

## Supplement C 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 2

**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](#).

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

#	Respondent	Comments
<b>Investors and Analysts</b>		
1.	CFA	<p><b>Professional Skepticism</b></p> <p>CFA Institute believes professional skepticism is central to delivering a rigorous and high quality audit. We agree with the approach taken in the proposal to begin by emphasizing the importance of professional skepticism followed by requirements and application material that drive professionally skeptical behavior.</p> <p>Important aspects of applying professional skepticism, especially with regard to estimates, are to evaluate management’s methods and judgments, consider whether other methods and judgments may be more appropriate, and challenge management on their methods and judgements. A critical concern is the consistent use of boilerplate disclosure of the significant judgments and assumptions used by management over time. Professional skepticism would strongly suggest that a dynamic market place calls for changes in assumptions over time. The audits of such disclosures need to ask why these disclosures are static and uninformative. We thus contend the auditor should be encouraged to challenge management in this respect.</p>

		<p>We also urge the IAASB to finalize its separate project on professional skepticism as a matter of priority as that project may lead to further requirements to reinforce the use of professional skepticism in the context of estimates.</p> <p>While this is beyond the purview of the IAASB, we believe measures to strengthen professional skepticism should extend to those charged with governance, especially audit committees.</p>
<b>Those Charged with Governance</b>		
2.	AICD	
<b>Regulators and Oversight Authorities</b>		
3.	BCBS	<p><b>Professional skepticism and management bias</b></p> <p>Professional skepticism plays a central role in the audit of accounting estimates and the Committee notes that the ED contains several provisions to appropriately reinforce the auditor’s application of professional skepticism and consideration of the potential for management bias. The Committee supports these provisions, and recommends that additional language be included in the final standard to further emphasise the importance of auditors exercising professional skepticism throughout the entire audit process. For example, the final standard should state that, in responding to the assessed risks of material misstatement for accounting estimates that involve complexity, management judgment or estimation uncertainty, such as ECL, auditors should challenge management’s assumptions and question management’s evidence on an ongoing basis during the normal course of the audit and appropriately document this process in the auditor’s workpapers.</p> <p>The Committee agrees that, when accounting estimates are subject to a high degree of management judgment, the estimate is inherently more susceptible to management bias, particularly when this judgment involves greater subjectivity, as stated in paragraph A85. This statement should be further strengthened by including concrete examples of how auditors could demonstrate the application of professional skepticism in these instances. This would be particularly useful for estimates that require management to form a view of the future, which is inherently complex and subject to significant judgment. We understand that these recommendations may be further considered by the IAASB, the International Ethics Standards Board for Accountants and the International Accounting Education Standards Board’s Professional Skepticism Working Group, but we believe that professional skepticism is critically important and should be addressed in the final ISA 540.</p> <p><b>3. Professional skepticism and management bias</b></p> <p>The application of management judgment is pervasive in the measurement of complex accounting estimates, including, but not limited to, ECL. Significant management judgments may exist, for example, in the selection of key accounting policies, development of methodologies and data sources, and the choice of assumptions. We strongly support the efforts of the IAASB to address this issue. In particular, we support the references to unintentional or intentional bias in paragraphs 18(a)(i)b) and A7, and the requirement that the potential for management bias should be taken into account</p>

in paragraph 13(b) with respect to methods, assumptions and data.

As judgment can have a material impact on the outcome of the reported estimate, it is critical that ISA 540 emphasises that auditors must demonstrate how they exercised professional skepticism to critically evaluate management's judgments, throughout all stages of the audit, as well as at the end of the audit.

### 3.1 Demonstrating professional skepticism throughout all stages of the audit

The ED addresses professional skepticism as a key concept in paragraph 5. This paragraph emphasises the importance of the application of professional skepticism, particularly in relation to the risk of management bias affecting the outcome of estimates that are subjective, complex and uncertain. We agree that the application of professional skepticism plays a central role in the audit of estimates and thus, that this concept is appropriately located at the start of the standard. Paragraph 5 should be reinforced by adding a statement in the final standard that the auditor shall exercise professional skepticism throughout all stages of the audit and prepare appropriate audit documentation to demonstrate the application of professional skepticism.

With respect to the overall evaluation based on audit procedures performed that is required in paragraphs 22-23, we recommend that the "stand-back" test also require the auditor to perform an overall assessment of whether a sufficient level of professional skepticism has been applied by the auditor. This is particularly relevant to areas when the determination of an accounting estimate requires significant management judgment and is therefore more susceptible to management bias.

### 3.2 Professional skepticism and management judgment

The ED recognises the importance of professional skepticism, pointing in particular to the link to "estimation uncertainty" in the Application Material in paragraph A93. The final standard should strengthen the link between the existence of significant management judgments and the importance of auditors demonstrating professional skepticism. Paragraph A85 states: "[w]hen accounting estimates are subject to a high degree of judgment, the accounting estimate may be more susceptible to the potential for management bias, particularly when this judgment involves greater subjectivity...". We agree with this statement and believe that paragraphs 18 and A85 should be expanded to incorporate the need for the auditor to demonstrate the application of professional skepticism in these cases. This could be achieved by adding the following underlined language to paragraph A93: when the reasons for the assessment given to the risks of material misstatement include estimation uncertainty and management judgment, the auditor's application of professional skepticism is particularly important. We further recommend incorporating paragraph A93 into the standard's Requirements in paragraph 18.

In addition, paragraph A85 speaks to the potential for management bias when new estimates make it necessary to revise judgments previously made by management for other estimates. We suggest that the latter be emphasised because there is a high risk of management bias when a new estimate indicates that a previous management judgment needs revision.

Lastly, an increased focus on skepticism could be achieved by adding the following to the end of paragraph A69:

		<p><b>“applying specialized skills or knowledge as well as demonstrating a questioning mind-set and sound professional judgment”.</b></p> <p><b>3.3 Application of professional skepticism to areas of management judgment</b></p> <p>Where the risks of material misstatement are high and require more persuasive audit evidence (paragraph 15b), the final standard should explicitly require auditors to use professional skepticism by “challenging” management’s assumptions, where appropriate. This could be reinforced by including examples in the corresponding Application Material (paragraph A97) on how auditors could form their own independent views on certain data or management assumptions and on how auditors could challenge management’s assumptions. As an example, auditors could do so by looking at sources of data other than those chosen by management, such as macroeconomic data relevant for forward-looking information, as a way of demonstrating a questioning mind-set and gathering more persuasive audit evidence. Auditors should also seek to obtain and consider any contradictory audit evidence during the course of the audit as part of the overall “stand-back” test included in the ED in paragraphs 22–23.</p> <p><b>3.4 Work of the Professional Skepticism Working Group</b></p> <p>We understand that the Professional Skepticism Working Group was established jointly by the IAASB, the IESBA and the IAESB in June 2015 to provide input into the development of ISAs under revision, including the ISA 540 ED. We strongly encourage that this work continue as a priority and view it as an opportune time for the PSWG to now develop recommendations on how to more effectively respond to issues related to professional skepticism, including the interaction between professional skepticism and the audit of complex estimates. Nevertheless, to support the timely issuance of ISA 540, we recommend that the specific requirements on professional skepticism that we have recommended above be included in the final version of ISA 540. If the PSWG identifies further enhancements on professional skepticism, these may be added later to the appropriate ISAs.</p>
4.	CEAOB	<p><b>Consideration of other valuations techniques, data and assumptions</b></p> <p><b>21. We believe the consideration of whether there are other available valuation techniques, assumptions or data that could have been more appropriate is a way to exercise the auditors’ professional scepticism. Thus, we believe the content of application material A101 should be applicable for all kind of factors addressed in par.17 to 20, since it is a way to reduce auditor’s bias when assessing the risk of material misstatements in the accounting estimates</b></p>
5.	EBA	<p><b>In addition, although we recognise that a Professional Skepticism Working Group<sup>1</sup> has been established by the IAASB, we believe that professional skepticism should also be addressed in the revised ISA 540 as we consider that professional scepticism should underpin the performance of an audit at all times and it is key in ensuring high quality audit of ECL. We also believe that the ED could include stronger requirements on auditors to challenge management and to obtain specific audit documentation to demonstrate how they have exercised professional scepticism in their audit of accounting estimates.</b></p> <p><b>Key concepts of this ISA - Professional scepticism</b></p> <p><b>Although we recognise that a Professional Skepticism Working Group has been established<sup>3</sup> by the IAASB, we believe that</b></p>

		<p><b>professional scepticism should also be addressed in the revised ISA 540 as we consider that professional scepticism should underpin the performance of an audit at all times and it is key in ensuring high quality audit of ECL. In this regard, we welcome the explicit reference in the ED to the importance of professional scepticism in paragraph 5, being a key concept of the standard and linked to management bias. Indeed, the consideration of management bias throughout the audit of accounting estimates is of outstanding importance for us. In areas which require the exercise of judgement, there is a potential for bias with respect to methods, assumptions and data. This is of particular importance for the estimation of ECL, because of the high level of complexity, estimation uncertainty and judgement embedded in ECL.</b></p> <p><b>In addition, we support the development of the concept of professional scepticism in the context of estimation uncertainty in paragraph A93 of the application guidance. However we think the connection between estimation uncertainty and professional scepticism could be included in the standard itself (e.g. in paragraph 5 where professional scepticism is mentioned under the ‘Key Concepts of this ISA’).</b></p> <p><b>We believe that the development of the concept of professional scepticism at the beginning of the application guidance is missing, as paragraphs A2-A3 (‘Key Concepts’) address only the key concept of paragraph 6 related to the need for an overall evaluation based on the audit procedures performed (‘stand-back’ provision). To us, the introduction of the stand-back provision in paragraphs 6 and 22-23, which we welcome, should be an area where professional scepticism needs to be applied. We recommend therefore that the stand-back evaluation also includes the auditor’s overall consideration of whether a sufficient level of professional scepticism was applied.</b></p> <p><b>In addition, the ED could be more explicit and require auditors to use professional scepticism by challenging management when appropriate, for example in relation to their judgments and assumptions (e.g. by encouraging or requiring the auditor to look for contradictory evidence). We recommend that stronger wording is used when it comes to ‘challenging’ management (e.g. paragraph A67, where specialised skills or knowledge are addressed, could also read that these need to be coupled with a questioning mindset and sound professional judgment by the auditors) and that special documentation in the context of ‘challenging’ management is required (e.g. paragraph 27 could include a requirement for auditors to document how, why and when they applied professional scepticism and if they have a sufficient level of seniority related to key judgment areas in the audit of a particular industry such as banking or insurance).</b></p> <p><b>In this regard, we believe that the quality of accounting estimates will be enhanced if the revised standard includes minimum documentation requirements for the audit of significant accounting estimates in addition to the proposed requirements in paragraph 27 of the ED. These documentation requirements should demonstrate the application of professional scepticism by guiding the auditor to focus on certain areas and issues for which supporting documentation should exist, including significant judgements made by the auditor when assessing estimates</b></p>
6.	ESMA	<ol style="list-style-type: none"> <li>1. ESMA welcomes that the proposed requirements highlight the role for the professional scepticism applied by the auditors when auditing accounting estimates. However, ESMA believes that the IAASB should emphasise further the need for rigorous application of professional scepticism throughout ISA 540 (Revised) requires gathering sufficient level of evidence to support the judgments and its proper documentation.</li> <li>2. While ESMA acknowledges that the IAASB has a separate project dedicated to the enhancement of professional scepticism as</li> </ol>

		<p>part of the audit, ESMA is of the view that further requirements might be necessary to strengthen and document the use of professional scepticism in the context of ISA 540 (Revised). This is particularly the case when auditing accounting estimates for balances for which the inherent risk is not low. As these specific considerations might need to be considered comprehensively in that separate project, ESMA is of the view that the IAASB should finalise that separate project as a matter of priority.</p>
7.	<b>IAIS</b>	<p>As we stated in our 4 May 2016 response to the IAASB's Invitation to Comment (ITC) <i>Enhancing Audit Quality in the Public Interest</i>, professional skepticism is by nature a questioning state of mind which can be better supported at many levels including through enhanced audit standards as well as better audit firm and engagement practices. At the standards setting level, we highlighted that IAASB literature needs to be sufficiently flexible and open-ended such that it not interpreted as an exhaustive or self-contained set of rules or procedures designed to 'prove' skepticism – i.e. to avoid a 'tick-box' auditor mind-set - and that can be meaningfully applied to new situations as they arise.</p> <p>Also, professional skepticism is closely interrelated with professional judgment. Professional skepticism cannot be considered as professional without sound professional experience and judgment. In order for skepticism to function properly, the auditor must have the requisite technical knowledge and experience that relates to key judgment areas in the audit of a particular industry.</p> <p>By that criteria, the ED-540 appropriately reinforces the application of professional skepticism by focussing on audit objectives and allowing flexibility for external auditors to address the underlying drivers of the risk of material misstatement in a more tailored fashion. At the same time, the ED-540 speaks directly to indicators of management bias, includes a 'stand-back' assessment provision, and outlines that all relevant audit evidence obtained whether corroborative or contradictory needs to be considered – these are all useful considerations for reinforcing the application of professional skepticism.</p> <p>In addition, the importance of specialized skills or knowledge to properly assess some accounting estimates is relatively well covered in paragraphs A67-A70. It would be useful in paragraph 27 of the ED to require auditors to document the basis for not requiring the use of an expert with specialized skills or knowledge when the inherent risk of material misstatements with an accounting estimate is not low, as we expect would often be the case for accounting estimates of insurance contract liabilities.</p> <p>However, we also note the ISA 540 material could include more emphasis around auditors 'challenging' the consistency of the management assumptions, as this is a concrete application of professional skepticism. While not precluding further emphasis in other areas - as auditors should demonstrate professional skepticism in all stages of the audit - we suggest that further emphasis on 'challenging' management assumptions should particularly be included within the guidance material relating to auditor responses when the risks of material misstatement are not low due to the extent of judgement applied, and when assessing management bias. In particular, we suggest strengthening the auditor's role in assessing the consistency of management assumptions within an entity and in comparison to relevant objective information and market data.</p> <p>Furthermore, more could be done outside of ED-540 to support the application of professional skepticism. This includes more at the standard-setting level, such as reinforcing the definition of professional skepticism within ISA 200 to make it less 'neutral' by introducing a concept of a questioning mind that would tend to exhibit a more doubting attitude.</p>
8.	<b>IFIAR</b>	<p><b>Professional scepticism</b></p> <p><b>22. The guidance included in paragraph A101 around considering “whether there were alternative concepts, techniques or</b></p>

		<b>factors, types of assumptions or sources of data” that might have been appropriate should help drive a more sceptical auditor mind-set. However, it is not clear to us why this consideration applies only to the ‘complexity’ risk factor and why this questioning attitude should not be further required by the ED.</b>
9.	IOSCO	<p><b>Professional skepticism</b></p> <p>As referred to in paragraph 5, the application of professional skepticism by the auditor is particularly important to the auditor’s work relating to accounting estimates. While there are requirements in ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Statements on Auditing concerning professional skepticism, there is a lack of specific guidance on what constitutes ‘professional skepticism’, including its meaning and definition, as well as specific application procedures related to auditing of accounting estimates. We encourage the Board to provide greater guidance in these areas throughout ISA 540.</p>
10.	IRBA	<p>7. ED-540 appropriately reinforces the application of professional scepticism when auditing accounting estimates.</p> <p>8. The following requirements, in particular, reinforce the application of professional scepticism when auditing accounting estimates:</p> <ol style="list-style-type: none"> <li>a. Enhanced risk assessment requirements, including the requirements for retrospective review and the determination of whether specialised skills or knowledge is required. (Paragraphs 10-12 of ED-540.)</li> <li>b. More granular objective-based requirements for work-effort. (Paragraphs 17-20 of ED-540.)</li> <li>c. “Stand-back” requirements. (Paragraphs 22-23 of ED-540.)</li> </ol> <p>9. The introduction of requirements generally has an impact on improving the application of professional scepticism. We would therefore not object, in any area of the standard, to further requirements that have the effect of addressing such scepticism.</p>
11.	UKFRC	<ul style="list-style-type: none"> <li>• <b>The inclusion of requirements and application material that should have the effect of enhancing professionally sceptical behaviour. Professional scepticism is absolutely fundamental in delivering a rigorous and high quality audit and we discuss this further in our response to question 2.</b></li> <li>• <b>The new requirement in paragraph 26 to remind auditors of their responsibilities to communicate certain matters to those charged with governance. An important aspect of paragraph 16(a) of ISA 260 is that, when applicable, the auditor communicates why the auditor considers a significant accounting practice, which is acceptable under the applicable accounting framework, is not the most appropriate to the particular circumstances of the entity. However, we believe that the auditor should be specifically required to consider in performing its work, whether management has used the most, rather than an, appropriate approach. This would support the auditor’s communication responsibilities and serve the public interest by requiring actions that would be more likely to drive appropriately sceptical behaviour. We comment further on this in our response to Q2.</b></li> <li>• <b>We agree with the approach being taken by the IAASB in ED 540 to emphasise the importance of professional scepticism. However, we are concerned about the absence of clear drivers to challenge management and believe there is room for use of the words “question” and “challenge” in the context of the requirements and application material that</b></li> </ul>

**address how the auditor approaches its work. We comment further on this in our response to Q2.**

Professional scepticism is fundamental in delivering a rigorous and high quality audit. We discussed this extensively in our response in 2016 to the IAASB's *Invitation to Comment – Enhancing Audit Quality in the Public Interest – A focus on Professional Skepticism, Quality Control and Group Audits*.

We agree with the approach being taken by the IAASB in ED 540 - to emphasise the importance of professional scepticism in the Introduction to standard, and then establish requirements and application material that are intended to drive sceptical behaviour, rather than to scatter the words “professional scepticism” more liberally throughout the standard.

An important aspect of applying professional scepticism, particularly in relation to estimates, is evaluating management's methods and judgments, considering whether there is evidence that other methods and/or judgments may be appropriate and challenging management accordingly. Management's methods and judgments may be appropriate, but are they the most appropriate – if not, why not, and what are the implications? We are concerned with the absence of clear requirements for the auditor to challenge management and believe there is room for use of the words “question” and “challenge” in the context of the requirements and application material that address how the auditor approaches its work.

For example, many of the requirements in paragraphs 18 and 19 are in the form of obtaining evidence that what management has done is appropriate in the context of the applicable financial reporting framework (AFRF). This could suggest an approach that looks to obtain evidence that supports management, rather than actively determining whether there is evidence to the contrary.

Paragraph 23 requires the auditor, in performing an overall evaluation, to consider all relevant audit evidence obtained whether corroborative or contradictory. We believe, however, that earlier requirements should clearly drive actions that are more likely to ensure the auditor identifies potential alternative sources of evidence that may be contradictory. For example the hanging paragraph at the end of paragraph 15 could be amended to:

“The auditor's further audit procedures shall be responsive to the reasons for the assessment given to the risk of material misstatement in accordance with paragraph 13, recognizing that the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be. The auditor shall seek to obtain all relevant audit evidence, whether it corroborates or contradicts management's assertions.”

Paragraph 26 reminds auditors of their responsibilities to communicate certain matters to those charged with governance. An important aspect of paragraph 16(a) of ISA 260, as referred to in paragraph A155 of ED 540, is that, when applicable, the auditor communicates why the auditor considers a significant accounting practice (which includes management's judgments in making accounting estimates), which is acceptable under the applicable accounting framework, is not the most appropriate to the particular circumstances of the entity. However, we think that consistent with ISA 260, there should be a requirement for the auditor to consider, in performing its work, whether management has used the most, rather than an, appropriate approach. For example, under 10(e) when obtaining an understanding of how management makes accounting estimates; 18(a)(i) when obtaining evidence about management's judgments regarding the selection and use of the method; and the overall evaluation required by paragraph 22. This would support the auditor's communication responsibilities and serve the public interest by requiring actions that would be more likely to drive appropriately sceptical behaviour.

For example paragraph 22(c) could be amended as follows:

		<p>“[whether] Management’s decisions relating to the recognition, measurement, presentation and disclosure of these accounting estimates in the financial statements are:</p> <p>(i) in accordance with the applicable financial reporting framework;</p> <p>(ii) <u>where alternative decisions would be acceptable under the applicable financial reporting framework, whether management’s decisions are the most appropriate in the circumstances of the entity.</u>”</p> <p>Similar amendments could be included in paragraphs 10 and 18.</p>
<p><b>National Auditing Standard Setters</b></p>		
<p>12.</p>	<p>AUASB</p>	<p>The AUASB considers that the application of professional scepticism is appropriately reinforced when auditing accounting estimates in the ED. While professional scepticism is a general concept that sits across the suite of auditing standards, owing to its nature and significance as it relates to accounting estimates, the AUASB is supportive that the ED does not need to explicitly reference the term ‘professional scepticism’. We support the approach taken in the ED which includes specific audit procedures designed to enhance the auditor’s application of professional scepticism, including more granular requirements with respect to obtaining audit evidence, better identify indicators of bias and including a stand back provision.</p> <p>2.1 Stand back provision</p> <p>The ED has included concepts that appropriately align to and highlight the importance of the exercise of professional scepticism, particularly the inclusion of a stand back provision as introduced by paragraph 22. This requirement serves as a reminder to practitioners as to the importance of the exercise of professional scepticism in their overall assessment of accounting estimates and related disclosures.</p> <p>While this stand-back provision is a new requirement of the standard, the AUASB considers that the requirement needs to be more explicit in its wording and call out exactly what the intention of the requirement is. i.e. for auditors to stand-back and assess the estimates considering all supporting audit evidence.</p> <p>Additionally, there is a level of concern expressed by practitioners that the requirement in paragraph 27 does not adequately address the documentation requirements regarding this provision. The AUASB recommends that the documentation requirements or application material is expanded to address the nature and extent of documentation requirements in relation to the stand back provision.</p> <p>Furthermore, the AUASB considers that a missing element from the stand-back provision is the requirement for the auditor to revisit their initial risk assessment to determine whether their assessments remain appropriate.</p> <p>2.2 Audit evidence as provided by management</p> <p>The AUASB is concerned that the designation of responsibilities between the auditor and management in the ED is sometimes unclear. This may lead to confusion and potentially an increase in scope of auditor’s responsibilities when applied in practice. In our view, the root cause of any perceived shortcomings in the application of professional scepticism in relation to accounting</p>

		<p>estimates and related disclosures may be associated with inadequate documentation, calculation and models in relation to estimates that are provided to auditors by management and those charged with governance. Whilst this issue is unlikely to be addressed solely through the revision to auditing standards, the AUASB considers that the ED has the potential to inappropriately shift the onus of proof from preparer to auditor without a clear pathway for when the auditor determines material non-compliance with the accounting standards and therefore modifies the auditor's report. Where the auditor develops their own point estimate or range to evaluate reasonableness of an estimate, as a replacement for management's point estimate or range, as indicated by paragraphs 19(b) and A127, this may limit the exercise of professional scepticism and judgement. Where the auditor develops their own point estimate or range as an independent check to management's outcome, this is considered appropriate. The AUASB would like to see this distinction clearly articulated in the standard.</p> <p>ED 540 needs clarification for circumstances where sufficient and appropriate audit evidence cannot be obtained from management, which may result in a modification to the opinion in the auditor's report based on a scope limitation. The AUASB would like to see clearer requirements or application guidance in the standard that the requirement to produce evidence supporting the reasonableness of accounting estimates lies with the preparer and not the auditor.</p> <p>2.3 Prescriptiveness and language of standard</p> <p>The AUASB considers that the standard, in particular the application material, is too verbose (for example paragraphs 17 and 18), and is overly prescriptive and rules based. This may result in a checklist mentality being applied and a diminution of auditors' professional judgement and scepticism, leading to an unintended decline in audit quality.</p> <p>Furthermore, the AUASB considers that there are a considerable amount of new concepts and new terminology being introduced by this standard that has not been appropriately defined and considered in the context of the entire suite of standards. For example – 'low inherent risk'; 'significant data'; 'significant assumptions'; and (in the context of disclosures) a shift in terminology from 'adequate' to 'reasonable'. Additionally the term 'reasonable' is used throughout the standard and the term is highly subjective and general. Such a large shift in concepts and terminology in one standard may cause unintended consequences in the application of these concepts.</p> <p>In addition, the AUASB considers that the language in the standard could be strengthened to further promote the exercise of professional scepticism by being more focused on words that challenge and critically assess rather than corroborate. An example is in paragraph 19, where the auditor obtains sufficient appropriate audit evidence whether managements point estimate is reasonable.</p> <p>Finally, the AUASB considers that the wording of the standard is, in certain instances, taking the exercise of professional scepticism too far. For example, paragraph A101 indicates that the auditor should look to any other alternative.</p>
13.	CAASB	<p>Yes - we believe that ED-540 appropriately reinforces the application of professional skepticism when auditing accounting estimates.</p> <p>We support the inclusion of introductory paragraph 5 to emphasize, at the outset, the importance of the application of professional skepticism by the auditor. We believe that the application of professional skepticism is strengthened through the enhanced risk assessment requirements, and the requirements to "stand back" and evaluate the audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence.</p>

14.	CNCC- CSOEC	<p>Professional skepticism plays a central role in the audit of accounting estimates. ED-540 contains several key provisions that are designed to enhance the auditor's application of professional skepticism and consideration of the potential for management bias, including enhanced risk assessment requirements, more granular requirements with respect to obtaining audit evidence (when inherent risk is not low), and requirements to "stand back" and evaluate the audit evidence obtained regarding the accounting estimate, Including both corroborative and contradictory audit evidence.</p> <p>We welcome the Initiative taken by the IAASB to drive actions that promote professional skepticism. We consider that this Is a step forward. However<sup>1</sup> we believe that professional skepticism is not stemmed from a checklist. As mentioned in ISA 200, professional skepticism is an attitude that Includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud and a critical assessment of audit evidence.</p> <p>We therefore consider that the requirements and application material of ED-540 appropriately and adequately reinforce the application of professional skepticism when auditing accounting estimate</p>
15.	HKICPA	<p>We believe the requirements and application material would reinforce the application of professional skepticism, but we strongly recommend that the IAASB explicitly mentions and explains the 'stand back' concept in the body of requirements under ISA 540, not in the explanatory material.</p>
16.	IDW	<p>In our view, by focussing the standard on "what can go wrong" due to complexity, judgment and estimation uncertainty, the standard provides a better basis for the application of professional skepticism when auditors deal with the measurement of accounting estimates and making related disclosures.</p>
17.	JICPA	<p>No response</p>
18.	MAASB	<p>The AASB agrees that the application of professional scepticism has been reinforced in the requirements on management bias in paragraph 24 and stand back provision in paragraph 22. There will be a certain level of judgement involved in deriving an accounting estimate by management and hence the existence of an element of management bias. Applying the principle of ISA 240, the AASB recommends the IAASB to consider that when the inherent risk of the accounting estimate is assessed as significant, the auditor shall, based on the presumption that management bias exists, address the bias according to the requirements of paragraph 24. If the auditor concludes that management bias does not exist, the auditor shall include in the audit documentation the reasons for the conclusion.</p>
19.	NBA	<p>Although attention is paid to professional skepticism, we feel that the standard could pro-vide more examples to demonstrate how professional skepticism can be applied. For in-stance we suggest to add more guidance on how to deal with contradictory audit evidence. More guidance could also be given as to whether, how and to what extent management's estimates should be challenged.</p> <p>At the same time the standard should be clear that the auditor cannot reduce inherent estimation uncertainty by performing more audit procedures and applying professional skepticism.</p>
20.	NZAuASB	<p>Overall respondents indicated that professional scepticism has been appropriately reinforced within ED-540. However, feedback from practitioners indicated that some are concerned that the level of granularity in the requirements of ED-540, in particular paragraphs 17-19, may create a compliance mentality, rather than reinforce the notion of professional scepticism when auditing accounting estimates (see</p>

		<p>our response to question 4).</p> <p>While the auditor does consider complexity, use of judgement and estimation uncertainty when auditing accounting estimates, each factor is not separately considered as appears in the case in ED-540. Rather, the factors are integrated and often overlap.</p> <p>The NZAuASB is very supportive of including a stand-back provision in ED-540. One of the objectives of the IAASB's Clarity Project was to reduce duplication of material in the standards. Accordingly, with respect to the stand-back provision, the NZAuASB believes that the requirement in ED-540 should be incremental to the requirement in ISA 330. As such, we recommend that the requirement in paragraph 22 of ED-540 focus on the auditor's consideration of management bias and the auditor's evaluation of management's decisions relating to the accounting estimates. The requirements to evaluate whether the assessments of the risk of material misstatement at the assertion level remain appropriate and whether sufficient appropriate audit evidence has been obtained (as drafted in paragraphs 22(a) and 22(b)) are, in our view, already sufficiently addressed in ISA 330. Further, the NZAuASB considers that the stand-back provision should apply to the auditor's initial assessment of inherent risk for all accounting estimates, not just those that are initially identified as being "not low" risk. We believe that, in this regard, ED-540 needs to be clearer. The auditor's assessment of risk is the foundation on which the auditor determines the response to those assessed risks and the further audit procedures to be performed.</p>
<b>Accounting Firms</b>		
21.	BDO*	<p>We support the increased emphasis on professional skepticism in ED-540. The placement of the requirement to apply professional skepticism in paragraph 5 sets the appropriate tone on its significance. This is especially important as one of the factors to be considered in assessing the risk of an accounting estimate is judgment which may result in management bias. The stand back provision operates as an effective mechanism to overtly emphasise the application of professional scepticism. That said, we believe that additional application guidance is necessary to provide auditors with practices they may consider employing in performing the stand back review in order to best demonstrate professional skepticism. If there are best practices which were contemplated in the drafting of this provision, (i.e. involvement of others not previously associated with the work, a cooling off period before the review is undertaken, increased involvement of the engagement quality control reviewer, etc.), practitioners would benefit from having this guidance. In the absence of more specificity around what is meant to be involved in this procedure, it will likely result in all too many instances where this procedure will become a "self review" by auditors of their own work. The preparers may already be anchored into their conclusions on the sufficiency of their procedures and the adequacy of the evidence obtained, thereby diluting the efficacy of the stand back review.</p> <p>Further, we believe that where there are other ISAs in which complexity, judgment and uncertainty come into play (e.g. ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements and ISA 550 Related Parties), that consideration be given to adding similar requirements regarding professional skepticism and the stand back provision.</p> <p>To provide further clarity, we suggest adding guidance on the documentation that would be sufficient to show that the auditor appropriately challenged management assumptions and the extent to which alternatives were considered. In our response to the IAASB's Enhancing Audit Quality in the Public Interest consultation paper, we noted that: 'It is important that the IAASB does not focus only on drivers and impediments to professional skepticism, but also provides examples of how outcomes indicate professional skepticism has been appropriately exercised. One way of doing this could be through the provision of a professional judgment framework that could provide analyses of particular scenarios and demonstrate how a conclusion was reached in practice.'</p>

		We also note some concerns around the use of the term 'low inherent risk' and the procedures that are required as a result of this assessment may give the appearance of a reduced level of professional skepticism.
22.	CHI	
23.	DTT*	DTTL concurs with the direction the IAASB has taken in strengthening the requirements and guidance surrounding the actions auditors are to take when incorporating the fundamental attitude of professional skepticism in the audit. DTTL agrees that it is not necessary to actually use the phrase “professional skepticism” throughout ED-540. This approach would ultimately necessitate ensuring similar terminology be inserted throughout the ISAs. Regardless, DTTL does not believe that the mere insertion of the words “professional skepticism” into the requirements in ED-540 would translate into clearly executable actions on the part of the auditor. DTTL believes that the enhanced and granular risk assessment process to be undertaken by the auditor in ED-540 provides for a better basis to critically challenge management’s accounting estimates and develop effective audit responses. This emphasis on risk assessment in turn reinforces the underlying concept of remaining professionally skeptical.
24.	EYG*	<p>We have the following observations and suggestions regarding how ED-540 reinforces or could be further enhanced to reinforce the application of professional skepticism:</p> <ul style="list-style-type: none"> <li>• When auditors take the approach of testing how management makes the accounting estimate, which is common for more complex and subjective estimates, the auditor is often focused on auditing the individual components of the estimate (i.e., method, assumptions and data). When doing so, it is quite useful for the auditor to also “stand back” and perform an overall evaluation of whether accounting estimates, both individually and in the aggregate, are appropriate in the context of the financial reporting framework. Therefore, we support the enhancements to the overall evaluations in paragraphs 22 and 23 of ED-540.</li> <li>• We also support the addition to paragraph 23 for the auditor to consider all relevant audit evidence obtained, whether corroborative or contradictory, in making the overall evaluation of accounting estimates. However, we believe that more guidance could be provided earlier in ED-540 about how the auditor may deal with contradictory evidence when it is discovered in performing procedures, and prior to the stage of performing the overall evaluation of accounting estimates.</li> <li>• Our suggested enhancements to ED-540 (that we have included in our response to Q1) to more explicitly link the auditor’s understanding of the applicable financial reporting framework to the auditor’s expectations for its application to accounting estimates in the entity’s circumstances will, in our view, assist in promoting application of professional skepticism in the design and performance of the audit procedures, including better informing the auditor’s judgment of whether the auditor may need to take the approach of developing a point estimate or a range.</li> <li>• As expressed in our response to Q6, we believe more guidance is needed on the auditor’s evaluation of qualitative disclosures. In our view, providing such guidance would contribute toward the goal of enhancing the appropriate application of professional skepticism when evaluating disclosures related to accounting estimates.</li> </ul>
25.	GTI*	Professional skepticism is particularly relevant in the audit of accounting estimates and we support the acknowledgment of this in the key concepts section of ED 540. We agree with a number of the IAASB’s decisions in this regard, including

		<ul style="list-style-type: none"> <li>• The inclusion of requirements and application material that assist the auditor in how to apply professional skepticism;</li> <li>• The introduction of a requirement to consider both contradictory and corroborative evidence in paragraph 23 of ED 540 when evaluating whether an estimate is misstated.</li> <li>• The revision of the requirement in respect of management bias, to consider indicators of management bias in aggregate, even if accounting estimates made by management are individually reasonable.</li> </ul> <p>We also make the following observations:</p> <ul style="list-style-type: none"> <li>• The “stand back” provision in paragraph 22 and 23 could be more explicit. It is not clear if this would be required when the inherent risk assessment is low or just when the inherent risk assessment is not low. (Also, see our comments under Question 6).</li> <li>• By directing the auditor to ISA 315 (Revised) and ISA 330 for estimates with low inherent risk, it is not clear whether the auditor is only required to comply with the requirements in paragraph 15(a)(i) – 15(a)(iii) of ED 540 or if the requirements that follow may also be relevant to these estimates. In particular, we are of the view that the requirements concerning the application of professional skepticism should apply to all estimates, including those with a low inherent risk and that this should be made more explicit within ED 540.</li> <li>• Paragraph 24 of ED 540 requires that when the auditor identifies indicators of possible bias, the implications for the audit should be evaluated. We are of the view that in all circumstances there will be management bias and it is inappropriate management bias that the auditor needs to address in determining whether there are any implications for the audit. It is also unclear what the auditor is required to document in this respect.</li> <li>• Application material paragraph A101 states that: “when management uses a complex method, an important factor that the auditor may need to consider regarding the appropriateness of the method, and significant data and significant assumptions, is whether there were other available valuation concepts, techniques or factors, types of assumptions or source data that, in the circumstances, might have been more appropriate, or more generally accepted, in the context of the applicable financial reporting framework.” This could be interpreted too broadly and require the auditor to consider all possible options to determine which is the most appropriate rather than those options that would be considered reasonable.</li> </ul>
26.	KPMG*	<p>We are generally supportive of the steps being taken by the IAASB to reinforce the application of professional scepticism. However, we have concerns regarding the following:</p> <ul style="list-style-type: none"> <li>— The use of the three risk factors (i.e. complexity, judgments and estimation uncertainty) – see our response to question 3;</li> <li>— The requirement in ED-540.19(b) for the auditor to develop an independent estimate when management has not appropriately understood and addressed estimation uncertainty – see our response to question 5. We believe that this requirement may imply that it is the auditor’s responsibility to compensate for management’s ineffectiveness which, in our view, would not be consistent with the concept of maintaining professional scepticism; and</li> <li>— The guidance with respect to management bias – see below.</li> </ul>

### Management Bias

ED-540 refers to management bias throughout various phases of the audit:

- (1) Risk assessment procedures – understanding how management is identifying and addressing the risk of management bias when preparing accounting estimates and considering the potential for management bias when identifying and assessing the risks of material misstatement (ED-540.10(e)(v) and ED-540.13(b));
- (2) Risk response procedures – obtaining evidence about whether management's judgments give rise to indicators of possible management bias (ED- 540.18(a)(i)(b));
- (3) Overall evaluation based on the audit procedures performed – considering the need to re-assess the risks of material misstatement due indicators of possible management bias and evaluating the implications for the audit (ED-540.22(a), 24);
- (4) Documentation of indicators of possible management bias and the auditor's evaluation thereof in forming an opinion on whether the financial statements as a whole are free from material misstatement (ED-540.27(b)).

We recognise the importance of identifying and appropriately responding to management bias and are supportive of the emphasis being put on the issue of management bias in ED-540. However, we have the following concerns:

- a. ED-540 focuses on identifying and addressing all indicators of management bias. We believe it is neither practical nor possible for auditors to identify all indicators of management bias and, as recognised by paragraph ED-540.A148, indicators of possible management bias themselves do not constitute misstatements for the purpose of drawing conclusions on the reasonableness of individual accounting estimates. Consequently, we believe that ED-540 should be clearer that the auditor should focus on identifying and addressing indicators of possible management bias which could result in a material misstatement; and
- b. ED-540.18(a)(i)(b) requires the auditor to obtain sufficient appropriate audit evidence about whether management's judgments regarding the selection and use of the methods and the significant data and assumptions give rise to indicators of possible management bias.

We believe that the auditor should not specifically plan and perform the audit to obtain evidence of the existence of indicators of possible management bias on their own. In our view, the auditor obtains evidence over the data, assumptions and methods that were used to make the estimate, and through evaluating this evidence the auditor considers whether there are any indicators of management bias that may represent a risk of material misstatement. We also believe that if risk assessment procedures indicate a risk of possible management bias that could result in a material misstatement, then the auditor may exercise a heightened professional scepticism to the implications of this potential bias when the auditor obtains evidence over the different components of each estimate.

Furthermore, the auditor may find that obtaining evidence about indicators of possible management bias, as suggested above, is impracticable at the estimate level, considering that ED-540.A7 recognises that management bias may be difficult to detect at an account level and may only be identified when considered in groups of accounting estimates, all accounting estimates in aggregate, or when observed over a number of accounting periods.

Our recommendation is that the IAASB more clearly articulate the auditor's responsibilities in this area.

		Finally, we believe the location of ED-540.24 should be reconsidered. In our view, the auditor should consider whether there are indicators of possible management bias before the auditor performs an overall evaluation based on audit procedures performed in ED-540.22-23. This is because, if indicators of possible management bias are identified, the auditor shall evaluate the implications for the audit, including whether the auditor's risk assessment and related responses remain appropriate.
27.	PKF	Yes.
28.	PWC*	<p>We support the need to ensure that the standard provides a strong foundation that supports the appropriate application of professional scepticism. Evaluating the relevance, reliability and sufficiency of evidence and providing robust challenge to management in areas of subjective judgement are critical elements in auditing accounting estimates. That is best achieved through the nature of the requirements rather than statements that remind or reinforce the importance of the concept.</p> <p>We believe the revised requirements in the proposed ISA will encourage a more detailed understanding of how accounting estimates are determined by management. That, alongside the requirements we have suggested in appendix 2 on the identification and assessment of, and response to, risks, will focus the auditor to think more about the reasons for the assessment given to risks of material misstatement and where audit procedures need to be targeted to obtain sufficient appropriate audit evidence. We also support the additional focus on consideration of management bias and the proposed stand-back evaluation to assess the sufficiency of evidence obtained.</p> <p>As noted in our response to question 1, we believe it is also important to address questions regarding the sufficiency of audit evidence in areas in which there has been debate. The proposed requirements and guidance regarding what is expected in relation to assumptions, data and information from external information sources are helpful in this regard.</p>
29.	RSM	<p>Yes, we believe they do encourage the application of professional scepticism despite our reservations over the risk assessment process which we discuss below under Q4.</p> <p>In particular, we welcome the clear focus on assessing risk and developing appropriate responses coupled with a requirement to "stand back" in paragraph 22. Auditors can be prone to focussing on individual audit procedures and not seeing the bigger picture. Paragraph 22 should, if properly performed, help to address this issue.</p>
30.	SRA	
<b>Public Sector Organizations</b>		
31.	ACAG	<p>ACAG agrees the 'stand back' requirement in paragraph 22 reinforces the principle of professional scepticism. While auditors may currently be 'standing back' and assessing whether sufficient appropriate audit evidence has been obtained, this may not be appropriately documented and evidenced on the audit file, and the ED's requirements should ensure the auditor's thought processes are more explicitly documented.</p> <p>We caution however that the ED may be interpreted to limit the use of professional scepticism when the inherent risk of the accounting estimate is assessed as low, as the prescriptive requirements of the paragraph apply only to situations where the risk is assessed as not low.</p>

32.	AGA	Yes. We note that engagement quality control reviewer (EQCR) involvement may promote skepticism; consider adding specific guidance (or amending ISCQ-1) that where the financial statements contain estimates it is (rebuttably) presumed that an EQCR will be assigned. Note that it should not be only “where the risk of material misstatement due to estimates is other than low” because, in the logic of the new 540, it is itself a significant and difficult judgment what is the risk associated with estimates.
33.	AGC	Yes, the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates.
34.	AGNZ	<p><b>3. There is confusion around applicability of ED-540 to all situations (“scalability”).</b></p> <p>There are some sections where the application of professional scepticism when auditing accounting estimates is reinforced. For example, paragraph A2 identifies some of the factors auditors should consider when assessing the reasonableness of accounting estimates. The section encourages auditors to consider the consistency of the data and assumptions applied by management in reaching its estimates. Although there is nothing in the extant ISA 540 that prevents auditors from considering this or other factors, the explicit inclusion of more factors can assist the auditor identifying areas where scepticism could be applied.</p> <p>However, please also refer to our comments at section 2 in the main body of this submission. The Standard needs to focus on the application of principles, rather than procedures. We are concerned that too much focus on procedures may distract auditors from focusing on professional scepticism.</p>
35.	CIPFA	<p>CIPFA considers that the material in ED-540 appropriately reinforces the application of professional skepticism, mainly by promoting rigorous planning, testing and evaluation, while in some places simply highlighting the need to apply professional skepticism.</p> <p>Both approaches are necessary, given that professional skepticism is characterised both by a mindset which reflects an appropriate degree of challenge in the circumstances of the audit, and a technical understanding of the adequacy of audit evidence having particular regard to issues arising from information obtained from sources related to the audited entity, or other interested parties.</p>
36.	GAO	We agree that the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates. We support the enhanced risk assessment requirements and the requirements to “stand back” and evaluate audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence.
37.	INTOSAI	<p>Public sector considerations:</p> <p>No public sector considerations requiring communication to the Board were identified.</p> <p>Other comments:</p> <p>In general, we find that the requirements and application material appropriately reinforce the application of professional skepticism however the Board is encouraged to include a clear requirement that the auditor conclude whether any of the accounting estimates identified give rise to an inherent risk that is not low.</p>
38.	PAS	Yes, the requirements and application material appropriately reinforce the application of professional skepticism when auditing accounting estimates.

<b>Preparers of Financial Statements</b>		
39.	ABA	<p><b>Steps to Address Professional Skepticism Will be Ineffective</b></p> <p>The Proposal stresses the need for professional skepticism during audits, emphasizing the need to “stand back” and evaluate whether sufficient appropriate audit evidence (SAAE) has been obtained and that management’s decisions relating to recognition, measurement, presentation, and disclosure are in accordance with the accounting framework. While this appears to be a sound step in the overall audit process, we are confused as to how such a process is different from current auditing processes relating to other issues or of the audit process as a whole. If “standing back” merely formalizes what is already performed (and would be expected in any audit), ABA questions the overall benefit of codifying such a process. While ABA generally welcomes professional skepticism in the audit process, without more detail as to how such a process is conducted, it is difficult to see how such guidance will improve audits.</p> <p>The Proposal also discusses professional skepticism in the light of addressing management bias in accounting estimates. This seems reasonable for fair value estimates, as the estimates made are meant to reflect market-based (and not management-based) assumptions. However, subjectivity and bias are inherent features of the CECL standard (as well as IFRS 9). True, expected credit loss assumptions are meant to be “reasonable and supportable.” However, both FASB and U.S. banking regulators acknowledge the expectation that different banks will have different views of the future – “bias” is an integral part of these expected credit loss accounting standards.</p> <p>There may be the notion that the auditor can detect bias that is considered unreasonable. However, due to the non-linear relationship of economic forecasts to credit losses (for example, there are often no credit losses on collateral-based loans until a specific loan-to-value ratio is reached), small differences in forecasted macroeconomic factors can often have a large impact on the reported financial performance. Unreasonable bias will often be very difficult to detect. By the design of these accounting standards, there will be no practical way to reduce management bias in these estimates.</p>
<b>Member Bodies and Other Professional Organizations</b>		
40.	ACCA- CAANZ	<p><b>Lack of professional skepticism/challenge of management’s assumptions</b></p> <p>Our members found it useful to have additional focus on professional skepticism through the step back requirements and discussion of management bias. However, there was a view that the discussion of potential biases could be enhanced as this is a key issue in the exercise of professional skepticism. In addition, the documentation requirements in relation to these areas are unclear. We believe that documentation of how the auditor has exercised professional skepticism throughout the audit process is key to addressing the perception that auditors are not sufficiently skeptical and also in assisting auditors to ensure that sufficient professional skepticism has been exercised. While there’s an argument to be made that consideration of documentation of professional skepticism could be addressed by a separate workstream, the central nature of management judgement within ED-540 suggests that the IAASB should provide further explanation of its thinking now within ED-540 by providing additional application material on this issue.</p> <p><b>While ED-540 has partly addressed this area, it needs to go further in addressing documentation of professional skepticism and</b></p>

		<p><b>in providing guidance on management and auditor biases. CA ANZ's Practical ways to improve the exercise and documentation of Professional Scepticism in an ISA Audit addresses documentation of professional skepticism.</b></p> <p>We are pleased to see an acknowledgement in paragraph 10(c) of ED-540 of the danger of anchoring bias to auditor decision-making. However, it is unclear to us that this section, and its supporting application material, is sufficient to fully mitigate the impact of the bias. For example, there is a fine balance between avoiding knowledge of the entity to mitigate anchoring bias and obtaining knowledge of the entity in order to make the auditor's assessment under paragraph 10(c) relevant. The application material does not help the auditor navigate these two positions.</p> <p>ED-540 should make a stronger connection between the use of judgement by management and the extent to which that judgement might be affected by cognitive biases. Auditing standards require the auditor to be alert to indicators of management bias and to take mitigating action where it is identified. Academic research indicates that cognitive biases are subconscious and will always be present. Therefore it is important when auditing estimates to seek and obtain evidence of the extent to which management's use of judgement is affected by bias and whether this means balances and disclosures are materially misstated. ACCA's publication <i>Banishing Bias</i> provides an analysis of the main cognitive biases and how they might impact on the audit process. CA ANZ's <i>The Art of Professional Scepticism</i> series also address biases.</p> <p>We therefore believe that further guidance would be useful, particularly in relation to management/auditor biases and documentation.</p>
41.	AE	<p><b>(8) The explanatory memorandum to ED-540 gives a lot of prominence to the application of professional scepticism. Whilst we welcome the steps taken by the IAASB to drive actions that promote professional scepticism, we think it remains a challenging area and, even with the best effort, applying professional scepticism can never overcome the inherent estimation uncertainty of accounting estimates included in the financial statements. Being more explicit regarding this might help manage expectations. We draw your attention to our response to question 2 that expands upon this point.</b></p> <p>The explanatory memorandum to ED-540 includes significant discussion of professional scepticism to the extent that it suggests the matter would be given greater prominence in the revised standard than it actually is. Having said that, the overall evaluation based on the audit procedures performed is a good aspect of ED-540 that implicitly reinforces the application of professional scepticism.</p> <p>Whilst we welcome the steps taken by the IAASB to drive actions that promote professional scepticism, we think it still remains a challenging area, particularly since the effective application of it is judged by others with the benefit of hindsight. In such instances, it is easy to conclude, sometimes unfairly, that the auditor did not take all the reasonable steps to evaluate the requirements in paragraphs 22 (a)-(c). Applying adequate professional scepticism is critical and we fully support and encourage the continuing work undertaken by the IAASB with the professional scepticism working group. When the work of this group is finalised, it will likely be necessary to consider consequential impact to existing ISAs, including ISA 540.</p> <p>Regulators have been significant contributors to the professional scepticism debate and we suggest that the IAASB continue liaising with these stakeholders for dialogue on external inspection findings in the area of accounting estimates. Accounting estimates with a high degree of inherent uncertainty require the application of greater judgement. The judgment as to whether there has been sufficient application of professional scepticism can be challenged at a later date by someone who has the benefit of hindsight. As such, even if ISA 540 appropriately reinforces the application of professional scepticism, this will not solve the issue of someone looking at the audit work</p>

		and having the benefit of hindsight in comparison with the auditor performing the work with the facts and circumstances available at the time of the audit.
42.	AICPA	Yes. We generally support the proposed amendments in ED 540 that reinforce professional skepticism when auditing accounting estimates. Those have been put forth as (1) the enhanced risk assessment requirements, (2) more granular requirements for higher inherent risk estimates, and (3) the stand back provision. We are also supportive of the IAASB's efforts with respect to exploring ways in which professional skepticism can be embedded in the ISAs and are aware of the IAASB's project addressing professional skepticism. However, with respect to the three areas of focus, we have noted certain concerns about how those are operationalized (noted elsewhere in this letter) and would suggest that the IAASB can achieve certain objectives through the approach of adding additional requirements, but strongly caution the Board that adding more requirements does not always equate to driving higher professional skepticism.
43.	ANAN	It is the considered opinion of the Association that application material ED appropriately reinforces the application of professional skepticism when dealing with auditing accounting estimates. The reinforcements are evidenced in the key provisions contained in the ED specially designed to enhance the auditor's application of professional skepticism. These include enhancement of risk assessment requirements which provides a better basis for identifying and assessing the risk of material misstatement related to accounting estimate, robust requirements for obtaining audit evidence when dealing with inherent risk that is low, and the stand back requirements for evaluating audit evidence. These requirements would conscientise the auditor and enhance his inquisitiveness and alertness to circumstances of possible fraud or financial misstatement.  Moreso, the inclusion of the stand back that enables auditors to set aside and re-evaluate the judgment of management especially where the inherent risk is not low, actually reinforce the ability of the auditors to apply the concept of skepticism.
44.	CAI	The application of professional scepticism to the audit of accounting estimates is essential. On balance, it is our view that ED 540 does appropriately reinforce the application of professional scepticism through requirements and guidance which, although not always explicitly referring to the concept of professional scepticism, require the appropriate mindset of the auditor. We welcome the inclusion of paragraph 23 and the requirement for the auditor to "stand back" and perform an overall evaluation of the audit evidence obtained whether corroborative or contradictory. However, additional guidance could be included earlier in ED 540 referencing how the auditor may deal with contrary evidence when it is discovered in performing the procedures and prior to the overall evaluation stage.
45.	CAQ	
46.	CPAA	Effective exercise of professional scepticism is particularly relevant when auditing accounting estimates, which we agree is unlikely to be achieved by simply calling for greater professional scepticism. Therefore, we support the IAASB's approach of including auditor actions which reflect how exercise of professional scepticism would manifest in auditing of accounting estimates in ED-540. In particular, we support the enhanced risk assessment requirements, more precise requirements with respect to obtaining audit evidence, and requirements to "stand back" and evaluate the audit evidence obtained. We, however, consider that the concept of standing back could be more clearly articulated or expressly stated in paragraph 22.
47.	CRUF	
48.	EFAA	The requirements and application material appropriately reinforce the application of professional skepticism when auditing accounting

		estimates. We are, however, concerned from a scalability point of view as to how much evidence and documentation of effective challenges of management and exercise of skepticism regulators will expect of SME audits.
49.	FACPCE	Answer 2) We consider that the requirements and application material of ED-540 include all the issues in which must be reinforce the application of professional skepticism when auditing accounting estimates.
50.	IAA	Refer to letter
51.	IAAA	In our opinion, they adequately reinforce the application of professional skepticism when reviewing accounting estimates and other aspects of an audit of financial statements. We understand that the requirements included in the draft revision of ISA 540 as well as the accompanying application material will help, more than anything, to remind the auditor to keep his skepticism always up to date, although we understand that no normative material is necessary So that the accountant always maintains his professional skepticism but it is well known that professionals often "forget" this essential requirement in an audit practice of financial statements.
52.	IBRACON	<p>We support the increased emphasis on professional skepticism in ED-540. Evaluating the relevance, reliability and sufficiency of evidence and providing robust challenge to management in areas of subjective judgement are critical elements in auditing accounting estimates. We believe that the revised requirements in the proposed ISA, which includes an enhanced and granular risk assessment process, will encourage a more detailed understanding of how accounting estimates are determined by management and also will focus the auditor to think more about the reasons for the assessment given to risks of material misstatement and where audit procedures need to be targeted to obtain sufficient appropriate audit evidence.</p> <p>We suggest adding further guidance on the documentation that would be sufficient to demonstrate the auditor's responsibilities in this area and that the auditor appropriately challenged management's assumptions and the extent to which alternatives were considered.</p> <p>Additionally, we suggest take into account the IAASB's Professional Skepticism Working Group point of view prior the issuance of the revised ISA 540, to ensure that appropriate terminology to address the auditor's work efforts related to professional skepticism is being used in ED-540.</p>
53.	IBR-IRE	ED 540 integrate certain elements that should be helpful in promoting professional skepticism. However, we do not believe professional skepticism is prominently addressed in ED 540. In our view the application of professional skepticism is not necessarily addressed within individual standards but should be part of a comprehensive approach combining standard-setting, education and potentially, the development of a professional skepticism framework. While D 540 is a step in the right direction, we encourage the IAASB to continue to investigate appropriate avenues to strengthen the application of professional skepticism by auditors.
54.	ICAEW	37. We understand the importance of scepticism relating to estimates because of the risk of management bias, and note that the idea is to drive actions that promote scepticism as set out in paragraph 4. If followed properly, the proposals represent a challenging standard. But the outstanding question for practitioners now, as before, is how much evidence will be considered 'enough' by regulators. How far do auditors need to go to show that they have challenged management assumptions effectively, and to what extent do management and auditors need to consider alternative assumptions. Some guidance regarding the nature and extent of the 'stand back', and/or examples thereof, is important, particularly in jurisdictions in which a compliance framework is mandated and in which the concept of a 'stand back' is not well-embedded.

		<p>38. Some query the proposed paragraphs 12 and 14 requirements to determine the need for the use of experts in all cases. The issue is less about the requirement, and more about the need to document a negative, i.e. to make a statement in the vast majority of cases in which an expert is not required. While the increase in the use of fair values in UK and international frameworks has led to increasing reliance on specialists by management and auditors alike, the use of specialists remains the exception rather than the rule. It might be better to deal with this issue in application material in the context of the team discussion, rather than having two separate requirements.</p>
55.	ICAG	<p>Yes, we believe that the ED 540 appropriately reinforce the application of professional scepticism when auditing accounting estimates. The auditor has to understand how management identifies transactions; makes accounting estimates; and understand internal controls, in evaluating the appropriateness of accounting estimates applied in the management of an entity. Also the auditor has to “look-back” on Prior Year estimates which will reinforce the understanding of accounting estimates applied in the preparation of the financial statements.</p>
56.	ICAP	<p>The ED 540 contains references to the professional skepticism and we support IAASB’s approach to reinforce the need for professional skepticism when auditing accounting estimates.</p> <p>However, we believe that the requirements to apply professional skepticism should be further emphasized and included in ED 540, along with guidance and explanatory material. This would assist in improving the understanding and practical application of the professional skepticism when auditing accounting estimates, consequently leading to enhanced audit quality and meeting the stakeholders’ expectations.</p>
57.	ICAS	<p>We are supportive of the approach that the IAASB has adopted in ED-540 and agree with the comment in the Executive Summary which states that the exposure draft contains some key provisions to enhance the way in which the auditor applies professional scepticism. We prefer the adoption of such a substantive approach than merely referring to the need for auditors to exercise professional scepticism at various parts of the proposed revised standard. However, as the regulatory community have been particularly vocal in the professional scepticism debate, there is a need to ensure that they appreciate the enhanced requirements within the proposed standard and how, if appropriately applied, they should enhance the manner in which the auditor applies professional scepticism.</p> <p>One area where we believe further enhancement could be made is to include additional guidance in relation to how the auditor should evaluate qualitative disclosures to emphasise the need for the application of an appropriate level of professional scepticism. Such disclosures can be extremely important to allow the user to properly assess the uncertainty surrounding the recognition and measurement of certain elements of the financial statements. We would suggest that the Professional Scepticism Working Group considers this issue as part of their project.</p>
58.	ICAZ	<p>With the appreciation that accounting estimates are complex, there is need for the use of judgment by management, and estimation uncertainty, ED-540’s key provisions enhance the auditor’s application of professional skepticism and consideration of the potential for management bias. ED- 540 includes enhanced risk assessment requirements, more granular requirements with respect to obtaining audit evidence, and requirements to “stand back” and evaluate the audit evidence obtained. These conditions reinforce the application of professional skepticism.</p> <p>According to ISA 220 paragraph 15 the auditor shall plan and perform an audit with professional skepticism recognising that</p>

		circumstances may exist that cause the financial statements to be materially misstated. Therefore, requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates.
59.	ICPAK	The ED and accompanying material do reinforce the application of professional skepticism in the application of audit procedures to accounting estimates. There is appropriate recognition of levels of risk of misstatement including inherent risks as well as due importance to the need to consider when specialized skills and knowledge are required.
60.	ISCA	<p>2.1 We agree with the IAASB that professional scepticism plays a pivotal role in the audit of management’s accounting estimates.</p> <p>2.2 While this fundamental principle is embedded within ED-540, its importance could be further emphasised with an additional focus at the start of the proposed standard. We recommend that the IAASB specifically highlight the importance of applying professional scepticism when auditing management’s estimates. This includes maintaining an inquisitive and independent mindset to gather alternative audit evidence to corroborate with management’s estimates.</p> <p>2.3 Whilst one of the objectives of ED-540 is to reinforce professional scepticism, of which several key provisions are designed to set the intended tone and audit approach, more clarity could be provided regarding the extent of audit documentation required to demonstrate the application of professional scepticism.</p>
61.	KICPA	We support IAASB’s decision not to explicitly include reference to professional skepticism in paragraph 22 over possible misunderstanding that the inclusion of reference to professional skepticism in specific requirements, but not others, could be seen as not improving professional skepticism to the others. We believe that the Board’s decisions to include a stand back provision in paragraph 22 and a requirement in paragraph 23 to consider all relevant audit evidence obtained, whether corroborative or contradictory, reinforce the application of professional skepticism when auditing accounting estimates.
62.	NASBA	Yes, we agree that the requirements and application material will add clarity to reinforce the application of professional skepticism when auditing accounting estimates.
63.	SAICA	<p>18. Most of the survey respondents agreed. The upfront emphasis of its importance underlines the frame of mind with which the auditor should approach all audit work related to accounting estimates.</p> <p>19. SAICA agrees that the ED appropriately reinforces the application of professional scepticism. At an overall level professional scepticism has been reinforced by enhancing the risk assessment requirements which will provide the auditor with a more in-depth basis for identifying and assessing RoMM. There is further a requirement for the auditor to “stand back” and re-evaluate the audit evidence obtained. The following specific requirements will also require the auditor to apply professional scepticism:</p> <ul style="list-style-type: none"> <li>• 10(c): That requires an understanding of the nature of accounting estimates and related disclosures that the auditor expects to be included, in addition to what has been included in the entity’s financial statements.</li> <li>• 24: That requires the auditor to consider management bias by evaluating the judgements and decisions made by management for individual accounting estimates and in aggregate.</li> </ul> <p>20. The IAASB could consider linking the professional scepticism “catch all” in paragraph 5 to ISA 200, paragraph 15 (and its related application material) for additional clarity and support of the concept.</p>

		<p>21. The application of professional scepticism could be further enhanced if the following guidance is provided:</p> <ul style="list-style-type: none"> <li>• How the auditor should deal with contradictory evidence as described in ED-ISA 540 (Revised).23.</li> <li>• How the auditor should evaluate qualitative disclosures as mentioned in ED-ISA 540 (Revised).A57 and A137.</li> </ul>
64.	SMPC	<p>In general, the requirements and application material appropriately reinforce the application of professional skepticism when auditing accounting estimates. A key factor will continue to be how much evidence and documentation is needed for auditors to support that they have challenged management effectively and the degree of skepticism that was exercised on the audit i.e. what will be considered 'enough' by regulators. There is a risk that an expectations gap would be increased with additional recognition of professional skepticism.</p>

Academics		
65.	GC	
Individuals and Others		
66.	CYGNUS ATRATUS	<p>In order to reinforce professional skepticism and risk assessment procedures in line with the required audit procedures we would suggest adding understanding of:</p> <ul style="list-style-type: none"> <li>• Risks of manipulating data, assumptions used or calculations performed / models used.</li> <li>• The (mathematical) complexity of calculations or modelling, and nature of IT systems involved.</li> </ul>
67.	NDEG	<p>2.1 We support the need to ensure that the Standard provides a strong foundation that supports the appropriate application of professional skepticism. Evaluating the relevance, reliability and sufficiency of evidence and providing robust challenge to management in the areas of subjective judgement are critical elements in auditing accounting estimates. That is best achieved through the nature of the requirements rather than statements that remind or reinforce the importance of the concept.</p> <p>2.2 We believe that the revised requirements in the proposed Revised ISA 540 will encourage a more detailed understanding of how accounting estimates are determined by management. That, alongside the requirements on identification, assessment and response to risk will, in our view, focus the auditor to think more about the reasons for the assessment given to risks of material misstatement and where audit procedures need to be targeted to obtain sufficient appropriate audit evidence.</p> <p>2.3 We also support the additional focus on consideration of management bias and the proposed stand-back evaluation to assess the sufficiency of evidence obtained.</p>