Supplement B
to Agenda Item 9

RESPONSES RECEIVED ON THE EXPOSURE DRAFT

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

COMMENTS TO QUESTION 1

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.

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

#	Respondent	Comments
Investors and Analysts		
1.	CFA	**Introduction** **As set out in the Explanatory Memorandum to ED 540, the 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, IFRS 9 Financial Instruments,** **• Management's increasing use of external information to make estimates,** **• 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 and increased complexity in financial reporting frameworks,** **• Inconsistent disclosures, and**

		• Lack of focus on professional scepticism. **Recent accounting standards (IFRS 9 Financial Instruments, IFRS 15 Revenue Recognition, IFRS 17 Insurance Contracts) increase significantly the use of, and the reliance on management judgement when making accounting estimates. This often requires the use of complex models and long forecast periods. This combined with the deficiencies in auditing accounting estimates as identified by the PCAOB and IFIAR, are strong reasons for the IAASB to update the standards for auditing accounting estimates. We believe that audit standard setters need to consider these developments as well as investor interests and ensure rigorous audit requirements for accounting estimates and the underlying judgements made by management. Furthermore, investors need comprehensive disclosures on these estimates and judgements. Inconsistent disclosures has been an issue for users. Thus ED 540 is an important step into the right direction. With greater focus on professional skepticism, more granular risk assessment requirements, and the proposed 'stand back', we believe the ED will lead to higher audit quality.** **This proposal is important as it also encompasses the reliability of valuation of assets and liabilities reported on a fair value basis. As reflected in several member surveys and articulated in our commentary (e.g. 2007 Comprehensive Business Reporting Model) over the last several years, CFA Institute has consistently supported fair value measurement (FVM) as a basis of recording assets and liabilities in the financial statements.** **Under both US GAAP and IFRS, fair value measurement is applicable in the recognition, measurement and disclosure of a wide array of financial instruments, impairments of financial instruments, non-financial asset impairments, assets acquired and liabilities assumed in business combinations - intangible assets, contingent consideration, stock-based compensation, net pension obligations and asset retirement obligations.** **Given the widespread application of FVM by both financial and non-financial companies and the usefulness of these measures, the rigorous audit and reliability of FVM estimates is critical for investors**.
Those Charged with Governance		
2.	AICD	
Regulators and Oversight Authorities		
3.	**BCBS**	
4.	CEAOB	
5.	EBA	
6.	ESMA	<u>Scope of application (Q1 of the Request for comments)</u> 1. ESMA welcomes that the proposed requirements in the ED are applicable to the audit of all accounting estimates for all entities. ESMA highlights that the auditing of specific accounting estimates based on forward-looking information, long-term forecasting or projection has raised issues in the past. This has been particularly the case when auditing impairment of goodwill, recognition and measurement of deferred tax assets arising from the tax losses carried forward or determination of the fair value that rely on third-

party pricing services or unobservable inputs (such as when using the discounting cash flow method). ESMA therefore believes that the current revision of the standard for auditing of accounting estimates should specifically address these issues.

2. ESMA acknowledges that use of forward-looking information will become more complex under the new accounting standards, notably for the financial sector. In this context, we would like to express our serious concerns on whether the proposed requirements are sufficiently specific to ensure effective audit of complex models led by the introduction of expected credit loss (ECL) models for impairment of financial assets in IFRS 9 or valuation of insurance liabilities at their fulfilment value in IFRS 17. Accordingly, in our view, the audit of the application of the ECL model might require specific guidance, notably with respect to the testing of effectiveness of controls and to the governance over the modelling and validation processes.

<u>Specificity of the standard with regards to audit of ECL (Q1 of the Request for comments)</u>

3. ESMA notes that the IAASB previously considered addressing some specific issues related to the audit of financial institutions in a separate International Auditing Practice Note (IAPN #1). ESMA prefers that all requirements and application guidance specifically targeted to audit of accounting estimates stemming from ECL models for all entities are provided in ISA 540 (Revised). This reasoning applies equally to the audit of fair value measurement that rely on third-party pricing services. Currently the ISAs include discussion on pricing services in IAPN 1000, Special Considerations in Auditing Financial Instruments. ESMA is of the view that the IAASB should include in ISA 540 (Revised) the requirements on using of third-party pricing services when auditing assumptions used while determining fair values.

4. Consequently, ESMA recommends that the IAASB re-evaluates its decision and provides specific requirements on audit of ECL directly in ISA 540 (Revised), including any specific considerations relevant for audit of specific types of complex organisations, such as financial institutions or audit of fair value measurement relying on external pricing services.

5. ESMA accepts that the provisioning under the new ECL model and auditing of these estimates under ISA 540 (Revised) might raise a number of implementation issues and challenges. Therefore, ESMA calls on the IAASB to scrutinise carefully any issues arising from the audit of the new ECL model; this is especially relevant in cases of complex ECL models' audits, such as in the financial sector. ESMA strongly believes that as part of its implementation monitoring, the IAASB should be prepared to provide, if necessary, additional guidance on a timely basis and as a matter of priority. Such guidance might be in form of amendments to ISA 540 (Revised) or other additional guidance depending on the questions that might arise after the implementation of the new standard.

<u>Key concepts and objectives of the standard (Q1 of the Request for comments)</u>

6. ESMA believes that the objective of the ISA 540 (Revised) should not be merely ”focusing auditors attention on design and performing further audit procedures responsive to reasons for the assessment given to the assessed risks of material misstatement” (paragraph 4 of the ED). Instead, it should also explicitly refer to the determination of the key methodological issues/procedures in the audit of accounting estimates. In this respect, ISA 540 (Revised) should require sufficient work effort on audit of accounting estimates in order for the auditor to be able to formulate an opinion in the audit report and evaluate whether accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated. This reasoning applies equally to audit documentation. Furthermore, the audit procedures identified by the ED should cross-refer to the appropriate audit procedure requirements in other ISAs and be accompanied by specific guidance for audit of

		accounting estimates where appropriate. 7. While ESMA agrees with the proposed objectives of the work of the auditor, we are of the view that the objectives should explicitly require the auditor to evaluate whether management has made all the estimates necessary by the financial reporting framework in the specific circumstances of the reporting entity. <u>Scope and nature of the application guidance (Q1 of the Request for comments)</u> 8. ESMA welcomes the IAASB willingness to provide sufficient application guidance for the requirements of the ISA 540 (Revised). However, ESMA is of the view that the ED does not strike the right balance between the requirements of the standard and its application guidance, which do not have the same authoritative status. Notably ESMA believes that part of the application guidance should be transformed into binding requirements in order to ensure that the provisions are applied consistently. 9. This is for example the case with regards to the application guidance related to the need to consider whether the auditor has obtained sufficient understanding of the entity and its environment in order to identify and assess the risks of material misstatement and to plan further audit procedures (paragraph A9 of the ED) and the enumeration of the cases when auditors may not rely on substantive testing alone (paragraph A98 of the ED). Further examples are included in a specific section of this letter. 10. On the other hand, the application guidance should be clear and avoid repetition to the extent possible. In this context, ESMA encourages the IAASB to review further the drafting of the application guidance in order to ensure clarity and readability of the text and where possible avoid unnecessary repetition. 11. For example, the IAASB could consider whether, when referring to other ISAs a cross-reference is sufficient when no new guidance specific to audit of accounting estimates is provided in ISA 540 (Revised). This might be the case e.g. in paragraphs A10-A11 of the ED in relation to ISA 260 - Communication with Those Charged with Governance and ISA 315 - Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment, paragraph A76 in relation to ISA 315 and paragraphs A67, A70 and A94-A96 of the ED in relation to a number of ISAs. Furthermore, in some cases the application guidance refers only to basic procedures without sufficient level of specification. In these cases, it could be considered either to simplify the guidance or provide guidance more adapted to the level of complexity of the audit of accounting estimates. This might be the case e.g. when referring to basic accounting or auditing procedures in paragraphs A26-A29, A32 and A117-122 of the ED. 12. Finally, while we welcome that the IAASB decided to provide some specific examples on audit of ECL in the application guidance, we would prefer that the standard includes more specific considerations for auditing of estimates related to ECL. Furthermore, ESMA is of the view that the examples provided in the application guidance should not lead to an overly narrow interpretation of the requirements. Consequently, while ESMA appreciates the example in paragraph A73 of the ED that considers accounting estimate of an ECL model in a financial institution as an example of an estimate where the inherent risk is not low, ESMA doubts that this example should be limited only to ECL models of financial institutions that are active in different markets. Indeed, ESMA is of the view that the example applies to all financial institutions.
7.	**IAIS**	On a general basis, the ED-540 looks to cover key matters in the development of accounting estimates, including new requirements for further audit procedures that respond to the reasons for a specific assessment of material misstatement, and relevant application material

		on topics such as complex modelling, model adjustments, use of point estimates, significant data and assumptions, inactive and illiquid markets, and internal controls. However, the generic nature of the ISA requirements do not allow for a more detailed consideration of important aspects of significant accounting estimates made within particular industries, such as insurance industry. Many jurisdictions have (or have had) specific guidance around auditing insurance contract liabilities, and such guidance allows for the development of specific considerations to address the particular features of these typically significant and complex accounting estimates being made by insurance entities. With respect to ISA 540, given its development as a principles-based standard, more detailed guidance on particular insurance audit specificities would provide auditors with more clarity on ISA 540 application, as well as a stronger foundation for assessing auditors' compliance with its principles-based requirements. Lastly, it is unfortunate that topical dialogue and experience on particular audit considerations around IFRS 17 (Insurance Contracts) could not have been more prominent during development of the revised ISA 540 given the late timing of the release of IFRS 17. The revised ISA 540 was developed without the benefit of IFRS 17 application experience and hindsight, which will come with time, and so there may be a need for some further considerations. Consequently, the IAIS strongly encourages the IAASB to consider on a priority basis the further development of audit application or guidance material, such as an *International Auditing Practice Note* (IAPN), to better address the specific considerations around auditing insurance contract liabilities.
8.	**IFIAR**	
9.	**IOSCO**	
10.	IRBA	4. In South Africa, a company is required to prepare its financial statements in accordance with International Accounting Standards Board's International Financial Reporting Standards (IFRS) or International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). Other standards may apply to entities in the public sector, and to entities in specialised industries. Financial reporting frameworks are in a constant state of evolution, and the IAASB's monitoring efforts should keep pace with the developments. 5. The upcoming implementation of IFRS 9, especially the introduction of the expected credit loss model, introduces implementation challenges to preparers, auditors and the users. Although ED-540 is an appropriate response to deal with IFRS 9, without IFRS 9 being effective and without the auditor having had to respond thereto in practice, it is too early to conclude whether further updates to ED-540 may be necessary. Our comment letter addresses a few areas where the audit response should be enhanced, keeping in mind some of the practical challenges with implementation that could arise. 6. Refer also to our comments contained in paragraph 21 below.
11.	UKFRC	**Having regard to developments in financial reporting, but not attempting to address within the standard specific accounting requirements at a detailed level. We comment more on this in our response to question 1.** • **As a matter of practicality, the ISA needs to be generic and cannot, nor should it attempt to, address in detail all the various emerging accounting requirements. Nevertheless, we do believe there is a need for separate detailed guidance to help apply the standard to different types of more complex or judgmental estimate and the IAASB should set out how this will be addressed when it issues the final standard. We comment further on this in our response to Q1.**

		The proposed new "objective based" approach to developing responses to risks of material misstatement is suited to addressing a wide range of types of estimate. It has the potential to drive more appropriate responses to risks of material misstatement when complexity, judgment and uncertainty are particular factors giving rise to the underlying susceptibility of estimates to misstatement. However, as inherent risk increases, particularly as a result of complexity of accounting requirements and methods to address them, auditors will need sufficient knowledge and expertise to design and perform appropriate specific procedures. The emphasis on the need for the auditor carefully to consider the need for specialised skills and knowledge, both in the risk assessment and performance phases of the audit, is important and welcomed. The application material has been enhanced from extant 540 but, understandably given the wide range of types of accounting estimates that the standard will apply to, provides relatively little specific guidance to help design procedures to address particular circumstances. For example, although a number of references to 'expected credit loss' have been included in the application material, we note that they generally just provide examples of estimates that may have high complexity, judgment and uncertainty and where controls around models may be particularly relevant. As a matter of practicality, the ISA needs to be generic and cannot, nor should it attempt to, address all the various emerging accounting requirements. Nevertheless, as explained below, we do believe there is a need for separate guidance to help apply the standard to different types of complex estimate. The IAASB should set out how these needs will be met when it issues the final standard. Attachment 1, dealing with the broad nature and types of estimate, is important both in explaining the underlying concepts relating to accounting estimates referred to in the ED and in providing a reasonable degree of future proofing. However, more specific guidance to assist application of the revised standard is needed. We note that the IAASB's work plan for 2017-2018 (issued in February 2017) identifies that the 'Accounting Estimates project' includes developing IAPNs or other publications as appropriate. We support the development of such guidance, although a lack of authoritative status may be an issue for some sector regulators. Specialised areas that could be covered include estimates of expected credit losses under International Financial Reporting Standard (IFRS) 9, which the IAASB specifically identifies as one of the drivers for revising ISA 540, but also new accounting standards covering leases (IFRS 16), revenue recognition (IFRS 15) and insurance contracts (IFRS 17). We are aware of the limitations of the IAASB's resources - we note that the development of an IAPN on "Special Audit Considerations Relevant to Financial Institutions", included in the IAASB's work plan, is behind schedule - and we encourage the IAASB to explore means to overcome this.
National Auditing Standard Setters		
12.	AUASB	**1. Does the revision appropriately address the concerns causing the revision?** **We understand that a key driver to the revision of ISA 540, as indicated in the IAASB's outreach activities, was in response to concerns raised by regulators in relation to audits of financial institutions and other entities, including the application of IFRS 9. Accordingly, the focus of ED ISA 540 is on auditing complex estimates largely found in the financial services sector and not on less complex estimates observed across all industries.** **For this reason, the AUASB considers that in its current form, the ED will not rectify the concerns raised by regulators. For example, this revision was originally intended to provide guidance on auditing financial instrument values and loan loss provisioning under the expected credit loss model. While there is some guidance in the proposed consequential**

		amendments to ISA 500, the ED does not contain specific requirements or guidance in these areas. Additionally, in many instances, the ED may widen the gap between practitioners and regulators, particularly with reference to the responsibilities of auditor verses management; the application of a new concept of 'low inherent risk'; and the introduction of the 3 factors of complexity, judgement and estimation uncertainty (refer to questions 3 and 4 of the detailed submission). The AUASB is supportive of the intentions behind the IAASB's proposed 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: 4. Does the revision appropriately address the concerns causing the revision? We understand that a key driver to the revision of ISA 540, as indicated in the IAASB's outreach activities, was in response to concerns raised by regulators in relation to audits of financial institutions and other entities, including the application of IFRS 9. Accordingly, the focus of ED ISA 540 is on auditing complex estimates largely found in the financial services sector and not on less complex estimates observed across all industries. For this reason, the AUASB considers that in its current form, the ED will not rectify the concerns raised by regulators. For example, this revision was originally intended to provide guidance on auditing financial instrument values and loan loss provisioning under the expected credit loss model. While there is some guidance in the proposed consequential amendments to ISA 500, the ED does not contain specific requirements or guidance in these areas. Additionally, in many instances, the ED may widen the gap between practitioners and regulators, particularly with reference to the responsibilities of auditor verses management; the application of a new concept of 'low inherent risk'; and the introduction of the 3 factors of complexity, judgement and estimation uncertainty (refer to questions 3 and 4 of the detailed submission). 5. 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 bespoke 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. 6. Do the revisions achieve the required flexibility in application? A key element in the purpose of the revision of ISA 540 was to promote scalability of the ISA. In its current form the AUASB is

		concerned as to how this ED will work practically outside of large and complex sectors and industries (particularly financial services), as well as posing significant practical challenges for mid-tier and smaller practitioners (refer response to question 3 of the detailed submission).
13.	CAASB	In part. We believe ED-540 has been appropriately updated to deal with International Financial Reporting Standard (IFRS) 9, Financial Instruments, as it relates to accounting estimates that are typical in entities such as financial institutions and those that trade complex financial instruments. However, our stakeholders, particularly SMPs, made the observation that ED-540 is heavily skewed towards addressing considerations relevant to accounting estimates arising from IFRS 9. They believed that the standard needs to also focus on considerations relevant to accounting estimates in the non-financial sector and those that are more commonly included in financial statements. Such accounting estimates may include: goodwill, intangible assets, property valuations, asset retirement obligations, property plant and equipment impairments, inventory valuations, and acquisition valuations. We believe that a more balanced coverage of material addressing accounting estimates of varying degrees of complexity and levels of risk would make ISA 540 more scalable and meaningful to a wide range of practitioners and applicable across entities of varying sizes.
14.	CNCC-CSOEC	We appreciate the efforts done to revise ISA 540 to deal with evolving financial frameworks relating to accounting estimates, especially IFRS 9 - International Financial Reporting Standard (IFRS) 9 - Financial Instruments. For example, ED-540 highlights that the auditor's identification and assessment of the risks of material misstatement for accounting estimates, and the auditor's responses to those assessed risks, are affected by complexity, the need for the use of judgment by management and estimation uncertainty. Accordingly, these three factors are incorporated throughout ED-540. ED-540 also emphasizes the important considerations regarding complex models, forward-looking information, and internal controls In auditing accounting estimates. Insurance contracts However, we have the feeling that ED 540 Is currently focused on financial institutions and should also Include some insurance companies' considerations. We therefore suggest the following amendments to take into account the specificities Introduced by the newly published IFRS 17 - Insurance contracts, while remaining framework neutral. These amendments are listed below: - Paragraph AS could mention the fulfilment cash flows of insurance contracts as an example of an accounting estimate as a whole; - Paragraph A73 could make a reference to insurance contracts liabilities as an example of • Accounting estimates for which a complex model is used with entity's specific assumptions (third bullet point) • Accounting estimates that collate, weight and integrate assumptions and data from a wide range of sources (fourth bullet point); - In paragraph A74,an example regarding insurance liabilities could be added to Illustrate complex modelling under IFRS 17 (IFRS 17 basis for conclusion includes wording illustrating the complexity of the accounting model that could be re-used}; - Paragraph A84 could make a reference to contractual cash flows of a group of insurance contracts as an example of accounting estimates that are likely to be subject to a high degree of judgment in amount, timing and uncertainty (first bullet point};

		- Paragraph 18 of Appendix 1could refer to Insurance contracts liabilities estimation as an Illustration of situations where expert or entity specific values are used rather than historical transactions; In paragraph 24 which typically deals with situations met in insurance, a reference to insurance contracts could usefully be added.
15.	HKICPA	The extensive update provides the key principles for auditors to apply when auditing complex accounting estimates.
16.	IDW	**we recognize the political imperative under which the IAASB operates to respond to the calls from stakeholders to deal with the audit implications of the fundamental changes occurring in some financial reporting frameworks - and in particular, the changes engendered by the issuance of IFRS 9 and its introduction of an expected loss model approach to valuing certain kinds of assets. We also recognize that the overall greater incidence of accounting estimates whose measurement and related disclosures involve complex methods or models based on larger volumes of data from outside the general and subsidiary ledger systems of entities, and calls for better auditor performance in dealing with estimates and management judgement about them, means that a general overhaul of ISA 540 is warranted.** In our view, the ED has been appropriately updated for developments in IFRS as they relate to accounting estimates. However, the IAASB should be cognizant of the fact that many financial reporting frameworks have not changed significantly and that this means that it is important that the scope of the standard remains appropriate (see our comments in Appendix 2 on the scope of the standard on paragraph 9 (a)) and the requirements scalable (see our comments in Appendix 2 on paragraph 10)
17.	JICPA	No response
18.	MAASB	The AASB supports the initiatives taken by the IAASB in relation to the proposed ED-540. In particular, the AASB welcomes the stand back provision in paragraph 22 of the proposed standard as it re-emphasises the overall objective of auditing accounting estimates. The AASB recommends for the IAASB to consider enhancing this provision to take into consideration the auditor's understanding of the business model and environment to the extent that they affect the accounting estimates. Further, the AASB recommends for the application guidance in the proposed standard to be expanded to reflect contemporary requirements of International Financial Reporting Standards (IFRS) in particular those relating to management's intention, for example: (a) Business model test in IFRS 9 to classify financial assets at amortised cost requires management's intention to hold such financial assets to collect contractual cash flows. What is considered sufficient, appropriate audit evidence to support management's intention in ED-540? (b) Assessment of lease period with embedded derivatives (e.g. renewal options and termination options) involves management's intention as well as assessment of environmental factors (e.g. economic conditions). Consequently, what is considered sufficient, appropriate audit evidence to support management's intention in ED-540?
19.	NBA	The ED 540 sufficiently reflects the developments in financial reporting frameworks. For-ward looking information is taken into account by describing models and assumptions. There is extensive attention to models in the ED and in our opinion part of the application material can be considered as educational material. Given the fact that according to the IESBA Code of Ethics the auditor is required to act with professional competence and due care we wonder whether some of this educational material might be considered as knowledge that the

		auditor should have upfront when auditing certain types of entities such as financial institutions. We wonder whether the ISA's are the right place to educate the auditor. Although reporting frameworks are getting more complex, it would be helpful if the ISA's focused on auditing their requirements. We recommend shortening the educational material about models and/or removing them to an appendix. This would focus the application material on how the auditor should apply the requirements of the standard. For example, the explanation of paragraph 10, which ranges from paragraph A9 up to A60 could (partly) be moved to an appendix.
20.	NZAuASB	The explanatory memorandum indicates that ISA 540 has been updated to focus on issues for audits of financial institutions arising from IFRS 9 which fundamentally change the way that banks and other entities account for their loan assets and other credit exposures. The NZAuASB acknowledges the inclusion of additional guidance relating to complex modelling, which we agree is needed. The NZAuASB, however, is concerned that the focus of ED-540 is heavily weighted towards complex accounting estimates found in the banking and insurance industries, and recommends that additional examples could be included in the guidance that reflect auditing issues relating to accounting estimates that are common in other sectors. Such an approach would provide a more balanced standard. As previously noted, a number of our constituents observed that ED-540 does not adequately address auditing issues relating to accounting estimates in the public sector.
Accounting Firms		
21.	BDO*	We acknowledge that revisions are required to address the complexity of evolving financial reporting frameworks, specifically as they relate to accounting estimates, such as International Financial Reporting Standards (IFRS). We believe that the revised ISA 540 will lead to a more consistent approach in auditing accounting estimates. Although we understand that this is an ISA that applies to all accounting estimates, we support the development of additional guidance, or implementation support materials, to address concepts such as the auditing of expected credit losses (ECL) under IFRS 9 Financial Instruments. We suggest the separate guidance would include: • Guidance on assessing the risk of material misstatement and the auditor's response if management's procedures and internal control give rise to increased risk of material misstatement in addition to complexity, estimation uncertainty and judgment • Guidance on auditing management's estimate of ECL, particularly where management's estimation model is not sufficiently rigorous • Expanding the material relating to the 'standing back' and management bias assessments in the context of ECL under IFRS 9 • Evaluating judgments and ensuring disclosures on ECL are useful, and • Increasing application and other explanatory material on auditing disclosures. We also propose that ED-540 be more forward-looking in addressing estimates and judgments made in other areas of the financial statements, such as the impending IFRS 15 Revenue from Contracts with Customers. We also note that ED-540 seems to take a prescriptive approach in some areas (e.g. paragraph 10 listing the Risk Assessment Procedures) and a principles-based approach in other areas (e.g. paragph 15 on Responding to the Assessed Risks of Material Mistatement). We suggest having a more consistent approach.

22.	CHI	
23.	DTT*	While DTTL believes that ED-540 can be amended to better articulate the auditor's identification and assessment of risks of material misstatement as highlighted and addressed in this comment letter, DTTL agrees that the IAASB has made many enhancements to ED-540 that will allow for auditors to deal with the evolving financial reporting frameworks, including as it relates to new accounting standards where the effective date is imminent (e.g., IFRS 9).
24.	EYG*	The enhancements to ED-540 are appropriate in many respects in relation to auditing accounting estimates that are prepared in accordance with financial reporting standards that continue to increase in their complexity. The comments that we make to the other questions in the ED, as well as in Appendix 2 to our letter, take into account the application of ED-540 to such estimates. Specifically, we believe the following enhancements are particularly relevant to the audit of accounting estimates that are prepared in accordance with increasingly complex financial reporting standards: • We agree it is appropriate to require the auditor to test how management has made the accounting estimate when the inherent risk for the estimate is "not low", which we believe is essentially the approach that paragraphs 17-19 of ED-540 are prescribing (see Q4 (c) for further comments in this regard). • We support the change made to paragraph 19 (b) of ED-540 to recognize that when point estimates or ranges are developed by the auditor, they should be developed "to the extent possible". We also support the related application material in paragraphs A128-A134. Specifically, the guidance in A134 that acknowledges that auditor ranges may be multiples of materiality is helpful because this reflects what a realistic outcome may be when the auditor develops ranges for accounting estimates subject to high estimation uncertainty. And, we agree with the emphasis on the auditor's evaluation of disclosures related to estimation uncertainty in these circumstances. However see our response to Q5 for further suggestions to improve this paragraph. • The additional guidance proposed for ISA 500 related to the auditor determining the reliability of external information sources is useful, particularly in the context of evaluating the fair value of financial instruments, and as it relates to evaluating assumptions and data used in preparing estimates that management obtains from external sources (e.g., economic indicators). However, see response to Q7 where we express the view that this guidance would be better placed in the context of accounting estimates, and thus included in ISA 540. In addition to the enhancements proposed in ED-540, we believe ED-540 could benefit from additional enhancements that specifically recognize that certain financial reporting standards, such as IFRS 9, can be challenging for management to initially implement but also to prepare accounting estimates on a recurring basis in future periods that fully meet the requirements of the standards. Due to the increasing complexity of financial reporting standards, we strongly agree that the auditor's required understanding of the applicable financial reporting framework under paragraph 10 (a) in ED-540 is important. However, we believe further guidance could be provided, starting from the auditor's risk assessment procedures, on the importance of the auditor giving explicit consideration to whether management's process to make the accounting estimate represents the appropriate application of the requirements of the applicable financial reporting framework. We find in practice that, when management's processes are not as robust as expected in context of the requirements of the applicable financial reporting framework, this can have a significant impact on the auditor's risk assessment and on the auditor's design of

		responsive audit procedures for the estimate. In this circumstance, the auditor taking an approach to solely test how management has made the estimate may not result in sufficient appropriate audit evidence, and it is possible that the auditor may need to supplement that testing by developing a point estimate or range, either for the estimate as a whole or in relation to certain components of the estimate. Accordingly, we have the following suggestions for further enhancements to ED-540: • Paragraph 10 (e), which requires the auditor to understand how management makes accounting estimates as part of risk assessment procedures, or its related application material, should be enhanced to draw a more explicit linkage to paragraph 10 (a) regarding the auditor's understanding of the applicable financial reporting framework, and the related possible effects on the auditor's risk assessment. Paragraphs A11-A13 to 10 (a) do not fully capture this relationship. • Application material to paragraph 15 could be included to explain that the appropriateness of the auditor taking an approach to test how management has made the estimate is conditioned in part upon the results of the auditor's risk assessment procedures and whether the auditor believes that management's process achieves appropriate application of the requirements of the applicable financial reporting framework. • For estimates for which the inherent risk is "not low", paragraph 19 requires the auditor to assess whether management has appropriately addressed estimation uncertainty, and if not, the auditor is required to develop a point estimate or range. We believe the application material to this requirement could be enhanced for the auditor to also take into account the results of the auditor's work (in accordance with paragraphs 17-18) to test how management has made the estimate in order for the auditor to consider whether development of a point estimate or range may be appropriate for reasons other than management's failure to appropriately address estimation uncertainty.
25.	GTI*	Overall, the results of the field-testing indicated that the structure of ED 540 was overly complex. The three basic approaches in ED 540 are contained within the approach to low inherent risk estimates, when in practice, one or a combination of these approaches are applied to all estimates subject to audit, irrespective of the risk category. We are of the view that it would be preferable to follow a more simplified structure that clearly sets out the basic approaches to auditing estimates and then builds on how the auditor would apply each of these basic approaches to the audit of estimates. The updates to ED 540 do, however, provide a framework to address the auditing of estimates, which could form a basis to deal with evolving financial reporting frameworks as they relate to accounting estimates. However, we are of the view that certain matters, as detailed in our response, need to be addressed. We highlight the following matters for consideration in this respect: • Paragraph 10(b) of ED 540 requires the auditor to obtain an understanding of "regulatory factors, if any, relevant to accounting estimates." Whilst this paragraph better links the audit of accounting estimates to the regulatory requirements of banking institutions, it could be interpreted very broadly and consequently encompass other non-financial regulatory factors. • The requirements in ED 540 give the appearance of being a mixture of principles-based requirements and procedural requirements. For example, in accordance with our comments below, paragraphs 17-19 are effectively procedural based requirements. We are of the view that the standard should maintain principles-based requirements throughout.

		• The application material as currently drafted has a bias towards estimates related to financial instruments. We would recommend identification of areas where the application material could be updated to encompass all types of estimates. • The guidance on use of an external expert is helpful as this is becoming more commonplace in audits. We would also recommend consideration of the importance of the integrity of the data and the value of data obtained from different sources as well as guidance on the validity of the model.
26.	KPMG*	As noted in comments on our overall impressions of ED-540, considering the challenges imposed by evolving financial reporting framework and the business environment, we agree with the objectives of the project 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. Our response to other questions below highlight those concerns and the possible ways of addressing them.
27.	PKF	Yes, however, updating this ISA would likely need to be an on-going process. While we believe that the ED is appropriately updated while remaining neutral to any specific financial reporting framework, we encourage the IAASB to consider the IFRS 13 Fair Value Measurement Post Implementation Review which is set to close for comment on September 22, 2017.
28.	PWC*	Given the need for the ISA to remain framework neutral, it is challenging to include very specific requirements linked to a specific framework. However, in our view the changes made address important concepts that are common to financial reporting frameworks, including a heightened focus on data, assumptions and disclosures. The proposed risk factors of complexity, the need for the use of judgement and estimation uncertainty are useful considerations when thinking about the susceptibility of the estimate to error or fraud, or “what could go wrong”. However, we comment in question 4 on why we believe the way in which the factors have been incorporated into the standard does not result in an effective approach to identifying and assessing the risks of material misstatement at the assertion level, and responding to those risks. The proposed amendment to ISA 500 to address external information sources and the importance of assessing the relevance and reliability of information obtained from sources outside of the entity also helps in focusing attention on new sources of data and information that evolving financial reporting frameworks will require entities to make use of in determining certain accounting estimates, for example expected credit losses. In thinking about evolving financial reporting framework requirements and whether the ISA addresses relevant considerations, it is also critical to consider expectations of users, including regulators, about what is needed to comply with those financial reporting requirements, in particular disclosures. And, as a consequence, what is therefore expected of auditors in terms of “how much evidence is enough”. At its heart, where there has been debate on the audit of accounting estimates this often relates to questions about what constitutes sufficient appropriate audit evidence in particular circumstances – for example, what evidence is needed to demonstrate that the auditor has sufficiently challenged managements’ assumption or in relation to information from external information sources. We believe that greater specificity of matters on which the auditor needs to obtain evidence in designing appropriate responses to assessed risks of

		material misstatement is a useful step-forward in helping to resolve those fundamental questions.
29.	RSM*	In overall terms, we believe that ED540 has been appropriately updated, particularly in the light of IFRS 9. Our view is that the requirements and application paragraphs are generally clear and useful, although there is the danger that some auditors adopt a checklist approach to the guidance and try to address every paragraph. To mitigate this issue, but being mindful of the danger that some auditors may copy the ISA without regard to the particular circumstances of their client, some practical examples of risk assessment and response in different situations might be helpful. In addition, a draft flowchart summarising ED540 was provided to attendees at the Forum of Firms meeting in London in May. Once the standard is finalised, an updated flowchart as an appendix would help auditors to see the bigger picture in the new ISA. However, we have a few concerns regarding risk assessment and the related response as set out below under Q4.
30.	SRA	
Public Sector Organizations		
31.	ACAG	Yes, the Exposure Draft ISA 540 (the ED) addresses the key points. However, the ED could include more examples, other than those related to financial instruments, to help auditors apply the concepts in the ED for all estimates.
32.	AGA	The ED notes that the update is necessary because of increasing complex estimates, in particular those for financial institutions. So it is appropriate that the auditing standards are being updated. However, we caution the IAASB to think forward in the cycle that they are perpetuating: users wanting more relevant financial reporting and more reliable estimates ☐ accounting standard setters responding by trying to have shareholders' equity = market value of the firm ☐ failures and criticisms of the audit profession when inherently subjective and unknowable estimates turn out to be wrong ☐ even longer and more complex auditing standards ☐new expectations from users that auditors can somehow "prove" estimates are correct and a good basis for making investment or other decisions. In other words, the ED is trying to solve an accounting problem with an auditing solution. Instead, we suggest what may be needed is accounting standard setters recognizing the consequences that follow from the fact that accounting, even fair value accounting, can only partially predict the future, and that the best way to communicate the uncertainty that they are introducing in their quest for relevance is to communicate that reliability decreases when estimates are involved. Technical language on measurement uncertainty seems to not have narrowed the expectation gap, and possibly has expanded it because the auditor is expected to audit this uncertainty as well. Where there is a reasonable range of estimates, then perhaps accounting standards should require the entity to report this reasonable range of net income: multiple net incomes. Until accounting standards recognize this, perhaps the auditing standards could help move to the future by requiring modifications to the auditor's report in the form of scope limitations. To illustrate, the ED, with consequential amendments to ISA700, 705 and 706, could provide guidance that would lead to audit reports that said something like "We obtained sufficient appropriate audit evidence that income is between $10 million and $12 million. Our audit's reports is not qualified with respect to this matter." Nevertheless, whether or not the auditing standards require a point estimate or range of reasonable amounts is not the problem and won't solve the problem; the fundamental problem is not with auditing

		but with the expectations created by reporting a single number, when many are equally reasonable. We note that some financial reporting frameworks (for example public sector accounting standards) use the concept of "best estimate." The concept of a "reasonable estimate" is used throughout the ED. Guidance should be added to clarify that the auditor may need to adapt the standard in circumstances where the applicable financial reporting framework uses a concept other than "reasonable estimate" such as "best estimate." While many estimates may be reasonable, only one may be the best, and the auditor may need additional evidence that the estimate is the best.
33.	AGC	Yes, ED-540 has been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates.
34.	AGNZ	We have no specific comments to make on this matter.
35.	CIPFA	CIPFA considers that ED-540 has been appropriately updated to reflect the changing financial reporting environment, including IFRS developments and specific issues arising from implementation of changed IFRS requirements to the financial services and insurance sectors. This will also probably be helpful in connection with any issues arising from related changes to other standards frameworks, whether these are local implementation which have regard to IFRS, and changes to International Public Sector Accounting Standards (IPSASs), which are developed having regard to related IFRS treatments insofar as these are relevant to public sector financial reporting. We would note our view that, in making these changes, ED-540 seems to us to achieve a better balance than the extant ISA 540, both in making the body of the ISA requirements independent of the financial reporting framework, and in including material which is helpful for auditors of a variety of reporting entities, without providing too much detail on specific sector issues. Having regard to the representations made to the IAASB on its workplan, we believe that there may be an appetite for additional material on matters relating to e.g. the audit of entities in the financial services sector. However, if the Board were to provide further more detailed guidance or educational material, this would be better placed in a practice statement or other document separate from the main ISA standards.
36.	GAO	We support the IAASB's efforts to update ED-540 to address evolving financial reporting frameworks as they relate to accounting estimates. As indicated above, we agree with the requirements related to obtaining sufficient appropriate audit evidence in paragraphs 17 through 20. However, we believe that these requirements should be linked to the audit procedures in paragraph 15(a). We also support the IAASB's efforts to update the objective of auditing accounting estimates and related disclosures. In addition, we support the requirement in paragraph 21, but we encourage the IAASB to provide additional application guidance related to paragraph 21(a), such as examples of the circumstances in which management might provide disclosures beyond those specifically required by the framework that are necessary to achieve the fair presentation of the financial statements as a whole.
37.	PAS	Yes, ED-540 has been appropriately updated.
38.	INTOSAI	Public sector considerations: Numerous financial reporting frameworks are presently applied by governments and other public sector entities. Some governments and public sector entities apply IFRS and IPSAS while others apply financial reporting frameworks developed specifically for their respective jurisdictions. In general, we are seeing an increase in the application of accrual-basis accounting in the public sector (particularly IPSAS-

		based). This trend has increased the volume and significance of accounting estimates in public sector financial statements therefore we believe the suggested revisions to ISA 540 are timely and appropriate to address these developments. Also, public sector activities are continuing to become more complex. For example, governments and public sector entities commonly enter into commitments on financial markets and engage in larger and increasingly complex infrastructure projects. This increased complexity in public sector activities is introducing increasingly complex accounting estimates into public sector financial statements. In recognition of the above, we suggest including examples of accounting estimates that are specific to the public sector environment in addition to those already mentioned. We suggest adding the following to the application material: "Accounting for the following public sector activities may require significant estimation: • Social insurance programs; • Health care programs; • Veterans' benefits programs; • Government guarantee programs; • Public debt • Environmental liabilities; • Tax revenue and receivables; • Infrastructure assets; • Specialized property and equipment such as military equipment and heritage assets;
Preparers of Financial Statements		
39.	ABA	
Member Bodies and Other Professional Organizations		
40.	ACCA-CAANZ	No. For the standard to adequately deal with estimates in future standards, it is important that it takes a principles-based and scalable approach. ED-540 as drafted is overly prescriptive and lacks scalability. These issues need to be addressed for the standard to be fit for purpose. It is also important that future accounting standards adequately address management's responsibilities in relation to estimates. ED-540 has requirements which put the auditor in the position of trying to compel management to perform certain responsibilities which is inappropriate. The IAASB should work with the IASB to ensure management's responsibilities for estimates are included in the relevant IASB standards. ED-540 as drafted seems focused on financial services concepts and addressing the estimates that exist within IFRS 9 but does not seem to address the kinds of estimates that will be introduced or changed by other standards that will soon by applicable, including leases (IFRS 16), revenue recognition (IFRS15) and insurance contracts (IFRS 17).

		In addition, the standard needs to be useful for auditors who in the future may be dealing with non-financial estimates and disclosures in emerging areas of reporting and assurance. For example, the ISAEs refer assurance practitioners to the ISAs for guidance on issues that are not dealt with specifically within assurance standards. As the ISAEs do not address estimates in detail, a practitioner would have to refer to ISA 540 for guidance.
41.	AE	(1) We acknowledge the efforts to revise ISA 540 to deal with evolving financial reporting frameworks and their inclusion of accounting estimates, especially IFRS 9 Financial Instruments. Notwithstanding this, we share some observations below where some aspects of ED-540 might need further consideration. (2) In addition to IFRS 9, we also acknowledge and support the fact that the revisions address further complexities arising from other new international accounting standards, for example IFRS 16 Leases, IFRS 15 Revenue from Contracts with Customers, IFRS 4 Insurance Contracts. (3) A number of our members who deal with audits of insurance companies though are of the view that ED-540 is more focused on financial institutions' issues than on insurance companies' ones. IFRS 9 has been considered, but the timing did not allow consideration of IFRS 17. Yet, we note that there are a few areas where the proposals in the ED-540 have not proven to be adequate neither for the banking nor the insurance sector. (4) Our members working in banking and insurance have expressed scepticism as to how the proposals as they stand, will enhance consistency in the audit of financial institutions. The material on the expected credit loss model (ECL) under IFRS 9 and technical provisions under IFRS 17 is thin. (5) We strongly suggest that IAASB considers the development of guidance for the application of ISA 540 to the financial sector in the form of an IAPN. This should provide guidance on, among other things, the audit of forward-looking information and approaches to determining when a significant increase in credit risk has occurred. We understand that the Basle Committee is in favour of an IAPN for this sector. (6) Our members in the banking sector are also rightly concerned about a lack of relevant guidance on internal control within the proposals. This is part of a wider issue about the audit of highly complex estimates. The quality of internal controls, and the control environment in particular, is critical in the audit of such estimates. While sector specific guidance is not appropriate for a general-purpose ISA, and we are satisfied that most of the proposed material on internal control is in the application material, these concerns point strongly to the need for an IAPN, developed on a timely basis, for the financial sector. (7) Other examples of areas in which the proposals seem light, especially in the context of ECL and technical provisions under IFRS 17, include: • the requirements relating to the 'stand back' and bias assessment; • different types of reporting, including regulatory reporting; • disclosures. (8) Moreover, the references in paragraph A5 to the development of point estimates and ranges for components of estimates such as

		assumptions and data can be confusing for companies that operate in the banking sector. In effect, they amount to developing different assumptions and data against which to benchmark those used by management. What is critical is the impact of those on the actual ECL estimated by management. (9) We also list below other comments with particular relevance to the audit of ECL: • The application material on management's point estimate, 9(e), and on 17(a) and (b) on complexity, is limited. Ditto 17(e), 18(a) (iii), 18(c) (i) and (ii). • The extent and depth of the required auditor understanding of applicable regulatory factors are not made clear in paragraph A15. • There is a lack of application material addressing the audit of mid-sized entities. These are critical in the financial sector which has many, including smaller investment businesses and banks, which are nonetheless Public Interest Entities (PIEs). • Paragraph A30 on auditing policy is light in relation to issues such as changes in credit risk, ditto paragraph A31 on model validation. • Paragraph A73 is simplistic as a bank does not need to be active internally for ECL to be complex, subject to estimation uncertainty and involve judgement. • Paragraphs A76 and A77 are insufficiently granular for the audit of ECL. • Paragraph A86 seems to imply that estimation and judgemental differences are not misstatements, only known and factual ones are. The sentence beginning 'The variation in the measurement of an accounting estimate…' should perhaps state 'The variation in the measurement of an accounting estimate that results from estimation uncertainty is not necessarily, in itself, a misstatement'. • Paragraph A104 is light in terms of ensuring that appropriate data is used in a model and assessing the appropriateness of management assumptions.
42.	AICPA	Accounting estimates are prevalent in financial reporting and often have higher risks of material misstatements for reasons cited in ED 540. We acknowledge that evolving financial reporting frameworks, for example, IFRS, often require management to modify an entity's financial reporting processes to address more complex accounting principles such as those accounting principles that will be required under IFRS 9. However, we believe that ISAs should be scalable to audit risk and how entities operate while remaining framework neutral. We are concerned that driving more prescription into the ISAs to allay concerns around application to a specific standard is not appropriate and could result in multiple future amendments as reporting frameworks change. While we believe that the existing requirements in extant ISA 540 are sufficient for addressing the misstatement risk related to estimates for most audits, we do believe that certain additional application material could be provided in light of significant changes in the way entities operate, such as increasing the use of technology, volumes of data, and the increased use of forward-looking information being required by financial reporting frameworks. Additionally, as mentioned earlier, we also would support targeted changes such as those proposed by the PCAOB, especially in the area where specialists are used.

		In order to address concerns over changes in the reporting frameworks, we are supportive of alternative approaches such as continued or expanded use of IAPNs to provide specific industry guidance for audits of financial institutions and other entities where the expected credit loss model will likely impose significant accounting changes, as one example. We believe the flexibility in guidance will be needed, particularly when looking through the changes with an industry-specific lens.
43.	ANAN	The Association of National Accountants of Nigeria (ANAN) believes that Ed 540 has been appropriately updated to deal with evolving financial reporting framework as they relate to accounting estimates. This is because the ED has clarified the several concerns raised in relation to complexity, judgment and estimation uncertainty which are embedded in IFRS 9 and other ISAs. Clearly, the Ed has covered evolving financial framework in relation to recognition, measurement and disclosure of accounting estimates and role of auditor in this respect.
44.	CAI	We note from paragraph 5 of the explanatory memorandum to ED 540 that IAASB concluded that "a holistic revision of ISA 540 should be undertaken" rather than focusing solely on "audits of financial institutions arising from IFRS 9". We also note from paragraph 7 of the explanatory memorandum the IAASB purpose of "modernising ISA 540 for evolving financial reporting frameworks" and from paragraph 3 that outreach by IAASB has included meetings with representatives of the International Accounting Standards Board (“IASB”). Accordingly, we understand that the revisions to ISA 540 have had a fair degree of focus on the major evolution in accounting for loan impairment under IFRS 9. We wish to make two points arising from this. Firstly, we suggest that the revised ISA 540 should expressly note the areas where the "evolution of accounting frameworks" has already occurred and has added to and formalised the level of estimation required. We make this suggestion given the significant changes in revenue recognition arising from IFRS 15, the significant changes in the recognition and measurement of assets and liabilities arising from leasing contracts under IFRS 16, together with the imminence of more standardised measurement of insurance liabilities under IFRS 17 and new updated guidance of the measurement of uncertain tax positions under IFRIC 23, many involving estimation. For example, the list of examples of estimates at paragraph A1 of ED 540 is quite similar to the current ISA 540 and might benefit from adding some of the newer areas of estimation required by the updated requirements of IFRS and other accounting frameworks. We also consider that ongoing liaison with representatives of IASB, during the process of finalising ISA 540 (Revised), should assist in ensuring it keeps pace with evolving accounting frameworks as far as possible. Secondly, we note from the annual reports of public companies that the process of adopting the new accounting standards such as IFRS 9 and IFRS 15 can be quite complex and protracted, and indeed in the majority of cases has not yet been completed. Consequently, there is a lack of experience with the actual methodology and systems by which entities will make the estimates required by these standards. In this context, we suggest that the IAASB consider how best to road test the proposals of ED ISA 540 to ensure, as far as possible, that its requirements will be fit for the purpose of auditing how entities make these estimates. As noted above in our general comments, we consider it important for the revised ISA 540 to contain generic principles which can be applied to any accounting estimate. It would be appropriate for IAASB to develop separate guidance in relation to specific accounting estimates to support the application of the revised ISA 540.
45.	CAQ	
46.	CPAA	CPA Australia acknowledges that ED-540 seeks to address the auditor’s considerations relevant to the new International Financial

		Reporting Standards, including IFRS 9 Financial Instruments, which give rise to greater estimation uncertainty. However, in doing so the proposed standard has become overly lengthy and complex. This has resulted in an overly prescriptive standard which cannot be easily scaled for smaller entities.
47.	CRUF	
48.	EFAA	We recognize that one of the main motivations for this project is the adoption of IFRS 9 Financial Instruments. EFAA research, The Trickle Down Effect - IFRS and accounting by SMEs, revealed the existence of a trickle-down effect whereby accounting practices of larger entities, including those in IFRS 9, cascade down to the accounting practices of SMEs that are not required to apply IFRS. This effect means that auditing estimates will likely impact SMEs more than they might think. Indeed, our research revealed that there are many financial reporting frameworks, especially those based on or heavily influenced by IFRS, which require the use of fair values in SME financial statements. This reinforces the need for better quality guidance on how the extensive and complex requirements relating to non-low IR estimates apply to the audit of SMEs.
49.	FACPCE	Answer 1) The purpose of the ED-540 for the auditor to obtain sufficient appropriate audit evidence to assess whether accounting estimates and related information are reasonable in the context of the applicable financial reporting framework, or if they are mistaken, appears to be Adequately achieved, as it includes improved requirements for risk assessment procedures and the auditor's work effort in responding to assessed risks of material misstatement to support this assessment
50.	IAA	Refer to letter
51.	IAAA	Yes. The draft revision of ISA 540 responds to the information standards issued by the IASB, in force on regarding accounting estimates. Referring to other current financial information frameworks issued in jurisdictions where different (national) standards are issued than those issued by the IASB
52.	IBRACON	In our view, the proposed changes address important concepts to financial reporting frameworks, including focus on data, assumptions and disclosures. However, we have concerns regarding key aspects of ED-540, such as the integration of proposed risk factors into the risk assessment framework and the design of the audit response outlined in questions 3 and 4, being overly complicated, lacking in clarity or difficult to operationalize. In this way, we believe further guidance could be provided in this ED, starting from the auditor's risk assessment procedures, on the importance of the auditor giving explicit consideration to whether management's process to make the accounting estimate represents the appropriate requirements of the applicable financial reporting framework. The need for the use of judgement and estimation uncertainty are useful considerations when thinking about the susceptibility of the estimate to error or fraud. However, we believe the way in which the factors have been incorporated into the standard does not result in an effective approach to identifying and assessing the risks of material misstatement at the assertion level, and, consequently, to responding to those risks. The proposed amendment to ISA 540 to address external information sources and the importance of assessing the relevance and reliability of information obtained from sources outside of the entity also helps in focusing attention on new sources of data and information related to financial reporting frameworks. It is also critical to consider expectations of users, including regulators, about what is needed to comply with those financial reporting

		requirements, in particular disclosures. We believe the proposed additions to the requirements included in the ED, specifically the greater granularity of the matters about which the auditor is required to obtain audit evidence are an improvement in guidance on the matter. This is important to show which evidence is sufficient to demonstrate that the auditor has appropriately challenged managements' assumption or what evidence is required regarding external information received from third party sources.
53.	IBR-IRE	We recognized the efforts made to revise IAS 540 to address the evolution of the financial reporting framework, in particular the International Financial Reporting Standards. We note that ED 540 incorporates various concepts that are of relevance in the context of the adoption of IFRS 9. We further note that several other recent standards such as IFRS 15 and IFRS 16 require a greater use of estimates and judgment but are rarely illustrated in ED 540.
54.	ICAEW	24. We note above that despite an absence of guiding principles, expectations of both preparers and auditors are high, in terms of the 'accuracy' of the forecasts and projections underpinning many estimates now embedded in financial reporting frameworks such as IFRS. 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. Principles of preparation for forward looking information. such as those promulgated by ICAEW's Corporate Finance Faculty, 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 both preparers and their auditors. 25. IAASB might acknowledge this issue 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 figures produced by preparers, using IAASB's three factors, for the want of guiding principles for preparers. Giving greater prominence to principles of preparation, where they exist, would help align the work of preparers and auditors. 26. As they stand, the proposals are weighted towards accounting estimates that are not low IR, but are not the most complex of estimates found in the financial statements of banks, insurers and other financial institutions. There is much more material on not low IR estimates than low IR estimates. Good quality application material and detailed examples are needed to make the proposals workable for both for banks, insurers and other financial institutions, and for the vast majority of audits in which run of the mill estimates are generally assessed as low IR - but not always. 27. For not low IR estimates, IAASB could make it clearer that no extensive changes to the extant approach to the response are intended and to highlight the enhancements in respect of the risk assessment. Better quality and more detailed examples are also needed. Currently, IAASB provides examples of estimates that 'are' low IR, rather than a nuanced discussion of different types of risk, the different circumstances in which they might be assessed as low IR or otherwise and, most importantly, how such risks might be dealt with in practice. 28. Implementation material prepared by IAASB for the benefit of smaller firms and the SMEs they serve is needed and we strongly urge IAASB to consider setting a precedent. A staff publication that explains and illustrates the practical application of the

		proposed requirements and provides further examples of estimates that might be considered low IR in some situations and not in others, and how they might be dealt with in those different situations would encourage consistency of application. 29. At both ends of the scale, observations have been made repeatedly to the effect that had the existing requirements been applied properly, much of what is proposed would have been unnecessary. Revisions to standards are only part of the overall effort to improve audit quality. When finalising this standard, IAASB should call on other stakeholders in the financial reporting supply chain to acknowledge the responsibility of management to provide auditors with adequate support on a timely basis for their accounting estimates when preparing financial statements, including situations in which valuations are provided by third parties. Engagements should not be accepted or continued if management does not acknowledge its responsibilities for the preparation of the financial statements and while this is sometimes a difficult area in practice, IAASB should resist any suggestion that might dilute, or appear to dilute this important principal. Without auditor independence, there is no audit and auditors cannot eliminate estimation uncertainty by preparing the estimate themselves. 30. IAASB acknowledges that the quality of disclosures relating to estimates is critical and we agree with the upgrade and alignment of the audit objective for disclosures with the objective for estimates themselves. However, auditors will inevitably be unclear as to how the current requirements differ from the previous requirements. The application material has numerous, scattered references to disclosures and there are few cross-references. It would be helpful to consider how these could be drawn together. The need for an IAPN 31. The original objective of this project was to deal with IFRS 9 issues in the light of G20 concerns about the financial statements of large financial institutions. Our members in that sector have expressed scepticism about how the proposals will, of themselves, enhance consistency in the audit of financial institutions, particularly given the lack of application material on ECL under IFRS 9 and technical provisions under IFRS 17. The example in A5 which refers to the auditors independently estimating ECL on a single loan is grossly over-simplified because it ignores the complexities involved in calculating ECL for an institution whose main business is lending. 32. We strongly suggest that IAASB considers the development of guidance for the application of ISA 540 to the financial sector in the form of an IAPN. This should provide guidance on, among other things, the audit of forward-looking information and approaches to determining when a significant increase in credit risk has occurred. We understand that the Basel Committee is in favour of an IAPN for this sector. 33. Our members in that sector are also rightly concerned about a lack of relevant guidance on internal control within the proposals. This is part of a wider issue about the audit of highly complex estimates. The quality of internal controls, and the control environment in particular, is critical in the audit of such estimates. While sector specific guidance is not appropriate for a general purpose ISA, and we are satisfied that most of the proposed material on internal control is in the application material, these concerns point strongly to the need for an IAPN, developed on a timely basis, for the financial sector. 34. Other examples of areas in which the proposals seem very light, especially in the context of ECL and technical provisions under IFRS 17, include: • the requirements relating to the ‘stand back’ and bias assessment;

		• different types of reporting, including regulatory reporting; • disclosures. 35. References in A5 to the development of point estimates and ranges for components of estimates such as assumptions and data are confusing. In effect, they amount to developing different assumptions and data against which to benchmark those used by management. What is critical is the impact of those on the actual ECL estimated by management. Similarly, the difference between the 2nd and 4th bullets of A131 is unclear. The former uses management's model and selects alternative assumptions or data sources to develop a point estimate or range, the latter uses alternative assumptions to those used by management. If the former involves independent inputs to management's model to assess the actual estimate, this can and should be clearer. 36. We make further more detailed drafting points regarding the audit of ECL below.
55.	ICAG	Yes, we believe that the ED 540 has been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates.
56.	ICAP	We understand that IAASB initiated the project to address the issues relevant to the audits of financial institutions, as well as ISA 540 more broadly. We support the IAASB approach in addressing the limitations of extant ISA 540 with the publication of ED 540, with the objective to make the auditing requirements relevant in the current business environment and financial reporting landscape. In view of the IAASB project, we feel that ED 540 is mainly focused on the auditing accounting estimates that would generally relate to the financial institutions. We understand that the forward looking information will be more complex to audit, and specific guidance may be included in the ED 540 in relation to the audit of Expected Credit Loss (ECL) model for impairment under International Financial Reporting Standard 9 'Financial Instruments'. In addition to this, we believe that further guidance is required within ED 540 to address the scalability of the requirements based on the particular type of the entity (for example, different in size, complexity, nature of operations etc.). We understand that in the context of current financial reporting environment, the requirements of ED 540 will upwardly effect the time and resources required for both the practitioner and the client. In consideration of this we believe that the strategy may be developed to communicate and educate the client of the evolving and enhanced auditing requirements, including the ED 540.
57.	ICAS	We support the IAASB's attempts to update ED-540 to recognise the impact on the work of auditors of evolving financial reporting frameworks in so far as they relate to accounting estimates, most specifically the introduction of IFRS 9, Financial Instruments, but also new financial reporting standards on Leases, Revenue Recognition and Insurance Contracts. It is helpful that the IAASB has also attempted to address the issue of the audit of disclosures in relation to accounting estimates in the exposure draft as such disclosures in certain instances need to be presented in greater detail to explain the basis and methodology behind the accounting estimate. However, we believe that the increasingly complex financial reporting regime is relevant not only to auditors but also to preparers. Therefore, whilst we acknowledge the importance of the auditor's understanding of the applicable financial reporting framework, equal emphasis should be placed on the auditor's consideration as to whether management's estimate has been determined following management's appropriate understanding and application of the relevant financial reporting framework.
58.	ICAZ	Yes, ED-540 incorporates enhanced requirements for risk assessment procedures and guidance of the auditor's work effort in responding to the assessed risks of material misstatement. With the fast approaching adoption of IFRS 9 and vast use of estimates in the accounting

		treatment of Financial Instruments the update of ED-540 is appropriate to deal with evolving financial reporting frameworks as they relate to accounting estimates. Enhancing requirements on risk assessment will result in the standard becoming more scalable to the audit of different types of financial instruments.
59.	ICPAK	The ED recognizes the increasing complexity, use of judgement and estimation uncertainty created by more recent changes to global financial reporting frameworks including standards such as IFRS 9 on Financial Instruments. On the whole the standard has been appropriately updated to reflect the heightened audit risks arising from the application of such accounting estimates and the disclosures related thereto.
60.	ISCA	No response
61.	KICPA	We believe the proposed ED-540 enhances requirements for risk assessment procedures and the work effort of an auditor engaged in auditing accounting estimates, in response to the financial reporting framework, such as evolving business environments, complex models of accounting estimates, and the growth of forward-looking information and of the necessity of using external information sources, all of which are increasing the estimation uncertainty, and provides useful guidance accordingly.
62.	NASBA	We understand that one of the goals of the proposed standard is to enable the auditor to address audit risks arising from the management's adoption of the evolving financial reporting framework, when applicable. To achieve this objective, we recommend including additional application guidance to assist auditors in addressing relevant risks and developing appropriate audit procedures (e.g. application guidance on the expected credit loss model).
63.	SAICA	9. All the survey respondents agreed that the ED has been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates, including enhanced emphasis on obtaining an understanding of the requirements of the financial reporting framework. 10. The following comments to the SAICA survey refer to the additional requirements introduced in paragraph 10 of the ED and illustrate support for the additional focus in the ED to draw the auditor's attention on obtaining an understanding of accounting estimates: • 10(b): Regulatory factors, if any, relevant to accounting estimates. This requirement also re-enforces the auditor's existing responsibilities in this regard in terms of ISA 250. • 10(c): The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements. It is further SAICA's view that it is appropriate to add the context of "expects to be included"; i.e. anticipating what would be relevant and required in the circumstances of the entity, and thereby enhancing the auditor's application of professional scepticism. • 10(e)(iii): The process used by management to select data, including the source(s) of that data and how management identifies significant data. The application material further recognises that there could be large volumes of data from complex IT systems. • 10(e)(v): How management identifies and addresses the risk of management bias, together with the application material in paragraph A45 provide much needed emphasis on this important element of accounting estimates. • 10(f): Although extant ISA 540 required the auditor to obtain an understanding of the relevant controls related to how

		management makes accounting estimates, this paragraph specifies that the auditor must obtain an understanding of each of the components of internal control. This will ensure that the auditor obtains a more thorough understanding of management's process of making accounting estimates, leading to a more robust risk assessment and identification of risks of material misstatement (RoMM). 11. SAICA agrees that the ED has been appropriately updated. In addition to the points referred to above, paragraph 10(a) clarifies the auditor's responsibility of understanding the applicable financial reporting framework in respect of accounting estimates in its full context, i.e. the recognition criteria, measurement bases and presentation and disclosure requirements. 12. We appreciate the fact that the International Standards on Auditing (ISAs) are written in the context of being framework neutral. The expansion of the application material throughout, in particular in relation to complexity, the use of judgement by management and estimation uncertainty enhances the standard's ability to remain principles based in dealing with evolving financial reporting frameworks. Appendix 1 and Appendix 2 provide helpful guidance in the context of relevant requirements of financial reporting frameworks, and the application material in paragraphs A135 to A138 focuses appropriately on disclosures in terms of the requirements of the applicable financial reporting framework. 13. We do however suggest that the IAASB consider expanding the guidance relating to mainly future orientated accounting estimates where the amounts may not be directly observable, including those estimates that utilise significant data and assumptions outside of the traditional general ledger and financial reporting system (e.g. include as a 3rd appendix) to further assist auditors with evolving financial reporting frameworks which include models such as the Expected Credit Loss model. SAICA also considered the following additional question: Do you agree that the requirements in paragraphs 10 and 11 will result in a more detailed understanding of the accounting estimates at the entity and do you believe it will improve your ability to identify RoMM? 14. All the survey respondents agreed that these requirements will result in a more detailed understanding of the accounting estimates at the entity and do believe that it will improve their ability to identify RoMM. 15. The field testing respondents also agreed with these requirements but did indicate that the requirements may be too onerous for less complex accounting estimates. From a practical application point of view, guidance/ clarity is required on whether professional judgement can be applied in determining the extent of understanding required (e.g. are all of the elements identified in paragraph 10 always relevant; or are they all relevant in principle, but the depth of understanding may vary depending on the circumstances around the nature and extent of an entity's accounting estimates in the context of the understanding that the auditor is required to obtain in terms of ISA 315 (Revised)). Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (d)). 16. The counter argument could be that the auditor needs to cover all of these aspects as part of the understanding phase of the audit to be more confident in the eventual result of the risk assessment, including distinguishing between when inherent risk is low and when inherent risk is not low. 17. SAICA agrees that the proposed revised requirements will result in a more detailed understanding. Our comments to question 3 should however be referred to in respect of the scalability of risk assessment procedures and related activities for an entity with less complex accounting estimates.

64.	SMPC	One of the driving factors of the project to revise ISA 540 is the impending adoption of IFRS 9 , which has been considered in the proposals. However, it is less clear about other new international reporting standards, including leases (IFRS 16), revenue recognition (IFRS 15) and insurance contracts (IFRS 17) as so much of the guidance is for financial instruments, as well as being more relevant for high inherent risk accounting estimates. Furthermore, there are many financial reporting frameworks, particularly those based on IFRS, which increasingly require the use of fair values in SME financial statements. This reinforces the need for better quality guidance on how the extensive and complex requirements relating to non-low inherent risk (IR) estimates apply to the audit of SMEs. We broadly support the IAASB's proposal to make significant revisions to the definition of the term "accounting estimate" in paragraph 9(a). The wording may need to be revised slightly in order to be clear that the uncertainty relates to the assumptions applied in measuring the subject matter.
Academics		
65.	GC	
Individuals and Others		
66.	CYGNUS ATRATUS	The requirements in paragraph 10 have been updated slightly compared to the previous standard, as a results of which coherence with the assessment of risk required in 540.13 and the procedures in paragraph 17-20 could be improved. We would suggest adding requirements for obtaining understanding, of for instance, the risk of manipulation or corruption of data. Either due to manipulating the data itself or errors in the automated processing (gathering, categorisation and summarisation) of data. Furthermore, paragraph 10e-ii requires understanding of the selection of assumptions. But, in order to improve coherence with 13c and 18a, we feel that paragraph 10 should contain the requirement to obtain an understanding of the impact of changes in assumptions to the outcome of the estimate.
67.	NDEG	1.1 Given the need for the ISA to remain framework neutral, it is challenging to include very specific requirements linked to a specific framework. However, in our view the changes made address important concepts that are common to financial reporting frameworks, including a heightened focus on data, assumptions and disclosures. 1.2 In thinking about evolving financial reporting framework requirements and whether the ISA addresses relevant considerations, it is also critical to consider expectations of users, including regulators, about what is needed to comply with those financial reporting requirements, in particular disclosures. We believe that the proposed additions to the requirements proposed in the ED, specifically the greater granularity of the matters about which the auditor is required to obtain audit evidence, is a useful stepforward in addressing the aforesaid issue