation to use the clearer language found in the definition in paragraph A2, we believe further holistic consideration across the ISAs of the effect of such change is necessary. This is because we find that the new explanation of "reasonable" would not apply exclusively to estimates and related disclosures, but would be applicable to all amounts and related disclosures throughout the financial statements. Consideration across the ISAs of the effect of the change should be specifically given to the: • Implications for the evaluation of disclosures in the financial statements that are not related to accounting estimates. In principle, we believe that there needs to be common criteria and terminology for the evaluation of all disclosures in the financial statements in order for a consistent evaluation of fair presentation. We do not support an evaluation of disclosures related to accounting estimates that uses what appears to be a higher threshold for fair presentation than the evaluation of other disclosures in the financial statements. • Implications for the auditor's evaluation of misstatements in disclosures. Paragraphs A17 of ISA 450 , and A3 and A7 of ISA 705 (Revised) address evaluating whether misstatements in disclosures are material. This application material, which is not referenced in ED-540, speaks to the appropriateness, accuracy and adequacy of disclosures, and it is unclear how the IAASB's proposed change in ED-540 to evaluate their "reasonableness" affects the auditor's evaluation of material misstatements in accordance with ISA 450. This disparity in terminology runs the risk of the auditor making inappropriate judgments about whether the financial statements are materially misstated. As expressed, we believe the terminology for evaluation of disclosures, if changes are pursued in conjunction with ED-540, needs to be aligned across the ISAs, in particular across ED-540, ISA 450, ISA 700 (Revised) and ISA 705 (Revised). We note that Paragraph 13 of the explanatory memorandum recognizes the degree of inconsistency between the revised criterion in ED-540 and that in paragraph 13 of ISA 700 (Revised), which addresses the auditor's evaluation of the fair presentation of the financial statements, and the intention of the IAASB to further consider conforming amendments to ISA 700 (Revised) as part of the post-implementation review for auditor reporting. It is not clear exactly what conforming amendments to ISA 700 (Revised) are being considered. However, we would not support a conforming amendment to simply change paragraph 13 (c) to read "the accounting estimates and related disclosures are reasonable" based on the views previously expressed in this letter. To summarize, our primary concern is the use of different terminology across the ISAs as it relates to evaluating disclosures, which we believe will be confusing in practice and may result in inconsistencies in the evaluation of the fair presentation of the financial statements, which would not be in the public interest. We suggest the IAASB consider whether the terms "reasonable", "appropriate", and "adequate", could be equally and consistently replaced throughout the ISAs with the concept of appropriate application of the requirements of the applicable financial reporting framework. Should the IAASB determine that a change is not appropriate across the ISAs at this time, we

		recommend that the proposed change in the criterion for the evaluation of disclosures related to accounting estimates be reverted to the extant criterion of "adequate". Significant data and significant assumptions We note that the auditor's evaluation of significant assumptions has been emphasized in ED-540 along with a much greater prominence of the auditor's evaluation of the data used in accounting estimates, which includes introducing a new term of "significant data". In ED-540, an explanation that seems to be relevant to both terms is included in paragraph A35. In regard to significant assumptions, the extent to which the variation in the assumption would materially affect the measurement of the accounting estimate is a key criterion, but we believe there are further possible considerations relevant to determining whether an assumption is significant. These may include whether the assumption involves unobservable data, or the extent to which the assumption is a source of estimation uncertainty, or the extent the assumption may be susceptible to management bias. Due to the increased prominence of the term "significant assumption" throughout ED-540 and the increased requirements for the auditor to evaluate significant assumptions, we believe that this term should be a defined term in ED-540 so that the concept is consistently understood and applied in practice. In regard to significant data, we do not believe that the explanation put forth in paragraph A35 is appropriate. Data sets may inherently have wide variations in them, which does not make the data any more or less "significant". In our view, the auditor should consider the relevance and reliability of the data used, regardless of its "significance" to the accounting estimate. As a result, we are uncertain what is meant by "significant data" as opposed to the relevant data used in preparing the accounting estimate. We do not believe that management has a choice in data in the same manner that management may have a choice in assumptions and therefore the same definition and evaluation criteria should not apply. In our view, the new concept of "significant data" is not capable of being consistently implemented in practice based on the requirements in ED-540, and therefore we strongly encourage the IAASB to consider whether such a scaled concept for data used in preparing accounting estimates is truly necessary. Management representations We agree with broadening the current required representation from management that addresses only the significant assumptions of accounting estimates to address management's preparation of the estimates more holistically. However, we have concerns about requiring management representations related to: • The "reasonableness" of the estimate and its related disclosures in context of the financial reporting framework. "Reasonableness" is currently the auditor's objective in ED-540 and is defined in the context of the audit of accounting estimates; management should not be requested to provide representations in relation to the audit objective. We believe it would be more appropriate for management representations to address whether the relevant requirements of the applicable financial reporting framework have been appropriately applied in the preparation of the accounting estimates and the related disclosures. • Significant data and significant assumptions. As noted above, we believe the term "significant assumption" is in need of a clear definition due to its increased prominence in ED-540, and this, must also be clear to management in order for management to be able to make representations about them. Regarding "significant data", we do not believe it is necessary to include "significant data" in management's representations regardless of whether the term is retained in ED-540. Any required representations about data should focus on the source and integrity of the data used in preparing the accounting estimate, without regard to its "significance".

		Risk assessment procedures We have the following comments related to the enhancements to the risk assessment procedures in paragraph 10 of ED-540 and related application material: • Paragraph 10 (b) – We agree with the addition of regulatory factors as a required consideration for risk assessment of accounting estimates, but we believe that the application material should acknowledge that ED-540 also applies to audits of special purpose financial statements in accordance with ISA 800 (Revised) , which may be the case when the entity is required to report in accordance with a regulatory framework instead of a general purpose framework. In such audits, the auditor should rightfully be focused on compliance with the regulatory framework. • Paragraph 10 (c) – We do not support the proposed risk assessment procedure for the auditor to understand the nature of accounting estimates and related disclosures "to be expected" in the financial statements. We believe this requirement is inconsistent with ISA 315 (Revised). ISA 315 (Revised) does not impose a requirement to form an expectation of accounts or disclosures in the financial statements; it requires the auditor to obtain an understanding of the entity and its environment so that the auditor has an expectation of the accounts and disclosures in the financial statements (i.e., it is a rationale for the understanding of the entity and its environment and is not an audit procedure on its own). • Paragraph 10 (f) – We do not support expanding the current required understanding of "relevant controls" to include understanding "each of the components of internal control as they relate to making accounting estimates" because: • This creates redundancy in the requirements. We believe the relevant understanding of the risk assessment process component of internal control is already covered by paragraph10 (d) and that the relevant understanding of the information system component of internal control is covered by paragraph 10 (e). • The new application material to this requirement addresses the relevance of the control environment only. We would agree that the auditor should consider the effect of the entity's control environment on management's preparation of accounting estimates. In order to reflect this necessary consideration in the requirements, we would suggest reverting paragraph 10 (f) to "relevant controls" and inserting a new paragraph 10 (a) focused on the effect of the control environment. • This change loses the connection to the required identification of controls relevant to the audit in ISA 315 (Revised). Identification and understanding of controls relevant to accounting estimates is important to the auditor's assessment of the risks of material misstatement for the relevant assertions for accounting estimates. "Relevant controls" also include those that address significant risks, which often relate to accounting estimates. We believe that the emphasis on identifying and understanding controls relevant to accounting estimates should not be lost. • The application material to paragraph 10 has been substantially expanded and enhanced. In light of the IAASB's concurrent project on ISA 315 (Revised), we encourage consideration of whether some of this new guidance may apply more broadly to risk assessment across the financial statements (and not just to accounting estimates) and, if so, whether this guidance would be better placed in ISA 315 (Revised). In some respects, it may appear that ED-540 is setting expectations for risk assessment procedures above and beyond what ISA 315 (Revised) may be believed to require. Further, we encourage the IAASB to ensure that there is close coordination between the two projects to reduce the risk of significant conforming amendments to ISA 540 after its revision to accommodate changes in ISA 315 (Revised), to the extent that such changes can be foreseen.

		Documentation Although we acknowledge that ISA 230 sets forth overall requirements for audit documentation, we believe it is important to clarify the requirements for documentation specifically related to accounting estimates. Paragraph A158 of ED-540 seems to include expectations for documentation that go beyond paragraph 27 of ED-540. We encourage the IAASB to be clear in the requirements of ED-540 as to the documentation expected, even when such documentation may be viewed to fall within the scope of a broader requirement of ISA 230, in order to promote consistency across audits, and in stakeholder expectations, related to audit documentation.
25.	GTI*	Overall, we support the identification of the factors that drive the inherent risk of estimates; however, we are of the view that the IAASB should consider how this approach can be applied in practice by auditors. Our concerns include (1) whether there is benefit to separating the factors of estimation uncertainty, complexity and judgment; and (2) how the three factors interact and if it is necessary to develop separate procedures for each of these three factors. Although the requirements addressing how the auditor obtains sufficient appropriate audit evidence for each of the three factors are expressed as matters over which the auditor should obtain sufficient appropriate audit evidence, the practical application of these requirements is that the matters will become a checklist that the auditor will work through to be "certain" of obtaining sufficient audit evidence. This may not result in the most effective and efficient approach to the audit of estimates. This level of unintended prescription in the requirements would also represent a departure from a principles-based standard. We are also concerned with the direction of paragraph 19(b) of ED 540, which, as currently written, would appear to suggest that if management is unable to develop a reasonable estimate, the auditors are responsible for its development. We are of the view that, in addition to blurring the line between the responsibilities of management and those of the auditor, it is not reasonable to expect, or provide the impression, that the auditor will be able to develop a range of acceptable values if management is unable to do so. If management is unable to develop a reasonable estimate, we are of the view that this would lead to a limitation of the scope of an audit that would accordingly be reflected in the audit opinion. Without the elimination of this requirement from the standard or further clarification of the intention of this requirement, it has the potential to be a fatal flaw. We welcome the efforts to revise ISA 540 in light of increasing use and complexity of accounting estimates in today's financial statements. It is important that the standard is drafted in a way that can be understood by the users, i.e. the standard should be written in "plain English." In order to accomplish this, we are of the view that some of the information and explanations in the accompanying Explanatory Memorandum should be incorporated into the proposed standard. We have included specific suggestions in this area in our more detailed responses below. We welcomed the opportunity provided by the IAASB to participate in the field-testing of ED 540 and have included some of our observations in our response below. Of further note, the Public Company Accounting Oversight Body (PCAOB) issued Docket 43: Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements, on June 1, 2017 and we note that the PCAOB's proposed changes build on the existing approach to auditing estimates. We further note significant differences between the PCAOB's proposals and those of the IAASB. We would recommend consideration of whether further consistency can be achieved between the two standards.
26.	KPMG*	The need to change ISA 540 Leading financial reporting frameworks have undergone significant changes in recent years, moving towards a more forward-looking and judgmental accounting for many financial statement items. Consequently, there is an increasing need for management to make accounting

		estimates and financial statements are subject to greater levels of estimation uncertainty than before. These changes have been accompanied by increasing complexities in the global business environment. Coupled together, these trends pose significant challenges to both preparers and auditors, as the preparation of accounting estimates often involves the use of numerous subjective and, often inter-related assumptions, complex modelling and increasingly large amounts of data. These challenges necessitate that ISA 540, and other International Standards on Auditing, be modernised to make them more fit for purpose. Our overall impressions of ED-540 We agree with the objectives of the project as set out in ED-540 and we appreciate the efforts that have been undertaken to modernise and enhance the requirements of ISA 540. We also recognise the challenge of drafting a standard that is sufficiently scalable, addresses the challenges currently faced by auditors and is future-proof to the extent possible. Whilst we agree there is the need to update the standard, we have concerns regarding key aspects of the proposals being overly complicated, lacking in clarity and difficult to operationalise. In summary, these concerns relate primarily to the following: (1) Risk assessment Risk assessment plays a key role in addressing the challenges described above, enabling the auditor to identify the relevant risk factors that have the most impact on the identification and assessment of the risks of material misstatement, thereby allowing the auditor to develop an audit approach that appropriately responds to those risks. Whilst we believe there is merit in enhancing risk assessment for the more sophisticated accounting estimates, we believe that ED-540 lacks clarity around some of the requirements pertaining to risk assessment – for example, the extent of these procedures and their interaction with ISA 315; Our detailed comments on ED-540 and possible ways of addressing these comments are described in the Appendix to this letter. It should be noted that our observations above are consistent with feedback received from our engagement teams involved in the limited-scope field testing of the proposals. Considering our observations above, we believe that additional work is needed on ED- 540. Our assessment is that ED-540 may not be a significant improvement to extant ISA 540 in addressing the challenges of auditing sophisticated estimates, and we believe it may actually be more complicated to apply in practice for both simple and more sophisticated estimates. Furthermore, considering the standard cannot provide detailed application guidance with respect to how the requirements apply to the many varied types of accounting estimates, it may be useful if the standard is complemented by non-authoritative guidance dealing with application of the requirements to more specific sophisticated estimates. Other Matters Written Representations In accordance with the proposed ED-540.25, “the auditor shall obtain written representations from management and, where appropriate, those charged with governance that they believe the methods, significant data and significant assumptions used in making the accounting

		estimates and their related disclosures are appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of the applicable financial reporting framework". We have the following concerns regarding the requirement in paragraph 25: a. The required representation uses terms that may not be defined under the applicable financial reporting framework (and if defined – they may be defined differently than the ED) and may not be well understood by management (e.g. the meaning of "significant data" or "significant assumptions", as defined in ED-540.A35, or the meaning of the terms "reasonable" and "appropriate" as defined in ED-540.A2-A3); b. It is not clear why the auditor would be satisfied with representations about only the significant data and assumptions rather than all data and assumptions, and why data and assumptions would be referred to differently from methods in this respect; and c. The representation does not relate to the reasonableness of the estimate as a whole. It may be the case, for example, that while assumptions are reasonable on their own, they may be inconsistent with each other or result in estimates that are not reasonable. Consequently, we would recommend that the representation obtained relate to the reasonableness of the accounting estimates, including the appropriateness of underlying methods, assumptions and data, in the context of the applicable financial reporting framework. Appendices With respect to Appendix 1, Measurement Bases of Accounting Estimates, we recommend the IAASB consider removing this content from the standard. The guidance appears to be primarily accounting related, educational in nature, and it is unclear how it interacts with, or complements, the requirements and guidance in the standard itself, which could cause confusion.
27.	PKF	While we recognise the substantial proposed revisions, and given the need for national due process and translation, we believe, in anticipation of the imminent effects of IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers and the increased application of fair value accounting generally, there should be no undue delays in finalising the requirements and application material of this Standard. We are supportive of the IAASB's response and continued efforts to improve the requirements and application material in light of the developments in accounting and reporting frameworks. Further, we are particularly supportive of the approach taken in ED-540 with regards to risk identification and assessment, the recognition of low inherent risk, and the scaled approach to addressing identified risks. We trust this approach will have positive implications for the review of ISA 315 and 330.
28.	PWC*	Accounting estimates and related disclosures ("accounting estimates") are an integral part of financial reporting, often having a significant impact on the results of operations and financial position presented in financial statements. The evolving business environment and related developments in financial reporting frameworks are resulting in increasing complexity and management judgement in making accounting estimates. We, therefore, support the IAASB in developing a revised ISA 540 that: • incorporates relevant considerations underpinning how accounting estimates need to be made in the context of relevant financial reporting requirements; and • supports the performance of high quality, scalable, auditing procedures over accounting estimates, including reinforcing professional scepticism and evaluating the sufficiency of the audit evidence obtained.

		We applaud the extensive outreach undertaken by the IAASB with a wide variety of stakeholders in informing and developing the proposed changes. We support the aim of promoting a more granular consideration of "what could go wrong", to inform the auditor's risk assessment at the assertion level and design of appropriate responses. Much of the related guidance that has been added in the application material is very valuable. We also believe that close alignment between the IAASB and PCAOB standards on auditing accounting estimates is in the public interest and in our recommendations we make reference to the recent exposure draft issued by the PCAOB . In the remainder of this covering letter, we provide an overview of what we consider to be necessary changes to address the concerns described above. Our comments on how to address the points above reflect where we felt the structure of the PCAOB standard was more logical and capable of practical application, while still achieving the desired objectives. Responses to the specific questions posed in the explanatory memorandum, including additional explanation of the matters addressed in this covering letter, together with constructive drafting suggestions that would address our comments, have been included in the accompanying appendices. In conclusion, we support the IAASB's objectives in revising ISA 540. To achieve the desired outcomes, however, we believe that it is essential that the revised standard: is understandable and capable of practical application; supports high quality audit procedures and the application of appropriate professional scepticism; and addresses fundamental questions about the nature and extent of audit evidence the auditor needs to obtain as a basis for their conclusion on the reasonableness of accounting estimates. We believe the IAASB has made good progress in this ED towards achieving these aims. But the proposed structure and logic in the ED needs to be revised. The requirements, as drafted, are not how an experienced auditor thinks about how to logically audit an accounting estimate, are not easy to apply in practice and may, therefore, result in unintended consequences. As explained above and illustrated in the appendices, we believe that it is possible to restructure the requirements to address these concerns, without losing the valuable additional guidance that has been developed. Restructuring them into a more logical and intuitive structure will, in our view, result in a robust, high quality auditing standard that will further contribute to enhancing audit quality. As a final comment, we note the cooperation between the IAASB and PCAOB, primarily through outreach and the PCAOB's participation in the ISA 540 Task Force, in developing this ED. It is clearly in the public interest to reach solutions that can bring about consistent, high quality auditing standards when addressing the same or similar subject-matters and auditing concepts. It is unfortunate that the EDs issued by each board on the subject of auditing accounting estimates contain quite fundamental differences in approach. In our view, this risks confusion and will not help bring consistency in practice to how accounting estimates are addressed in the audit. In responding to the feedback on this ED, and in finalising the revised ISA, we therefore strongly encourage both the IAASB and PCAOB to work closely together to achieve close alignment in their respective final standards. Summary of approach to field testing In field testing the proposed requirements set out in the ED we undertook two parallel exercises, as described below: General – Four engagement teams were asked to: consider the six accounting estimate scenarios presented in the IAASB field testing package; read the new requirements; identify and assess the risks of material misstatement relating to each estimate; and respond to a series of questions that were broadly aligned with those in the IAASB package (see below).

		Banking and Insurance – Seven engagement teams were asked to undertake the same exercise as that described above but with the subject-matter being accounting estimates common to their client base/ relevant industry (banking or insurance), rather than the six scenarios presented in the IAASB package. We specifically requested that Expected Credit Losses under IFRS9 be included. The same series of questions were posed, modified, where appropriate, to reflect the different subject-matter. Questions 1. Did the revised understanding the entity risk assessment requirement (paragraph 10) provide you with sufficient guidance to identify and assess the risks of material misstatement? 2. With respect to the revised requirement to identify and assess the risks of material misstatement (paragraph 13) how capable were you of thinking about the estimate in terms of the risk factors of complexity, the need for the use of judgement and estimation uncertainty? 3. What risk(s) of material misstatement did you identify for each estimate and which risk factor(s) did you determine as being the reason for your assessment? 4. Did you identify any other relevant risk factor(s) when thinking about the risks of material misstatement? If so, please explain. 5. Recognising that risks exist on a spectrum, how easy or otherwise did you find it to make the judgement required under paragraph 15 as to whether inherent risk is low or not low? 6. If you considered the estimate to have low inherent risk, was it clear from paragraph 15 (a) what you would need to do to design an appropriate response to the risk? What sort of procedures did you think were appropriate to respond to the risk? If you determined a different approach than those listed in the requirement please explain (mark N/A if risk is not assessed as low inherent risk). 7. If inherent risk was considered to be 'not low', was it sufficiently clear to you what procedures you would need to perform to obtain evidence about the matters in paragraphs 17-20, as applicable (mark N/A if risk is assessed as low inherent risk)? 8. Did you find that the reasons for the assessed risks included more than one risk factor (complexity, judgement, estimation uncertainty), and, if so, how did you approach addressing paragraphs 17-20? What challenges did you encounter when trying to address multiple factors? 9. In reading each of the new requirements and thinking about the different estimates you had to consider, was it clear to you what you needed to do to comply with each requirement? 10. Did this new approach, based on consideration of "risk factors" and "matters about what audit evidence needs to be obtained, when applicable", change your overall approach to thinking about risks related to accounting estimates and how best to address them, compared with applying existing ISA 540? If so, what was different? 11. Recognising that risks exist along a spectrum, were you able to tailor the procedures you would perform to the level of assessed risk? If you identified any significant risks, based on the work effort you think would be needed to comply with paragraphs 15-20, would you expect to do anything different/additional as a consequence of the risk being determined as significant?

		12. Regarding misstatements, did you find the application material in paragraphs A142-A146 clear in determining what constitutes a misstatement?
29.	RSM*	Overall, we support the IAASB's proposals in the Exposure Draft as they would strengthen the quality of audit procedures for addressing the risks of material misstatement associated with accounting estimates. We also find the IAASB's proposals to be responsive to calls heard from regulatory bodies and other stakeholders to strengthen the auditing standards in this context. However, our view is that the IAASB should be open to considering the structure and organisation proposed by the PCAOB for the revision of its own auditing standard for auditing accounting estimates. Further, we encourage the IAASB and PCAOB to continue dialogue to minimise differences in these standards by combining the strengths and robustness of the IAASB proposals with the structure and organisation of the PCAOB standard. In addition, we have a number of concerns relating to the practical aspects involved in the assessment of inherent risk and the related audit response. These are set out in more detail in our comments on Question 4a below.
30.	SRA	Our response to the specific comments questions is limited to questions 3 and 4, as these questions are particularly relevant to the audits of SME's. We concur with the scalability, introduced in this proposed ISA, by making the choice to limit the required audit work as set out in par. 15a of ISA 540, if inherent risk is estimated to be low. The required (limited) audit work is adequate in those circumstances. We acknowledge that the proposed ISA states that further work has to be carried out when inherent risk is not low and that this work is more extensive compared to the extant IS 540. In our view the requirements which are applicable in this situation are adequate and clearly described.
Public Sector Organizations		
31.	ACAG	Overall ACAG agrees with the revised intent of the ED. However, we have concerns that this standard will be issued before ISA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment, which we believe should establish the risk assessment framework for ISA 540. ACAG also notes that this standard appears to be more prescriptive in nature than the existing suite of auditing standards, rather than being principles based, and questions whether this was the intent of the IAASB. Additionally, the level of effort required of auditors and consequently, preparers, is greater than that required from the preparers applying comparative accounting standards. ACAG recommends that preparer requirements be embedded only in the accounting standards, to help achieve compliance and consistency in application. We have identified some areas of the ED which could be improved or refined to help with the practical application of this standard. ACAG recommends conducting a post implementation review of the standard to identify and address practical application issues faced by auditors. ACAG appreciates the opportunity to respond and trust that you find our comments useful.
32.	AGA	
33.	AGC	

34.	AGNZ	In making our submission, we have identified the matters below for the attention of the IAASB: 1. The focus of ED-540's application is too narrow. 2. ED-540 is unnecessarily long and complicated. 4. There is an inconsistent approach to risk assessment. 5. There are concerns around the practical consequences for auditors. 6. Disclosure is not sufficiently emphasized. A number of our comments relate to matters that are broader than the individual questions asked about ED-540. Where relevant, we have made reference to specific questions in our attached response. 1 The focus of ED-540's application is too narrow 1.1 In our view, the existing standard does not adequately reflect the public sector. Likewise, we think that ED-540 does not adequately consider public sector entities. We question whether there has been sufficient consideration of how ED-540 would be applied to audits of entities that are neither financial institutions nor have complex accounting estimates, especially those in the public sector. 1.2 It is clear that audits of financial institutions and complex estimates were the main consideration when ED-540 was prepared. It is also clear that the main focus of outreach activities was to engage with regulators and auditors of financial institutions. 1.3 In our view, ED-540 fails to adequately consider the significant range of accounting estimates that are likely to be encountered outside banking and insurance institutions. This lack of consideration of how ED-540 will apply, and the consequential impact that any changes will have on an auditor's workload, is an important concern for us. 1.4 There can be a high degree of complexity, uncertainty, and judgement involved in preparing accounting estimates for many entities. Auditors must exercise their own judgement and professional scepticism in the audit of those estimates. 1.5 However, unlike the examples cited in ED-540 (such as expected credit losses from internationally active banking institutions), there are also many accounting estimates that are frequently prepared without any significant degree of estimation uncertainty, or where there is no complex model involved in the estimation process. 1.6 Some examples from the public sector include: ☐ valuing infrastructure assets and property, plant and equipment carried at fair value; ☐ estimating impairments or liabilities arising from natural disasters; ☐ providing for the post-closure restoration costs of a landfill site; and ☐ accruing for taxes receivable. 1.7 As it is currently written, we think that the application of ED-540 should be limited to the audit of banks and financial institutions, or engagements which involve significant financial instruments. If ED-540 is to be applied more broadly, we are of the view that it needs to be written in a way that auditors can relate to for a wider range of accounting estimates.

		2 ED-540 is unnecessarily long and complicated 2.1 In our view, ED-540 is significantly longer than it needs to be, and this adds to its complexity. 2.2 Accounting estimates are common throughout all financial statements, and they represent a significant proportion of the audit work undertaken by auditors. It is, therefore, reasonable to expect auditors to be familiar with the requirements and expectations set out in the Standard. 2.3 Auditing accounting estimates is difficult and there is an elevated audit risk. It is important that relevant guidance and expectations are set out in a way that is clear to auditors, so that they complete the appropriate level of work. Otherwise there remains a risk of a material misstatement not being identified. A lack of clear and concise language 2.4 We think that the length of ED-540 makes it difficult for auditors to properly understand and apply. ED-540 is twice as long as the existing Standard, and the application guidance section is considerably longer than the main body. 2.5 Also, ED-540 uses some excessively long sentences, and some vague language, which makes it difficult to understand. For example, paragraph 4 states: "This ISA focuses the auditor's attention on designing and performing further audit procedures (including, where appropriate, tests of controls) responsive to the reasons for the assessment given to the assessed risks of material misstatement, particularly when those reasons include complexity, judgment or estimation uncertainty." 2.6 This sentence is confusing. The effectiveness of a standard is dependent on how easy it is to read and understand. In our view, ED-540 fails to meet the "understandability" test. Confusion, inconsistencies, and conflicts in ED-540 2.7 We are concerned that the large number of possible procedures included in the application guidance section could lead to regulators and reviewers using those procedures as a checklist to "tick off" whether auditors have performed them. One of the stated intentions of the revisions proposed in ED-540 is to enhance "the auditor's application of professional scepticism". 2.8 We do not think that the inclusion of so many possible procedures gives effect to this intention. Instead, it interferes with the expectation that auditors should apply their own professional judgement and scepticism to each engagement, based on their knowledge and understanding of the business and operating environment of the entity subject to audit. 2.9 We also consider some of the paragraphs in the application guidance section to be requirements rather than guidance (for example, paragraphs A96 and A135). These paragraphs would be better placed in the main body of ED-540. 2.10 In addition, there are a number of instances in ED-540 where it is not readily apparent whether the procedures described are required or if they are merely illustrative examples of the types of work an auditor could choose to undertake. An example of this is paragraph A49, which could be interpreted either as a requirement that the internal controls must be tested or as a suggestion that such testing is a possibility. 2.11 There are also sections that appear to be contradictory. An example is paragraph A97 in the application guidance section, which states "when inherent risk is low, this ISA does not specify the nature of the further audit procedures to be performed". However,

		the same paragraph goes on to list a number of procedures in a manner that could be interpreted as suggesting that the auditor is expected to carry them out. 2.12 Collectively, these examples demonstrate the difficulty in identifying the areas where there is scope for auditor judgement and scepticism to be applied. Unnecessary content 2.13 There are also a number of sections that we consider to be unnecessary because they: ☐ State the obvious. Paragraphs A39-A41 give examples of types of data, sources of data, and matters that auditors might consider when assessing data. None of these appear to be particularly new, unusual, surprising, or complex. It is our view that concepts such as these are widely understood and do not require specialist accounting or auditing knowledge or expertise. ☐ Discuss fundamental concepts that should be well understood by auditors (and are not specific to auditing estimates). Paragraph A96 states “If the further audit procedures in paragraph 15(a) do not provide sufficient appropriate audit evidence, the auditor is required by ISA 330 to design and perform other procedures.” An experienced or competent auditor should be able to reach the same conclusion without needing to refer to these paragraphs. ☐ Repeat issues already discussed in ED-540. Paragraph A71 states that “Paragraph 13 requires the auditor, in identifying and assessing the risks of material misstatement, to take into account the extent to which the accounting estimate is subject to, or affected by relevant factors, including complexity, the need for the use of judgement by management in making the estimate, and estimation uncertainty.” This essentially summarises and repeats the content of Paragraph 13, without providing any additional guidance. 2.14 The two appendices contain even more material that auditors are expected to read, consider, and, where appropriate, apply. It is not entirely clear what the purpose of this extra material is or what value it adds for auditors. Removing these Appendices will not adversely affect the way in which auditors and engagement teams plan and execute their approach to auditing accounting estimates. 2.15 Being focused about the content of ED-540, and reducing the number of pages would make it more useful and relevant to auditors. And, making ED-540 more accessible and relevant to auditors is likely to lead to an improvement in audit quality. At what point should further audit procedures be applied? 3.7 We also have concerns about the new requirement at paragraph 10(f), which requires auditors to “consider each of the components of internal control as they relate to making accounting estimates”. 3.8 Because paragraph 10(f) appears in ED-540 before the auditor is required to complete their initial risk assessment, it seems to apply to all audits. This is unusual, since initial risk assessments are generally determined only by considering inherent risk factors and without allowing for any relevant controls. 3.9 There are few accounting estimates where auditors would seek to place the bulk of their reliance on internal controls. One exception might be complex estimates, where models are used to prepare figures for inclusion in financial statements, and where there are controls in place over the input of data to the model.

		3.10 Because of the significant amount of audit judgement required and the limited assurance available, it is unlikely that auditors would seek to rely on controls for most estimates. As a result, the requirement for auditors to consider the components of internal control before confirming the initial assessment of risk seems excessive and provides no additional assurance. 3.11 In our view, if the requirement to consider elements of internal control is retained, it would be better placed elsewhere in ED-540. An appropriate place may be in the section titled Responses to the Assessed Risks of Material Misstatement, which comes after the auditor has classified inherent risks as either "low" or "not low". Application of a scalable approach based on the nature of the entity 3.12 The existing ISA 540 contains a paragraph (A11) in the application guidance section, Considerations Specific to Public Sector Entities. This paragraph has been removed in the proposed revision and ED-540 instead has a paragraph at A23, Considerations Specific to Smaller Entities. 3.13 It is unclear what the purpose of this paragraph is. It permits auditors to tailor their audit approach for smaller entities, but auditors should already be tailoring their approach for all engagements, regardless of the size of the entity. Designing and following an appropriate audit approach enables the auditor to demonstrate that audit judgement has been applied, and that the engagement has been completed in a manner that should meet expected quality standards. 3.14 The intention for including this paragraph is not clear. ED-540 should identify any specific audit considerations that are unlikely to be relevant to the audit of smaller entities. Conversely, if the expectation is that all audits require the same procedures, regardless of the entity's size, then paragraph A23 adds no value. 4 An inconsistent approach to risk assessment 4.1 The auditor's assessment of risk is fundamental to planning and performing appropriate audit procedures. It is crucial for concepts to be clearly understood so that they are consistently applied. 4.2 We are concerned that the assessment of risk in ED-540 is not clear. It is confusing that ED-540 refers initially to significant risk, but later refers to inherent risk. 4.3 We are also concerned that the assessment of risk in ED-540 is not consistent with other standards. ISA 200 clearly states that the inherent risk should be assessed "before consideration of any related controls", but ED-540 appears to contradict this, through the requirements of paragraph 10(f) referred to in 3.8 above. 4.4 Paragraph A42 of ISA 200 also goes on to state that "the ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the 'risks of material misstatement'." ED-540, however, clearly sets an expectation that the inherent risk is assessed separately, after considering the components of internal control as they relate to making accounting estimates. 5 Concerns around the practical consequences for auditors 5.1 We have some concerns around the practical implications of applying ED-540. 5.2 Our interpretation of how ED-540 will apply indicates potential for: ☐ A greater burden of work for auditors;

		☐ An increased "self-review" threat to independence; and ☐ An increased use of experts by auditors. A greater burden of work for auditors 5.3 ED-540 could lead to a greater level of work for auditors of public sector entities, where the largest items on the balance sheet are assets recognised at fair value, such as: ☐ roads and bridges; ☐ water, wastewater, and stormwater reticulation networks; and ☐ special purpose buildings such as hospitals and stadiums. 5.4 It is unlikely that the auditor would assess those assets as being of low inherent risk (the relative size of the item(s) alone could mean it is the account area most likely to be at risk of a material misstatement). 5.5 In many cases, it is probable that such estimates would be determined on the basis of a valuer's report, received by management, or based on the information provided by an internal expert. Where this is the case, the most likely current approach would be to review the assumptions applied by management (or management's expert) and assess them for reasonableness. This approach is permitted in ED-540 under paragraph 15(a)(ii), but only applies to account areas where the inherent risk is assessed as low. 5.6 Since the trigger point under ED-540 is the assessment given to the inherent risk, land and building valuations are likely to require application of the further audit procedures referred to in paragraph 15(b). This could mean a considerable increase in work effort is required for many public sector entities. An increased "self-review" threat to independence 5.7 Our observation from public sector audits is that often valuers' reports do not contain evidence of how estimation uncertainty has been addressed. Where that is the case, under paragraph 19(b) "the auditor shall, to the extent possible, develop an auditor's point estimate or range". 5.8 We are concerned that ED-540 may require auditors to perform work which could pose a "self-review" threat. In our view, it is not the auditor's role to develop a model or even a point estimate. This should remain the responsibility of management. Where auditors become aware of deficiencies in an entity's approach, this should be communicated to management and those charged with governance, but the auditor should stop short of actually calculating a figure. 5.9 The necessary level of work to develop an auditor's point estimate or range could be quite onerous and it is unclear whether the additional work is required in all circumstances or just when the auditor is concerned that an estimate might be materially misstated. 5.10 There is also a small risk that this could become a factor in the auditors' assessment of inherent risk and, as a result, inadvertently influence irrational behaviours (that is, lead to auditors inappropriately assessing an estimate as low risk). An increased use of experts by auditors 5.11 Application guidance paragraph A69 provides examples of estimates that auditors should be capable of assessing. Paragraph A69 also suggests that other estimates (such as expected credit losses or insurance contract liabilities) would be likely to require auditors

		to apply specialised skills or knowledge from outside the audit team's collective "experience", implying that auditors are unlikely to be able to audit such figures themselves. 5.12 We believe that many auditors would have the skills and knowledge required in order to obtain sufficient appropriate audit evidence relating to many accounting estimates that fall between the two extremes cited in paragraph A69. In particular, there are a number of professional service firms that carry out a range of services. It would seem unusual for them to be able to carry out valuation services on a consultancy basis, but at the same time, not be considered capable of assessing similar estimates in an audit capacity. 5.13 We foresee a future where auditors are increasingly required to engage an independent auditor's expert to review and/or challenge an estimate that has been developed by an expert engaged by management. We question what added value this approach will provide for users of financial statements. 5.14 In our experience, a knowledgeable and experienced auditor often asks more probing questions and applies more professional scepticism than independent "experts" and also has a considerable amount of practical experience and knowledge that they are able to draw on. 6 Disclosure is not sufficiently emphasised 6.1 Accounting estimates, by their nature, cannot be sufficiently represented in financial statements only by a numerical amount. They must be accompanied by appropriate note disclosure. This disclosure should provide users with clear information about the uncertainties that surround the figure presented in the financial statements and the method used to determine the final figure. 6.2 The fair presentation of an accounting estimate requires a significant effort in quantifying the figure to be recognised together with appropriate disclosure. The auditor's role is to satisfy themselves that the combination of the figure recorded and the associated note disclosure is fairly presented. 6.3 In our view, ED-540 does not adequately emphasise the importance of appropriate disclosure around accounting estimates. Nor does ED-540 sufficiently clarify the auditor's role in assessing the adequacy of disclosures, in order to form an opinion on fair presentation.
35.	CIPFA	Comments On The Drafting Level And Specificity In April 2007 CIPFA responded to an IAASB exposure draft which combined the previously separate standards ISA 540 (on accounting estimates) with ISA 545 (on fair value). CIPFA was strongly supportive of the withdrawal of ISA 545, and we noted our view that having a separate ISA relating to a specific accounting measurement approach was in retrospect anomalous. CIPFA was glad to see requirements which focused on more general requirements to obtain assurance on the correct application of financial reporting guidance, and in respect of the reliability of estimate data and calculations. Even so, we noted some respects in which the proposed revisions still engaged with the specifics of the IFRS framework rather than matters of fully general application. Against this background, it does not surprise us that, when reviewing issues arising in connection with the audit of financial institutions, the Board found that most if not all of these would be equally relevant when auditing other complex accounting estimates. We are glad to see that the proposed revision has removed from the main body of the standard a number of details relating to fair value (including e.g. references to marketplace participants). We are also glad to see that these were not simply replaced by references to e.g. expected credit loss models. Material on both fair value and the specifics of ECL has been incorporated in the Application and Other Explanatory Material,

		framed as important examples, and we consider that this approach has been well executed. We also consider that the reframed 'Measurement Bases' appendix is an improvement on 'Fair Value Measurements and Disclosures under Different Reporting Frameworks'. CIPFA's response to the IAASB Request for Comments CIPFA's comments on the questions in the Request for Comments are attached in an Annex. Generally we support the approach taken in the ED. Redrawing the boundary between basic procedures and enhanced audit effort based on 'low inherent risk' (rather than a holistic view of significant risk of material misstatement) is a novel approach, but does appear workable. We also note and agree that in those cases where reliance on controls forms part of the basis for auditor assurance, the ED is clear that controls must be tested.
36.	GAO	We support the International Auditing and Assurance Standards Board's (IAASB) efforts to update the standards for auditing accounting estimates. However, we believe that the proposed standard could benefit from linking the audit procedures in paragraph 15(a) to the audit evidence required to be obtained in paragraphs 17 through 20. We believe that this approach will increase the clarity of the standard and will make it easier for auditors to effectively apply. Further, we suggest that the IAASB consider grouping the guidance in paragraphs 17 through 20 by procedures that evaluate evidence related to methods, data, and assumptions. We have found this approach to be useful in our audits of complex estimates in the federal government and believe that it may be easier to apply than the approach described in the proposed standard, which is organized by the factors complexity, judgment, and estimation uncertainty. Other Comments While we appreciate the IAASB's efforts to provide an abundance of guidance to assist auditors in applying the standard, we suggest moving the information contained in the appendix to a separate guide or tool to increase the clarity and usability of the standard.
37.	INTOSAI	
38.	PAS	
Preparers of Financial Statements		
39.	ABA	The American Bankers Association (ABA) appreciates the opportunity to comment on the Proposed International Standard on Auditing 540 (Revised) – Auditing Accounting Estimates and Related Disclosures (the Proposal). Accounting estimates are pervasive throughout bank financial statements, mainly through the allowance for loan and lease losses (ALLL) and the fair value measurement of various financial assets and liabilities. While IAASB standards technically do not apply to U.S. companies, we believe that only in rare occasions will the Auditing Standards Board of the American Institute of CPAs (ASB) approve auditing standards for non-SEC registrants that are significantly different from the IAASB. With the Accounting Standards Updates (ASUs) recently issued by the Financial Accounting Standards Board (FASB) that will change how loan fair values are disclosed and how credit losses are measured , it is easy to see that the Proposal will have a significant impact on audits of many non-SEC registrant banking institutions. We believe the concurrently outstanding proposal issued by the Public Company Accounting Oversight Board (PCAOB) largely conforms to the spirit of this Proposal, while perhaps providing more prescriptive guidance related to the auditing of management assumptions. As such, we believe that certain aspects of the PCAOB proposal will be used to understand how specific procedures may address certain objectives noted in this Proposal. With those things in mind, we are also attaching our response to the PCAOB proposal, as we believe our comments therein have relevance to this Proposal. The comments included here are specific to this Proposal.

		The Auditing Requirements will be Costly We believe the upcoming implementation of IFRS 9 and the CECL standard, in light of the requirements in the Proposal relating to obtaining and evaluating sufficient audit evidence over the complexity, judgments, and estimation uncertainty of the ALLL, will require significantly more supporting documentation from the bank and more industry expertise on the part of the auditor. This will be costly to banks, especially at the community bank level, where auditors may need to hire valuation and credit risk specialists to evaluate whether these highly judgmental assumptions are considered "reasonable." In light of the IAASB's observation that, if the auditor decides to perform an independent estimate, its range for the estimate "may be multiples of materiality for the financial statements", it is very difficult to see how the value of such additional audit requirements will exceed the costs. With such estimation uncertainty, users of financial statements will get little comfort from the more stringent documentation requirements, especially in times of economic stress, when significant skepticism over any assumptions of the future would be expected. This is not necessarily a defect in the proposed auditing standard, but is the nature of the related accounting standards. *** The American Bankers Association (ABA) appreciates the opportunity to comment on the Proposed Auditing Standard – Auditing Accounting Estimates and Fair Value Measurements (the Proposal). Accounting estimates and fair value measurements are pervasive throughout bank financial statements, mainly through the allowance for loan and lease losses (ALLL) and the measurement of other financial assets and liabilities. While PCAOB standards technically apply only to audits of public companies, for practical purposes, the proposed revisions will likely be considered interpretations of current and future standards of audits related to non-public companies, as the Proposal is largely consistent with the concurrently outstanding proposal issued by the International Auditing and Assurance Standards Board (IAASB) to address international auditing standards. We have attached our comments to the IAASB proposal as an Appendix. Not only do the accounting estimates and fair value measurements made within bank financial statements involve significant judgment, but third-party specialists and pricing services – addressed in a related proposal – are often used by banks of all sizes in generating such estimates. With the Accounting Standards Updates (ASUs) recently issued by the Financial Accounting Standards Board (FASB) that will change how loan fair values are disclosed and how credit losses are measured , it is easy to see that the Proposal will have a significant impact on audits of banking institutions. The Costs of the Proposal Exceed its Benefits, Due to Upcoming Accounting Standards The Proposal appears to attempt to codify the increasingly extensive documentation that auditors of large banks have required over the past few years – in response to PCAOB inspections – to support the quantitative assumptions made by management in their accounting estimates. The Proposal also stresses the need for professional skepticism during audits. For example, terms such as "corroborate" are replaced by "evaluate" and "compare" in order for the auditor to challenge any potential bias in management's judgments. The intent behind these aspects of the Proposal seems understandable. However, if approved, the requirements of the Proposal will result in significantly higher audit costs and, possibly, the end of the ability of many local auditing firms to audit community banks. Worse, however, it will do so with no significant improvement to auditing of the most significant balance on most bank balance sheets – the allowance for loan and lease losses (ALLL). In other words, the costs of the expanded documentation and audit responsibilities will exceed its benefits. The Proposal notes that one of the main benefits of the proposed standard will be from a capital market perspective: "An increase in investors' confidence about the information provided in companies' financial statements resulting from improved audit quality can increase the efficiency of capital allocation decisions"

		We generally agree with the statement. However, any declines in investor confidence in bank financial statements have not been the result of insufficient auditor scrutiny, but rather because highly judgmental estimates of the fair value of financial instruments and the ALLL are made during times of illiquid markets and intense economic uncertainty. The assumptions, and their quantitative impacts, will always be subject to intense skepticism and no auditing standard will increase investor confidence in the assumptions made during these times. Going forward, however, with the CECL standard's requirement to forecast the depth and timing of such future economic uncertainty, there will likely be nothing an auditor can do to increase investor confidence in such estimates at any point in the economic cycle. With that in mind, the main benefits cited in the Proposal are highly questionable. We believe the upcoming implementation of ASU 2016-1 (specifically related to the requirement of disclosing the fair value of loans at "exit price") and the CECL standard, in light of the requirements in the Proposal relating to scrutiny of management's assumptions, will require significantly more supporting documentation from the bank and more industry expertise on the part of the auditor. This will be costly to banks, especially at the community bank level, where auditors may need to hire valuation and credit risk specialists to determine whether the highly judgmental assumptions are "reasonable." In light of the IAASB's observation in their proposed revision to International Standard on Auditing 540 that, if the auditor decides to perform an independent estimate, its range for the estimate "may be multiples of materiality for the financial statements", it is very difficult to see the value that such a specialist brings to a bank investor. As a result, the PCAOB must recognize that the costs of the Proposal will be borne by many smaller banks that may have to hire larger auditing firms. The Final Standard Must Recognize that Bias is Inherent to CECL A significant portion of the Proposal discusses professional skepticism and the elimination of management bias in accounting estimates. This seems reasonable for fair value estimates, as the estimates made are supposedly based on market-based assumptions. However, subjectivity and bias are inherent features of the CECL standard. True, CECL assumptions are meant to be "reasonable and supportable" and there may be the notion that the auditor can detect bias that is considered unreasonable. However, due to the non-linear relationship of economic forecasts to credit losses (for example, there are often no credit losses on collateral-based loans until a specific loan-to-value ratio is reached), small differences in forecasted macroeconomic factors can often have a large impact on the reported financial performance. Unreasonable bias will often be very difficult to detect. By the design of the CECL standard, there will be no practical way to reduce management bias in a way that brings investor confidence in the financial statements. Designing and testing an internal control system intended to eliminate bias in such an environment will include quarterly analysis of which assumptions are (and are not) significant in each estimate. For example, as consideration of prepayments is required within CECL, short-term movement of interest rates can sometimes be a significant assumption, and sometimes not. More significantly, however, is that for practical purposes, the Proposal effectively requires a bank to perform a sensitivity analysis of its significant assumptions to change, based on other reasonably likely outcomes that would have a material effect. While this sensitivity test can be performed in many ways, ABA believes it is likely it will include probability weighting–a process specifically omitted from the CECL standard – as a sign of an effective internal control system. Without probability weighting, it is difficult to see how sensitivity testing will address management bias. A further difficulty in the attempt to eliminate bias is the requirement in paragraph .64 of the proposed amendments to AS 2301, The Auditor's Responses to the Risks of Material Misstatement to effectively back-test the estimates. While model back-testing is a standard practice in the banking industry, doing so to ensure the elimination of management bias is not. Backtesting for this purpose appears to effectively require banks to apply macroeconomic "market views" when forecasting the future. Such a requirement appears to contradict the intent of FASB in codifying the forecasts of the future into the CECL estimate. In discussions ABA has conducted with FASB members, banking agency personnel, and auditing firms, backtesting was foreseen to be performed on specific components of the model (for example, a

		default rate given a specific forecasted macroeconomic assumption) but not the total model (which would include the accuracy of the macroeconomic assumption). It was assumed that the macroeconomic assumption would always contain inaccuracies. As a whole, the Proposal appears to commingle legitimate auditing concerns relating to management bias of certain fair value estimates with those that are inherent to the CECL estimate. CECL's management-based forecast of the future is, by design, highly subjective and efforts to eliminate its subjectivity and bias will be futile. As a result, ABA recommends that guidance related to reducing management bias not apply to the CECL standard. Guidance on how an auditor assesses the reasonableness of assumptions and their quantitative impacts, including the evaluation of related internal controls, may better serve the auditor of the ALLL. The Final Standard Must Recognize the Work of Industry Regulators Banking agency examinations are critical aspects of ALLL and fair value estimation processes for banks. For all practical purposes, we believe that the perspectives of the bank regulatory examiners and auditors are similar and many of the same substantive tests are currently used by both parties, resulting in significant redundancy in the audit process. In many situations, regulatory bank examiners provide guidance to banks on ALLL assumptions and may even qualify as specialists in their review of the ALLL and of other issues regarding financial instruments. With this in mind, we recommend that PCAOB specifically and explicitly address the work of regulatory examiners in assessing the reasonableness of management assumptions. The Final Standard Must Clarify the Definition of "Methods" Use of specific valuation methods are common practice within fair value measurements. However, as various methods and models may emphasize different aspects of credit risk, estimating credit losses normally involves a combination of various methods in order to arrive at a final ALLL balance. For example, a credit loss estimate under CECL can involve using a vintage loss rate method, supplemented by analyses of credit rating migration and estimated loan-to-value ratios; both of which may equate to roll rate and probability of default/loss given default "methods". In practice, quarterly estimation processes can be fluid, with different weight given to the different analyses over time, due to various circumstances. Other further supplemental analyses may provide further adjustments and, in some cases, the baseline estimate may not make up the majority of final amount. Based on the bank, the processes can be different and change by product, subsidiary, geographic region, etc. Paragraph .11 of the Proposal requires auditors, if the company has changed the method for determining the accounting estimate, to determine the reasons for such change and to evaluate the appropriateness of the change. Under such a requirement, onerous documentation requirements await bankers to support why (or why not) a change in method is appropriate. We do not believe this is the intent of the PCAOB. However, without further clarification, we believe such requirements will be understood. Therefore, the final standard should clarify the difference between methods and analyses, as well as provide guidance on how auditors and bankers can interpret when a change in method occurs in a fluid environment, such as credit risk analysis.
Member Bodies and Other Professional Organizations		
40.	ACCA-CAANZ	Joint Submission Comments CA ANZ and ACCA appreciate the opportunity to comment on ED-540. In responding to the proposals and undertaking outreach with our members, we have considered whether ED-540 addresses the concerns that underlie the call for a revision of extant ISA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures ("ISA 540"). We understand the key concerns to be:

		• regulator findings that indicate that there is insufficient/inappropriate work effort by auditors in relation to auditing accounting estimates (during both the risk assessment phase and the gathering of audit evidence) • lack of professional skepticism in challenging management's assumptions and biases in the auditing of accounting estimates • lack of sufficient work effort and attention given by auditors to the disclosures in relation to accounting estimates, particularly in relation to the increasing complexity of estimates contained within accounting standards. Before addressing the specific questions raised on ED-540 we have overall comments on whether ED-540 appropriately addresses these concerns raised about ISA 540. Ensuring the application guidance is useful. The application guidance as drafted is too long and appears to repeat requirements rather than providing additional guidance on those requirements. We are also concerned that listing estimates that may be low or not low inherent risk will potentially cause conflict as some of the examples given will not always fall into the categories they are listed under for all entities. The number of 'low' risks in A72 compared to the number of 'not low' risks in A73 may reinforce the notion that there are always relatively more risks that are not low. In respect of this issue, therefore, we would welcome more guidance in the application material to help auditors and regulators understand the IAASB's thinking on categorizing risks. Addressing documentation appropriately. Documentation is a key element in audit quality but ED-540 does not really expand on the documentation requirements in the extant standard. Although the additional requirements will require documentation, this point is not addressed in the ED. More precise documentation requirements and application guidance to enable auditors to appropriately and proportionately explain the work they have performed should be included. Lack of sufficient auditor attention to disclosures The requirements and application material in ED-540 in relation to auditing disclosures of accounting estimates appear very similar to the extant standard. If there is a perceived deficiency in ISA 540, we would expect that there would be new requirements or, if the requirements are sufficient, new application guidance to direct work effort in this area. As the material in ED-540 addressing disclosures is similar to ISA 540, we do not feel it will address the concern in this area. The requirements and guidance need to address not only disclosure of estimates contained in the financial statements but estimates which are only contained in the disclosures. Clearer documentation requirements and application material, particularly in relation to the exercise of professional skepticism and disclosures, in particular for estimates that are only contained within disclosures. Refinement of the application material with a focus on providing guidance and some relevant examples to assist the auditor in applying the requirements.
41.	AE	(1) Accountancy Europe is pleased to provide you with its comments on the IAASB's proposal to modernise the financial estimate audits in support of audit quality. We support the IAASB´s decision to explore this topic. The revision of ISA 540 is essential to ensure the standard remains fit for purpose in light of today's evolving and complex business environment. (2) We acknowledge that ISA 540 is an important standard which deals with various issues. We recognise IAASB's effort to provide sufficient guidance in the diverse circumstances in which ISA 540 should apply, ranging from simple accounting estimates to very complex ones. Accounting estimates are one of the major issues identified globally in regulatory audit inspections, specifically around the lack of auditor challenge and apparent shortcomings in the application of professional scepticism.

		(3) The introduction explains that accounting estimates are subject to inherent limitations, which means that it is impossible for either preparers or auditors to reduce estimation uncertainty beyond certain limits. This statement should be more explicitly linked to the requirements in the standard, in particular related to the resulting challenge for preparers and the auditor in relation to such measurement uncertainty. (4) We are also aware of concerns expressed in the past that a narrow-scoped ISA 540 could result in auditors overlooking some accounting estimates that ought to be addressed in a specific way, if auditors erroneously would assess the ISA 540 standard as not applicable to individual client circumstances. The IAASB should make sure this is considered as part of the revision of ISA 315. (5) Furthermore, there is anticipation of possible changes of ISA 315 already in ED-540 and therefore we would have favoured that the revision of both standards be done in parallel. Whilst we understand the urgency of delivering on ISA 540, this could cause some confusion and we urge the IAASB to coordinate the finalisation of ISA 540 with its project to revise ISA 315. (6) Whilst helpful, the application material is lengthy and reads like implementation guidance. It might be seen as excessive in comparison with application and other explanatory material in other ISAs; the IAASB might consider whether it would be better supplied in another form outside of the standard to auditors who wish to have a comprehensive reference, i.e. perhaps in the form of an International Auditing Practice Note (IAPN), particularly for the aspects of the explanatory material that are linked to the financial sector. (7) We welcome the IAASB's supplement to proposed ISA 540 (Revised) , which illustrates the work effort requirements. It explains the reasoning behind paragraphs 13-23 of the Exposure Draft (ED-540) and thus facilitates the understanding of the requirements. The IAASB should consider including this flowchart as an appendix to the revised standard. (12) Regarding complex accounting estimates, we anticipate that the field testing exercise will provide a valuable feedback as to whether the proposed requirements will lead to more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates. We applaud the IAASB for initiating this field testing. We expect that the IAASB will evaluate the operability of the proposed new requirements based on the feedback received from the audit firms. We draw your attention to our response to question 4 for further information on complex accounting estimates. (13) Our responses to the specific questions can be found in the attached appendix to this letter.
42.	AICPA	The AICPA is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. AICPA members represent many areas of practice, including business and industry, public practice, government, education, and consulting. Among other things, the AICPA sets ethical standards for the profession and U.S. auditing standards (generally accepted auditing standards or GAAS) for private companies, nonprofit organizations, and federal, state and local governments (nonissuers). As set forth in the Explanatory Memorandum to ED 540 (Explanatory Memorandum), ED 540 proposals are intended to modernize extant ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures, for the following reasons: • The anticipated auditing challenges arising from the new international accounting standard, International Financial Reporting Standard (IFRS) 9, Financial Instruments, • Management's increasing use of external information to make estimates, and

- The ongoing criticism of auditors' inadequate assessment of risks of material misstatement by not considering inherent risk factors such as increased complexity of business environment, increased use of information technology, and large amounts of data. Criticism cited also included inadequate control risk assessments. The criticism of inadequate assessment of risks of material misstatement resulted in inadequate design and execution of further audit procedures, thereby resulting in a failure to obtain sufficient appropriate audit evidence.

In the Explanatory Memorandum, the IAASB describes its extensive outreach activities, which included consulting with the U.S. Public Company Accounting Oversight Board (PCAOB), in the development of ED 540. The PCAOB recently released for exposure its Proposed Amendments to Auditing Estimates, Including Fair Value Measurements (PCAOB Proposal). While the ASB's focus is on the development of auditing, attestation, and quality control standards for nonissuers, our strategy also considers PCAOB standards in an effort to minimize unnecessary differences for auditors of nonissuers, particularly when the identified differences improve professional standards. We note that the PCAOB Proposal is closely aligned with extant ISA 540, while also proposing enhancements targeted at improving audit execution and quality.

We believe that the PCAOB Proposal contains proposed requirements that may address the issues we have identified with ED 540. We urge the IAASB to continue its outreach activities with the PCAOB with the goal of achieving closer convergence.

While we are supportive of the IAASB's project to enhance extant ISA 540, we believe that significant changes to ED 540 are necessary before it should be finalized, specifically in the following areas:

- Connectivity of ISA 540 to other ISAs; in particular, ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
- Clarity of the ED 540 requirements related to the proposed standards
- Work effort and scope of ED 540

For the IAASB's consideration, we have provided our overall comments in the following section. In the appendix to this letter, we have provided our specific responses to the questions presented in ED 540.

Overall Comments

In our jurisdiction, deficiencies in auditing accounting estimates continue to be a common inspection finding identified by regulators. Examples of such deficiencies include failures to sufficiently (i) test data used by companies to develop accounting estimates, (ii) evaluate the reasonableness of significant assumptions used by management, (iii) understand information provided by third-party pricing sources, and (iv) obtain an understanding of the process for determining fair value measurements in audits of brokers and dealers. These inspection observations continue to raise concerns about auditors' application of professional skepticism and consideration of the potential for management bias in accounting estimates.

Therefore, while we recognize the need to evaluate the efficacy of ED 540 for these reasons, we would be supportive of the IAASB making targeted amendments to extant ISA 540 to address these inspection findings and observations rather than overhauling the entire standard. We also believe such enhancements would be relevant to and address further changes in financial reporting frameworks, most notably those related to recognition of revenue and accounting for expected credit losses (as set forth in IFRS 9).

This section highlights our overall comments, which will then be explained in further detail in our response to the questions.

		Connectivity to Other ISAs While we agree with the IAASB's reasons to modernize extant ISA 540, we believe that it would be more appropriate for many of the proposed changes to be a result of: • enhancements to the overall risk assessment process, • clarity regarding circumstances when substantive procedures alone will not provide sufficient appropriate audit evidence, and • the relevance and reliability of internal and external data We understand that most of these suggestions are being addressed as part of the IAASB's ISA 315 (Revised) project and, eventually, the ISA 500, Audit Evidence, project. We are concerned that adopting changes to risk assessment and evaluation of evidence in such a narrow focus will result in these changes being subject to revisions as the new projects are developed. Accordingly, we believe that a targeted amendment should focus on providing auditors with an explicit linkage between ED 540 and the risk assessment standards, ISA 315 (Revised) and ISA 330, The Auditor's Responses to Assessed Risks. These ISAs represent the foundational standards underpinning an audit, and as a special considerations standard, extant ISA 540 is intended to build upon, not replace, those foundational standards; this point is not clear enough in ED 540. One could draw the conclusion that a separate assessment and related documentation of the matters related specifically to estimates would be required, which could result in a redundant, inefficient approach. The Way Forward Therefore, we strongly recommend that the IAASB reconsider the proposed approach of having two separate paths of addressing risks of material misstatements for estimates. We believe ED 540 should include an approach similar to extant ISA 540—that is, to test all accounting estimates within the context of the focused areas of risk (complexity, judgment, and uncertainty), scaled to clearly explain that as the risks of material misstatement increases, the auditor would be required to obtain more persuasive audit evidence. The application material could then further explain the challenges of auditing more complex accounting estimates such as those recorded under the expected credit loss model, including specific considerations where judgement could be affected by management's bias, and so on. Finally, we recommend that several of the concepts in the appendix be reconfigured as an International Auditing Practice Note (IAPN) that could be issued to provide more detailed guidance to assist in the implementation of the revised ISA.
43.	ANAN	
44.	CAI	We are supportive of the expressed intentions of IAASB to develop an auditing standard which seeks to enable auditors to respond appropriately to evolving financial reporting frameworks. While acknowledging the IAASB's work in this regard we also have some concerns in relation to the extent to which this has been achieved in ED 540 and we articulate those in answer the consultation questions below. We have the following general comments to make in relation to ED 540 in addition to our responses to the specific questions asked in the consultation paper. These are: 1) Further consideration needed in relation to new concepts introduced in ED 540: We note the introduction in ED 540 of the new concepts of assessing inherent risk as low and not low as well as the analysis of the factors influencing the risks of material misstatement in relation to an accounting estimate; complexity, the level of judgement involved and

		estimation uncertainty. We consider that it will be necessary for IAASB to develop these concepts more fully and provide further clarity as to their application. We provide some additional comments in this regard in answer to question 4 of ED 540 below. 2) Balance between a principles approach and granular requirements: It is evident that, in developing ED 540, the IAASB has faced a challenge of managing the balance between providing auditors with principles to apply to the audit of accounting estimates as well as providing sufficiently granular requirements to ensure that auditors consistently apply those principles to specific accounting estimates. We consider that the standard should remain principles based and applicable to any accounting estimate. It may therefore be necessary for IAASB to develop separate guidance in relation to the application of those principles to specific accounting estimates for example in the format of International Auditing Practice Notes (IAPNs). 3) Continuous review required: The approach taken by ED 540 will require continuous review of ISA 540 (Revised) after publication, in particular because of the following features of ED 540: (a) ED 540 includes more granular requirements than the extant version of this standard. The maintenance of this level of detail will require ongoing review of the ISA 540 (Revised). (b) As ED 540 seeks to meet the needs of auditors in relation to evolving financial reporting frameworks, the revised standard will require ongoing and continuous review to ensure it keeps pace with the ongoing evolution of global financial reporting frameworks. (c) We are keenly aware that the modern accounting standards, for example IFRS 9, which ED 540 intends to address, have not been implemented in most jurisdictions to date. Therefore it is likely that the experience of implementing those accounting standards may give rise to as yet unforeseen implications for auditors in their consideration of the ensuing accounting estimates. Consequently it will be necessary to review the ISA 540 (Revised) as the practical implementation of modern financial reporting frameworks takes place. Similarly, as we note in answer to question 1 below, we are strongly supportive of testing of ED 540, to the extent possible, before the final publication of ISA 540 (revised).
45.	CAQ	The CAQ is supportive of the IAASB's efforts to consider ways to strengthen auditing practices to continuously improve audit quality. We recognize that the Board has been working diligently on this project since early 2015, and appreciate its outreach and responsiveness to concerns raised by key stakeholders. In this letter, we offer for the IAASB's consideration our views regarding certain topics outlined in the Exposure. Our views are organized into the following sections: I. Public Company Accounting Oversight Board's Related Standard Setting Project II. Risk Assessment III. Auditor and Management Responsibilities IV. Audit Evidence V. Conclusion I. Public Company Accounting Oversight Board's Related Standard Setting Project

		As part of the Public Company Accounting Oversight Board's (PCAOB) standard setting project related to auditing accounting estimates, including fair value measurements and the auditor's use of the work of specialists, the PCAOB has issued two staff consultation papers,1 and two proposed rules.2 In response to the staff consultation papers, the CAQ has submitted to the PCAOB multiple comment letters,3 as well as Auditing Accounting Estimates and Fair Value Measurements: A Framework (the Framework).4 The Framework represents a collaborative effort by members of the profession to provide the PCAOB with our views as it relates to its current standard-setting projects in this area. The Framework is principles-based and intended to be scalable to accounting estimates of different sizes and complexities. Please see Appendix A for a copy of the letter and Framework the CAQ submitted to the PCAOB on December 1, 2015. We believe the PCAOB's proposed auditing standard, Auditing Accounting Estimates, Including Fair Value Measurements and amendments to other PCAOB auditing standards (PCAOB Release 2017-002), incorporates many of the concepts in the Framework. The Framework is based on the key principles laid out in extant ISA 540, which builds upon the risk assessment requirements set forth in ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment (ISA 315) and ISA 330, The Auditor's Procedures In Response to Assessed Risks (ISA 330). Those key principles continue to be foundational to the quality of auditing related to estimates. The concepts within the framework are as follows: Obtaining an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates: I. The applicable financial reporting framework; II. How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates (including how management monitors and identifies changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates); and III. How management makes the accounting estimates, and an understanding of the data on which they are based, including: i. The method or model used in making the accounting estimate; ii. Relevant controls; iii. Whether management has engaged a specialist; iv. The assumptions underlying the accounting estimates; v. Whether there was or should have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and vi. Whether, and if so, how management has assessed the effect of estimation uncertainty. These foundational principles do not come across clearly in the Exposure even though the explanatory memorandum suggests that the IAASB also views them as important. The IAASB should continue to work closely with the PCAOB and consider whether changes to the Exposure could result in more consistent auditor performance and convergence in the auditing standards, which would benefit audit quality. In the sections of this comment letter, we provide examples of where we would recommend keeping the scalable concepts of extant ISA 540 and/or adding further clarity, in application or supplemental guidance, regarding the auditor's expected performance when assessing

		and responding to risks associated with accounting estimates. We believe these changes are necessary before the Exposure is finalized so that the IAASB's objectives in revising the standard can be realized. V. Conclusion The CAQ recognizes the complexity and challenges related to auditing accounting estimates. The IAASB, the PCAOB, and other stakeholders have engaged in extensive outreach and discussion related to this topic, and we would encourage both organizations to consider aligning their standards where it makes sense to provide as much consistency as possible. Consistency promotes quality and also provides financial statement users with comparable information. The CAQ appreciates the opportunity to comment on the Exposure and would be pleased to discuss our comments or answer any questions that the Board may have regarding the views expressed in this letter. *** December 1, 2015 Office of the Secretary Public Company Accounting Oversight Board 1666 K Street, N.W. Washington, D.C. 20006-2803 Re: Staff Consultations Papers: Auditing Accounting Estimates and Fair Value Measurements and No. 2015-01, The Auditor's Use of the Work of Specialists Dear Office of the Secretary: The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants. This is an addendum to our comment letters to the PCAOB in response to recent Staff Consultation Papers regarding auditing accounting estimates, including fair value measurements, and using the work of specialists.1 As stated in those letters, the CAQ is supportive of enhancements to the auditing standards related to accounting estimates that align with the PCAOB's risk assessment standards, promote audit quality by narrowing, or at least not expanding, any potential stakeholders' expectation gaps, and allow for auditors of entities of all different sizes to be able to apply the requirements consistently, while providing for flexibility in approaches. The appendix to this letter, Auditing Accounting Estimates and Fair Value Measurements: A Framework (the Framework), represents a collaborative effort by members of the profession to provide the Public Company Accounting Oversight Board (PCAOB or the Board) with our views as it relates to the current standard- setting projects of the Board on auditing accounting estimates and fair value measurements as well as the use of specialists. This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member. In developing the Framework, the CAQ considered the views in each of the Staff Consultations Papers, as well as discussions with PCAOB staff as part of its outreach efforts regarding auditing estimates and fair value measurements, as well as the use of specialists. The

		Framework also reflects input received from CAQ member firm representatives that have participated in recent PCAOB Standing Advisory Group discussions on this important topic.2 The Framework is principles-based. We believe this is critical in order to be operational under the current construct of (and sustainable to changes within) the capital markets and sensitive to the availability of data and information from specialists, pricing services and other relevant market participants. Within the Framework, we offer suggestions for auditing accounting estimates that build upon the overarching principles described in our comment letters. Those principles state that any enhancements to existing auditing standards should: • Recognize the relationship between the auditor's risk assessment and the audit procedures designed to sufficiently and appropriately respond to that risk; • Consider the range of accounts (and elements of accounts) that involve varying levels of estimation uncertainty and the varying levels of complexity in measurement and risk associated with different accounting estimates; • Recognize that accounting estimates may be subject to a significant degree of measurement uncertainty, and such inherent uncertainty will exist irrespective of the level of effort involved in auditing the accounting estimate (e.g., not imply that a level of precision exists in an inherently imprecise measurement exclusively as a result of an audit of that measurement); and • Continue to recognize that auditors may use the work of a specialist when situations arise that require specialized knowledge and subject matter expertise in a field other than accounting or auditing. Again, we appreciate the opportunity to share our views regarding auditing accounting estimates and fair value measurements and the use of specialists. We stand ready to assist you in any way we can, including participation in any future meetings or roundtables. Sincerely, Cynthia M. Fornelli Executive Director Center for Audit Quality Attachment Appendix: Auditing Accounting Estimates and Fair Value Measurements: A Framework 1 Overview 1.1 Background • Over the past decade, changes in financial reporting frameworks have led to an increase in the use of accounting estimates (and, in particular, fair value measurements) 1 in the preparation of financial statements. The complexity associated with certain accounting estimates also has increased during this time, as has the subjectivity that can be associated with their underlying assumptions. • Given the many different types of accounting estimates, the varying nature of the related estimation processes, and the underlying inputs and assumptions, there may not be a 'one-size- fits-all' solution that enhances existing auditing standards relating to

accounting estimates. It is important that any improvements to existing auditing standards result in scalable requirements and guidance that audit firms of all sizes can apply to issuers of all sizes.

1.2 Design of the Framework

- This framework is intended to enhance and clarify the existing auditing standards by:
  - Improving the linkage between the performance requirements in the PCAOB's existing auditing standards2 and the auditor's risk assessment process when determining an appropriate audit response (e.g., PCAOB Auditing Standard No. 12, Identifying and Assessing Risks of Material Misstatement (AS 12) and PCAOB Auditing Standard No. 13, The Auditor's Responses to the Risks of Material Misstatement (AS 13));3
  - Clarifying the objectives and scope of the standards to reduce any perceived inconsistencies in expectations for substantive testing of fair value measurements versus other accounting estimates, including instances in which the auditor uses the work of a specialist when auditing accounting estimates; and
  - Providing supplemental or application guidance to promote greater consistency and more effective application across the audit profession.
- Because of the variety of accounting estimates, this framework includes examples to illustrate key aspects of the framework. These examples are highlighted throughout this document to facilitate identification of what could be considered supplemental or application guidance. This framework also includes explanatory narrative descriptions that elaborate on the thought process behind a requirement to facilitate the application of auditor judgment to a variety of facts and circumstances.

1 This framework acknowledges and adopts an approach similar to that outlined in footnote 1 of the Staff Consultation Paper on Auditing Accounting Estimates and Fair Value Measurements (Estimates Staff Consultation Paper), in that it generally uses the term "accounting estimate" to mean both accounting estimates and fair value measurements, unless noted otherwise. When discussing existing requirements of extant standards, this framework generally uses the terms "accounting estimate" and "fair value measurement" to have the same meaning as those terms have in AU sec. 328, Auditing Fair Value Measurements and Disclosures (AU 328) and AU sec. 342, Auditing Accounting Estimates (AU 342).

2 When auditing accounting estimates, including fair value measurements, performance requirements are currently included in AU 328, AU 342, AU sec. 332, Auditing Derivative Instruments, Hedging Activities, and Investments in Securities (AU 332), and, when a specialist is involved, AU sec. 336, Using the Work of a Specialist (AU 336).

3 We agree with the view in the Estimates Staff Consultation Paper that any changes to the auditing standards related to accounting estimates should build upon the principles in the PCAOB's risk assessment standards, particularly AS 12 and AS 13.In this framework we provide specific suggestions to demonstrate how auditors may apply the risk assessment requirements in the context of auditing accounting estimates and when using the work of a specialist.

  - We recognize that PCAOB auditing standards typically do not include such guidance; however, we believe doing so would provide clarity in the objectives of certain aspects of the standards and lead to greater consistency in application.
- We believe this framework will help to improve audit quality regardless of how enhancements ultimately are codified in the standards (i.e., the creation of one or more new standards or enhancements to existing standards).

2 Alignment with the Auditor's Risk Assessment Process

- The CAQ believes that many of the performance requirements in the PCAOB's existing auditing standards for auditing accounting estimates and using the work of specialists are appropriate. We therefore start with the objectives of these existing auditing standards, and recommend enhancements to both better align these standards with the PCAOB's risk assessment standards and emphasize the importance of the auditor obtaining an understanding of management's processes, including management's use of specialists and other third-party sources, and system of internal control. In providing these recommended enhancements, we considered views expressed in the Staff Consultation Papers and concepts from relevant International Standards on Auditing (ISA), in addition to the existing PCAOB auditing standards.

- This framework is designed to apply to audit procedures performed over all accounting estimates, regardless of whether the auditor or the company uses the work of a specialist. The auditor's risk assessment, which includes an evaluation of the knowledge, skill, and objectivity of a company's specialist(s), will assist the auditor in designing and implementing appropriate responses to risks of material misstatement.

2.1 Consideration of Thematic Elements of ISA 540

- ISA 540,4 which builds upon the risk assessment guidance in ISA 3155 and ISA 330,6 illustrates thematically how the risk assessment standards could be aligned with the standards relating to accounting estimates. Similarly, revisions to PCAOB standards could build upon the principles of AS 12 and AS 13 and include incremental considerations specific to accounting estimates to guide the auditor's consideration of the subjectivity of accounting estimates, the susceptibility of accounting estimates to fraud, and other factors when performing a risk assessment.7
- The following are concepts from ISA 540 specific to accounting estimates that could be incorporated or enhanced within the PCAOB's risk assessment standards:8

4 ISA 540, Auditing Accounting Estimates, Including Fair Value Estimates, and Related Disclosures. Although the International Auditing and Assurance Standards Board is considering changes to ISA 540, the concepts in the standard as currently written provide a general basis for consideration of enhancements to PCAOB auditing standards.

5 ISA 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment.

6 ISA 330, The Auditor's Responses to Assessed Risks.

7 ISA 540 illustrates the type of considerations we believe should be incorporated into the auditing standard(s) related to accounting estimates, all of which are already embodied in the PCAOB's risk assessment standards (i.e., AS 12 and AS 13).

8 We acknowledge that some of these items are already contained in the PCAOB's risk assessment standards.

  - o Obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates:
    - ☐ The applicable financial reporting framework;
    - ☐ How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates (including how management monitors and identifies changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates); and
    - ☐ How management makes the accounting estimates, and an understanding of the data on which they are based, including:

- The method or model used in making the accounting estimate;

		• Relevant controls; • Whether management has engaged a specialist; • The assumptions underlying the accounting estimates; • Whether there was or should have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and • Whether, and if so, how management has assessed the effect of estimation uncertainty. • In addition to considering conditions specific to accounting estimates in the auditor's risk assessment, supplemental guidance would serve to further clarify the auditor's expected performance in assessing risk and appropriately designing audit procedures to obtain sufficient relevant audit evidence. 2.2 Performing a Risk Assessment for Accounting Estimates • AS 12, paragraph 59 addresses how the auditor determines which risks of misstatement represent risks of material misstatement at the financial statement and assertion level, and those risks of material misstatement that are significant risks. AS 12, paragraph 59(e) states that, in identifying and assessing risks of material misstatement, the auditor should identify significant accounts and disclosures and their relevant assertions. • In addition, consistent with paragraph 16 of PCAOB Auditing Standard No. 9, Audit Planning (AS 9), based on the nature of accounting estimates contained in significant accounts and disclosures, the auditor determines whether specialized skill or knowledge in relation to one or more aspects of the accounting estimates is required to: o Perform an effective risk assessment; o Plan or perform audit procedures; or o Evaluate audit results. • Generally speaking, accounting estimates are present in most accounts and disclosures in the financial statements. Risks related to the data, model, method and assumptions used exist for all accounting estimates, and the relative significance of those risks vary across the many types of accounting estimates. o It is not appropriate to presume that every relevant assertion associated with an accounting estimate represents a significant risk. Similarly, it is not appropriate to presume that every accounting estimate gives rise to a significant risk. o Rather, in order to perform an appropriate risk assessment, the auditor considers the following with respect to management's process for determining the estimate: ☐ The relevant inputs; ☐ The complexity of those inputs and the subjectivity of the judgments related to them; and ☐ Alternative methods that may support the reasonableness of the accounting estimate in the auditor's consideration of the risk(s) relevant to a particular significant account or disclosure.

		o In addition, the auditor considers management's ability and expertise to determine an accounting estimate (including whether management has used a specialist to assist with this determination), as well as whether the knowledge and skills of an auditor's specialist may be needed. • The auditing standards acknowledge that "the components of a potential significant account or disclosure might be subject to significantly differing risks."9 This is particularly true for accounting estimates, and may result in the need for the auditor to disaggregate a significant account in order to perform an effective risk assessment. • The auditing standards could expand upon the concepts in AS 1210 to clarify that the auditor considers the potential sources of risk of material misstatement within a significant account at a sufficiently disaggregated level based on auditor judgment in order to enable the auditor to appropriately determine the nature of audit procedures to perform. In other words, the auditor completes the risk assessment at a disaggregated level within the components of an account in order to design appropriate audit procedures. In determining the appropriate level at which to assess the risk of material misstatement for a particular account or components of an account, the auditor could consider the information presented in the footnote disclosures related to that particular account. o While we suggest the auditor disaggregate components of an account when performing a risk assessment, we do not suggest requiring disaggregation to the lowest possible unit of account level (e.g., individual security basis by CUSIP number). In many cases, after considering factors such as the similarity of the nature of the accounting estimates, the consistency of management's process for determining accounting estimates, and the sources of risk, the auditor may conclude that certain components are sufficiently similar based on their risk, such that they do not need to be disaggregated further for purposes of designing appropriate audit procedures. 9 AS 12, paragraph 63. 10 Specifically the concepts in paragraph 59 regarding the identification and assessment of risks of material misstatement at the financial statement level and the assertion level. 2.3 Consideration of Management's Process • Assessing management's process for determining accounting estimates is an important element of the auditor's risk assessment process. In preparing accounting estimates, management selects or develops assumptions that represent their judgment of the most likely circumstances and events with respect to the relevant factors.11 The significance of management's assumptions, along with other factors such as the sensitivity of the assumptions to variability, affects the 11 AU 342, paragraph 05(d). auditor's determination of the risk of material misstatement associated with a particular accounting estimate.12 • In some cases, events that occur after the balance sheet date may provide more persuasive audit evidence than the auditor's consideration of information used to corroborate management's assumptions used to derive an accounting estimate. In certain of these cases, the related estimation uncertainty may be substantially reduced by the recent information available to the auditor. 2.4 Accounting Estimates with a High Level of Estimation Uncertainty • Part of the auditor's risk assessment process includes evaluating the degree of estimation uncertainty associated with an accounting estimate. Certain accounting estimates may include a level of estimation uncertainty that exceeds the auditor's established materiality threshold; two appropriately qualified and objective professionals may arrive at different results based on the same facts because they apply different but equally reasonable assumptions. We believe it is important that the auditing standards

		acknowledge this and emphasize that, in those circumstances, both a comprehensive evaluation in light of the circumstances and facts involved and specific documentation regarding conclusions are important. • For accounting estimates with a high level of estimation uncertainty, the range of reasonable outcomes may exceed the auditor's established materiality threshold. In such cases, the level of estimation uncertainty may not be able to be reduced to an amount less than the auditor's established materiality threshold regardless of the amount of relevant and reliable audit evidence accumulated. In those circumstances, the auditor evaluates whether management's disclosures adequately describe the estimation uncertainty inherent in the accounting estimate in accordance with the applicable financial reporting framework. o Supplemental guidance that acknowledges that there is variability and imprecision in accounting estimates having high estimation uncertainty would be beneficial. This guidance could remind auditors of their responsibility to perform sufficient appropriate procedures to be able to reasonably conclude that the accounting estimate has been determined (a) in accordance with the applicable financial reporting framework, (b) using a consistent approach from period to period (if appropriate) and (c) that there is adequate disclosure (in accordance with the applicable financial reporting framework) regarding the methods and assumptions such that the estimation uncertainty is transparent to the user. Auditors would continue to assess the facts and circumstances through the date of the auditor's report. 12 AU 342, paragraph 05. 2.5 Consideration of Management Bias • When evaluating management's judgments and decisions in their determination of accounting estimates as part of the auditor's risk assessment process, the auditor applies professional skepticism when identifying whether there are any indicators of management bias. • When evaluating potential bias, including that of a company's specialist, it is important for the auditor to consider the incentives and pressures on management to manipulate the financial statements, and opportunities to do so. • When a risk of material misstatement due to fraud has been identified related to an accounting estimate, the auditor applies AU sec. 316, Consideration of Fraud in a Financial Statement Audit (AU 316), in addition to this framework. o Examples of incentives and pressures may include the level of pressure or focus by management or investors on key performance indicators, the structure of executive compensation arrangements, and economic or industry conditions. o Examples of opportunities may include the susceptibility of the company's accounting systems to manipulation due to inherent risks from management override, collusion, or poorly designed or implemented internal control structures. • When evaluating potential bias, the auditor evaluates the qualitative aspects of the company's accounting practices, including potential bias in management's judgments about the amounts and disclosures in the financial statements. In addition to applying the guidance in paragraphs 24-27 of PCAOB Auditing Standard No. 14, Evaluating Audit Results, and paragraphs 63-65 of AU 316, the auditor considers performing the following risk assessment procedures: o Review the accuracy of prior year accounting estimates to assess whether there is any indication of bias in management's estimation process.

		o Evaluate whether there is a pattern of bias in management's accounting estimates (e.g., whether management's rationale to use the various assumptions in an accounting estimate(s) is driven by its bias for a particular result). o When the applicable financial reporting framework does not prescribe a specific methodology, consider whether the accounting estimate typically is developed using an estimation methodology that is an industry standard or is a generally applied approach (regardless of the industry). If the auditor determines that management's method used to determine the accounting estimate is not a generally applied approach or, when applicable, is not consistent with methods used in the company's industry, the auditor evaluates how that compares to the facts and circumstances specific to the company and whether management's rationale to use the unique methodology is driven by its bias for a particular result. • The auditor also should be alert to contradictory evidence when evaluating management's estimation process, and should not ignore significant assumptions within management's estimate that contradict other information known to the auditor. If contradictory evidence is identified, the auditor gives appropriate consideration to whether that evidence is indicative of management bias or could result in a material misstatement. • If indicators of management bias are identified, the auditor evaluates how those indicators may affect the auditor's conclusion as to whether his or her risk assessment and related responses remain appropriate with respect to the affected accounting estimates. The auditor also considers whether those indicators of bias have implications for the other areas of the audit. o In these situations, the auditor also communicates to the audit committee the results of the auditor's evaluation of accounting estimates included in the financial statements, which are individually reasonable, that indicate a possible bias on the part of the company's management. This is consistent with paragraph 13 of PCAOB Auditing Standard No. 16, Communicating with Audit Committees. 2.6 Revisions of Risk Assessment • This framework recognizes the iterative nature of the planning process and allows for the auditor to modify or tailor the substantive testing approach from the planned audit procedures to obtain sufficient appropriate audit evidence and document his or her rationale for doing so in light of changes in facts and circumstances.13 • This is particularly relevant in instances where the auditor obtains evidence during the course of the audit that is contradictory to the audit evidence on which the auditor originally based his or her risk assessment, or that indicates the existence of management bias that was not previously identified as part of the risk assessment process. If the auditor obtains evidence that contradicts the original risk assessment, the auditor revises the related risk assessments and modifies the planned nature, timing, or extent of substantive procedures as necessary.14 13 This concept is consistent with paragraph 74 of AS 12. 14 AS 13, paragraph 46. 3 The Auditor's Responses to the Assessed Risks of Material Misstatement 3.1 Testing Controls for Accounting Estimates • As part of the risk assessment process (as discussed in section 2), the auditor obtains an understanding of management's process for determining the accounting estimate, including understanding whether and, if so, how management has used a specialist.

		• If the auditor plans to rely on controls to reduce the amount of substantive procedures to perform, the auditor identifies the relevant controls for each risk of material misstatement at the relevant assertion level, and assesses the effectiveness of their design and implementation. In addition, the auditor also tests the operating effectiveness of those controls. • If the auditor does not plan to rely on controls to reduce the amount of substantive procedures to be performed, or if the auditor determines that the controls necessary to sufficiently address the assessed risks of material misstatement for relevant assertions are missing or ineffective, the auditor assesses control risk at the maximum level. • With regard to accounting estimates that give rise to a significant risk, the auditor should evaluate the design of the company's controls that are intended to address risks of material misstatement due to fraud and other significant risks, and determine whether those controls have been implemented, if the auditor has not already done so when obtaining an understanding of internal control.15 Examples of these procedures could include an evaluation of: o How management determines the completeness, relevance and accuracy of the data used to develop accounting estimates. o Controls related to the review and approval of accounting estimates, including the assumptions or inputs used in their development, by sufficiently competent and experienced members of management or those charged with governance. o The segregation of duties between those committing the company to the underlying transactions and those responsible for developing and reviewing the accounting estimates, including whether the assignment of responsibilities appropriately takes into account the nature of the company and its products or services (e.g., relevant segregation of duties may include an independent function responsible for estimation and validation of fair value whose remuneration is not explicitly tied to such estimates of fair value).16 3.2 Substantive Testing Approaches • This framework retains the three substantive testing approaches included in the existing standards. • When determining a substantive testing approach (or combination of approaches) to address the identified risks of material misstatement, the auditor takes into account his or her understanding of the company and its environment, including its internal control, his or her understanding of management's estimation process, and the results of the auditor's risk assessment. In making this determination, the auditor assesses whether it is appropriate to use of the work of an auditor's specialist to address the identified risks of material misstatement. • Audit procedures should be designed to address the assessed risk of material misstatement at both the overall financial statement level and at the relevant assertion level. With appropriate consideration to the above factors, the auditor uses one or a combination of the following three substantive testing approaches: (a) Review and test management's significant assumptions and the model and underlying data used to develop the accounting estimate. ☐ The nature, timing and extent of testing management's assumptions, the valuation model and the underlying data should be commensurate with the assessed level of risk and the relevance and reliability of the audit evidence that can be obtained through such testing.

		(b) Develop an independent expectation of the accounting estimate to corroborate the reasonableness of management's accounting estimate. ☐ Develop a point estimate or a range to evaluate management's point estimate. For this purpose: 15 Consistent with AS 12, paragraph 72. 16 Consistent with the themes in ISA 540. • The auditor may choose to develop an independent accounting estimate to compare to management's estimate by either (1) using management's assumptions or (2) developing his or her own independent assumptions. When the auditor's independent accounting estimate uses assumptions or methods that differ from those used by management, the auditor nevertheless understands management's assumptions. The auditor uses that understanding to verify that his or her independent accounting estimate takes all significant variables into consideration and to evaluate any significant difference from management's accounting estimate.17 This understanding should be obtained at the level of disaggregation determined by the auditor's risk assessment procedures, and the depth of understanding and rigor of substantive testing should be commensurate with the associated level of risk for that disaggregated group. (c) Review subsequent events and transactions occurring prior to the date of the auditor's report. ☐ Determine whether events occurring up to the date of the auditor's report provide relevant and reliable audit evidence for the recorded accounting estimate. 3.3 Considerations for Evaluating Audit Evidence • The auditor applies PCAOB Auditing Standard No. 15, Audit Evidence (AS 15), for purposes of designing and performing procedures to obtain sufficient appropriate audit evidence. In doing so, the auditor considers evidence obtained in other areas of the audit that contradicts evidence provided by the company to support an accounting estimate. This includes situations where the auditor has chosen to develop an independent expectation of an accounting estimate. Regardless of the nature of planned audit procedures, the auditor understands management's process for developing the accounting estimate and considers whether the auditor is aware of potentially contradictory audit evidence, either related to the estimate or from evidence obtained elsewhere in the audit. • The existence of contradictory evidence does not necessarily indicate that management's accounting estimate is unreasonable. The nature, relevance and source (e.g., internal management representations as opposed to an external source such as published industry data) of contradictory evidence should be considered in conjunction with other evidence obtained, including evidence corroborating management's conclusion. The reasonable expectations of the auditor also should be considered (e.g., if variances within a certain threshold are expected, they may not be considered contradictory evidence). 17 AU 328, paragraph 40. • A wide range of reasonableness for an accounting estimate does not necessarily represent contradictory evidence. It may, however, reflect a higher level of estimation uncertainty, which may be an indicator of a significant risk.

		• The auditor also gives appropriate consideration to information known to the auditor that contradicts management's conclusion. Once an appropriate consideration has been made, if the auditor concludes that there is sufficient corroborative evidence to support management's conclusion, the auditor documents those considerations. While the auditor considers alternative methods or assumptions not used by management, an auditor is not required to perform an exhaustive search for contradictory evidence. 3.4 Evaluating the Company's Method Used to Develop an Accounting Estimate • When evaluating a company's method used to develop an accounting estimate, the auditor determines whether the method used by management in developing the accounting estimate is appropriate in the context of the applicable financial reporting framework. In doing so, the auditor reviews management's model, significant assumptions and other inputs and data used to develop the accounting estimate. The nature, timing and extent of these procedures should correspond with the assessed level of risk, as determined based on the process discussed in section 2, and the relevance and reliability of the audit evidence that can be obtained through such testing. • Specifically, based on the assessed risk of material misstatement as described in section 2, the auditor evaluates whether: o Management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; o The method(s) for making the accounting estimate(s) is appropriate and have been applied consistently from period to period, if consistency is appropriate; and o Changes, if any, in the accounting estimate(s) or in the method(s) for making the estimate from the prior period are appropriate in the circumstances. • When the applicable financial reporting framework does not prescribe a particular method of measurement to be used for developing an accounting estimate, the auditor could consider the methods used within a company's industry in determining whether management's method is acceptable, if doing so is determined to be appropriate in response to the associated risk. In these instances, the auditor considers: o How management considered the nature of the asset or liability being estimated when selecting a particular method. o Whether the company operates in a particular business, industry or environment in which there are methods commonly used to make the particular type of accounting estimate.18 ☐ Additionally, this framework acknowledges the impact on the risk of material misstatement when management uses a method not commonly used in a particular industry or segment (and that method is unique to the issuer's industry). For example, there may be greater risks of material misstatement when management is departing from a method commonly used in a particular industry or environment. 19 18 Consistent with the concepts in paragraph A25, ISA 540. ☐ If the auditor determines that management's method used to determine the accounting estimate is not consistent with methods used in the company's industry, the auditor considers why the method selected is being used and whether the selection of that method is an indication of management bias.

		• The auditor also evaluates the adequacy of management's disclosure about the method used to determine the accounting estimate, including whether it is in conformity with the applicable financial reporting framework. In doing so, the auditor also considers whether the applicable financial reporting framework contemplates the use of more than one estimation method, as Accounting Standards Codification Topic 820, Fair Value Measurement, acknowledges will be appropriate in some cases.20 Evaluating whether management uses more than one estimation method – and the reasons for doing so (or not doing so) – could be useful in evaluating the range of reasonableness for accounting estimates with significant estimation uncertainty. 3.5 Evaluating the Reasonableness of Significant Assumptions • Auditors plan and perform audit procedures to address the identified risks of material misstatement related to accounting estimates, which can arise from a variety of sources, including external factors (e.g., conditions in the company's industry and environment) and company- specific factors (e.g., the nature of the company, its activities, and internal control over financial reporting). • The auditor's response to risks of material misstatement related to accounting estimates includes considering the sensitivity of the accounting estimate to its underlying significant assumptions and determining whether any significant assumptions are not supported by sufficient appropriate evidence. Although these procedures may be planned and performed at the relevant assertion and significant account level, the auditor determines whether the overall approach is responsive to the risks of material misstatement for the financial statements taken as a whole (see detailed discussion within section 2). • This framework considers a description of significant assumptions that recognizes that "an assumption used in making an accounting estimate may be deemed to be significant if a reasonable variation in the assumption would materially affect the measurement of the accounting estimate."21 o The determination of which significant assumptions are inherently sensitive (i.e., those for which a reasonable variation in the assumption would materially affect the accounting estimate) will be informed by the auditor's risk assessment process, including the understanding of management's method for determining the accounting estimate, and the evaluation of the inherent estimation uncertainty within a particular accounting estimate. In other words, an auditor determines through its risk assessment procedures the level of estimation uncertainty within an accounting estimate and the drivers of that uncertainty. 19 Consistent with the concepts in paragraph A26, ISA 540. 20 Paragraph 820-10-35-24B. 21 Consistent with the concepts in ISA 540, paragraph A107. o Consistent with AU 328 paragraph 33, we believe the auditor should focus on the assumptions that management has identified as significant to the accounting estimate. AU 328 paragraph 34 states that if management has not identified particularly sensitive assumptions, the auditor considers whether to employ techniques to identify those assumptions. • Matters that auditors may consider in evaluating the reasonableness of significant assumptions include:22 o Whether individual significant assumptions appear reasonable. o Whether the significant assumptions are interdependent and internally consistent.

		o Whether the significant assumptions appear reasonable when considered collectively or in conjunction with other assumptions, either for that accounting estimate or for other accounting estimates. o Whether the significant assumptions appropriately reflect observable marketplace assumptions (when applicable based on the accounting estimate's applicable financial reporting framework). o Whether significant assumptions that reflect management's expectations of the outcome of its objectives and strategies are consistent with: ☐ The general economic environment and the company's economic circumstances. ☐ The plans of the company. ☐ Significant assumptions made in prior periods, if relevant. ☐ Experience of, or previous conditions experienced by, the company, to the extent this historical information may be considered representative of future conditions or events. ☐ Other assumptions used by management relating to the financial statements. o Whether significant assumptions that depend on management's ability and intent to carry out certain actions are reasonable in light of:23 ☐ Management's history of carrying out its stated intentions. ☐ Written plans and other documentation, including, where applicable, formally approved budgets, authorizations or minutes. ☐ Management's reasons for a particular course of action. ☐ The auditor's review of events occurring subsequent to the date of the financial statements and up to the date of the auditor's report. ☐ Where relevant, management's ability to carry out a particular course of action given the company's economic circumstances, including the implications of its existing commitments. 22 Consistent with the concepts in ISA 540, paragraphs A77-A81. 23 Depending on the nature of the accounting estimate and the requirements of the applicable financial reporting framework, appropriate consideration should be given to a market participant's ability and intent by applying these factors from a market participant perspective (as opposed to entity-specific). • When considering the matters listed above, the auditor remains alert to contradictory evidence and does not ignore evidence that contradicts other audit evidence known to the auditor. If contradictory evidence is identified, the auditor gives appropriate consideration to whether that evidence is indicative of management bias or an error, and performs further procedures, as appropriate. • The auditor considers his or her understanding of management's method for determining the accounting estimate when evaluating whether any significant assumptions may exist; however, the auditor need not necessarily consider all assumptions used by

management in developing their accounting estimate. To do so might focus undue attention on individual assumptions rather than their impact on the development of the accounting estimate as a whole. Existing auditing standards, and this framework, require the auditor to focus his or her efforts on the assumptions that are significant to the development of the accounting estimate.

- For accounting estimates with a high level of estimation uncertainty that give rise to a significant risk, the auditor considers how management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate (refer to Section 3.7).

3.6 Developing a Reasonable Range for an Accounting Estimate

- The auditor may develop a reasonable range for the accounting estimate as a primary audit procedure or in combination with other procedures, as described in AU 342. There are a variety of complex accounting estimates where the results of the auditor's procedures indicate a range of 'reasonable' accounting estimates,24 which could exceed the auditor's established materiality threshold. If the auditor concludes that it is appropriate to develop a range, the auditor narrows the range, based on available audit evidence, until all outcomes within the range are considered reasonable.

o Narrowing the range to a point where all outcomes within the range may be considered reasonable is achieved by:

- ☐ Eliminating from the range those outcomes at the extremities of the range judged by the auditor to be unlikely to occur; and
- ☐ Continuing to narrow the range, based on audit evidence available, until the auditor concludes that all outcomes within the range are considered reasonable. In some rare cases, the auditor may be able to narrow the range until the audit evidence indicates a point estimate.25

- While a wide range may confirm that higher estimation uncertainty exists and may indicate that an accounting estimate contains a significant risk, this does not preclude the auditor, after performing sufficient appropriate procedures and obtaining sufficient appropriate evidence, from concluding that management's accounting estimate is reasonable in accordance with the applicable financial reporting framework. Certain accounting estimates, based on their size

24 As an example, ASC 275-10-50-15 identifies examples of estimates that are particularly sensitive to change in the near term, and thus could result in a range of "reasonable" accounting estimates.

25 ISA 540, paragraph A95.

and/or subjectivity, may inherently have a relatively wide range of reasonableness. The auditor considers these situations; however, not all accounting estimates can be estimated within a range smaller than the auditor's established materiality threshold simply by performing additional procedures. An auditor's assessment of certain other factors could include the following:

- o Assessing evidence of management bias or lack thereof;
- o Assessing whether there were changes in the methodology used to develop the estimate and, if so, the reasons for that change. A change in the methodology can be an indicator of management bias. Similarly, a lack of a change in the methodology used to develop the accounting estimate, when facts and circumstances indicate that there should have been a change, could also be an indicator of management bias;
- o Assessing whether there were changes in significant assumptions period over period without a triggering event;

		o Evaluating the point within the reasonable range (e.g., high end vs. low end) at which the client's accounting estimate falls as compared to prior periods. Significant movement within the range may be an indicator of management bias; o Evaluating whether management's assumptions are inconsistent with its peers and competitors (to the extent known by the auditor); o Reviewing management's history of executing on its stated course of action and meeting its forecasts (e.g., budgeted operating cash flow) to evaluate the effectiveness of management's forecasting process; o Evaluating whether the auditor is aware of contradictory evidence related to management's accounting estimate; o Considering whether a specialist was used by management in developing its own accounting estimates and our assessment of the specialist's knowledge, skill, and objectivity; o Evaluating the transparency of management's disclosures in the financial statements regarding the estimation uncertainty of the accounting estimate and how it was derived. • The above considerations are not applied as a checklist. The importance of each is weighed according to the particular set of facts and circumstances and the related risk assessment of the accounting estimate. 3.7 Accounting Estimates with Significant Risks • After performing the risk assessment procedures discussed in section 2, the auditor may determine that an accounting estimate (or some component thereof) gives rise to a significant risk. When this determination is made, the auditor performs substantive procedures, including tests of details, that are specifically responsive to the risk of material misstatement. This is consistent with current requirements for significant risks in AS 13, paragraph 11. • With respect to audit evidence for accounting estimates that give rise to significant risks, in addition to the requirements in AS 15, the auditor obtains sufficient appropriate audit evidence about whether the following are in accordance with the applicable financial reporting framework: o Management's decision to recognize, or to not recognize, the accounting estimates in the financial statements; and o The selected measurement basis for the accounting estimates. ☐ For example, when auditing a complex fair value measurement that is determined using a discounted cash flow analysis that includes highly sensitive management judgments, an auditor may identify this as a significant risk and would likely perform additional procedures to gather evidence to support projections prepared by the company. Additional focus also may be placed on the selected discount rate to ensure it reflects the higher level of uncertainty in the projections. • When an accounting estimate that has a high level of estimation uncertainty is assessed as a significant risk, the auditor performs substantive procedures to meet the requirements of AS 13. These include procedures to determine whether management has assessed how the estimation uncertainty impacts the accounting estimate and related disclosures. • The auditor's procedures should consider whether management has appropriately addressed estimation uncertainty. Examples of how management addresses estimation uncertainty could include one or more of the following:

		o Considering alternative assumptions or outcomes, and, if so, why it has rejected them; o Performing sensitivity analyses for significant assumptions; or o Considering different valuation models. • This is not intended to suggest that one particular method of addressing estimation uncertainty (such as sensitivity analysis) is more suitable than another, or that management's consideration of estimation uncertainty needs to be conducted through a detailed process supported by extensive documentation. Rather, it is how management has assessed estimation uncertainty in selecting the method(s) and developing the assumption(s) that is important. o For example, management may have documentation that supports the assumptions used, but does not explicitly list all other potential assumptions that were not used. In this case, the auditor would perform procedures to understand the process management went through when identifying the assumptions used and how management determined they were the most appropriate (i.e., how management determined not to use other assumptions). o Accordingly, where management has not considered alternative assumptions or outcomes, it may be necessary for the auditor to discuss with management, and request support for, how it has considered the effects of estimation uncertainty on the accounting estimate. o In addition, the auditor's procedures also could include evaluating: ☐ Whether the significant assumptions used by management are reasonable; ☐ Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so; and ☐ The adequacy of the disclosure of their estimation uncertainty in the financial statements in the context of the applicable financial reporting framework or regulatory disclosure requirements. The auditor's evaluation of the adequacy of disclosure of estimation uncertainty increases in importance the greater the range of possible outcomes of the accounting estimate is in relation to materiality. 4 Using the Work of an Auditor's Specialist • A specialist is a person with specialized knowledge or skill in a field of expertise other than accounting or auditing. Because income taxes and information technology, as they relate to the audit, are specialized areas of accounting and auditing, this definition should not apply to a person with specialized knowledge or skill in those areas. • The auditor is not expected to have the expertise of a person trained for, or qualified to engage in, the practice of another profession or occupation.26 During the audit, the auditor may encounter matters that, in the auditor's judgment, require such specialized skill in the audit. • The auditor's determination of whether to use the work of a specialist in the audit is driven by the auditor's risk assessment process, as described in section 2 above. This includes considering the complexity of the accounting estimate and its significance to the financial statements, as well as the knowledge, skill, and ability of the engagement team members.

- An auditor's specialist is a specialist who performs work to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's specialist may be either employed by the auditor ("auditor's employed specialist") or a third party engaged by the auditor ("auditor's engaged specialist").

4.1 Evaluating the Knowledge, Skill, and Objectivity of an Auditor's Specialist

- If the auditor decides to use the work of an auditor's specialist (whether engaged or employed), the auditor evaluates the knowledge, skill, and objectivity of the auditor's specialist and supervises the auditor's specialist's activities. Based on this assessment, the auditor determines the nature, timing, and extent of the specialist's involvement in the audit.
- The auditor should have sufficient knowledge of the subject matter to be addressed by the auditor's specialist to enable the auditor to:
  - o Communicate the objectives of that person's work;
  - o Determine whether that person's procedures meet the auditor's objectives; and
  - o Evaluate the results of that person's procedures as they relate to the nature, timing, and extent of other planned audit procedures and the effects on the auditor's report.27
- As it relates to evaluating the knowledge and skill of an auditor's specialist, the auditor should consider the following:

26 AU 336, paragraph 6.

27 Consistent with AS 9, paragraph 17.

  - o When a specialist is engaged by the auditor, the auditor performs an evaluation of the knowledge and skill of that auditor's engaged specialist in order to determine the reliability of the auditor's engaged specialist's work.
  - o Factors considered by the auditor include:
    - ☐ Whether the auditor's engaged specialist is subject to technical performance standards or other professional or industry requirements;
    - ☐ The auditor's engaged specialist's experience and professional reputation in the field relevant to the accounting estimate;
    - ☐ The auditor's engaged specialist's knowledge of and experience in the company's industry, when relevant to the accounting estimate;
    - ☐ The auditor's engaged specialist's competence in the matter for which the specialist's work will be used, including any areas of specialty within the specialist's field;28 and
    - ☐ The auditor's engaged specialist's competence with respect to relevant accounting and auditing requirements.29
  - o When a specialist is employed by the auditor, the specialist is considered a member of the engagement team and is supervised in accordance with Auditing Standard No. 10, Supervision of the Audit Engagement.

		☐ Under Quality Control Section 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice (QC 20), an auditor's employed specialist is subject to the firm's overall system of quality control, which includes an evaluation of an employee's independence, integrity and objectivity, personnel management, engagement performance, and monitoring, among other things. ☐ This system of quality control is intended to provide a firm with reasonable assurance that employees are independent (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities. ☐ QC 20 provides engagement teams that use the work of an employed specialist with the appropriate basis to evaluate an employed specialist's knowledge, skills, and objectivity. Accordingly, the auditor can determine that their employed specialist has sufficient knowledge, skill and objectivity by concluding that the employed specialist is subject to the firm's overall system of quality control. • As it relates to evaluating the objectivity of an auditor's specialist, the auditor considers the following: o For an auditor's employed specialist, as discussed above, an audit firm's system of quality control provides the auditor with the appropriate basis to evaluate the objectivity of the specialist. 28 For example, a particular actuary may specialize in property and casualty insurance, but have limited expertise regarding pension calculations. 29 These requirements are consistent with those listed in the PCAOB's Staff Consultation Paper No. 2015-01, The Auditor's Use of the Work of Specialists (Specialists Staff Consultation Paper) and in ISA 620. o An auditor's engaged specialist is not a part of the accounting firm's training, resource monitoring, or overall system of quality control. Accordingly, in evaluating the objectivity of an auditor's engaged specialist, the auditor views objectivity as a continuum that, based on the auditor's judgment, affects the nature, timing, and extent of the auditor's procedures and the reliability of the specialist's work as audit evidence. In evaluating the objectivity of an auditor's engaged specialist, the auditor: ☐ Obtains information regarding business, employment, and financial relationships between the auditor's specialist and the company; ☐ Determines, based on an evaluation of that information, whether there are any threats to the specialist's objectivity (e.g., due to an identified relationship between the specialist and the company); and ☐ If threats to the specialist's objectivity are identified, the auditor evaluates the impact of the relationship on the nature timing and extent of the audit procedures, taking into consideration whether the relationship has a significant bearing on the ability of the specialist to perform his or her work objectively. • For example, as the auditor evaluates the objectivity of the auditor's engaged specialist along the continuum, the auditor may determine that there is a relationship between the company and the auditor's engaged specialist that may appear to impair the objectivity of the auditor's engaged specialist. In response, the auditor would perform additional procedures to further understand the relationship. The auditor also could perform additional procedures related to the estimate his or herself, such as further

evaluation of the reasonableness of some or all of the assumptions, methods, or findings of the auditor's engaged specialist. If the auditor determines that the objectivity of the auditor's engaged specialist is impaired (e.g., the auditor's engaged specialist has prepared the company's valuation), the auditor would not use the work of that auditor's engaged specialist.

4.2 Informing an Auditor's Specialist of His or Her Responsibilities

- Communication (agreement) with the auditor's specialist, whether engaged or employed, is an important element in ensuring the sufficiency and appropriateness of the audit procedures performed. The auditor agrees, in writing, with the auditor's specialist about their responsibilities, which could include:
  - o The responsibilities of the auditor's specialist, including: (1) the objectives of the work that the specialist is to perform; (2) the nature, timing, and extent of the work that the specialist is to perform; and (3) matters that could affect the work the specialist is to perform or the evaluation of that work, including relevant aspects of the company, its environment, and its internal control over financial reporting, and possible accounting and auditing issues related to areas in which the auditor plans to use the work of the specialist;
    - ☐ When the work of the auditor's specialist relates to an accounting estimate, whether the work of the specialist will assist the auditor in: (1) developing an independent estimate, including how the specialist's work will use methods (which may include models) or significant assumptions; or (2) testing the methods and significant assumptions used by the company;
  - o The nature of company-provided or third-party information to be used by the auditor's specialist, including the source of the information and whether the specialist is responsible for performing work to assist the auditor in evaluating the: (1) accuracy and completeness of company-provided information; and/or the (2) relevance and reliability of third-party information;
  - o Requirements of the applicable financial reporting framework that are relevant to the work of the auditor's specialist;
  - o The nature and extent of audit documentation the auditor's specialist will provide and, if applicable, the form of report to be issued by the auditor's specialist;
  - o The nature, timing, and extent of communications between the engagement partner or other engagement team members performing supervisory activities and the auditor's specialist, including any changes in the scope of the work of the specialist or any other changes to the matters addressed in the agreement; and
  - o The importance of professional skepticism in an audit and the need to consider contradictory information.30
- In communicating the responsibilities of the auditor's specialist, the auditor also includes confirmation of the auditor's responsibilities that are relevant to the work being conducted by the auditor's specialist.
- This agreement between the auditor and the auditor's specialist can be evidenced in a memorandum or other relevant workpaper documentation in the audit workpapers.

4.3 Evaluating the Work of an Auditor's Specialist

- Once the auditor concludes that the auditor's specialist is knowledgeable, capable, objective, and has reached an agreement regarding his or her responsibilities, the auditor evaluates the reasonableness of the specialist's conclusions.

		• The auditor's evaluation of the work of an auditor's specialist includes: a) When the auditor's specialist assists the auditor in developing an independent estimate or testing the methods and significant assumptions used by the company, evaluating the conclusions of the specialist about: 1) The appropriateness of the methods including whether those methods are (1) in conformity with the applicable financial reporting framework, (2) generally accepted within the specialist's field of expertise, and (3) applied consistently, including whether consistency is appropriate considering changes in the environment or circumstances affecting the company; 30 These requirements are consistent with those listed in the Consultation Paper. 2) The relevance and reasonableness of the significant assumptions and methods in the circumstances, taking into account information presented in the report or documentation of the specialist, in view of the auditor's understanding of the company, its environment, and other evidence available to the auditor; and 3) When testing the company's methods and significant assumptions, the basis for selecting the methods and assumptions used in developing the estimate, including whether the company considered alternative methods and assumptions. b) Determining whether the procedures performed and the results and conclusions of the specialist's work: 1) Support or contradict the relevant financial statement assertions or conclusions regarding the design or operating effectiveness of the company's controls; 2) Are consistent or inconsistent with evidence obtained from other audit procedures performed;31 and 3) Are consistent or inconsistent with the work agreed upon between the auditor and auditor's specialist. c) In situations where the auditor believes that the results and conclusions of the specialist are not adequate for the auditor's purposes, the auditor agrees with the specialist on the nature and extent of further work to be performed by the auditor's specialist or perform additional audit procedures appropriate to the circumstances.32 • As an example, the conclusion of an auditor's specialist might indicate that the cash flow assumptions used by management in an impairment evaluation support management's conclusion that its goodwill balance is not impaired. However, if the output of the specialist's calculation indicates that the calculated implied fair value of a reporting unit approximates its carrying amount, the auditor may request that the specialist perform additional procedures (e.g., a sensitivity analysis) or the auditor may perform additional audit procedures appropriate to the circumstances. 5 Using the Work of the Company's Specialist • As noted in section 4 above, a specialist is a person with specialized knowledge or skill in a field of expertise other than accounting or auditing.

		• A company's specialist is a specialist who performs work to assist the company in its preparation of the financial statements. A company's specialist may be either employed by the company ("company's employed specialist") or a third party engaged by the company ("company's engaged specialist"). • When the work of a company's specialist will be used as audit evidence for an accounting estimate, the auditor performs the procedures in the following sections in addition to 31 These requirements are consistent with those listed in the Consultation Paper. 32 Consistent with the requirements in ISA 620, paragraph 13. performing risk assessment procedures, as discussed in section 2, and performs procedures to respond to the assessed risks of material misstatement, as discussed in section 3. • As part of assessing a company's specialist, the auditor evaluates management's internal controls related to the accounts or components of accounts in which the specialist is involved, as discussed in section 3.1. The auditor also assesses the knowledge, skill and objectivity of the company's specialist and the work performed by the company's specialist, as discussed further below. The auditor may obtain information about the knowledge, skill, and objectivity of the company's specialist as part of the risk assessment procedures, when obtaining an understanding of management's process and identifying controls for testing, or through other means. 5.1 Evaluating the Knowledge, Skill and Objectivity of a Company's Specialist • The auditor assesses the risks of material misstatement, and designs and implements audit responses that address the risks of material misstatement when using the work of a company's specialist. • When evaluating the knowledge and skill of a company's specialist, an auditor considers, among other things: o Whether the company's specialist is subject to technical performance standards or other professional or industry requirements; o The company's specialist's experience and professional reputation in the field relevant to the accounting estimate; o The company's specialist's knowledge of and experience in the company's industry, where relevant to the accounting estimate; o The company's specialist's competence in the matter for which the specialist's work will be used, including any areas of specialty within the specialist's field; and o The company's specialist's competence with respect to relevant accounting and auditing requirements. • Evaluating the degree of objectivity of a company's specialist should be viewed as a continuum that affects the nature timing and extent of audit procedures. An auditor considers, among other things: o Any interests and relationships that create threats to the specialist's objectivity, such as self-interest threats, advocacy threats, familiarity threats, self-review threats, intimidation threats, and any applicable safeguards, including any professional requirements that apply to the specialist, and evaluation of whether such safeguards are adequate;

		o Threats to a specialist's objectivity posed by an employment relationship and whether there is any direct reporting by the specialist; o The terms of the agreement to engage the specialist, including whether, and if so, how, the payment structure is tied to a particular outcome; o Whether management has the ability to dictate revisions to the specialist's results before finalization (with or without the agreement of the specialist); o The significance of the relationship between the engaged specialist and management (i.e., whether the specialist has an extensive relationship with management, and whether the fees charged by the specialist are material to the specialist); and o The nature of other services provided by the specialist to the company. 5.2 Evaluating the Work of a Company's Specialist • The nature, timing and extent of the auditor's procedures over the work of a company's specialist should be based on auditor's professional judgment, and responsive to the auditor's assessment of risk and the specific facts and circumstances of an audit engagement. • In addition to those substantive procedures listed within section 3 above, when evaluating the adequacy of the work of the company's specialist, the auditor also: o Considers whether significant assumptions, inputs, and methods used to develop the estimate are dependent on the use of specialized models, and; o Focuses his or her efforts on the assumptions that are significant to the development of the estimate and consider management controls over the estimation process. 6 Use of Third-Party Pricing Sources Not Acting as a Specialist • We agree with the distinction made in the Estimates Staff Consultation Paper that there are different types of third-party pricing sources, some of whom provide information "that is developed for, and widely available to, the public" and some of whom provide information "that is generated specifically for the auditor" or for management, and we agree with the staff that an approach in the potential new standard that could recognize some of these differences would be appropriate. Our comments in this area focus on the former. • The relevance and reliability of evidence obtained from third-party pricing sources33 should be evaluated for appropriateness under AS 15. For example, in general: o Evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources. • Generally, third-party pricing sources are knowledgeable and provide independent pricing information that is free of influence from any one company and is broadly used by market participants (e.g., the same price is released to all customers, buyers and sellers, without bias).

		o Additionally, given that the pricing information provided by a third-party pricing source is used every day by market participants, and is subject to price challenges by these same market participants, there appears to be an element of monitoring inherent in the process. • When auditors obtain independent pricing information from third-party pricing sources that is widely available for accounting estimates for which the auditor's risk assessment is determined to be of lower risk, the relevance and reliability of that information is evaluated to assess its appropriateness as audit evidence in accordance with AS 15. 33 While this section focuses on the use of third-party pricing sources, our proposed framework could be applied to other third parties that possess skill or knowledge that is not accounting or auditing when they are not acting as a specialist. • When auditors obtain audit evidence from third-party pricing sources not acting as a specialist, tests for relevance and reliability could include: o Performing due diligence over the third-party pricing source's general methodology, including how outliers may be identified in a security group (e.g., setting a range to evaluate pricing differences outside of a reasonable range); o Obtaining an understanding of the pricing source's price-challenge process (e.g., the frequency of price challenges, the extent to which pricing challenges are affirmed); o Evaluating the competence and objectivity of the pricing source; o Considering the quality of the pricing source (e.g., its historical accuracy and level of experience); o Reviewing pricing data obtained and considering the information in relation to the financial instrument; and o Considering inconsistent observable market information regarding the pricing assertion (i.e., contradictory evidence). • For securities selected for testing, when the auditor determines that the third-party pricing source's methods or assumptions reflect increased subjectivity or estimation uncertainty due to a higher risk assessment, in addition to the procedures listed above for accounting estimates of lower risk, additional procedures for relevance and reliability could include: o Comparing the reported price with evidence of a recent transaction for the security; o Comparing the reported price to other relevant observable market information; and o Assuming a lack of observable market information, determining the need to test management's process for determining fair value, including testing the valuation model, underlying data and the reasonableness of significant assumptions, or developing an independent estimate of the fair value of the securities selected for testing for corroborative purposes.
46.	CPAA	Clarity, Understandability and Practicality of the ED The IAASB has asked for comments on the clarity, understandability and practicality of application of the requirements and related application material of ED-540, in addition to the specific questions posed, which we address below. We consider that clarity and understandability of the standard is hampered by its length, wordiness and the presence of some duplication. We would suggest that to avoid the lengthy and overly prescriptive requirements, as for example is the case with paragraphs 17, 18 and

		19, some of the content is moved to application material, and the wording is made more concise in both the requirements and the application material. With respect to practicality of application, we do not consider that the concepts of low risk and not low risk (para.15) provide a practical basis for scaling the requirements to the engagement. We consider that the threshold is too low in that the majority of estimates are likely to be considered not low risk and that the contrast in the required response between low risk and not low risk is too significant. An assessment of not low risk results in auditors being required to consider a long list of matters depending on whether the assessed risk is a result of complexity, management judgment and/or estimation uncertainty. In addition, the requirements to consider matters listed under complexity (para.17), judgement (para.18) and estimation uncertainty (para.19) separately are not practical as these three factors are closely related and usually not mutually exclusive. Consequently, auditors will often be required to ensure they have addressed and documented the three separate lists of matters in those paragraphs. This is not practical as it does not allow for professional judgment in determining which matters are relevant to the engagement circumstances, but instead requires the auditor to obtain sufficient appropriate audit evidence on all of the matters listed, if the factor applies. As a consequence, the impact of the requirements is likely to be unnecessarily onerous without any evidence that it would lead to improved audit quality.
47.	CRUF	Firstly, we agree with paragraphs 21 (a) and A135 through A138 of ED-540 and would like to comment on these paragraphs from a viewpoint of users of financial information, such as investors and analysts. Modern financial reporting frameworks require preparers to make accounting estimates using financial models and forward-looking information. Under this situation, it is very important for the users making investment decisions to correctly understand the model and the assumptions used by preparers, and the extent to which accounting estimates are subject to estimation uncertainty. We believe that such information should be provided through financial statements footnotes at sufficient level, however we note that some financial reporting frameworks do not regulate specific disclosure requirements at that level. Therefore, from a user's standpoint, we need paragraphs 21 (a) and A135 through A138 of ED-540 which require auditors to request additional disclosures (beyond those specified in the relevant financial reporting framework) when necessary to achieve fair presentation of the financial statements as a whole under that framework. We also believe that sufficient disclosures related to accounting estimates are essential for effective auditor's communication of key audit matters to the users. Secondly, we agree with paragraph 26, A155 and A156 of ED-540 and would like to comment on the paragraph from a viewpoint of the users of financial information. It is considered that users such as investors and analysts will seek more opportunities to request explanations on accounting estimates and key audit matters thereof as a result of the introduction of key audit matters and the revision of ISA 540. Because auditors bear confidentiality requirements, the users will firstly contact those charged with governance instead of auditors. In order for such users' discussions with those charged with governance to be effective, it is an essential prerequisite that those charged with governance discuss accounting estimates and key audit matters thoroughly with auditors. When the auditors discuss with the those charged with governance, we believe that the auditors need to be mindful that their ultimate clients are the users of financial statements rather than the company. Therefore, it is important for the auditors to grasp the needs and interests of the users through the discussion. As users we rely on auditors to be sceptical and challenge management accordingly. For example, while an estimate may be within an acceptable range, the auditor should consider whether that estimate is at the most appropriate point within the range in the circumstances. Finally, we very much appreciate the IAASB in making the effort to improve quality of information related to accounting estimates through the recent projects for revisions of related ISAs.

48.	EFAA	General Observations Overall the ED marks a significant improvement on the extant in terms of structure and understandability. We appreciate the effort undertaken to contain the length and complexity of the requirements' section and to ensure the standard is scalable.
49.	FACPCE	
50.	IAA	Refer to letter
51.	IAAA	General comments: We decisively support the IAASB initiative on this important issue, considering the educational issue as fundamental in the formation and exercise of the accounting and auditing professional.
52.	IBRACON	Leading financial reporting frameworks have undergone significant changes in recent years, moving towards a more forward-looking and judgmental accounting for many financial statements items, which involves an increasing use of accounting estimates. Consequently, we believe it is appropriate for the IAASB to consider how International Standard on Auditing (ISA) 540 should be revised to reflect the evolving nature of financial reporting standards that address accounting estimates, as well as the auditing challenges that arise therefrom. We support the IAASB's initiative to prioritize the enhancements of ISA 540 to be responsive to, in particular, the impending effective date of IFRS 9 - Financial Instruments, which presents heightened challenges to both management and auditors as it relates to the preparation and auditing, respectively, of estimates related to expected credit losses. Nevertheless, some of the same auditing challenges identified in respect of IFRS 9 exist in practice today for other complex accounting estimates, to varying degrees, including across industries. Therefore, we support the IAASB's approach to enhance ISA 540 for the audit of all accounting estimates, not just those related to IFRS 9 or the audit of financial institutions.
53.	IBR-IRE	IRE-IBR welcomes the initiative of the IAASB to revise ISA 540 enhancing the auditor's identification and assessment of the risks of material misstatement for accounting estimates. In general, we endorse the response given by Accountancy Europe.
54.	ICAEW	MAJOR POINTS Support for the project 1. We welcome this ED and congratulate IAASB on its proposals. ED ISA 540 on the audit of estimates is the first in a series of important and far-reaching revisions. The risk ISAs and standards on quality control, group audits and audit evidence are being revised. They all go to the heart of every audit. We also welcome the field testing being conducted through the Global Public Policy Committee and urge IAASB to pay particular attention to the results. IAASB also needs to engage actively in the implementation effort and establish a model with the implementation of ISA 540 that can be used again. 2. An audit regulatory observation made over many years is that auditors deal with estimates inconsistently. There are several reasons for this, some of them firm-related, some driven by regulatory pressure and some relating to ISA 540 itself. The proposals are an attempt to reduce inconsistency and overall, we broadly support the reduction in emphasis on significant risks, the proposed 'stand back', and the enhanced focus on disclosures, models, and bias. Restructuring is needed

		3. We are concerned about the structure of the proposed standard. All of those we consulted believe that while the three risk factors are useful in driving thought processes in performing the analysis, driving the response through three risk factors will result in inconsistency, repetition and inefficiency. We understand that field testing has demonstrated this. 4. Complexity, estimation uncertainty and judgement are tightly interrelated. An estimate by definition includes estimation uncertainty, and estimation uncertainty by definition involves the use of judgement, and any complex estimate therefore involves the other two. Furthermore, they are not, of themselves, risks. They are not 'things that can go wrong'. They are categories that can help auditors think about what might go wrong. The requirement to focus the response on which are the main 'drivers', will result in practice in all three approaches being adopted in many cases, to avoid regulatory challenge. Is this what IAASB really intended? Will it normally be two out of three? Are there any situations in which IAASB can envisage it being one out of three? The distinction between the three approaches described is artificial. The extent of overlap and the interaction with financial statement assertions will result in complex and repetitive matrices analysing risk by line item, risk factor, assertion, assessed risk level and more. The use of the three risk factor model may be useful in the risk analysis process but IAASB should not force its use in driving the response. 5. The PCAOB's proposals on estimates retain an existing recognisable structure while incorporating many of the new elements of IAASB's proposals. This will lead some respondents to suggest that the PCAOB's proposals appear to be more readily workable. Calls for IAASB to restructure the proposals should not be dismissed lightly. Restructuring could be achieved in several different ways , without altering the substance of the proposals or the need for re-exposure. From a public interest perspective, it must surely be more important than ever that there is as much consistency as possible in the audit of the world's largest banks and other financial institutions and we will be urging the PCAOB to look at what it can do to bring the substance of its proposals closer to those of IAASB. 6. ICAEW's Corporate Finance Faculty has recently published its Consultation paper on prospective financial information to update Prospective Financial Information: Guidance for UK Directors, published in 2003. The proposals would result in updated prospective financial information (PFI) principles comprising, among other things, the three current preparation principles, i.e. reasonable disclosure, business analysis and subsequent validation: • reasonable disclosure is of uncertainties and mitigating actions; • sound business analysis renders PFI reliable; • subsequent validation renders PFI comparable. 7. We draw IAASB's attention to these principles because the consultation paper proposes to extend the principles beyond the regulated PFI currently in scope, to forward looking information more widely. Forward looking information is now embedded in financial reporting frameworks such as IFRS and many of the challenges faced by auditors auditing, for example, impairments and recoverability are the same as those faced by preparers. 8. Despite an absence of guidance, expectations of both preparers and auditors are high, in terms of the 'accuracy' of the forecasts and projections underpinning many estimates. Banks and others moving to the ECL model are struggling with the transition. It is not easy for any preparer to develop an estimate involving projections 40 years hence, and principles relating to the disclosure of uncertainties, based on a sound knowledge of the business, backed up by subsequent validation where short terms assumptions are projected forward, would be helpful to preparers and their auditors.

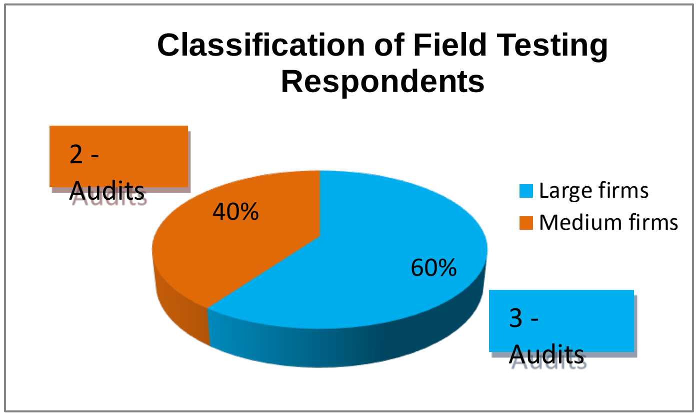
		9. IAASB cannot resolve this issue but it might acknowledge it in the introductory information to ISA 540. In its engagement with other stakeholders in the financial reporting supply chain, IAASB might also encourage the adoption by accounting standard-setters of guiding principles for the preparation and audit of forward looking information. The three factors developed by IAASB are not shared by preparers and some common ground in this difficult area would be welcomed by both. It would be an unfortunate, if not entirely unpredictable, unintended consequence if auditors were found to approach the audit of estimates by attempting to rationalise or retrofit estimates produced by preparers using IAASB's three factors, for the want of guiding principles. Giving greater prominence to principles of preparation, where they exist, would help align the work of preparers and auditors. Costs, benefits and the implementation effort 23. When proposals such as these are made it is often asserted that the best audit teams are already doing much of what is proposed. While this may be true in some cases, documenting it, changing methodologies, training and managing regulatory challenge all represent cost. It is easier to pass costs relating to changes in accounting standards on to clients and we believe that as part of its implementation effort, and for the proposals to stand the best chance of successful implementation, IAASB must seek to engage with preparers of financial statements to make them aware or remind them of the: • changes in the way auditors will be approaching the audit of estimates; • concomitant need to provide auditors with good quality and internally consistent support for estimates and the related disclosures on a timely basis; • importance of management taking full responsibility for their own estimates in the financial statements, and to stand back and challenge their own models, data, assumptions and processes, and those of any employed or engaged experts; • importance of the disclosure of assumptions and sensitivities; • benefits of better quality audits.
55.	ICAG	
56.	ICAP	We fully support IAASB's focus and efforts to update and improve extant ISA 540. We acknowledge that improvements envisaged in the ED 540 will contribute positively in enhancing the audit quality. However, there are areas in the ED 540 which we believe require further consideration and refinement, so as to make the requirements more relevant, understandable and effective for implementation.
57.	ICAS	General comments We welcome the opportunity to comment on the International Auditing and Assurance Standards Board's (IAASB) Exposure Draft of International Standard on Auditing (ISA) 540 (Revised), Auditing accounting estimates and related disclosures, (ED-540). The timing of the revised ISA is very relevant in response to proposed and imminent changes in the financial reporting environment, which are expected to place greater emphasis on the measurement and recognition of these accounting estimates, and the impact that these new reporting requirements are likely to have on the audit.
58.	ICAZ	
59.	ISCA	Risk assessment procedures and related activities

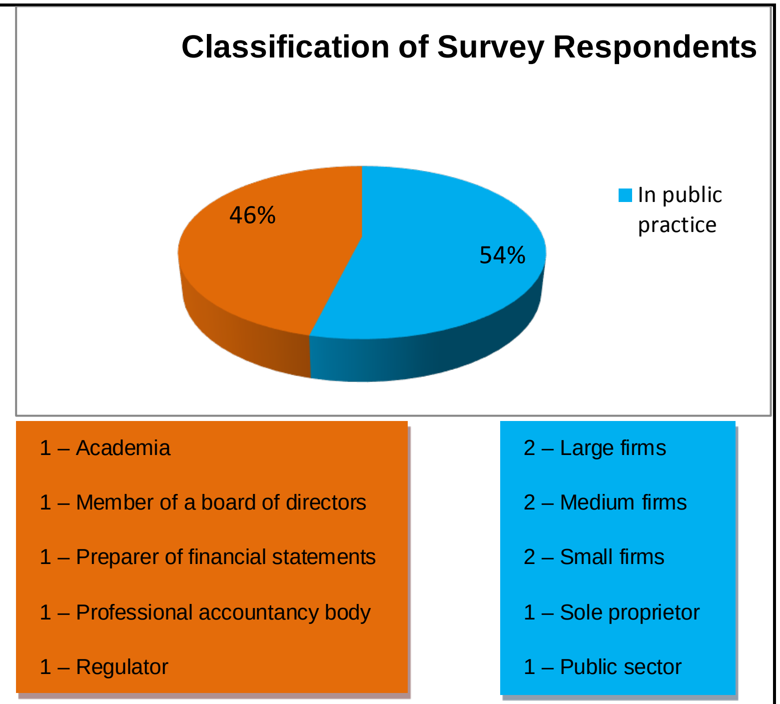
		4.1 Paragraph 10 of ED-540 imposes a list of new requirements for the auditor to obtain an understanding of the entity and its environment, including its internal control, as part of its risk assessment procedures. 4.2 Instead of imposing additional requirements on top of those in extant ISA 315 (Revised) which is the foundational risk assessment standard, the IAASB could consider streamlining the requirements in both standards. 4.3 In addition, the IAASB could provide further guidance on the extent of documentation required for the auditor to demonstrate the work done on the requirements in paragraph 10 of ED-540. Accounting estimates involving estimation uncertainty 4.4 In executing audit procedures such as testing for goodwill impairment where a high level of estimation uncertainty is involved, it is unclear whether the assessment of the risk factors relating to estimation uncertainty should be influenced by whether the accounting estimate is eventually recognised in the financial statements. (Ref: Paragraph 10(c) of ED-540). 4.5 The key assumptions such as revenue and growth rates which involve a high level of judgement and estimation typically will not directly impact the entity's financial statements, unless an impairment loss is eventually recorded. 4.6 We are of the view that a high level of estimation uncertainty exists in such cases, even though the accounting estimate may not be eventually recognised in the financial statements. We seek the IAASB to provide further clarification and guidance in this area. 4.7 In addition, we recommend that a sensitivity analysis test could be introduced as part of a more robust risk assessment process. By performing sensitivity analysis at the planning stage, the auditor could zoom into identifying specific parameters such as discount rates as a specific risk area instead of impairment of goodwill as a whole. This will allow the auditor to effectively direct adequate work efforts in that identified risk area. Retrospective review 4.12 The IAASB could consider highlighting that a retrospective review could constitute both a risk assessment and substantive audit procedure. 4.13 More clarity and guidance could also be provided in ED-540 on the auditor's next steps, for instance, the nature and extent of further audit procedures to be performed following the outcome of the retrospective review. 4.14 In addition, the IAASB could clarify if paragraph 11 of ED-540 on retrospective review would apply in the following scenarios: • estimates with low inherent risk; • estimates for which the outcome of the initial estimate may become known during the audit such as bonus accrual; and • where the auditor had already performed procedures in relation to paragraph 10(e)(vii) of ED-540 with a satisfactory conclusion on management's process over the need for a change in accounting estimates from the prior period Clarity of scope 8.1 With reference to paragraph A75 of ED-540, it is unclear if, estimates for which the outcome is expected to be known, are within scope of this ED-540, and accordingly, if the requirements in paragraphs 10 and 15-20 of ED-540 would apply. One such example

		would be where the auditor obtains sufficient appropriate audit evidence for bonus accrual, referred to in paragraph A72, by vouching to actual payouts and the relevant supporting documents prior to audit report date. 8.2 In our view, the IAASB could enhance clarity by specifying in ED-540 that such estimates, for which the outcome is expected to be known during the audit, are not within the scope of the standard, since there is no element of estimation uncertainty. Subsequent events 9.1 The revised requirement in ED-540 paragraph 15(a)(i) relating to obtaining audit evidence about events occurring up to the date of the auditor's report appears to be an extended procedure on subsequent events. It is unclear if the IAASB's original intent was to expand the auditor's responsibility on subsequent events on accounting estimates. 9.2 To minimise confusion, we propose to retain the wordings in the extant ISA 540 paragraph 13(a) which requires the auditor to "determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate". Use of terminology 10.1 ED-540 paragraph 19(a)(i) requires the auditor to obtain sufficient appropriate audit evidence about whether, in the context of the applicable financial reporting framework, management has taken appropriate steps to understand and address the estimation uncertainty, and develop a point estimate that meets the measurement objective. 10.2 Practically, it may be challenging for the auditor to obtain sufficient appropriate audit evidence to demonstrate that management has indeed taken appropriate steps to understand and address the estimation uncertainty. Hence, we propose to use the term "consider" or "evaluate" rather than "to obtain sufficient appropriate audit evidence". Effective Date 11.1 We support the IAASB's recommendation that an appropriate effective date for the standard would be for financial reporting periods ending approximately 18 months after the approval of the final ISA.
60.	ICPAK	
61.	KICPA	
62.	NASBA	GENERAL COMMENTS We understand that in developing the proposed standard, the IAASB aims to achieve the following: ☐ enhance requirements for risk assessment procedures to include specific factors related to accounting estimates, namely: complexity, judgment, and estimation uncertainty; ☐ set a more detailed expectation for the auditor's response to identified risks of material misstatement related to accounting estimates, including enhancing the auditor's application of professional skepticism; and ☐ scalability regardless of the size or sector of the business or audit firm. We would like to commend the IAASB on its efforts to develop a revised standard on auditing accounting estimates and related disclosures. The increasing complexity of financial instruments creates new risks which need to be assessed and addressed by auditors. In addition,

		recent accounting standards on fair value measurements, expected credit loss and other financial reporting standards mandate new accounting and disclosure requirements which contain disclosures that need to be audited. Thus, we would like to express our overall support for recognizing a need for updating the existing standard. Notwithstanding the above, we wish to emphasize the following matters: Overall Structure and Clarity of the Exposure Draft a) We found that the ED is extremely complex and not easy to follow. We recommend that the IAASB consider the Public Company Accounting Oversight Board's recent proposal on Auditing Accounting Estimates, Including Fair Value Measurements to simplify its proposal and to eliminate unnecessary differences for auditors. We also recommend either adding additional guidance in the current IAASB proposal or providing an explicit linkage to the auditing guidance on use of specialists. b) We believe that there should be a better linkage between ISA 540 and ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and Its Environment and ISA 330, The Auditor's Responses to Assessed Risks. c) We recommend including additional application guidance on auditing internal controls and management's process of developing estimates. d) Paragraph A1C of the Application and Other Explanatory Material prescribes use of the management expert. In some situations there may be limited public information available for determination of an independent estimate, which could create a challenge for differentiation between a management expert and external information source. Further application guidance may be required to elaborate further on such issues.
63.	SAICA	Overall we are supportive of the modernisation of ISA 540 for evolving financial reporting frameworks and the enhancement of the identification and assessment of risks of material misstatement and risk response with respect to accounting estimates and related disclosures. Please find included the comments prepared by SAICA (accompanying this cover letter). We wish to express our appreciation for the work of the IAASB task group in addressing this challenging, but extremely important aspect of an audit of financial statements. Please do not hesitate to contact us should you wish to discuss any of our comments. You are welcome to contact Willie Botha (willieb@saica.co.za) or Thinus Peyper (thinusp@saica.co.za). **CONTENTS** This submission is presented under the following headings: A. SAICA's approach to respond B. Overview of survey respondents and field testing respondents C. Detailed comments to questions D. Editorial and other comments on specific paragraphs Annexure 1: Summary of responses from field testing **A. SAICA'S APPROACH TO RESPOND**

		1. SAICA's approach to informing our members of the proposed amendments, and to gather information to inform our comment letter can be summarised as follows: • A SAICA internal working group studied and debated the ED and prepared initial thoughts and input pertaining to the questions that have been posed (questions 1 to 8), as well as identifying other matters of importance on which comments may be required. The internal working group proceeded to prepare a template of specific questions to be answered by field testing participants, as well as a survey questionnaire to be completed by other members wishing to participate (an online survey). • SAICA issued a communication requesting its members to respond to the questions asked in the explanatory memorandum by means of an online SAICA survey. The survey link was sent to all members. • SAICA further issued a communication requesting its members to participate in field testing the amended requirements and guidance on a live audit and to provide us with feedback based on specific questions around implementation. A questionnaire was sent to members who were willing to participate. Most of the feedback received were based on completed audits rather than live audits due to the timing of the audits, as well as the due date for providing feedback. • SAICA established a comment letter task group consisting of members of the SAICA Assurance Guidance Committee (AGC) to discuss the ED, review the draft comment letter and provide any additional inputs they may have. **B. OVERVIEW OF SURVEY REPSONDENTS AND FIELD TESTING REPSONDENTS** **Survey responses** 2. The SAICA survey was completed by 13 respondents. All the respondents are members of SAICA, while 9 are also registered with the IRBA. The graphic below provides an overview of the classification of respondents: 3. In the analysis above, the following meaning is attributable to the relevant terms: • Large firms are firms with more than 10 partners • Medium firms are firms with 5 – 10 partners • Small firms are firms with 2 – 5 partners





4. In applying the survey approach as part of previous comment letters submitted to the IAASB, SAICA has been able to achieve a higher response rate. We believe that the lower response rate this time is in part owing to the highly technical nature of the proposed standard and the fact that we did not have sufficient time to present to our members an information session (via webcast), before requesting the completion of the survey. However, we are satisfied that the respondents that replied provided appropriate input for the SAICA comment letter task group to consider and discuss.

5. Throughout this comment letter we present the results from the survey by referring to "**survey respondents**". The survey results have not been analysed statistically and cannot be extrapolated. The results are presented as perceptions and views that have been observed, and although not representative of a general or common view, provide insights into, and some additional perspectives regarding the matters on which the IAASB are seeking comments, as well as in relation to additional matters that were included in the survey that the IAASB may find helpful.

Field testing responses

6. Respondents from 5 audit firms agreed to participate in field testing and to complete SAICA's questionnaire designed for field testing respondents. The graphic below provides an overview of the classification of respondents.

7. Throughout this comment letter we present the results from the field testing by referring to "**field testing respondents**". As stated in paragraph 1, above, most of the feedback received were based on completed audits rather than live audits due to the timing of the audits, as well as the due date for providing feedback. However, the results still provide valuable additional insights into the application of the requirements of the ED. A summary of the responses from field testing is included as **Annexure 1** to this submission.

Additional questions

		68. SAICA also considered the following additional questions: Do you agree that the stand back provision in paragraph 22 will improve the auditor's focus on whether sufficient appropriate audit evidence has been obtained? 69. Most of the survey respondents agreed that the stand back provision in paragraph 22 will improve the auditor's focus on whether sufficient appropriate audit evidence has been obtained. It also enhances the auditor's exercise of professional scepticism. 70. One survey respondent commented that when auditing an accounting estimate, particularly one that is subject to more complexity, judgement and estimation uncertainty, the extent of audit work that the auditor is required to perform can easily lead the auditor to lose sight of the overall evaluation with respect to obtaining sufficient appropriate audit evidence whether the financial statements are materially misstated. Requiring the auditor to take a step back after having performed the relevant audit procedures and re-evaluate the outcome of the audit procedures will assist the auditor in making an overall/ holistic assessment of whether sufficient appropriate audit evidence has been obtained and to reach an appropriate conclusion on whether an accounting estimate is free from material misstatement. It was however suggested that paragraphs A139 – A141 be clarified by specifically stating that the auditor should 'stand back' and evaluate the audit evidence obtained regarding the accounting estimate. Do you agree with the decision of the IAASB to place more emphasis on communication with those charged with governance regarding accounting estimates in paragraph 26? 71. All of the survey respondents agreed with the decision of the IAASB to place more emphasis on communication with those charged with governance regarding accounting estimates. 72. One survey respondent commented that this will also enhance the communication of key audit matters which often relate to matters of significant complexity, judgement and estimation uncertainty. 73. The majority of the field testing respondents also agreed with the requirement and stated that it did not affect their audit where the risk was assessed as 'not low' because significant risks were already communicated to those charged with governance (and flagged as possible key audit matters). Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (i)(6). 74. SAICA agrees with the above-mentioned views expressed. Do you agree that the requirement in paragraph 27 and the related application material (see paragraphs A158–A159) will result in consistent documentation of the basis for the auditor's evaluation of the reasonableness of accounting estimates? 75. Most of the survey respondents agreed that the requirement in paragraph 27 and the related application material will result in consistent documentation of the basis for the auditor's evaluation of the reasonableness of accounting estimates. 76. One survey respondent and one field testing respondent suggested that a specific documentation requirement should be included in respect of the considerations and conclusions of the "stand back" provision.

		77. The majority of the field testing respondents indicated that the amended requirements did not affect their audits as the risks were previously assessed as significant and therefore required similar documentation. It was however noted that documentation would increase for risks assessed as 'low'. Furthermore, it was indicated that the link between documentation requirements and work effort requirements relating to the auditor's consideration of management bias is not clear. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (i)(7). 78. SAICA generally agrees with the respondents' views and have further comments and suggestions in the paragraphs that follow to contribute to the clarity and consistent application of the documentation requirements. 79. The ED does not contain specific documentation requirements regarding the following sections of the ISA: • Risk assessment procedures and related activities • Identifying and assessing the RoMM • Responses to the assessed RoMM • Disclosures related to accounting estimates We have deduced that the reason for this is that the ED describes in the scope section that the ISA expands on how ISA 315 (Revised), ISA 330, ISA 500 and other relevant ISAs are to be applied in relation to accounting estimates and therefore the documentation requirements in those ISAs should be applied in addition to the ED. 80. ISA 240 however, also contains requirements relating to risk assessment, identifying and assessing RoMM and responses to assessed RoMM. The documentation requirements in ISA 240 differ from the proposed requirements in ED-ISA 540 as it makes reference to ISA 315 (Revised) and ISA 330 and also includes the specific documentation requirements relating to these ISAs. It is therefore recommended that the documentation requirements in the ED should be worded similarly to the requirements in ISA 240 (i.e. applying a similar approach). SAICA believes it is important that the standard is written in such a way that auditors do not underestimate the implications for audit documentation. 81. With respect to the documentation requirements pertaining to the auditor's evaluation of management bias, paragraph A159 is narrow in referring only to the examples in paragraph A147. We believe that the reference should be more holistically to the requirement in paragraph 24, which will be aligned to the approach adopted in paragraph A158 that refers to paragraphs 17 – 21 and 22 – 23. One of the key components of the proposed revised standard is the expansion of the application material (i.e. the A-paragraphs). Do you believe that the application material is sufficient in extent and content to provide meaningful guidance in enhancing the auditor's understanding of the requirements regarding the auditing of accounting estimates and how to carry these requirements out? 82. Most of the survey respondents agreed that the application material is sufficient in extent and content to provide meaningful guidance in enhancing the auditor's understanding of the requirements and how to carry these requirements out. 83. One survey respondent suggested that it may be useful to expand the application material further to include more practical examples that will illustrate the practical application of the requirements.

84. The field testing respondents also agreed and believed that the application material is vital in understanding the ED. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (c)).

85. SAICA agrees that the application material is comprehensive and most helpful. We have included a few suggestions in terms of the possible expansion of application material in certain areas as part of our responses to the other questions in this comment letter.

86. There was a particular comment from the survey respondents that more guidance should be considered for the audits of smaller entities where accounting estimates may be less complex.

SAICA compared the ED to the extant standard in relation to "Considerations specific to smaller entities". We found that the relevant A-paragraphs in the ED (A23, A44, A60, A100, A107 and A110) have retained the guidance included in the extant standard, with some amendments, additions and clarification in certain cases. There are two instances where the guidance in the extant standard has not been 'transferred' to the ED:

- Extant ISA 540.A67: We believe that the matter relating to a longer period between the balance sheet date and the date of the auditor's report is a characteristic that is specific to smaller entities and relevant in considering the audit evidence for certain accounting estimates. We request that the IAASB consider retaining this guidance.
- Extant ISA 540.A106: This paragraph includes, among other, the following guidance that has not been retained in the ED, "… the auditor may explain to management the process or the different methods available for doing so, and the documentation thereof. This would not, however, change the responsibilities of management for the preparation of the financial statements." The circumstance described here is a reality of practice in dealing with many smaller entities. We are not sure why the IAASB has decided not to retain this as part of the guidance; we had considered that the decision may relate to a possible conflict with independence requirements in the Code of Professional Conduct.

Introduction

91. As indicated under section B of this comment letter, 5 audit firms agreed to participate in field testing the requirements and guidance of ED-ISA 540 (Revised) and to complete SAICA's questionnaire designed for field testing respondents.

92. In the paragraphs that follow, field testing respondents described their understanding and their experience in implementing the requirements and guidance. The comments are each from individual respondents, unless indicated otherwise.

93. This feedback is provided as additional information for the IAASB to consider with respect to the perceptions that have been expressed from field testing; in certain instances SAICA has added comments.

Field test question (a)

What difficulties did you experience in understanding the new requirements?

94. The standard appears to have been developed with complex estimates in mind but will likely result in significant incremental effort for lower risk estimates, as the standard is not very clear how to practically differentiate between the work effort that is required for estimates that is 'not low' risk compared to those that are 'low' risk.

95. In implementing responses to the risks of material misstatement that is 'not low', the practitioner is required to implement procedures in accordance with paragraphs 17 – 20. It is unclear how these procedures interact with the procedures articulated in paragraphs

		15(a)(i) to (iii). These procedures have always been applied to estimates and are presumably still relevant to address risks relating to estimates. It is assumed that paragraphs 17 – 20 are in addition to the procedures in paragraph 15(a). SAICA comment: The application material in paragraph A97 is intended to address this concern. 96. It is unclear what the extent of documentation should be to demonstrate the execution of the requirements in paragraphs 22 and 23. Field test question (b) What difficulties did you experience in implementing/ applying the new requirements during the audit? 97. The field testing respondents described difficulties in implementing the requirements in the paragraphs that follow. 98. How to determine the most appropriate point estimate or range. 99. In understanding the models used by management, the most complex part is evaluating the extent of management bias and the impact on the point estimate. 100. The approach of identifying all accounting estimates and then assessing the risks of material misstatement as ‘low’ or ‘not low’ resulted in more detailed documentation and a shift in the flow of the audit file to ensure these requirements are met. SAICA comment: This may also be linked to a firm’s audit methodology. The revised standard will require the necessary update of methodologies in terms of ensuring compliance with the standard, as well as the most efficient way in which this may be accomplished. 101. The entity’s documentation was not always formalised and in sufficient detail for the auditor to perform the risk assessment procedures. 102. The articulation of risks of material misstatement relating to disclosures and execution of procedures to address the risks. Field test question (c) The purpose of application and other explanatory material of an ISA is for the auditor to understand the objectives of the ISA, the meaning of the requirements and how to carry them out. Did you find that the application material assisted you during the audit? (Also taking into account that a key component of the revised standard is the expansion of the application material) 103. The field testing respondents agreed that the application material is detailed and does assist in guiding the assessment; they also commented that the application guidance is vital for an understanding of the requirements of the ED. Field test question (d) Did the requirements in paragraphs 10 and 11 result in a more detailed understanding of the accounting estimates at the entity and did it improve your ability to identify risks of material misstatement? Please provide reasons for either “Yes” or “No” responses. 104. The field testing respondents agreed and provided the following comments • The detailed breakdown in paragraph 10 is useful in identifying factors that should be considered. • The requirements prompt auditors to ask more probing and specific questions in obtaining an understanding.

		• The extent of understanding required is more detailed and drives a more granular risk assessment. The focus on risk assessment will inform the auditor's judgement regarding risk and an appropriate response thereto. • These requirements assist the team in ensuring that all factors are documented in one place. • It also assisted in increasing the documentation around the extent of management skills and knowledge used. • Paragraph 11 notes, "The review is not intended to call into question judgements about previous period accounting estimates that were appropriate based on the information available at the time they were made." This is a useful reminder to evaluate relevant factors each year, separately from the year before. A change in assumptions is based on what is available at the time and does not necessarily equate to management bias pertaining to achieving a specific outcome. 105. One respondent did however comment that these requirements may be too onerous for obvious low risk estimates, where this level of understanding would not be required. SAICA comment: Refer to our detailed comments to question 1. Field test question (e) How did these requirements affect your assessment of risks of material misstatement (RoMM) at assertion level; also linked to the three factors (complexity, judgement and estimation uncertainty) that are most likely to influence the RoMM? 106. The majority of the field testing respondents described that the requirements improved their assessment in that it was documented in more detailed, resulted in a better understanding and a more effective response to the assessed risks (the right work in the right areas). It highlighted more clearly the risk factors and considerations. 107. Two field testing respondents indicated that the assessment of RoMM was consistent with the previous year. 108. Another field testing respondent commented that previously complexity and judgement were sources of estimation uncertainty, and has always been considered. It is not clear whether estimation uncertainty is no longer impacted by these factors and whether it should be a factor on its own. SAICA comment: This talks to the interrelationship between the three risk factors identified in the standard. Also refer to our detailed comments to question 4(b). Field test question (f) How did the inherent risk you assessed as "low" and/ or "not low" affect your work effort? (in terms of nature, timing and extent) 109. All of the field testing respondents commented that at an overall level, the nature, timing and extent of further audit procedures performed did not significantly differ from the previous year for inherent risks assessed as 'not low'. Paragraphs 17 – 20 required a more detailed and specific response to RoMM. 110. One field testing respondent commented that the requirements streamlined the process in terms of once it was identified whether the risk is 'low' or 'not low' to then determine the extent of work that is required. SAICA comment: This observation confirms that the objective of the IAASB in terms of achieving scalability of the requirements and their application could be achieved.

111. Two field testing respondents commented that there was an increase in the documentation of how management made the estimate for risks assessed as 'low' and that this documentation is not necessary to reach a conclusion that the risk is 'low'.

Field test question (g)

What are your views on the effectiveness and efficiency of the objective based requirements (paragraphs 17 – 19) in guiding the design and performance of further audit procedures?

112. Most of the field testing respondents commented that the objective based requirements ensure that appropriate procedures are performed. It provides for a more detailed and direct response to the specific estimate. More applicable guidance has been provided, especially considering the new accounting standards that are soon to be implemented.

113. One respondent commented that once the RoMM is assessed as 'not low' the procedures required to obtain audit evidence regarding Complexity, Judgement and Estimation Uncertainty were consistent with the previous year.

114. Another respondent commented that in practice the procedures related to complexity and judgement might overlap.

Field test question (h)

What are your views on the internal controls requirement in paragraph 16? (The extant ISA 540 did not include a specific requirement, but a controls based approach has become more important due to the nature of accounting estimates, the complexity and judgement involved in selecting methods, making assumptions and the use of data.)

115. Most of the field testing respondents agreed with the requirement and commented that the applicability of the requirement (whether internal controls will be tested), will depend on the nature and size of the entity (e.g. large data intensive companies such as banks, insurers, and telecommunication entities), the processes around estimates and whether internal controls are in place that can be relied upon.

Field test question (i)

What are your views on how the following matters impacted the performance of your audit? (Did you experience difficulties in applying the matters and did the matters contribute to you achieving the objective of obtaining sufficient appropriate audit evidence in an efficient manner?)

Question (i)(1)

The change in focus relating to significant risks, in that the ED no longer include specific requirements for significant risks.

116. One of the field testing respondents commented that the team's focus shifted to correctly and thoroughly assessing the criteria set out, instead of distinguishing between significant/ not-significant risks.

SAICA comment: Although the ED does not include requirements specific to significant risks as is the case in extant ISA 540, the manner in which significant risks are referred to in paragraphs 13 and 15, and the related application material in paragraphs A76 – A77 and A94 – A95, are adequate.

117. Two of the field testing respondents commented that this change did not have an impact on their audit.

Question (i)(2)

The changes in paragraph 20 and the related application material (paragraphs A128 – A134) when developing a point estimate/ range.

118. Most of the field testing respondents indicated that it is difficult to determine a point estimate or range. The factors to be considered in identifying the range required is not clear and guidance and examples are required. Previously paragraph A94 of the extant ISA was used that permitted a range equal/less than performance materiality.

SAICA comment: Refer to our detailed comments to question 5.

119. One field testing respondent commented that it provides more reliable conclusions on whether the RoMM for that specific estimate was addressed and whether misstatements actually exist.

120. Another field testing respondent agreed with the changes with respect to the calculation of a range and setting the parameters of the range and commented that it recognises the complexity of some of the estimates being evaluated.

Question (i)(3)

Enhanced requirements in paragraph 21 and related application material on disclosures.

121. Most of the field testing respondents agreed with the requirements around disclosures. The requirements in paragraph 21 and the application guidance reinforce the IAASB's emphasis on risks related to disclosures; that the auditor should identify disclosures upfront and address the risks of material misstatement related to disclosures during the audit process instead of towards the end of the audit.

122. One field testing respondent however, commented that disclosures are typically only available for audit at the end of the audit and results in more work to be performed towards the end of the audit.

123. Another field testing respondent suggested that the detailed application guidance relating to the disclosures should be included in the main standard to clarify the auditor's objectives related to disclosures. It is suggested that the following matters relating to risks of material misstatement of disclosures be clearly articulated:

- understanding of the process to calculate disclosures,
- identification of risks of material misstatement related to disclosures, and
- the work effort related to disclosure risks.

Question (i)(4)

The stand-back provision in paragraph 22 when inherent risk is not low.

124. All of the field testing respondents agreed with the requirement and it was indicated that this already forms part of the approach of one of the firms.

125. One field testing respondent commented that the paragraph is useful in understanding the 'big picture'. It assists in defining what the outcome should be and confirming that the process makes sense and the outcome is reasonable.

126. Two respondents commented that guidance should be provided on how to perform and document the stand-back provision.

Question (i)(5)

		Evaluating whether the accounting estimate is reasonable or misstated in paragraph 23 (Including the sufficiency of guidance regarding the evaluation of misstatements). 127. Most of the field testing respondents agreed with the requirement. 128. One field testing respondent commented that the requirement ensures that the auditor takes into account all available information and then makes a decision on whether the result is reasonable or misstated. This assisted the audit team during discussions with management as all relevant and supporting evidence was available. 129. One field testing respondent however commented that the determination of reasonable vs. not-reasonable (i.e. misstated) could be clearer, especially where assumptions are highly sensitive. Question (i)(6) Enhanced communication with those charged with governance in paragraph 26. 130. The majority of the field testing respondents agreed with the requirement and indicated that it would not have an impact on audits where significant risks were previously communicated to those charged with governance or if the entity is a listed entity, the information around estimates would likely have been communicated and raised as possible key audit matters. 131. Two field testing respondents commented that it might be a more difficult process in an audit of a private company where there are less formal processes in place to communicate all these types of matters to TCWG. The list of possible matters to communicate in paragraph A155 however provides good guidance on what to report. 132. One field testing respondent commented that there is a need to clarify at which level these detailed communications should take place. Question (i)(7) The requirements in paragraph 27 and related application material in paragraph A158 regarding documentation. 133. The majority of the respondents agreed with the requirement and stated that it did not have an impact on the documentation for their accounting estimates assessed as significant. It was noted that the ED no longer focusses on documentation around risks relating to accounting estimates assessed as significant risks. SAICA comment: The explicit link to the documentation requirements in ISA 230 should address the matter relating to significant risks. Also refer to our other comments with respect to the proposed documentation requirements under additional questions on pages 13 – 14. 134. One field testing respondent commented that documenting the indicators of possible management bias required more detailed consideration. 135. Another field testing respondent commented that the documentation requirements do not clearly link back to the objective. The link between the work effort requirements and the documentation requirements relating to indicators of management bias, is further not clear. A suggestion was made to include some of the detail in paragraph A158 in the requirements section of the standard.

64.	SMPC	GENERAL COMMENTS The SMPC has closely followed the development of the ED and submitted comment letters in advance of a number of the IAASB quarterly Board meetings. We support the IAASB revising ISA 540 and commend the Board on the considerable amount of work that has been undertaken in developing the proposals. Accounting estimates can be very complex and both today, and in the future, will continue to be an important element of financial statements, so the ED represents significant progress. In our view, the IAASB should be sensitive to the risk of increasing public expectations of an audit where an accounting estimate is subject to a significant degree of estimation uncertainty. For instance, increasing the level of prescription in particular areas of ISA 540 (Revised) may inadvertently increase public perception that provided the entity applies the “right” process or model, an acceptably reliable estimate can “more or less always” be included in the financial statements. In reality, the desired degree of exactitude may inevitably remain unattainable in respect of certain accounting estimates. Although the introduction explains that accounting estimates are subject to inherent limitations, this material could be more explicit as to the equivalence of the limitations this places on the preparer’s and auditor’s ability in the context of measurement uncertainty. Otherwise there may be unrealistic expectations that the auditor can “enhance” the actual degree of reliability of an accounting estimate - an audit cannot make inherently uncertain measurements more precise than they are. We therefore believe that the IAASB has an educational role in explaining the responsibilities of other stakeholders in the financial reporting supply chain for accounting estimates. For example, highlighting the responsibility of management to provide auditors with adequate information on a timely basis for their accounting estimates when preparing financial statements. The information required from management with the new standard may require more detail on the inputs, ranges etc., but in general this is not considered negative, as it should lead to enhanced evidence and documentation on audit files.
Academics		
65.	GC	Based on our review of ED-540 and the proposed fair value standards from other standard setting bodies, it is our opinion that ED-540 appropriately addresses several key topics: • ED-540 provides guidance to auditors on how to reconcile estimation uncertainty with quantitative materiality (A2, A134, A142-A146). • ED-540 gives auditors explicit steps to address and respond to estimation uncertainty (Paragraph 19 of the standard, as well as A113-A134). • ED-540 helps auditors ensure that estimation uncertainty is adequately disclosed to users of the financial statements, both by management (A116-A125) and by auditors (A125). • ED-540 repeatedly discusses the need for management to perform sensitivity analyses to understand the extent of estimation uncertainty, while also encouraging auditors to perform such analyses (13c, 19, A2, A46, A92, A109, A113-A115, A123, A126-127, A136). • ED-540 discusses extreme estimation uncertainty and the potential that some estimates cannot be made in accordance with reporting frameworks (A90). On this point, we encourage the Board to further consider how multiple instances of large estimation uncertainty accumulate to summary measures such as earnings per share, and how this accumulation of uncertainty would affect auditors’ opinion on the financial statements taken as a whole.

Individuals and Others		
66.	CYGNUS ATRATUS	
67.	NDEG	9.Other Comments 9.1 Terminology 9.1. i It is important that, to avoid unintended confusion, terminology be applied consistently throughout the ISA. For example, paragraph 3(c)(ii) continues to use the term “appropriate” in relation to management’s selection of a point estimate and disclosures. This is unhelpful given that the term “reasonable” is used in the context of the same matters in the “Objective” of the ISA. 9.1.ii We note the explanation in the explanatory memorandum that there is inconsistency in terminology between proposed ISA 540 and ISA 700 (Revised) with respect to the use of the term “reasonable” or “adequate” as related to disclosures. ISA 700 (Revised) is, itself, internally inconsistent, using “reasonable” in describing the auditor’s responsibilities. We support aligning ISA 700 (Revised) paragraph 13 with the objective of ISA 540 and with paragraph 39 of ISA 700 (Revised) and that this be addressed through the auditor reporting implementation review. 9.2 Understanding the Entity and Internal control 9.2. i There is some lack of clarity about what is expected by the new requirement in paragraph 10(c). It is also not clear as to how this differs from the requirements of paragraph 10(a). The distinction between this and understanding what has been included and how management made those estimates is too subtle and it is not clear as to what documentation would be required to satisfy this requirement. 9.2. ii The language used in paragraph 10(f) seems to imply that there is some separate consideration of internal control specific to accounting estimates, beyond what is required in ISA 315. We suggest that, with the concurrent revision of ISA 315, it may be appropriate for additional guidance to be added to that Standard to better explain key considerations relating to accounting estimates. However, we are not proposing a wholesale relocation of paragraph 10 to ISA 315, as we acknowledge the established structure adopted in developing these “subject-matter” specific ISAs is to address the end-to-end audit process. 9.3 Specialised skills 9.3.i We are not convinced of the necessity of the need for a separate requirement to determine whether specialized skills or knowledge are required in order to perform the risk assessment procedures or to identify and assess the risks of material misstatement. In using the work of a specialist in the audit, the auditor needs to have a sufficient understanding to be able to evaluate their work. While the auditor may wish to involve specialists in planning the audit, they can and should be in a position to evaluate risks of material misstatement. This is likely to result in boilerplate documentation. At a minimum, we recommend consolidating the two requirements addressing the potential use of specialists (paragraphs 12 and 14) such that identification and response to risks are addressed in one holistic requirement. 9.4 Significant risks

		9.4.i We concur with the decision not to include any specific additional requirements unique to responding to risks related to accounting estimates. The Group did not identify any specific responses where they would expect to perform additional or different procedures to those required by the ED if the risk had been identified as significant. 9.5 Bias 9.5.i We agree that paragraph 24 needs to be assessed at the collective "estimates" level to be able to judge bias across the entire population of estimates, as some bias may only emerge at that level. This requirement does overlap considerably with the equivalent requirement in ISA 700 (Revised) and therefore recommend making this link more explicit. 9.6 Documentation 9.6. i We have concerns over what is expected in respect of documentation of: a) Paragraph 10(c) - The auditor's independent expectation of the nature of the accounting estimates the auditor expects to be included in the financial statements; b) Paragraph 10(f) – internal control; c) Paragraph 13 - Risk assessment; d) Paragraph 15 – Judgement on "low/not low" inherent risk; e) Paragraphs 17-19 – How procedures performed address these requirements given their inherent inter-relationship; f) Paragraph 23 – Level at which the evaluation is performed. 9.7 Other 9.7. i Paragraph A95 includes a statement that the ISA does not imply or require a separate assessment of inherent risk. In light of the paragraph 15(a) requirement this statement is factually incorrect. 9.7.ii While we appreciate that there is a dire need to enhance the audit quality bar, particularly in view of Public Interest involved in audit and also because of the growing expectation gap, it is felt that the draft ISA 540 is tending to be quite rule based. It needs to be more flexible in its requirements.