Supplement D
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 3

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.

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

#	Respondent	Comments
Investors and Analysts		
1.	CFA	**Scalability** **We believe that "low inherent risk" is the appropriate gauge for scalability and using it in the standard should be applicable to all estimates. We believe that the standard is sufficiently clear and capable of proportionate application to estimates that have risks of material misstatement for which inherent risk is low. We note, however, that there is some danger in auditors seeing this as a dividing line and perhaps assessing some estimates as having low inherent risk when in fact they do not. This would be a matter for audit regulators to monitor.**
Those Charged with Governance		
2.	AICD	
Regulators and Oversight Authorities		
3.	**BCBS**	

4.	CEAOB	**Link to be clarified between different levels of risks** **7. The revised standard is built on the concepts of estimates with a "low inherent risk" and estimates where "inherent risk is not low", which, we believe will be helpful in allowing responses to be adapted to those situations. Some questions could be raised on the linkage of those risks, if any, with the "significant risk" concept. We believe further explanation of the interrelationship between the different risk concepts would be beneficial.** **8. We believe par. A95 creates an ambiguity regarding the separate assessment of inherent and control risk, which should be avoided. We recommend further alignment of this paragraph with the provisions of par. 15.**
5.	EBA	
6.	ESMA	1. ESMA acknowledges that proportionality and scalability need to be able to address specific considerations related to audit of smaller or simpler entities, such as lack of segregation of duties and management override of controls. Furthermore, ESMA recognises that ISA 540 (Revised) should not be scalable only in one direction. On the contrary, it should highlight that for entities where the risks of material misstatement is exceptionally high (e.g. due to particular risk of management bias or because of their complexity) additional procedures would need to be required in order to achieve sufficient level of assurance for the audit of accounting estimates. Such requirements might be linked e.g. to the obligatory need to test effectiveness of internal controls for certain complex entities (see also paragraphs 24-25 of this letter). 2. ESMA highlights that from securities regulators perspective, consistent high-level audit requirements should be required for audits of similar underlying economic transactions in comparable types of entities. While considering proportionality, all entities with securities listed on a regulated market should be governed by the same (high) auditing standards.
7.	**IAIS**	Yes, the flexibility of the standard allows it to be scalable. That said, our focus was on considerations when inherent risk is not low, as we expect this would be the usual situation for an audit of accounting estimates involving insurance contract liabilities.
8.	**IFIAR**	
9.	**IOSCO**	**Responses to the assessed risks of material misstatement** **Paragraphs 14-20 under the heading "Responses to the Assessed Risks of Material Misstatement" require different testing objectives to be applied based on the assessed level of inherent risk. When inherent risk is assessed as 'low', the auditor response is required to follow paragraph 15(a). When inherent risk is assessed as 'not low', paragraph 15(b) directs the auditor to meet the testing objectives in paragraphs 17-20, when applicable.** **Contrary to the approach in the ED, we believe that a single set of testing objectives should apply in all cases irrespective of the assessment of risk or the classification of risk by complexity, judgement and estimation uncertainty. Instead, the nature, timing and extent of the procedures required to be designed and performed by the auditor should differ based on the risk assessment as 'low' or 'not low' and the reasons for that assessment. See our comments below related to the designation of 'low' or 'not low'.** **Even if the Board were to retain its current approach, and we do not support this, the Board should consider whether paragraphs 14-20 may be overly complex, unclear, and consequently could result in inconsistent application by auditors.**

		'Low' vs. 'Not Low' Inherent Risk Assessment **While paragraph 13(n)(i) of ISA 200 defines the term 'inherent risk', which is further discussed in paragraph 7 of ISA 330, paragraph A40 of ISA 200 states that the ISAs do not ordinarily refer to inherent risk and control risk separately. Instead, inherent risk is a component of the auditor's assessment of the risk of material misstatement. While it may be a matter for the ISA 315 project, we believe that the auditor should be required to consider and assess inherent risk and control risk separately.** **The significant focus in the ED on inherent risk assessment, including determination of further audit procedures based on the auditor's conclusions about the inherent risk, is a new approach under ISAs for requiring auditor responses to risk. This, combined with the fact that the concepts of 'low' and 'not low' inherent risk are new and not clearly defined and explained in the ED, could lead to inconsistent audit approaches.** **Responding to Inherent Risk that is 'Low'** **When responding to inherent risk that is 'low', paragraph 15(a) requires the auditor to evaluate whether one or more of the following three further audit procedures would provide sufficient appropriate audit evidence:** • **Obtaining audit evidence about events occurring up to the date of the auditor's report;** • **Testing how management made the accounting estimate and the data on which it is based; or** • **Developing a point estimate or range based on available audit evidence to evaluate management's point estimate.** **These three further audit procedures appear to be largely consistent with the approaches to auditing accounting estimates outlined in paragraph 13 of the extant ISA 540. However, we are concerned about the lack of more detailed requirements or guidance on these three further audit procedures in the ED. In particular, the ED does not retain the application guidance in paragraphs A59–A95 of the extant ISA 540. As a result, it may not be sufficiently clear what procedures the auditor is required to perform to achieve the objectives outlined in paragraph 15(a) of the ED, which could result in an inconsistent, and potentially inappropriate, audit execution. For example, it is not clear whether the auditor is required to evaluate if significant assumptions made by management in developing an accounting estimate are reasonable in each of the further audit procedures listed in paragraph 15(a). The Board should consider clarifying the requirements for the three further audit procedures as well as provide further guidance to auditors regarding execution of these procedures.** **Responding to Inherent Risk that is 'Not Low'** **The Board should consider the issues outlined in this section if the Board continues its current approach, which we do not support, of allocating testing objectives based on the assessment of inherent risk as 'low' or 'not low' and classifying risks based on 'complexity', 'judgement' and 'estimation uncertainty'.** **Definitions of 'low' and 'not low' risk** **Furthermore, the lack of definitions of 'low' and 'not low' risk, combined with the significant difference between the nature and extent of the further audit procedures required to achieve the objectives of paragraphs 15(a) and 15(b), might create an incentive**

		for some auditors to inappropriately assess the inherent risk as 'low' to avoid the burdens of the requirements in paragraphs 17-20 while claiming the protection of 'professional judgment' for their risk assessment conclusions. **Is the approach in paragraph 15(a) available?** **It is not clear from the ED whether the auditing procedures outlined in paragraph 15(a) would also be available to auditors when responding to inherent risk that is 'not low'. We are concerned about limiting the auditor's ability to select the most effective audit approach. There might be situations, even when inherent risk is assessed as 'not low', that one of the approaches listed in paragraph 15(a), or a combination thereof, might be more effective in obtaining sufficient appropriate audit evidence regarding an accounting estimate, for example when the outcome of the estimate is known based on an event or transaction that occurred prior to the date of the auditor's report. If, however, it is not the Board's intent to restrict the procedures the auditor can perform to comply with the requirements in paragraphs 17-20, this should be made clear.**
10.	IRBA	10. As a regulator and standard setter, our experience is always that too little work is done in the area of account estimates, or there is inadequate evidence of the work performed. Any focus on scalability should not have the unintended consequence of auditors doing less work than they should for each account estimate. 11. ED-540 has introduced scalability with respect to auditing accounting estimates by introducing a conditional requirement when the auditor has assessed the inherent risk of material misstatement as low. 12. However, there are a number of observations that the IRBA would like to bring to the IAASB's attention: a. ED-540 is unclear on how the auditor should respond when inherent risk has been assessed as low but the accounting estimate is considered material. We consider this to be a significant gap, and one that will create implementation challenges if not addressed in the requirements. There should be no circumstances, where material balances are under audited, and a low risk assessment used to justify that approach. b. We understand that paragraph 13 of ED-540 requires the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more of the relevant factors in identifying and assessing the risk of material misstatement. However, it is unclear from ED-540 whether inherent risk cannot be assessed as low when one or more of the relevant factors are present. c. Paragraph 22 of ED-540 requires the auditor, for each accounting estimate for which the auditor's further audit procedures were required to address the matters in paragraphs 17-19, to evaluate certain matters set out therein. Since this requirement only makes reference to the further audit procedures that the auditor performs in paragraphs 17-19, this stand-back requirement is not required to be performed when the auditor has assessed inherent risk as low and performs the procedures set out in paragraph 15(a). 13. ED-540 should be clarified and strengthened regarding the matters set out in paragraph 12 above.
11.	UKFRC	• **That the standard should be applicable to all estimates, with scalability to ensure that 'simpler' less risky estimates can be addressed in a proportionate manner. We believe this is more appropriate than developing two separate standards, particularly as there will be many audits with a combination of estimates with different levels of risk.**

		• **That the criterion of 'low inherent risk' is appropriate as a dividing line for scalability. As we comment in our response to question 3, there is a concern among some stakeholders that under this proposed approach, some auditors may assess estimates as having low inherent risk when in fact they do not. Nonetheless, we believe this criterion should be capable of more consistent interpretation than other possible criteria.** We agree that the standard should be applicable to all estimates and that the criterion of 'low inherent risk' is appropriate as a gauge for scalability. We believe that the standard is sufficiently clear and capable of proportionate application to estimates that have risks of material misstatement for which inherent risk is low. The proposed requirements are broadly the same in nature as those in the extant ISA 540 and we are not aware of significant issues in applying them to 'simpler' estimates. However, there is a concern amongst some stakeholders that under this proposed approach, some auditors may see a dividing line and assess estimates as having low inherent risk when in fact they do not. The examples in paragraphs A72 and A73 of where inherent risk may be low or not should help, but this is likely to be a matter that audit regulators will wish to monitor when the standard is implemented. For estimates that have risks of material misstatement for which inherent risk is not low, we believe that expressing the more detailed requirements on an objectives/outcomes basis should assist their proportionate application to the wide variety of accounting estimates, having regard to the spectrum of risk and that some estimates should be more straightforward to audit than others.
National Auditing Standard Setters		
12.	AUASB	**3. 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).** **In light of the comments above, and having reviewed the proposed changes and sought feedback from a wide range of stakeholders within Australia, the AUASB is not supportive of the ED in its current form and raises the following key points of particular importance for the IAASB's consideration. Each of these is elaborated on further in our attached detailed submission:** **i. The AUASB does not support the introduction of the new threshold 'low inherent risk', given the lack of definition or parameters around what constitutes a low inherent risk, as well as the disconnect and inconsistency to ISA 315, where risk of material misstatement is what determines nature, extent and timing of audit effort. The AUASB considers that the risk of material misstatement is what should be used as the driver of scalability. Estimates by their nature are judgemental - based on the examples presented in the ED it is questionable as to whether all but the simplest of estimates would have an inherent risk other than low associated with it. For this reason, the AUASB does not consider "low inherent risk" to be a workable concept in this standard (refer question 3 of the detailed submission).** The AUASB does not support the introduction of the term 'low inherent risk' (refer 3.1 below). The AUASB does not consider ED 540 to be sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk. There is no explicit scalability in many of the requirements within the ED, which may lead to uncertainty and the auditor

		undertaking an increased level of work effort at additional cost across all estimates even where the auditor does not consider the estimate to have a risk of material misstatement. Additionally, the AUASB raises concern as to the practicality of how the requirements apply outside of significantly large and complex sectors and industries. This may also pose significant practical challenges particularly for mid-tier and smaller practitioners. 3.1 Concept of low inherent risk The AUASB does not support the introduction of the threshold 'low inherent risk', given the lack of definition or parameters that define this term, as well as the inconsistency with ISA 315 where risk of material misstatement is what determines nature, extent and timing of audit effort. The AUASB considers that the risk of material misstatement is what should be used as the driver of work effort and scalability. The AUASB is concerned around the scalability of the standard being determined by an assessment of low inherent risk as distinct from risk of material misstatement and considers that this may drive an unintended significant uplift in audit effort. ISA 200 determines that the assessment of the risk of material misstatement can be completed as a combined or separate assessment of both controls and inherent risk. As the ED is based on a separate inherent risk assessment, it is not clear how practitioners that perform combined risk assessments will be impacted and a separate inherent risk assessment may be contrary to common practice. In addition, for those accounting estimates for which the inherent risk is assessed as 'not low' there is a broad range of different types of estimates, some of which will have a higher inherent risk than others. In the ED there is no category of inherent risk between 'low' and 'not low', however the granular requirements in paragraphs 17-19 apply to all estimates regardless of the level of inherent risk above 'not low'. For the reasons outlined above, the AUASB considers that inherent risk in isolation should not drive audit effort in the context of this standard. The AUASB considers that, while the intention of scalability is apparent in the standard, there is not sufficient flexibility in the requirements. Accordingly the AUASB is concerned that practitioners may audit estimates to a predefined 'checklist mentality', (refers response to question 1 and 2.3), applying the procedures within paragraphs 17-19, rather than responding to an appropriate level of assessed risk of material misstatement. The AUASB is therefore concerned that this would result in an increase in work effort that is disproportionate to the level of risk of material misstatement. 3.2 Examples of low inherent risk Estimates by their nature are judgmental, however based on the examples given in paragraph A72 it would appear that all but the simplest of estimates would have an inherent risk other than 'low'. Based on the examples provided it is arguable that almost all estimates would have an inherent risk greater than low and make it difficult for practitioners to justify a low inherent risk classification. For this reason, the AUASB is not supportive of the concept of low inherent risk as the driver of audit effort in this standard.
13.	CAASB	We have identified some challenges in the scalability of certain proposals. Based on feedback provided by our stakeholders, we offer suggestions below as to how ISA 540 could be made more scalable. Overall clarity and readability of ED-540 Many of our stakeholders found the application material in the proposed standard complex, resulting in readability and navigation difficulty. We believe that if certain requirements could be written to provide more clarity as to what is expected of the auditor, it would alleviate the

		need for extensive application material in the standard. As an example, we note paragraph 10(f) includes fourteen paragraphs of application material. Further, stakeholders found the flowchart supplemental to ED-540 helpful in illustrating the work effort requirements. We encourage the IAASB to include this, or a similar flowchart, as an appendix to the Basis for Conclusions of ISA 540 (Revised). Risk assessment procedures (paragraph 10) Paragraph 10(b) requires the auditor to understand regulatory factors, if any, relevant to accounting estimates. While the wording "if any" recognizes that regulatory factors may not be present in all circumstances, our stakeholders questioned the extent to which the auditor would be required to search for regulatory factors that may be applicable to the estimate. Clarity around "how much is enough" would be helpful. Paragraph 10(e) requires the auditor to understand how management makes accounting estimates, including sub-requirements to understand particular elements of management's processes. We have a few suggestions as to how this requirement could be made more scalable, as follows: • Adding clarity to explain the labelling convention used for "accounting estimate" and "accounting estimates" (plural). While we recognize that the IAASB's intention in using the term "accounting estimates" (plural) was to refer to accounting estimates as a whole, that concept was not understood clearly by field testing participants. Some participants misinterpreted the requirements under paragraph 10(e) to apply more granularly to individual accounting estimates. • Amending paragraphs 10(e)(v), (vi) and (vii) to include the wording "whether, and if so, how" (new wording emphasized by underline). The added wording recognizes that some smaller entities may not have processes in place to deal with risk of management bias, address estimation uncertainty, or address the need for change in the inputs to the estimate(s) from the prior period. • Expanding paragraph A44 to include discussion with the owner-manager about the need to use individuals with specialized skills and knowledge in accounting, in addition to the need to use an expert. Stakeholders felt that when management does not have the skills and knowledge in accounting necessary to make accounting estimates, it is important that this be identified early in the audit process so management can take appropriate action. Stakeholders also noted that the circumstances described in this paragraph can occur in entities of all sizes, and so this paragraph should not be under the heading "Considerations specific to smaller entities". Paragraph 10(f) requires the auditor to understand "each of the components of internal controls as they relate to making accounting estimates". Auditors of smaller entities may face a specific challenge with the interpretation of such wording because certain controls in these entities, such as the direct involvement of the owner-manager, may be relevant to many components. We suggest the IAASB clarify the requirement to make it more scalable to a particular circumstance. For example, using the wording in paragraph 8(c)(ii) of extant ISA 540, which refers to "relevant controls" rather than "each of the components of internal control" may be clearer. This may also allow the application material to be streamlined, thus, improving readability. Review the outcome of accounting estimates (paragraph 11)

		Paragraph 11 requires the auditor to review the outcome of accounting estimates included in the previous period financial statements, or, where applicable, their subsequent re-estimation. We recognize that this wording comes from extant ISA 540, however, our stakeholders have indicated that there is varied interpretation in practice as to when this requirement applies. For example, some stakeholders have interpreted this requirement as not being applicable in circumstances when the accounting estimate does not have an outcome, such as in the case of stock-based compensation. We encourage the IAASB to revisit the wording of the requirement and the application material to ensure that it is clear that, while some accounting estimates may not have an outcome, a retrospective review of the results of the inputs used (such as, data and assumptions) in making the estimate, or management's estimation process applied in prior periods, may also inform the auditor's risk assessment and indicate possible management bias. Response to risk (paragraphs 17-19) We believe that the requirements in paragraphs 17-19 are not sufficiently clear as to whether, and if so how, they are meant to be scalable to the level of risk of material misstatement and the degree of complexity, judgment and estimation uncertainty associated with the accounting estimate. See response to question 4 below for further discussion. Application material specific to smaller entities Our stakeholders find the application material in ED-540 on considerations specific to smaller entities to be helpful in assisting the auditor in understanding and applying specific requirements, especially when it goes beyond issue identification by also discussing what the auditor may do differently. Accordingly, we encourage the IAASB to continue its focus on the applicability of ISA 540 to audits of entities of all sizes and to give careful and due consideration to matters specific to smaller entities. We noted some application material in paragraphs A10 and A107 (last sentence) that refers to smaller entities, and therefore, we believe it should be identified with the title "Considerations Specific to Smaller Entities".
14.	CNCC-CSOEC	**We acknowledge that ISA 540 is an Important standard. We recognize the IAASB's effort to provide sufficient guidance on the diverse estimates to which ISA 540 should apply, ranging from simple accounting estimates to very complex ones. Accounting estimates are one of the major issues identified globally in regulatory audit inspections, with comments specifically around the lack of auditor challenge and apparent shortcomings in the application of professional skepticism.** **We recognize the IAASB's attempt to address scalability In E0-540.Nonetheless, we are concerned that the scalability that was desired has not actually been achieved at a satisfactory level due to:** **- the overall complexity and length of the standard, and** **- the lack of clarity on the extent of the required understanding of internal control forlow risk estimates (see answer to question 3).** We recognise the IAASB's willingness to properly address scalability In ED-540. The IAASB sought to make ED-540 scalable, recognizing that the standard applies to all accounting estimates. The ED-540 requires the auditor, when dealing with accounting estimates with low Inherent risk, to determine whether one or more specific further audit procedures that may provide sufficient appropriate audit evidence in the circumstances. For inherent risk that is not low, the auditor is required to design

further audit procedures to obtain audit evidence about matters relating to complexity ,judgment or estimation uncertainty, to the extent these factors are the reasons for the assessed risks of material misstatement.

Including such criteria helps distinguishing the work effort requirements for simple and non-risky accounting estimates from others that have been evaluated as having an inherent risk other than low.

However, we consider that the scalability that was desired has not actually been achieved at a satisfactory level for the following reasons:

- The overall complexity and length of the standard;
- The lack of application material for accounting estimates with low Inherent risk;
- The lack of clarity on the extent of the required understanding of internal control for low risk estimates.

Overall complexity and length of the standard. The standard is long and complex.

A diagram (illustration of work effort requirements), such as the one distributed with the ED, should be included as an appendix to the standard to help understanding the rationale and structure of the standard.

Lack of application material for accounting estimates with l ow inherent risk

Moreover, we note an important difference In weight in the application material between the sections dealing with low inherent risk and not low Inherent risk. There are limited examples provided in the application material in paragraph A72, where auditor's assessment of the risk of material misstatement may be based on low inherent risk. Even In those examples, we can see, depending on the facts and circumstances that an accounting estimate might result In being an inherent risk that Is not low. For

instance, regarding "bonus accrual for management•, we would argue that there will be an Increase in management bias where the profitability of the entity may affect the accounting estimate (I.e. their bonus) which will lead to the conclusion that the inherent risk is not low. To avoid any possible misinterpretation of these examples, we suggest including a sentence in paragraph A71 to reflect how important It Is for the auditor to consider the specific facts and circumstances before concluding If an inherent risk Is low or not low.

The lack of clarity on the extent of the required understanding of internal control for low risk estimates

In addition, we believe that there is lack of clarity on the extent of the required understanding of internal control for low risk estimates.

As defined In ISA 200, inherent risk is assessed before consideration of any related controls. The logic of this ED Is to set the assessment of risks on the estimates at the level of inherent risk. The auditor should therefore be allowed not to obtain an understanding of internal control for all estimates where he assesses the inherent risk as low. On the contrary, paragraph 10 (f) states that the auditor is required to obtain an understanding of each of the component of internal controls u they relate to making accounting estimates thereby giving the Impression that a detailed assessment of Internal control Is required for all the 5 components of internal control specifically for accounting estimates.

In addition, paragraph 16 placed at the end of the main work effort section gives the impression that the auditor has to test the controls as part of his response to the risk even if the auditor was able to apply paragraph 15 (a).

		As a matter of fact, in our opinion, ISA 315 by requiring that the auditor obtains an understanding of intemal control relevant to the audit should allow the auditor not to obtain an understanding of internal control relating to low inherent risk accounting estimates, since this understanding will in fact not be relevant to the audit. A proper treatment of this issue would certainly help the scalability of the approach.
15.	HKICPA	The approach to scalability appears to be clear as set out in paragraph 15. However, there seems to be a lack of further guidance when the inherent risk is low. The requirements in 15(a) are elevated mostly from extant ISA 540. However, the relevant application material does not seem to have been elevated into ED ISA 540. Such guidance would still be helpful when there is low inherent risk, in particular when applying to SMEs. In addition, we would like to make some observations for IAASB's consideration in relation to situations under paragraph 15(a): ☐ the key principles discussed in paragraphs 17-20 would also be relevant when performing paragraph 15(a)(ii); ☐ it would be useful to provide guidance for SMPs on how to develop a point estimate or range based on available audit evidence. The application material in A126-A134 for where the inherent risk is not low would also be relevant for paragraph 15(a)(iii); ☐ Paragraph 15(a) should also be drafted in the context of the applicable financial reporting framework;
16.	IDW	Based on our comments in Appendix 2 on paragraph 9 (a) and paragraph 10 in relation to the scope of the standard and the risk assessment procedures, respectively, we do not believe that the standard is sufficiently scalable with respect to accounting estimates whose measurement is not subject to significant measurement uncertainty or for which one or more of the procedures in paragraph 15 (a) would be sufficient when inherent risk is low. The standard appears to be scalable for instances when the inherent risk is not low due to measurement complexity.
17.	JICPA	We believe following requirements in ED-540 are not sufficiently scalable with respect to auditing accounting estimates with low inherent risk. ☐ Risk Assessment Procedures (Paragraph 10) Paragraph 10 seems to require the auditor to evenly obtain an understanding of all items listed in paragraph 10 in all cases with regard to each of all accounting estimates in financial statements. We believe, however, that it is not always necessary to understand how management has identified and addressed the risk of management bias (i.e. paragraph 10(c)(v)) concerning accounting estimates with low inherent risk, including the simple accounting estimate, for example, that is quantitatively trivial and that necessitates little management judgment. Therefore, we propose to clarify in the standard that: (1) paragraph 10 does not intend to require the auditor to obtain detailed understanding of all items listed in paragraph 10 for each individual accounting estimate in all cases; (2) the auditor obtains understanding to the extent necessary to design further audit procedures, and (3) the nature and extent of necessary understanding varies depending on the importance of the accounting estimate to the financial statements. ☐ Responses to the Assessed Risks of Material Misstatement (Paragraph 15(a))

		For accounting estimates with low inherent risk that are quantitatively trivial, we do not consider procedures in paragraph 15(a) (i) to (iii) to be required in all cases. In June 2017, US PCAOB released their proposed auditing standard for auditing accounting estimates ("PCAOB proposal"), and the PCAOB proposal requires the auditor to apply substantive procedures to accounting estimates in significant accounts and disclosures (PCAOB Proposal Appendix 1, paragraph 5). We understand that IAASB is undertaking the project to revise ISA 315, which includes exploring whether to introduce the concept of the identification of significant classes of transactions, account balances and disclosures in identifying and assessing the risks of material misstatement that is similar to the concept used in PCAOB standards. We believe introduction of this concept may also respond to the issue of scalability of ISA 540. Therefore, this concept should also be explored in the project for the revision of ISA 540.
18.	MAASB	The AASB is of the view that the ED-540 is sufficiently scalable and it addresses the assessed risk of accounting estimates accordingly.
19.	NBA	**Low inherent risk/threshold** **We support the thought that for an estimate with 'low' inherent risk it is not necessary to perform the same level of work as for an estimate with higher inherent risk. Thus we sup-port the threshold approach. We suspect that from a conceptual perspective low estima-tion uncertainty (as defined above), will probably lead to low inherent risk. Nevertheless the standard does not make clear to us how to distinguish between low inherent risk and other levels of inherent risk. Therefore it is not clear to us when the 'threshold'-approach can be taken (limited procedures when inherent risk is low).** **According to the definition of inherent risk, the determination of inherent risk should not be influenced by internal control Therefore, although sometimes helpful, it is conceptually not always necessary to understand the internal control environment to determine the level of inherent risk. Especially for simple estimates in simple environments it might not be use-ful and not worthwhile to get an understanding of the control environment. We suggest that the standard recognizes that as soon as the auditor has enough evidence to deter-mine that inherent risk is low there is no need to deepen his understanding of the internal control environment (see response to Q3).** The term 'scalability' might mean different things to different auditors / stakeholders and it is not entirely clear which one is meant here. The focus regarding the scalability of esti-mates is on estimates with a low inherent risk. In terms of SMEs, the ED is therefore not necessarily scalable (and we wonder whether it should be). That depends upon whether SMEs have low inherent risks regarding estimation uncertainty. Although SME's in gen-eral are less complex compared to for instance listed entities, for certain estimates of SMEs inherent risk will not be low. At the same time given the fact that the work load with regards to the factors is evidence driven we suppose that there is a second level of scalability. Sufficient appropriate evi-dence regarding (one of) the factors in case of high inherent risk might be more extensive then when inherent risk is moderate. The standard could demonstrate this in examples in the application material. In many cases SMEs could benefit from this. Although a few paragraphs are dedicated to SME's, this could be more extensive. For example, in paragraph A23 it is not clear which information should be obtained from the owner-manager and how to determine whether this is sufficient.

		In terms of work effort, the ED can be considered scalable if inherent risk is low (threshold'). However to clearly identify in practice whether inherent risk is low is difficult. The standard nor the ISAs in general do not provide guidance on how to decide whether inherent risk is low. Furthermore, we wonder whether internal controls need to be considered (paragraph 10f) if inherent risk is low and whether paragraph 16 can apply if paragraph 15a has been applied (low inherent risk). Internal control is not relevant to determine whether inherent risk is low. Paragraphs 10f suggests that internal control should be considered although inherent risk is low. This both would not eliminate the work effort. In some situations substantive testing would be sufficient. Therefore we suggest to move the paragraphs about internal control after paragraph 15a the 'threshold', or made conditional in situations where inher-ent risk is already evaluated as being low, and clearly explained that they might not be applicable when inherent risk is low. Finally, we suggest to make it clear which audit procedures should be performed in para-graphs 17-20 when inherent risk is not low and when there is insufficient internal control.
20.	NZAuASB	**Introduction of new concepts – low risk, not low risk** **ED-540 requires the auditor to determine whether the assessed risk of material misstatement related to accounting estimates is "low" or "not low", which in turn drives the nature, timing and extent of the auditor's further audit procedures. The NZAuASB is concerned that the new concepts of "low" and "not low" have not been clearly defined, and that there is a disconnect with the assessment of risk based on the extant standards. We note that ISA 315 (Revised) requires the auditor to determine whether any of the risks of material misstatement are, in the auditor's judgement, significant risks . Further, the NZAuASB is concerned that only the simplest of accounting estimates will be assessed as "low" and accordingly, those accounting estimates that exhibit one of the characteristics of complexity, judgement or estimation uncertainty may be inappropriately assessed as "not low". This is of particular concern in the public sector where an entity may have a small number of high value items on its balance sheet, for example, heritage assets or infrastructure assets. Such an item is likely to be the most significant item on the balance sheet and therefore attract most audit attention. Because ED-540 sets the threshold for designing and performing additional audit procedures at a level where inherent risk is "not low" rather than "significant", and the required work effort along the spectrum of risk is not clear, this could lead to a significant increase in work effort which is disproportionate with the level of risk.** The NZAuASB is concerned that ED-540 is not sufficiently scalable with respect to auditing accounting estimates. The NZAuASB is concerned with the requirement to assess risk of material misstatement related to accounting estimates as "low" or "not low" based on inherent risk. The concepts of "low" and "not low" have not been clearly defined and there is a disconnect with the assessment of risk based on the extant standards. Based on the examples provided in paragraph A72 only the simplest of accounting estimates will be assessed with inherent risk of "low". In such circumstances, ED-540 is specific as to the further audit procedures to be performed. For those accounting estimates for which the inherent risk is assessed as "not low" there is a broad range of different types of estimates, some of which will have a higher inherent risk than others. There is no category of inherent risk between "low" and "not low". The granular requirements in paragraphs 17-19, however, apply to all estimates regardless of the level of inherent risk above "not low". The concern of the NZAuASB is that the drafting of these requirements at such a granular level may reduce the application of professional judgement of the auditor and result in a compliance based approach to auditing the estimate. This is further discussed in response to question 4.

Accounting Firms		
21.	BDO*	**We have two primary concerns with the changes proposed in ED-540 relating to the work effort required for estimates assessed as having low inherent risk and the 'three factor' approach. We believe that ED-540 creates the impression that the work effort on low inherent risk estimates will significantly increase even though the conclusion may be the same as what would have been determined in the extant standard.** We believe that the ED-540 is a good start in addressing scalability in auditing accounting estimates. However, we have some concerns related to the requirement to assess inherent risk as low or not low. This is not currently a requirement under ISA 315 (Revised) Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment which involves an overall assessment of the risk of material misstatement, including both inherent risk and control risk. Further, the change in assessed risk levels of low inherent risk and not low inherent risk versus risk of material misstatement and significant risk of material misstatement (SRMM) results in a potential change in the methodologies of many auditors and audit firms that may not be the intention of ED-540. The implication of including the concept of 'low risk' within ED-540 is that the IAASB is potentially introducing a new concept that could have far wider implications for how auditors, irrespective of size of audit practice, may approach an audit. We understand that ISA 315 (Revised) is currently being reviewed and revised and may clarify the meaning and use of the different risk levels – potentially through the concept of a 'spectrum of risk'. Additional guidance regarding the requirements for auditing accounting estimates assessed to have SRMM would be particularly helpful. We also note that the requirements section of ED-540 focuses on the assessment of accounting estimates as having low inherent risk or not low inherent risk. However, the application and other explanatory material section, starting from paragraph A76 onwards, refers to SRMMs. We suggest that ED-540 be more consistent in the use of these terms and concepts. Further, the increased risk assessment procedures outlined in paragraphs 10(a) to 10(f), including the evaluation of internal controls related to accounting estimates, may lead to some confusion in the level of work effort required and may result in auditors performing too much work on non-complex, straight forward estimates. We believe that ED-540 will result in an overall increased work effort in comparison to the requirements in the extant ISA. Based on the examples included in the application paragraphs, it is not clear which types of estimates fall into the low inherent risk category. This lack of clarity has the potential to undermine the scalability of ED-540. Example approaches for a simpler low-risk estimate compared to a more complex high risk estimate would be helpful in applying the requirements in paragraphs 10(a) to 10(f). We also note that paragraph 11 includes two requirements ('[reviewing] the outcome of accounting estimates in previous period financial statements' and '[taking] into account the characteristics of the accounting estimates in determining the nature and extent of the review') . We suggest that the two requirements be in separate paragraphs to ensure that there are no hidden requirements and there is greater clarity for auditors.
22.	CHI*	
23.	DTT*	**Scalability** **Although DTTL acknowledges the commitment and efforts of the IAASB to introduce scalability into ED-540, DTTL does not believe that it is easily scalable in its current format. The concept relating to a spectrum of risk is grounded in ISA 315 (Revised),**

		and auditors are already familiar with the notion that not all risks are of equal significance, with certain risks being at the lower end of the spectrum and others at the higher end, with significant risks of material misstatement being those at the far end. Auditors and firms have adopted methodologies that address the concept of a risk spectrum; however, different firms will likely have done this in different ways and may not in all cases include a specific categorization of "low inherent risk." Therefore, introducing the specific terminology of "inherent risk is low" and "inherent risk is not low," and using this determination as the driver of the auditor's response may cause confusion and differences in interpretation. DTTL believes that scalability will be more effectively addressed by the granular identification and assessment of risks of material misstatement using the approach outlined above, as well as the professional judgment of the auditor. For example, for simple accounting estimates with less complexity, lesser use of judgment by management, and lower levels of estimation uncertainty, this may lead to the identification of fewer risks or risks at the lower end of the risk spectrum; likewise, for difficult or complex accounting estimates that involve more use of judgment by management and have higher levels of estimation uncertainty, this may lead to the identification of more risks of material misstatement. Appendix I (see response to question 3) contains additional detailed observations and recommendations relating to scalability. The response in this area should be read in conjunction with DTTL's comments on Scalability in our cover letter, as well as DTTL's proposals on restructuring ED-540 (see detailed response to question 4 below), both of which DTTL believes will improve the efforts of auditors as it relates to scaling with respect to auditing accounting estimates. Currently, the "roadmap" for auditing accounting estimates that are "simple" is not clear in ED-540, and in DTTL's opinion will lead to confusion and misapplication in practice. DTTL also believes that providing examples of accounting estimates falling into specific inherent risk categories, such as those in paragraphs A72 (low inherent risk) and A73 (inherent risk that is not low) of ED-540, may negate the professional judgment to be applied by the auditor depending on the facts and circumstances of the engagement and different accounting estimates. These examples appear to create an expectation for the auditor to categorize and address the accounting estimates listed in these paragraphs in a prescribed manner. DTTL does not believe this is the underlying intent of the proposed standard, and would recommend striking paragraphs that suggest a prescribed response or an assumption that an accounting estimate is "simple." In addition, these examples also create the impression that the assessment of inherent risk is at the level of the estimate as a whole and not at the risk of material misstatement level. In reality, the number and nature of individual risks of material misstatement will vary for different estimates. The requirements and related application guidance do not clearly address this point or deal with how the auditor would be expected to develop an overall strategy for auditing an estimate where the related risks of material misstatement include risks that are assessed as "low" and others that are assessed as "not low." Further, when reading the application material DTTL is concerned with the added emphasis placed on "Considerations specific to smaller entities." While DTTL understands and acknowledges the use of such paragraphs throughout the ISAs to draw the auditor's attention to specific matters that may be pertinent to certain smaller constituents, the special considerations applicable to auditing accounting estimates do not seem to lend themselves to being identified by the size of an entity. Rather, identifying and assessing risks of material misstatement is required irrespective of the size of an entity (and a very small entity could have difficult or complex accounting estimates with more complexity, involve more use of judgment by management, and have higher levels of estimation uncertainty).
24.	EYG*	We recognize the introduction of a differentiation in the prescribed work effort based on the inherent risk assessment to be a new approach within the ISAs to explicitly address scalability of the auditor's procedures. We implemented a very similar approach in our EY Global Audit

		Methodology two years ago, under which we have prescribed procedures to address estimates with higher inherent risk. Our experience in practice has been that greater prescription in audit procedures for estimates with higher inherent risk promotes greater consistency in the nature of the work performed, in particular as it relates to evaluating estimation uncertainty, and focuses the auditor's attention on these higher risks of material misstatement. As it relates to lower risk estimates, we have found that allowing greater auditor discretion in the approach to auditing these estimates to be appropriate. In considering ED-540, we believe further clarity is needed to fully implement the proposed risk-differentiated approach and for auditors and stakeholders to understand the IAASB's intentions for the scalability of the standard. Based on our experiences and input from our auditors on how ED-540 may be implemented in practice, we have the following observations and suggestions: • In regard to the risk assessment procedures, the guidance from ISA 315 (Revised) within paragraph A10 that summarizes considerations relevant to smaller entities when performing risk assessment is useful. However, for accounting estimates, we would suggest also putting such considerations in the context of the nature of the estimate. For estimates that are non-complex or have lower estimation uncertainty, whether in smaller entities or larger entities, entities are likely to have simpler business processes and, as a result, the effort to perform the risk assessment procedures also will be less for these estimates in comparison to estimates of greater complexity. • In regard to paragraph 15, it is not clear whether (a) or (b) applies when the inherent risk assessment for the estimate varies across the relevant assertions. For example, for some accounting estimates, the inherent risk assessment for the valuation assertion may be "not low", but the assessment for the other relevant assertions may be "low". • We appreciate the flexibility provided in paragraph 15 (a) for the auditor to determine which testing approach is appropriate in the circumstances when inherent risk is "low" for the estimate. However, there is limited guidance in the standard on how the selected testing approach may relate to the prescribed work effort in paragraphs 17-20 for estimates with "not low" inherent risk. In order to achieve consistency in how auditors address "low" inherent risk estimates, we believe clarification is needed. In our view, when the auditor determines to take the approach of developing an auditor's range for a "low" inherent risk estimate, the requirement in paragraph 20 that addresses the development of auditor ranges should apply. In addition, the application material that addresses the evaluation of management's point estimate when either an auditor's point estimate or range are used should apply. Similarly, when the auditor selects the approach of testing how management made the estimate, we believe the objectives in paragraphs 17-19 are relevant to the auditor's design of further audit procedures. We would expect, however, that the extent of effort and the persuasiveness of the evidence obtained from the further audit procedures is less for estimates with "low" inherent risk (see further comments regarding our views on paragraphs 17-19 in our response to Q4).
25.	GTI*	**We acknowledge the IAASB's efforts with respect to scalability by requiring that estimates be categorized as "low inherent risk" and "not low inherent risk." However, ED 540 does not provide guidance on whether it is possible to have an estimate that is "material only" (i.e. an estimate above the determined materiality level for the audit that has little or no assessed risk) and if so how the auditor would differentiate between an estimate that is low risk and an estimate that is material only. For example, it is common for an entity to record property, plant and equipment in its balance sheet, on which a depreciation charge is required to be calculated as an estimate of the use of that asset. Depending on the relative size of the property, plant and equipment balance,**

		the depreciation calculated may result in a charge in the financial statements that is above the determined materiality for the audit. However, based on the nature of that property, plant and equipment, the well-established parameters for determining the useful life of that category of asset and the lack of complexity to the calculation, it may be determined that little or no risk attaches to this estimate. As such, it is possible that the depreciation charge would be considered to be material only. We are therefore of the view that the IAASB should clarify the application of these requirements in order for auditors to appropriately and to consistently apply the revised standard. We are of the view that the revisions to ED 540 do provide some level of flexibility and scalability through the separation of estimates between those that are low inherent risk and those that are not low and by providing different levels of required work effort based on those categorizations. However, by setting a threshold of low, there is a risk that this will detract the auditor's attention from performing the necessary audit procedures to obtain sufficient appropriate audit evidence over the estimate, to focusing on the classification of the estimate into the category of either low or not low. A further challenge may arise for auditors in evaluating whether the results of the audit procedures performed cause a re-evaluation of the initial determination of the estimate's category from the low risk category to the not low risk category or vise-versa. We also make the following observations in respect of the proposed revisions: Risk of Material Misstatement • Separating estimates between those that are of low inherent risk and those that are not low may imply that all estimates have to be addressed by the auditor, irrespective of their materiality. If the intention was not to require all estimates to be addressed by the auditor, it is not clear if this could create a new category of "less than low" or remote risk. • The move to an assessment of inherent risk, rather than the overall risk of material misstatement, in the determination of the risk of the estimate and, accordingly, the resulting work effort, is generally a departure from current requirements in other standards, which allow a starting point of risk of material misstatement. Consideration needs to be given to weighing the cost of training staff in respect of these potential methodology changes against any potential perceived benefits. • The risk assessment process as described in ED 540, and how the auditor is expected to respond to the assessed risk is unclear. The discussion in the Explanatory Memorandum, particularly paragraphs 26(d) and 28 are helpful in clarifying what appears to be the intention of the IAASB in this area. We would recommend consideration of including some of this text in the standard itself. • Paragraph 10(f) of ED 540 requires the auditor to gain an understanding of each of the components of internal control as they relate to making accounting estimates. Whilst these are important considerations, it is not clear whether this is incremental to the requirement of ISA 315 (Revised); whether specific documentation is required of how each element of control addresses estimates or whether this is a duplication of the requirements contained within ISA 315 (Revised). The results of field-testing also indicated that it was not always clear exactly what the auditor was required to gain an understanding of. Inherent Risk is determined to be Not Low • ED 540 requires the auditor to evaluate whether the risk of material misstatement of the estimate is due to (1) complexity, (2) judgment or (3) estimation uncertainty. If one or more of these factors are present, then the auditor must design procedures to provide evidence about matters related to each of those factors. However, where the inherent risk of the estimate is determined to

		be not low, the proposed construct of paragraphs 14 and 15 of ED 540 make it unclear whether the auditor is still required to choose one of the three basic approaches (outlined above) and perform the additional testing required by paragraph 17-20 in the context of that overall approach. This is important because extant ISA 540 requires the auditor to choose from these same three basic methods without acknowledgement that the best approach to responding to the risk of material misstatement posed by an estimate may be a combination of all three methods, each aimed at the drivers of risk. That is, once the auditor identifies the key sources of complexity, judgment and estimation uncertainty, the auditor should be free to design the most appropriate responses to those risks. We recommend drafting language to clarify that on developing further audit procedures for estimates of not low risk the auditor: 1. Responds to that risk at the account / assertion level by using one of the three basic approaches. 2. Selects the appropriate procedures, based on the identified driver(s) of the assessed risk of the estimate that achieve the objectives in paragraphs 17-19. • Further, where the estimate is determined to be of not low inherent risk, we recommend clarification of whether the intention was to require the auditor to verify management's process for each of these estimates. • Paragraphs 17-19 of ED 540, despite being presented in terms of required outcomes, will more likely be interpreted as a checklist of individual audit procedures that are required to be performed in order to obtain sufficient appropriate audit evidence over an estimate. This may limit the ability of the auditor to exercise professional judgment in designing audit procedures that are appropriate to respond to the risk presented by the specific facts and circumstances of the estimate. Whilst we support revisions that promote the application of professional skepticism, it would be preferable if this enhancement could be achieved without detriment to the auditor's ability to exercise professional judgment. • We would also recommend that further guidance is developed with respect to the application of paragraphs 17-19 of ED 540 in the context of the basic approaches. For example, it is not clear how these procedures would be applied in situations where the auditor is developing an independent estimate. • In circumstances where sufficient appropriate audit evidence for the accounting estimate is obtained through the performance of subsequent events, or through the development of an auditor's point estimate, the requirements in paragraphs 17-19 may potentially be implicitly addressed. It is unclear whether paragraph 15(b) is addressing this situation by stating that "audit evidence about the matters in paragraphs 17-20 should be obtained when applicable." We would therefore recommend that this be clarified either in the requirement or with further application material.
26.	KPMG*	**(2) The work that the auditor needs to perform to test accounting estimates** **Some regulators have highlighted, for example, deficiencies in:** **a. Evaluating the appropriateness (and reliability) of the methods/models used to make accounting estimates;** **b. Evaluating the reliability of the data used to make accounting estimates;** **c. Evaluating the reasonableness of assumptions used to make accounting estimates, in particular significant assumptions; and**

		d. Evaluating the design and operating effectiveness of internal control over the methods/models, data and assumptions. **We believe that ED-540 needs to do more to directly address these issues. Specifically, we found that:** **— The approach used to make ED-540 scalable (i.e. using a "low inherent risk" threshold) and enhance the auditor's response by distinguishing between the three risk factors (i.e. complexity, judgment and estimation uncertainty) to be confusing, overly complicated and difficult to operationalise.** **Our initial impression of the approach taken by the PCAOB in its proposed auditing standard on accounting estimates to address scalability and enhance the auditor's response is that it is more intuitive because it is consistent with how management makes the estimate and how audit evidence is available. We encourage the IAASB to consider the merits of this more simplified approach.** **— ED-540 appears to be overly complicated for auditing relatively simple estimates;** **— There is a lack of clarity around how ED-540 specifically interacts with ISA 330;** **— ED-540 could benefit from additional guidance on how to apply its requirements when auditing accounting estimates (either for the simple or more sophisticated estimates). We note that some of the useful practical guidance that exists in extant ISA 540 has not been retained; and** **— Further consideration is needed in addressing the challenges related to evaluating the reliability of external information sources.** We have a number of concerns with respect to scalability of ED-540, which are outlined below. Our response to this question is divided into several sub-sections: — Risk assessment procedures and related activities — Identifying and assessing the risks of material misstatement — Responses to the assessed risks of material misstatement 3(a) Risk assessment procedures and related activities Interaction with ISA 315 ED-540.10 requires the auditor to perform risk assessment procedures and related activities to obtain an understanding of certain matters relevant to accounting estimates and related disclosures. The interaction between these requirements and those outlined in ISA 315 is not clear. ISA 315 is a foundational standard and the requirements in ED-540.10 should clearly build upon (not change or supplement) those in ISA 315. The lack of clear interaction may create the impression of another layer of risk assessment and/or may result in certain requirements being interpreted in isolation rather than in combination with related requirements in other ISAs. Consequently, we believe the interaction needs to be made more clear and explicit.

		Our comments below illustrate specific areas where the interaction between ED-540 and ISA 315 may need to be clearer. Extent of understanding - general ED-540.A9 elaborates that, in performing the procedures required by ED-540.10, the auditor's primary consideration is whether the understanding obtained is sufficient to: — Identify and assess the risks of material misstatement; and — Plan the nature, timing and extent of their further audit procedures. We believe there could be significant differences in interpretation with respect to the extent of understanding the auditor is required to obtain over accounting estimates. For example, some of the requirements can only feasibly be applied at the financial statement level (e.g. 10(c) and (d)), whilst others could be more easily applied to the individual accounting estimate (e.g. 10(a) and some of 10(e)). This lack of clarity may result in differing interpretations as to whether ED-540.10 is applied to each accounting estimate or to accounting estimates as a whole. ED-540.A9 and the references to "accounting estimates" in ED-540.10 imply that the auditor is not required to specifically address each requirement for each individual estimate. However, we believe ED-540 should be clarified regarding this matter. Our view is that the auditor should use professional judgment to determine the extent of understanding they need to obtain for the purpose of identifying and assessing the risks of material misstatement, which could vary significantly depending on the nature of the different estimates in the financial statements. We also note that ISA 315.18(e) requires the auditor to understand the financial reporting process used to prepare the entity's financial statements, including "significant" accounting estimates and disclosures. This appears to be inconsistent with the scope of the requirement in ED-540.10(e). We believe it is necessary to provide further clarification in this area including with respect to the interaction between ISA 315.18(e) and ED-540.10 and the meaning of "significant" accounting estimates. Extent of understanding - specific considerations for estimates with very little or no estimation uncertainty at the time that the audit is performed ED-540.9(a) defines an accounting estimate as "a monetary amount…the measurement of which is subject to estimation uncertainty." ED-540.A75 states that "The auditor's assessment of the risks of material misstatement at the assertion level may be informed by events occurring after the date of the financial statements. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise, when relevant, inherent risk as low, regardless of the extent to which the accounting estimate was subject to, or affected by, complexity, the need for the use of judgment by management or estimation uncertainty at the time management made the estimate." We believe that when the outcome of an accounting estimate may become known, in certain circumstances, this may enable the auditor to conclude that there is no longer a reasonable possibility of a risk of material misstatement related to estimation uncertainty. It is unclear whether the language in ED-540.A75 is suggesting that an accounting estimate subject to, or affected by, complexity, the need for the use of judgment by management or estimation uncertainty at the time management made the estimate always has a reasonable possibility of risk of material misstatement related to estimation uncertainty, or whether it is simply trying to make the point that, when the outcome of an

		accounting estimate may be known, it is more likely that inherent risk would be assessed as low and the requirements in ED-540.17-20 would not apply. Consequently, we believe clarification is needed with respect to the extent of understanding that the auditor needs to obtain with respect to accounting estimates that are expected to be subject to no or very low estimation uncertainty at the time the audit procedures are planned to be performed. For example, if, when planning the audit, the auditor has a reasonable basis for expecting the outcome from management estimates such as provisions for litigations and claims, purchase accruals or management bonuses to be known when the auditor plans to perform audit procedures, and the auditor expects that this known information will be highly relevant to the estimate made at the measurement date, what would be the extent of understanding required by the auditor? We believe that if the auditor's assessment is that estimation uncertainty is expected to no longer represent a reasonably possible risk of material misstatement when the procedures are planned to be performed, then the auditor would not need to obtain a detailed understanding of how the accounting estimate had been made. Additional application guidance could clarify that: — The fact that the outcome of a management estimate is expected to be known when the audit procedures are planned to be performed does not necessarily mean that estimation uncertainty no longer represents a risk of material misstatement. For example, the disposal of a "hard to value" financial instrument measured at fair value several months after the reporting date may provide an indication of fair value at the reporting date, but the auditor would need to consider whether the financial instrument's fair value could have been significantly impacted by changes in market conditions or other factors between the reporting date and the date of disposal. If this was a reasonable possibility, then estimation uncertainty may still represent a risk of material misstatement at the time that the auditor's procedures are performed; and — When the auditor performs testing, the auditor would need to reassess whether the initial assessment that estimation uncertainty does not represent a reasonably possible risk of material misstatement is still appropriate. For example, if when the auditor starts to perform testing on purchase accruals, and the auditor determines that a significant number of supplier invoices are unexpectedly still outstanding and a number of management's estimates for purchase accruals remain, then the auditor's reassessment of the risk of material misstatement related to estimation uncertainty may lead the auditor to conclude that more work needs to be performed to obtain a better understanding of the risks. Extent of understanding - internal control ED-540.10(f) requires the auditor to understand the components of internal control as they relate to making accounting estimates, which includes control activities. We believe clarifications are necessary related to this requirement. Specifically, the footnote to this requirement references ISA 315.14-24. However, ISA 315.12 makes it clear that the auditor obtains an understanding of control "relevant" to the audit. ISA 315.A100 elaborates that control activities that are relevant to the audit are those that relate to significant risks, those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence and those that are considered to be relevant in the judgment of the auditor. We believe the application guidance related to 10(f) needs to make it clearer that the requirement to understand control activities is consistent with ISA 315.A100 and therefore that the footnote needs to refer to ISA 315.12-24.

		Retrospective Review Consistent with extant ISA 540, ED-540.11 requires the auditor to review the "outcome" of accounting estimates included in the previous financial statements or their subsequent re-estimation. Although this requirement has not substantially changed from extant ISA 540, we do not believe there is consistent interpretation of the extent of procedures the auditor needs to obtain to perform to review the "outcome" of accounting estimates. In particular: — It is difficult to judge the extent of work necessary as it relates to long tail estimates as the outcome may not be known. The new application materials added has not provided sufficient guidance related to these matters. We believe it would be beneficial to provide further application guidance to clarify the work effort related to long tail estimates; — Paragraph ED-540.A63 states that a retrospective review of management judgments and assumptions related to "significant" accounting estimates (reflected in the prior year financial statements) is required by ISA 240 and that this review may be performed concurrently with the review of the prior period accounting estimates in ED-540.11. We believe it is necessary to provide further clarification application guidance in this area as to whether the retrospective review requirement in ED- 540.11 is required for all estimates or all "significant" accounting estimates. We believe it would also be useful to clarify the meaning of "significant" accounting estimates, which is not currently defined in ISA 315. Furthermore, with changes to financial reporting frameworks resulting in the emergence of increasingly sophisticated and subjective estimates, such as impairment provisions for loans measured using the expected credit loss model and insurance liabilities, we believe it will become increasingly difficult to apply this requirement. For example, a provision for impairment losses for loans at a large bank could be made up of individual estimates for each loan portfolio, with each of these estimates relying on multiple models to derive the estimate, and with each model likely having multiple judgments, assumptions and sources of data underlying them. It is unclear without further guidance how much work the auditor would need to undertake to satisfy the retrospective review requirement, particularly when the estimate is made at a point in time and is not affected by subsequent events. In addition, management of a large bank would likely have a process and internal controls to assist them with identifying the need for a change from the prior period in methods, assumptions or data used in making the estimate. As ED-540.10(e)(vii) requires the auditor to understand how management has addressed the need for a change from the prior period, if the auditor has understood management's process and believes it is sufficient to enable the auditor to identify and assess risks of material misstatement, then it may be unclear (e.g. when it is a recurring estimate) why the auditor would still be required to perform a retrospective review as an incremental risk assessment procedure. We believe further consideration should be given to the scope of the retrospective review requirement and that further application guidance should be added to clarify the work effort for the more sophisticated estimates. 3(b) Identifying and assessing the risks of material misstatement ED-540.13 requires the auditor, in identifying and assessing the risks of material misstatement, to take into account the extent to which the estimate is subject to, or affected by, one or more of the following factors:

— Complexity

— The need for use of judgment by management

— Estimation uncertainty

Distinguishing between these three risk factors is difficult given they are frequently interrelated and relatively broadly defined. Further, as an accounting estimate is defined in ED-540.9(a) as a monetary amount subject to estimation uncertainty, it is not clear how “estimation uncertainty” can be a distinct factor on its own, rather than a result of complexity, a need for judgment or a combination of both.

We also believe that all three risk factors will often be relevant to most accounting estimates, although the magnitude of the impact each factor may have on the estimate could vary significantly. Consequently, it is uncertain how often the auditor could avoid identifying at least two of the three as relevant risk factors. If this turns out to be the case, this could result in work effort that is not scalable to the risks of material misstatement.

We believe the auditor will likely resort to reviewing the objectives related to ED- 540.17-19 in an attempt to determine which risk factors are relevant to the estimate. However, as these more granular matters are organised by the three risk factors, rather than the different components of each estimate (data, assumptions and methods/models), this makes risk identification and assessment less intuitive for the auditor.

Consideration should be given to reducing the complexity of these requirements by instead requiring the auditor to understand different individual components of each estimate to identify and assess the risks of material misstatement (at a level more granular than the three risk factors).

Rather than requiring the auditor to separately consider the three relatively broad risk factors above (complexity, judgment and estimation uncertainty), we recommend more granular risk factors are developed, perhaps derived from the objectives outlined in ED- 540.17-19, and included as example risk factors in the application guidance. Organising these more granular risk factors based on the different components of each estimate (data, assumptions and methods/models) would better align with how management actually makes the accounting estimate and the way audit evidence is available, making risk identification and assessment more intuitive and streamlined.

3(c) Responses to the assessed risks of material misstatement

ED-540 has different requirements for responding to risks of material misstatement at the assertion level depending on whether inherent risk is “low” or “not low” for the purpose of scalability. This approach results in a number of issues:

Consistency with other ISAs

ISA 200.7 requires the auditor to identify and assess risks of material misstatement, which are comprised of inherent risk and control risk. ISA 200.A42 permits the auditor to make a combined assessment (there is no explicit requirement to assess inherent risk and control risk separately). Consequently, the requirement in ED-540.15 to separately assess inherent risk could be problematic for auditors that do not currently do this in practice as permitted by ISA 200. As other ISAs discuss the audit response responding to “higher” or “increased” risks of material misstatement, we believe it would be preferable to use these terms for consistency and because they are better understood.

Secondly, introducing a requirement to assess inherent risk separately for classes of transactions, account balances and disclosures that contain an estimate may raise questions as to whether this assessment is also required for classes of transactions, account balances and disclosures that do not contain an estimate.

Finally, we do not believe ED-540 clearly explains how the terms “inherent risk is low”, “inherent risk is not low” and “significant risk” interrelate. This may cause confusion as to whether inherent risk that is not low is the equivalent of a significant risk or is meant to capture a wider range of risks (we believe “inherent risk is not low” is intended to capture a wider range). We also believe that the approach of distinguishing the work effort between “low” and “not low” inherent risk creates an ambiguity with respect to the interaction between ED-540 and ISA 330 and ISA 500, as described further below.

Examples of low inherent risk

ED-540.A72 provides examples of accounting estimates that the auditor’s assessment of the risks of material misstatement may be based on low inherent risk.

We believe these examples should be reconsidered for the following reasons:

— Depreciation calculations for an entity using a single depreciation method for property and equipment and a relatively low level of additions and disposals.

We believe that estimation uncertainty for depreciation primarily arises from the selection of an appropriate method to allocate the depreciable amount on a systematic basis over its useful life, the estimate of the useful life and the estimated residual value at the end of the asset’s useful life. The fact that an entity has a single depreciation method and a low level of additions and disposals during a period do not seem to be particularly relevant considerations when identifying and assessing the risk of material misstatement related to estimation uncertainty.

— Accounting estimates that are based on data that is readily available - for example, translation of a cash balance that is held in a currency other than the reporting currency.

We believe that the inherent lack of precision associated with the measurement of an account balance of this nature would normally be so low that it is highly unlikely that an auditor would identify a reasonably possible risk of material misstatement related to this estimation uncertainty. The suggestion that the estimation uncertainty of a foreign currency denominated cash balance could on its own represent a reasonably possible risk of material misstatement could lead the auditor to conclude that there are almost no accounting estimates for which estimation uncertainty does not represent a reasonably possible risk of material misstatement. It may also suggest that all estimates other than the most simple would have inherent risk that is not low.

Further audit procedures

ED-540.15 has different requirements for further audit procedures depending on whether inherent risk is low or not low. When inherent risk is low, the auditor shall determine whether one or more of three audit procedures would provide sufficient appropriate audit evidence regarding the assessed risks of material misstatement (and perform further audit procedures if needed to obtain sufficient appropriate audit evidence). When inherent risk is not low, the auditor is required to perform further audit procedures to obtain audit evidence about the matters in ED-540.17-20. There are no requirements with respect to the procedures to be performed but ED-540.A97 suggests the three

		audit procedures in 15(a) may assist the auditor in obtaining audit evidence. There is limited guidance on how to perform these three audit procedures (some guidance in extant ISA 540 has been removed). This approach results in several issues: a. It is unclear how certain requirements interact with ISA 330 and ISA 500 and we believe the current wording could cause confusion with respect to the work effort required, particularly when inherent risk is assessed as low. For example, the objectives under ED-540.17-19 could be interpreted as meaning that the auditor only requires sufficient appropriate audit evidence for these objectives when inherent risk is not low. However, when inherent risk is low, we believe the auditor would still need to obtain sufficient appropriate audit evidence with respect to most of these objectives (but the persuasiveness of audit evidence would be less because the risk is lower). b. When inherent risk is not low, it is not clear whether the auditor is required to obtain sufficient appropriate audit evidence to address the matters under each of paragraphs 17, 18 and 19 if the auditor concludes, for example, that all three factors are relevant but only one or two of the three factors are the drivers of the higher assessed risk of material misstatement. If audit evidence does need to be obtained to address the matters for all relevant factors, regardless of whether they contribute to the higher assessed risk of material misstatement, then considering all three factors will be present in many estimates, it raises the question of what is the purpose of distinguishing between the three factors in the first place. c. We also find that the objectives under each of the three risk factors are not always intuitive. For example, ED-540.17(a) links whether the significant assumptions are appropriate in the content of the applicable financial reporting framework to complexity. It is not obvious what the link to complexity is in this example. d. As noted earlier, ED-540.15(b) does not prescribe the audit procedures to be performed when inherent risk is not low. However, several of the objectives for the factors seem to necessitate testing how management made the estimate to obtain audit evidence. For example, if the audit procedures in ED-540.15(a)(i) or (iii) were performed when inherent risk is not low, how would they provide sufficient appropriate audit evidence that management has appropriately understood or interpreted significant data or that management's judgments are appropriate in the context of the applicable financial reporting framework? ED-540.A97 states that the audit procedures performed need to be designed to address the matters in ED- 540.17-19. However, it is difficult to understand how some of these matters could be addressed if the auditor is not testing how management made the estimate. It is not clear whether the intention is to encourage the auditor to test management's process whenever inherent risk is not low, but it does appear that if an alternative audit procedure was performed, top up procedures would then be required to obtain sufficient appropriate audit evidence to meet certain objectives. If the intent is to encourage a preference for testing management's process, consideration should be given as to whether this is appropriate if alternative approaches may provide higher quality audit evidence (such as testing events after the reporting date). e. Finally, it is unclear whether ED-540.19 has any incremental work effort beyond that required to satisfy the objectives of ED-540.17-18. Suggested approach

		We believe consideration should be given to revising ED-540 as follows: a. Remove the requirement to differentiate between inherent risk of low and inherent risk of not low for scalability purposes and rather focus on the different components of the estimate (data, assumptions and methods/models) and how the specific relevant risk factors within these components impact the assessment of the risk of material misstatement (which, as noted in our response to 3(b), should be more granular). This would be broadly consistent with the approach taken in the PCAOB's proposed auditing standard on accounting estimates. b. ED-540.15 already notes that the auditor's further audit procedures shall be responsive to the reasons for the assessment of risk of material misstatement and the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be. It would be helpful to build on this requirement by making it clearer that when an estimate has a higher risk of material misstatement, whilst the general approach to auditing the estimate may be the same, the auditor would need to obtain more persuasive evidence to respond to the specific relevant risk factors identified. c. Remove requirements to obtain sufficient appropriate audit evidence to address the matters in ED-540.17-20 and instead focus requirements on the need to design an audit approach that appropriately responds to the specific risks identified. We believe that the "stand back" requirement in ED-540.22 could provide an extra "line of defence" to ensure that sufficient appropriate audit evidence has been obtained. d. Expand requirements and application guidance with respect to how the auditor perform the three audit procedures listed in ED-540.15(a) to obtain sufficient appropriate audit evidence.
27.	PKF	From an overall perspective, we believe the IAASB's intent is clear, and that ED-540 is mostly sufficiently scalable. We have some concern around the requirements in par. 10 not being particularly scalable. For example, the requirement to obtain an understanding of each of the components of internal control (par. 10 (f) should possibly be dependent on the related complexity, need for judgment and potential for bias (as referred to in par. 13), or other characteristics of the accounting estimates present. In the audit of an entity with very common and relatively uncomplicated accounting estimates, the requirements in par. 10 may be very difficult to comply with, especially for small and medium entities. While auditing is an iterative process and often difficult to describe in a linear fashion, we believe that the requirements in par. 10, as written, may not be completely scalable. The related application material provides considerations for small and medium entities, and provides further guidance which makes the requirements of par. 10 more scalable, but this is not immediately evident from the language used to state the requirements. This could further have unintended consequences regarding interpretation by audit regulators. Par. 11 on the other hand incorporates language which makes it more scalable when stating "The auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review." We suggest that par.10 should incorporate some of the considerations in par. 13 and an approach similar to that in par. 11. Paragraph 15 (a) requires, when inherent risk is low, that the auditor determine whether one or more of the listed further audit procedures would provide sufficient appropriate audit evidence. As written, these further procedures are only relevant when inherent risk is low. However, we believe that these same procedures may provide appropriate evidence, in combination with the considerations in par. 17-20, where inherent risk is not low. We suggest that par. 15(a) be required for all estimates, with additional procedures where inherent risk is not low.

		Further, the application guidance in par. A96 states that, if further audit procedures in paragraph 15(a) do not provide sufficient appropriate audit evidence, the auditor is required by ISA 330 to design and perform other procedures. We believe that the term "other" may not be consistent with other ISAs or be clear enough, and suggest replacing "other procedures" with "additional procedures responsive to the circumstances".
28.	PWC	• **"Low inherent risk" as a threshold for driving the extent of the auditor's work effort is not, in our view, an effective response to concerns about the scalability of the ISA. The three alternative "testing approaches" presented for low inherent risks apply to the response to any accounting estimate, not just those with low inherent risk. Furthermore, some of the "responses" for other than low inherent risks would be part of how the auditor can respond to a low inherent risk. Therefore, as our field testing showed, it is very unclear what the threshold actually achieves in practice.** **Bring scalability to life through application material rather than the proposed low inherent risk threshold** **We are very supportive of both the concept of scalability and of the objective of demonstrating scalability more explicitly in the revised ISA. But we do not believe that doing so through introducing a threshold of "low inherent risk" works. Simply stating that the auditor applies the options available under today's ISA does not bring the genuine scalability some are seeking.** **Scalability is, in our view, best addressed by establishing principles-based standards and allowing auditors to apply them by tailoring them to the circumstances and modifying the nature, timing and extent of procedures to be responsive to the assessment of risk. Using conditional requirements, and requirements focussing on where evidence needs to be obtained (rather than the specific procedures to obtain it), allows for appropriate tailoring to the circumstances.** **The best way to illustrate scalability in ISA 540 is through application material that can bring the scalability to life by demonstrating what might be an appropriate approach to a simple, non-complex estimate. For example, application material could be added to explain how events occurring up to the date of the auditor's report may provide robust evidence about the estimate, or how re-performing a simple straight forward calculation, such as depreciation, or using a simple, straightforward analytical procedure can provide reliable evidence for a less complex estimate, such as a basic bonus accrual.** We recognise and support the need to better articulate how the requirements of ISA 540 can be applied in a scalable manner to the very broad range of estimates that fall within the scope of the standard. But we do not believe that doing so through introducing a threshold of "low inherent risk" works. The results of our field testing indicated that auditors found paragraph 15(a) confusing because there was little guidance on how those approaches can be applied in a scalable manner. In their view, the approaches set out in paragraph 15(a) are applicable to the response to all estimates, not just those with low inherent risk, and they would ordinarily perform procedures to address some of the matters in paragraphs 17-19 even for those lower risk estimates. Overall, auditors were unclear on what is expected if selecting one or more of the approaches under this requirement. Furthermore, simply stating that the auditor applies the options available under the current ISA, absent any additional clarification of how the auditor applies those approaches in a scalable manner, does not, we believe, bring the genuine scalability some are seeking. Scalability is, in our view, best addressed by establishing principles-based standards and allowing auditors to apply them by tailoring them to the circumstances and modifying the nature, timing and extent of procedures to be responsive to the assessment of risk. Using conditional

		requirements, and requirements focusing on where evidence needs to be obtained (rather than the specific procedures to obtain it), allows for appropriate tailoring to the circumstances. We suggest that the application material could better illustrate scalability in responding to assessed risks through providing further explanation and examples about what may be involved in obtaining sufficient appropriate evidence for simpler accounting estimates. For example: • how events occurring up to the date of the auditor's report may provide robust evidence about the reasonableness of the estimate, • re-performing a simple calculation, such as depreciation, or • using a simple, straightforward analytical procedure to obtain evidence about a less complex estimate, such as a basic bonus accrual. Removing the low inherent risk threshold will, in our view, also eliminate the very significant potential for subjective disagreements between auditors and audit inspection bodies as to the auditor's determination of whether a risk is, or is not, subject to low inherent risk. What is of more importance than such a label is whether the audit response is commensurate to the assessed risk. Recognising that risks exist along a spectrum, we believe it is preferable to reinforce the principle, as set out in the second part of proposed paragraph 15, that the higher the assessed risk the more persuasive the audit evidence needs to be. As suggested above, this could be brought to life in examples within the application material. We also believe that a more prominent focus on testing events subsequent to the balance sheet date, when those provide sufficient appropriate audit evidence alone, would boost the perception of scalability.
29.	RSM	Yes, we consider that ED540 is sufficiently scalable and we generally support one ISA to deal with the wide range of estimates. The focus on inherent risk by considering complexity, judgment and estimation uncertainty will assist in this because smaller entities may well have only the less complex accounting estimates to deal with. However, we have some conceptual reservations about the way in which this assessment has been implemented as set out in Q4 below. Paragraph 10 is particularly useful in directing auditors to the risk assessment requirements however the length of the standard may add to a perceived problem regarding scalability for smaller entities. In particular, paragraph 10e seems to assume that all entities have robust procedures for making each individual accounting estimate. At best, smaller entities may only have these procedures at entity level and in many cases they will be undocumented and informal.
30.	SRA	
Public Sector Organizations		
31.	ACAG	In theory the separation of required responses according to assessed risk and, where risk is not low, according to whether, all or a combination of factors exist, provides a useful framework. In this respect, the ED is scalable in as much as it limits or expands audit considerations to relevant matters. In saying that, ACAG does not believe the ED is as scalable in practice as the theory may allow. In practice most estimates, unless clearly immaterial:

		• have higher than low inherent risk ratings and further audit procedures will therefore always be required • involve a combination of judgement, complexity and estimation uncertainty—these three elements being inextricably linked, and the first two being causally related to the third. In practical terms therefore, it may be difficult to discern or unwind and analyse each element in isolation, potentially leading to most estimates being designated as 'significant' risks. It would be useful to include in the standard further guidance on what factors, alone or in combination, may lead the auditor to judge the risk as significant.
32.	AGA	Scalability could be improved. It is useful to specifically communicate that estimates may be low risk. There is perhaps too much emphasis, caused in part by ISA 315, that estimates are automatically medium or high or significant risks. Scalability would be better achieved by not being as proscriptive in paragraph 15 about what audit procedures the auditor shall do in low risk situations. For example, there may be procedures other than 15 (a) (i) (ii) or (iii) that would be as appropriate, such as comparing budget to actual results and investigating variances. As well, it is unclear how in practice 15(a)(ii) differs from paragraph 17. Some auditors may interpret the two categories (low, other than low) as implying that auditors should not use more than two categories in assessing risk. But auditors may use different scales of risk (e.g. 5 scales: low, normal, medium, high, very high), or a numeric scale such as 1-10. Could auditors do only some of the procedures in paragraphs 17-20 if risk was other than low, or are they required via the wording in paragraph 15(b) to do all the procedures in paragraphs 17-20 if they, under their own methodology, conclude risk is "normal" or "medium," and would do only every procedure in paragraphs 17-20 if risk was "high" or "very high"?
33.	AGC	No, ED-540 is not sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk. The proposed standard is prescriptive on procedures the auditor must perform on "low" and "not low" risk. This reduces the auditor's discretion to apply professional judgement on nature and extent of work within these two categories. This reduction reduces scalability.
34.	AGNZ	**3 Confusion around the applicability of ED-540 to all situations** **What is meant by "scalable"?** **3.1 In seeking comments on ED-540, the IAASB has specifically asked "Is ED-540 sufficiently scalable with respect to accounting estimates, including when there is low inherent risk?" The term "scalable" is not defined in any standard, and in our view, there is a lack of clarity around what is intended by the IAASB in using it.** **3.2 In our experience, when auditors consider the concept of an audit being "scalable", it is applied with reference to the level of audit work required in response to the level of risk and complexity of the audit (that is, less risk means less work required).** **3.3 The distinction auditors are required to make between "low" and "not low" inherent risk appears to be overly simplistic and does not adequately reflect the full breadth of potential risk assessments. By creating a threshold based on inherent risk assessment, with the designations being either "low" or "not low", it is our view that the balance of work required has been inappropriately shifted. Especially when compared to the approach required in other standards, where additional audit procedures must be designed and performed only where significant risks are identified.**

		3.4 The model should be reconsidered. We believe that more balance would be provided by drawing a distinction between inherent risks that are assessed as either "high" or "not high". Alternatively, the distinction should be consistent with other auditing standards where the risk is assessed as "significant". **3.5 We agree that some of the changes proposed should enable auditors to develop a more scalable approach. For example, paragraph 15 no longer requires the auditor to undertake at least one of the listed procedures. Instead, the auditor is required to determine which of the procedures are appropriate.** **3.6 However, it is not clear that ED-540 will result in audit effort being directed to the areas of greatest risk. We believe that there is a risk that a disproportionate amount of time could be spent on risk assessment activities.** No, please refer to our comments at section 4 in the main body of this submission. 4 **An inconsistent approach to risk assessment**[1] 4.1 The auditor's assessment of risk is fundamental to planning and performing appropriate audit procedures. It is crucial for concepts to be clearly understood so that they are consistently applied. 4.2 We are concerned that the assessment of risk in ED-540 is not clear. It is confusing that ED-540 refers initially to significant risk,[2] but later refers to inherent risk. 4.3 We are also concerned that the assessment of risk in ED-540 is not consistent with other standards. ISA 200 clearly states that the inherent risk should be assessed "*before consideration of any related controls*", but ED-540 appears to contradict this, through the requirements of paragraph 10(f) referred to in 3.8 above. 4.4 Paragraph A42 of ISA 200 also goes on to state that "*the ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the 'risks of material misstatement'*." ED-540, however, clearly sets an expectation that the inherent risk is assessed separately, after considering the components of internal control as they relate to making accounting estimates.
35.	CIPFA	CIPFA was generally content with the approach to scalability in the extant ISA 540. However, we accept stakeholder suggestions that there may be difficulties in operationalising this effectively, and regulator representations which suggest that extant ISA 540 is not being applied correctly, resulting in both under and over audit. Against this background, we support the revised approach based on considering whether an accounting estimate is subject to low, or other than low, inherent risk.

[1] When inherent risk is not low (see paragraphs 13, 15 and 17-20): *Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?*

[2] See paragraph 13 of ED-540.

36.	GAO	We believe that auditors should determine whether one or more of the audit procedures listed in paragraph 15(a) would provide sufficient appropriate evidence whether inherent risk is low or not low. In our view, the standard will be scalable if auditors assess and respond to risk of material misstatement and focus on the standard's objective to obtain sufficient appropriate evidence.
37.	INTOSAI	Public sector considerations: The guidance provided in paragraph A10 for smaller entities may not always apply to smaller entities in the public sector. In the public sector, it is not uncommon for smaller entities to make significant accounting estimates. Smaller entities sometimes present a higher inherent risk of error due to lack of skills and competence, and the size of the entity is not necessarily a determining factor for assessing risk. Other comments: It is unclear whether the risk assessment requirements in paragraph 10 (a-f) should be applied for all the estimates or just those that are significant. When considering scalability and effectiveness, the question is whether it is relevant to proceed to paragraph 10f) if the auditor concludes that the estimate is not material nor significant (nor complex). The required audit procedures for items assessed as a low inherent risk, especially the requirements for testing set out in paragraph 15a) 9ii) could more clearly differentiate how the auditor's work effort will differ based on their risk assessment. Further, while specific requirements for audit procedures are suggested for low inherent risk areas, ISA 315 and ISA 330 emphasize audit procedures for areas with risk of material misstatement and not those with low risk. This inconsistency may impede the application of the proposed standard. We suggest further explanation and guidance on this matter in the proposed standard and/or conforming amendments to other ISAs.
38.	PAS	We are uncertain if ED-540 is sufficiently scalable with respect to auditing accounting estimates and support piloting the proposed standard to confirm it is.
Prepares of Financial Statements		
39.	ABA	
Member Bodies and Other Professional Organizations		
40.	ACCA-CAANZ	**Insufficient or inappropriate work effort** **We recognize that it is important that auditors perform an appropriate level of work when auditing estimates and that the change from 'significant risk' to 'not low inherent risk' as the trigger for determining the work effort required by the auditor is an attempt to address this issue. However, our members have significant concerns that this will drive auditors to performing excessive work on estimates. Too much work in relation to an estimate, when it is not warranted by the nature of the estimate, has the potential to negatively impact audit quality, just as too little work can. ED-540 states that at times auditors may not identify and assess risk at a sufficiently granular level. However a blanket increase in work effort is not appropriate either. We believe that the key areas which need to be addressed in order for the final standard to appropriately direct the auditors' work effort are:**

		• **Implementing a mechanism for evaluating the risk of the estimate (and thereby determining subsequent work effort) that is more flexible and is consistent with the concepts in ISA 315. The introduction of the low/not-low inherent risk concept is not useful. Our members' view is that it would be difficult to find many estimates that would not be categorized as 'not low' inherent risk, given the fundamentally judgmental nature of estimates. This is as true for the audits of very small entities as it is for the audits of large, listed companies. This will result in a higher than necessary level of work for many simpler estimates. It is also potentially confusing to have a mismatch between risk assessment as discussed in extant ISA 315 (based on significant risk of material misstatement) and 'not low' inherent risk in ED-540. The use of inherent risk to determine the auditor's procedures in relation to estimates is inconsistent with the approach taken in other standards, it is unclear which concept of inherent risk is being used and a lack of recognition that inherent risk is difficult to assess objectively in practice.** **Ensuring the standard is scalable. The ED lacks scalability. There is no recognition that there is scale of risk in relation to estimates and there seems to be little flexibility in how auditors address complexity, judgement and estimation uncertainty for any given estimate. ED-540 seems to be focused on complex estimates of the kind dealt with in the financial services industry and lacks guidance for auditors dealing with less complex estimates in other industries. Without scalability, the standards will force unnecessary work effort by auditors which will adversely impact audit quality as discussed above.** **Preferred approach** **In order for a revised ISA 540 to address the concerns raised, we recommend that the proposals in ED-540 be revised with a focus on:** • **Scalability via an appropriate measure for identifying and assessing the risk of the estimate and subsequently driving the work effort. This may be using significant risk (to ensure the revised standard is consistent with ISA 315) or a combination of significant risk and other factors that impact risk of material misstatement to allow for further granularity in addressing estimates appropriately. Appropriate guidance will be needed in the application material to help practitioners apply ED-540 consistently in respect of all sizes of entity.** • **Scalability via clear language in relation to the work effort in relation to each of the three factors – complexity, judgment and estimation uncertainty – if these are retained as separate elements. Also a clearer articulation of the auditor's ability to select the aspects of these elements that need to be addressed for a particular estimate and design appropriate procedures.** No. As discussed in our general comments, we believe that the ED is not sufficiently scalable and will drive auditors to an increased work effort and a compliance driven approach to auditing estimates that will not address the concerns raised in relation to ISA 540. We have made some suggestions as to how the necessary scalability might be achieved in our overall comments and responses to Question 4.
41.	AE	**(9) Moreover, we recognise the IAASB's attempt to address scalability in ED-540. Although the proposal may be a step in the right direction, we have some concerns that it will not achieve the level of scalability that is desired. One example of this is with regards to paragraph 10, which on one hand provides a good framework for assessing the inherent risk of an estimate, but equally creates a significant work effort even in cases where the estimate is clearly of a low inherent risk.**

		Equally, we are also concerned that requirements in paragraph 10 (f) create confusion as to the extent to which the auditor should consider internal controls, and the benefit of doing so in those cases where the auditor has reason to believe inherent risk is low. With the inherent risk consideration as a cornerstone of the revised standard approach, the extent of and reasons for auditor's work on the internal control assessment needs to be clear. Considering audits that may have to deal with a large number of low inherent risk estimates, both of these matters could create a significant work effort for which the value is unclear. We draw your attention to our response to question 3 that expands upon this point. We recognise the IAASB's attempt to properly address scalability in ED-540. The delineation for estimates of low-inherent risk is a practical approach that we favour. Including such a threshold clarifies the requirements for low-risk accounting estimates and is intended to help ensure that estimates assessed as low inherent risk are not subject to inappropriate audit procedures and that the work effort is focussed on those risks that have been evaluated as being other than low. Whilst some explanation in the introduction to ISA 540 is helpful, the wording included in paragraph 3 implies that the more extensive requirements apply to almost all financial statement line items. We do not believe this was the intention and, as such, the wording of this paragraph should be made clearer. The procedures listed in paragraph 10 provide a practical framework for risk assessment. However, even though these are clear, the fact that the auditor needs to prescriptively undertake all the procedures is cumbersome. The following related matters should be considered: firstly, there is no 'shortcut': even if it is clear and obvious that the estimate is of low risk, all procedures listed in paragraph 10 still have to be complied with. Secondly, it is unclear as to the extent of work required by paragraph 10 (f) related to controls and the value that this would bring to the audit in all instances, but especially when the auditor has reason to believe the inherent risk is low. Both matters could impose significant burden for non-complex SME audits which might have proportionately more low inherent risk estimates than complex larger entities. We understand that ISA 540 should be an application of ISA 315 and thus the introduction to paragraph 10 of a reference to the ISAs being founded upon an overriding principles-based framework, along with a list of potential procedures that might be advantageous. We also ask the IAASB to clarify if it should be understood that most SME audits have many low risk estimates. As this aspect is insufficiently clear, the issue of scalability has therefore, at best, only partly been addressed by the proposals. More relevant examples of better quality should be provided of the types of estimate and circumstances that might be evaluated as low risk. The interaction with the applicable financial reporting framework is important; albeit we acknowledge not under the control of the IAASB. Accounting frameworks applicable to SMEs are becoming more and more complex resulting in the creation of more complex accounting estimates in these entities. Preparers and users of financial statements start questioning the value of some of these complexities - which are often far removed from the key drivers of the business, such as operating profits leading to cash generation. Such estimates are for example those relating to certain intangible assets or financial instruments. It is likely that, under the proposed ED-540, such estimates would be considered not of low inherent risk. The result is likely to be that for the whole reporting chain that includes the preparer, the user and the auditor, the audit work effort will be considered as disproportionate. As already noted, the root cause likely lies with the accounting framework, but as views on the scalability of ISA 540 is likely to be linked to this, it is important to draw the attention of the IAASB to it. The above could perhaps be mitigated to some extent if the IAASB would reinforce the need to look at the concept of 'material misstatement' from the users' perspective. For instance, an accounting estimate may have inherent risk that is low not because the measurement uncertainty is low, but because the issue does not influence the economic decisions of the users of the financial statements.

		Expanding on the point made above, some amendments to the wording of the work effort should be considered when the inherent risk is low. According to paragraph 15 of the proposed requirements, the auditor is not required to design and perform test of controls. Nonetheless, in paragraph 10 (f), when discussing about the risk assessment procedures and related activities, the auditor is required to obtain an understanding of each component of internal controls in relation to accounting estimates. These will likely require quite detailed analysis and could create significant amount of work in respect of 'low inherent risk' accounting estimates. We do not believe this was the intention, but it creates at least confusion as to whether the auditor should consider internal controls or not when inherent risk is low. We suggest as a minimum that this ambiguity be removed and that the IAASB consider whether there would be any value from the auditor undertaking step 10 (f) in all instances, but especially when the auditor has reason to believe the inherent risk is low. In addition, the extensive related application material is largely applicable to larger audits and the only reference to the need for auditors to understand controls relevant to the audit (as required by ISA 315) is in paragraph A100 and even then, only in the context of 'very small entities'. The absence of reference to controls 'relevant to the audit' in paragraph 10 (f) has the effect of overstating the case. Paragraph A100 errs on the side of caution in this respect stating that controls may not be relevant to the audit in audits of all sizes. There is also a difference in volume of material in the standard between the sections dealing with low inherent risk and not low inherent risk. We acknowledge the examples provided in the application material in paragraph A72, where the auditor's assessment of the risk of material misstatement may be based on low inherent risk but note that, even in these selected examples, depending on the facts and circumstances, an accounting estimate might result in being an inherent risk that is not low. For instance, regarding bonus accrual for management, we would argue that there is an increased risk of management bias where the profitability of the entity may affect the accounting estimate (namely their bonus) which will lead to the conclusion that the inherent risk is not low. To avoid any possible misinterpretation of these examples, we suggest including a sentence in paragraph A71 to reflect how important it is for the auditor to consider the specific facts and circumstances before concluding if an inherent risk is low or not low. Also, the IAASB should include better quality examples or at least give a more nuanced description of the current examples. Related to this, it is currently unclear how inherent risk, as a concept, ties in with the requirements in ISA 315. For instance, the concept of significant risk does not explicitly include a reference to inherent risk. There is scope for confusion in the application of the standard because inherent risk is not defined with reference to significant risk. We would therefore welcome guidance reconciling the two concepts. There is also little information in ISA 315 or ISA 200 to support what is meant by inherent risk. The IAASB needs to explore this further to avoid confusion between inherent risk, business risk and significant risk. Furthermore, we would suggest clarifying the wording in paragraph 15 (a) where it states ''when inherent risk is low, the auditor shall determine whether one or more of the following further audit procedures would provide sufficient appropriate audit evidence regarding the assessed risk(s) of material misstatement''. The use of the word 'whether' could be aggressively interpreted to allow an auditor to choose not to do any further audit procedures at all. We would welcome clarification on this issue. If it is what was intended, we believe the IAASB should also clarify in ED-540 that the auditor is required to set the inherent risk on an account balance level rather than to the entire entity.

42.	AICPA	We believe that addressing scalability by proposing audit objectives dependent on the assessment of two categories of inherent risk, with differing requirements within these categories, will result in an ISA that is overly complex. Paragraphs 10–15 of ED 540 will be difficult for auditors to effectively apply for the following reasons: 1. With respect to the three risk factors contributing to inherent risk in ED 540 (complexity, use of judgment, and estimation uncertainty), we have the following concerns: a. The Explanatory Memorandum suggests that the ED 540 introduces “an enhanced risk assessment” by including new factors that would inform the inherent risk in accounting estimates, yet most of the factors exist in extant ISA 540. We believe that geographically including the risk assessment in ED 540 instead of ISA 315 (Revised) is confusing and may be a deterrent to audit quality. b. We believe that the distinction among the three risk factors may not be operational or beneficial in performing the audit and, instead, suggest a focus on the components of all accounting estimates—data, assumptions, a calculation, and estimation uncertainty. We believe matters related to complexity and judgment are closely related to the components listed above and could be part of the considerations related to assessing risks, including, for example, management’s addressing of estimation uncertainty through use of alternative models, more precision in judgments around assumptions, and so on. We acknowledge that the intention of the IAASB might not be to have auditors classify the estimates according to the three risk factors but, rather, to help the auditor in determining the nature of the risks, and then focus the auditor’s work on those risks accordingly. If that is the intent, we recommend that this intent be made clearer in ED 540, including clarity that all three factors will generally be applicable. The scalability should be in the performance of procedures within each risk factor, not whether the factor applies. c. Moreover, use of these three risk factors as part of considering inherent risk, without a clear linkage to ISA 315 (Revised) where these factors are first introduced, makes it seem like new terminology rather than an application of existing risk assessment concepts. 2. As drafted, we believe the assessment of inherent risk in paragraph 10 of ED 540 could be read as a separate risk assessment from what is required under ISA 315 (Revised) because, as proposed, it would seemingly require the auditor to separately understand management’s estimates without a clear linkage in the requirements or application material to how the risk assessment in ED 540 is integral to the risk assessment for the financial statements taken as a whole. Paragraphs 25–27 of ISA 315 (Revised) discuss that the risk associated with accounting estimates is in the context of classes of transactions, account balances, and disclosures in identifying and assessing the risks of material misstatement at the financial statements and assertions levels, including the identification of whether any of the assessed risks are significant risks. Yet, paragraphs 10(e)–(f) of ED 540 seemingly apply separately to each individual accounting estimate made when preparing financial statements without consideration of risk or materiality. Because the changes are set out in ED 540 rather than ISA 315 (Revised), we believe, as drafted, this ostensibly creates another layer of risk assessment because some of the requirements in ED 540, as drafted, may be interpreted to be read in isolation and not in combination with the requirements in other ISAs. An example of the inconsistency is paragraph 10(e) of ED 540, which is inconsistent with paragraph 18(e) of ISA 315 (Revised). Paragraph 18(e) of ISA 315 (Revised) requires the auditor to understand the financial reporting process used to prepare the entity's

		financial statements, including significant accounting estimates and disclosures, while paragraph 10(e) of ED 540 can be interpreted to refer to all accounting estimates. 3. We acknowledge that the retrospective review described in paragraph 11 of ED 540 exists in extant ISA 540, with certain exceptions. However, we do not believe that this requirement should be applicable to all estimates, only for those, as noted in extant ISA 540, "whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period [emphasis added] financial statements." For example, for accounting estimates with "long tails" such as actuarial liabilities, it is difficult to understand what, specifically, is the extent of work required by the auditor with respect to a retrospective review and to what extent any differences should be investigated. Without further clarification, we do not believe there will be consistent understanding of what is expected and at the level of granularity of performance that would be required. 4. ISA 315 (Revised) requires the assessment of the risks of material misstatement at the overall financial statement level and at the assertion level, including whether any of the risks identified are significant risks. We recommend that the IAASB be clear that the assessment of inherent risk referred to in ED 540 is part of the assessment of inherent risk already required in ISA 315 (Revised). Additionally, until the IAASB completes its risk assessment project, we recommend that ED 540 be consistent in its approach that the design of further audit procedures is based on the assessed risks of material misstatement as described in existing ISAs. 5. ED 540 is not clear as to whether the assessment of inherent risk should be made at the relevant assertion level as required by ISA 315 (Revised) and does not provide guidance as to what the relevant assertion might be. Rather, it refers to accounting estimates as if they are separate from classes of transactions, account balances, and disclosures used in both ISA 315 (Revised) and ISA 330. Providing guidance on identifying the relevant assertions will likely improve audit quality when it is better expressed in terms of the assertions to which the risks of material misstatement specifically relate (for example, valuation, completeness, or accuracy). 6. With respect to the assessment of inherent risk as "low" or "not low," we are not supportive of the proposed approach for the following reasons: a. We believe auditors will expend unnecessary effort determining what is meant by "low" inherent risk, and when considered with the related application material in paragraph A72 of ED 540, few accounting estimates may be assessed as "low" inherent risk. We think the construct of extant ISA 540 is already scalable based on risks of material misstatement. Further, we contend that guidance in extant ISAs already recognize that estimates are either higher or have greater inherent risk. For example, paragraph 27 of ISA 315 (Revised) requires the auditor to determine whether any of the risks identified are, in the auditor's judgment, significant (without consideration of controls). b. We believe that some auditors may infer that the "low" and "not low" assessment of inherent risk represents the only scalability of ED 540 and then fail to recognize that the nature, timing, and extent of audit responses within the "not low" category will also vary according to the assessed risks of material misstatement. Instead of using these two categories to address the issue of scalability, we recommend that a more explicit and clearer link to ISA 315 (Revised) and ISA 330 be made. In other words, the auditor's work effort in auditing accounting estimates remains based on the assessment of the risks of material misstatements, and the design and responses remains based on the assessed risks already required in

		ISA 315 (Revised) and ISA 330, respectively, with enhanced application guidance provided in areas of higher risk of material misstatement. This approach would help clarify that ED 540 is not a standalone standard but, rather, is incremental to the fundamental risk assessment in an audit already required under ISA 315 (Revised). However, we recognize that additional application material (and implementation guidance such as an IAPN) is needed to address audit challenges arising from more complex accounting estimates, such as those recorded using the expected credit loss model. c. The proposed requirement will force auditors to make a separate assessment of inherent risk. ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Auditing Standards, allows the auditor to make a combined assessment of risk of material misstatement, which is comprised of inherent risk and control risk. Moreover, the focus of other ISAs has typically been on audit response to "higher" or "increased" risks of material misstatement, which we believe is understood in practice. 7. With regard to paragraph 13 of ED 540, the differentiation between complexity, judgment, and estimation uncertainty will be difficult to implement for the following reasons: a. Most accounting estimates have some level of estimation uncertainty unless the accounting estimate is settled shortly after the reporting date. It will be difficult to determine whether an accounting estimate will be settled at the planning stage, so an interpretation of ED 540 is that consideration of estimation uncertainty would be applicable in all circumstances in varying degrees. It would generally be difficult to say that estimation uncertainty did not contribute to a risk assessment of "not low." Therefore, we are concerned that significant work effort will be unnecessarily dedicated for accounting estimates settled at the planning stages simply because of an inability to plan for settlement in the planning stages of the audit. Furthermore, it is unclear how the auditor may address this situation without incurring the work effort described in paragraphs 14–19 of ED 540 in these situations. b. As proposed, there would likely be questions and inconsistent application as it relates to the audit documentation required with respect to the assessment of which elements are contributing to the "not low" inherent risk assessment. Questions that this approach raises include: "Is there a presumption that each of the elements (complexity, judgment, and estimation uncertainty) do contribute, and the auditors should document their considerations with respect to why a particular element does not?" "Would the auditor only be required to document the considerations that they deemed to be present?" There is a concern that there would be extensive documentation requirements for these factors that, ultimately, would not necessarily assist the auditor in the design and performance of the appropriate responses. 8. Paragraph 15 of ED 540 retains the concept that events occurring up to the date of the auditor's report may constitute sufficient appropriate audit evidence in auditing an accounting estimate for use when inherent risk is "low." We have the following concerns with this requirement and related application material: a. With regard to the three testing strategies when inherent risk is "low," we recommend retaining them in ED 540 regardless of the assessed inherent risk. As currently drafted, all the application material on how to effectively apply the strategies has been deleted. Arguably, the three testing strategies and related application material are what is applied in all substantive

		procedures. The auditor either tests how management records transactions, including inspection of internal or external evidence, tests the settlement of transactions, or develops expectations to compare to management's balance. b. We agree that if the outcome of uncertainty becomes known before the date of the auditor's report, estimation uncertainty risk assessment may be revised. However, ED 540 does not adequately address considerations for considering the relevancy of the subsequent event. For example, an entity may sell an investment security for $100 in late January (an event subsequent to the balance sheet date that was not necessarily indicative of fair value at that date) and uses that value as an estimate of value at December 31. Paragraph 15(a)(i) of ED 540 should be rewritten to require the auditor to consider whether the subsequent transaction is relevant to the estimate or indicative of changes in market conditions. Also, we believe the requirement should be explicit as to whether the auditor is expected to perform the risk assessment procedures in ED 540 when the auditor expects to obtain sufficient appropriate audit evidence from events occurring up to the date of the auditor's report. We do, however, note that there is a risk that if subsequent events do not provide the necessary audit evidence as expected, there could be significant challenges in going back to perform the risk assessment procedures not considered when planning the engagement. c. As drafted, this requirement may be overly complicated for auditing simple accounting estimates. For example, we believe there are circumstances in which analytical procedures would provide sufficient appropriate audit evidence in auditing an accounting estimate (for example, in testing depreciation expense for routine annual property and equipment additions). d. For some accounting estimates, determining whether events occurring up to the date of the auditor's report provide audit evidence (that is, testing the outcome of an accounting estimate) may be the most effective and efficient way of obtaining sufficient appropriate audit evidence (that is, in some circumstances this may be highly persuasive and sufficient evidence). Based on how ED 540 is drafted, incremental procedures could be read as being required to be performed if the risk assessment was influenced by one or more of the three factors, increasing the audit effort with potentially little benefit. Guidance in paragraph A75 of ED 540 indicates that the auditor could revise inherent risk after the outcome becomes known, but we question whether the focus should instead be on the sufficiency of evidence.
43.	ANAN	In the Association's opinion, ED 540 does not provide sufficient quantifiable scaling system with respect to auditing accounting estimates when there is low inherent risk because the scaling is subjective and susceptible to individual professional accountant judgment. Nevertheless, the ED provided sufficient guidance that will enable the professional accountant develop appropriate skill when auditing accounting estimates including where there is low inherent risk. In our opinion, it would have been more appropriate if the ED can provide a quantitative scaling system.
44.	CAI	On balance we are not concerned with regard to the degree of scalability of the standard. We believe that even for a small entity "an audit is an audit" and when a relatively small entity has complex estimates in its financial statements then ED 540 applies in all its granularity, unless the auditor determines that there is low inherent risk in the estimate, and this is appropriate. We note however that scalability is not addressed in the standard itself other than through the 'low risk' / 'not low risk' threshold. The terminology 'low risk' and 'not low risk' has not previously been used in ISAs and therefore we consider it necessary, in introducing this new concept, to make conforming amendments to the ISA 300 and ISA 315 as appropriate to reflect the concept of 'low risk' and 'not low risk'

		in these risk focused standards. It will also be necessary to include further application guidance to ensure consistent application of this threshold by auditors.
45.	CAQ	**Scalability** **It is important that any improvements to existing auditing standards result in scalable requirements and guidance that audit firms of all sizes can apply to companies of all sizes. Given the many different types of accounting estimates, the varying nature of the related estimation processes, and the underlying inputs and assumptions, there may not be a 'one-size-fits-all' solution that enhances existing auditing standards relating to accounting estimates. The identification and assessment of risks associated with accounting estimates should not be based on the size of the entity or audit firm. We believe that one of the IAASB's primary reasons for introducing the concept of "low" versus "not low" risks may have been to address the scalability of the auditing requirements in the Exposure for smaller entities. The guidance for smaller entities (included in the Application Guidance of the Exposure) may lead some auditors to conclude that the risks associated with accounting estimates recorded by smaller entities and/or being audited by smaller auditing firms are generally assessed as "low" and, therefore, the expected level of work is different for a smaller entity. The identification and assessment of risk should be directly associated with the accounting estimate (including the components thereof) and the estimate's relationship to the financial statements and not the size of the entity or auditing firm.** **We are concerned that paragraph 10 of the Exposure could result in significant time spent assessing and documenting RoMM associated with relatively simple accounting estimates. While documentation is important, it may distract the auditor from the appropriate focus on risk assessment and importantly the response to the RoMM. Additionally, it was not clear whether the requirements in paragraph 10(e)-(f) apply to accounting estimates as a whole or to each individual accounting estimate. It also is not clear how these requirements interact with the requirement to assess the RoMM at the assertion level in accordance with paragraph 25 (b) of ISA 315 (Revised).**
46.	CPAA	We do not consider that scalability is adequately achieved in ED-540. The IAASB has sought to achieve scalability by providing a separate approach for low risk and not low risk and then breaking down work effort for not low risk into three factors: complexity, management judgment and estimation uncertainty. We consider that the majority of estimates, by their very nature, will fall into the not low risk category and for many of these all three factors will apply. Rather than using professional judgement to determine the nature, timing and extent of procedures necessary in the circumstances, auditors will then be required to conduct all of the procedures listed in paragraphs 17, 18 and 19 or document why any of the procedures are not applicable. Whilst we acknowledge that the three factors are relevant to accounting estimates, they are not often mutually exclusive. The first factor, complexity, the use of a complex model or specialized skills or knowledge, would normally necessitate the second factor, being the need for use of judgement by management, which would often result in the third factor, estimation uncertainty. Consequently, we do not consider dividing the procedures in three categories is effective in scaling the work effort. There is no escaping the need for professional judgement to determine the evidence needed in each circumstance. We would argue that the level of risk is more akin to a sliding scale rather than binary concept of either low or not low risk. In addition, the concepts of low and not low risk are inconsistent with ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment, which requires the risks of material misstatement to be identified and assessed, at the financial statement and assertion levels, and to determine whether any are significant risks. We consider that it is important, if a new approach to risk is to be introduced, that this is considered through the revision process for ISA 315. This would enable a consistent

		underlying approach to risk assessment applicable across the entire audit not just one aspect. Nevertheless, regardless of due process, we do not consider this binary view of risk is helpful nor applicable across the entire audit, so we would not be supportive of this concept being adopted in ISA 315.
47.	CRUF	
48.	EFAA	**We welcome the proposed approach designed to ensure that accounting estimates assessed as low inherent risk to avoid being subject to onerous and inappropriate audit procedures. However, we suspect that many accounting estimates of SMEs will not be assessed as low inherent risk. A risk threshold alone is insufficient to guarantee scalability. Hence, we strongly recommend that the IAASB investigate how it might build further scalability into the standard. We also encourage the IAASB to consider including further SME examples into a separate staff publication focused on how the standard can be applied efficiently to smaller audits and the expected, modest, level of documentation.** We welcome the IAASB's recognition of the need to seek standards that are scalable not least since many audits performed across Europe, our region of operation, are of simple SMEs. We are pleased to see the introduction of the threshold of low inherent risk. We suspect most accounting estimates in SME financial statements will be assessed as low inherent risk and this threshold will scope them out of the need for onerous procedures. However, many accounting estimates in SME financial statements will not fall within this threshold. Hence, we urge the IAASB to infuse further scalability in the approach when the inherent risk is not low. For example, ISA 540 could explicitly state that the three procedures listed for low inherent risk estimates (paragraph 15 (a)) may also be appropriate to other estimates. Overall, we are concerned that ED-540 is over-engineered in some respects. While we appreciate the intent to avoid making significant changes in the audit of accounting estimates when inherent risk is low we feel the proposals give the impression that a substantial increase in work is required to assess the risk associated with many estimates. Auditors of SMEs will often calculate their own point estimate and simply compare it to the result provided by management without investing the time and effort to understand how management arrived at their estimate. The proposed standard now requires an understanding of what management did. In the case of SME audits this will likely mean additional work effort for no new evidence. We are therefore concerned about the additional documentation that will be needed for practitioners to demonstrate how they meet all the requirements, especially to satisfy inspectors. Consequently, we foresee additional cost and no corresponding benefit in terms of improved audit quality. Accordingly, we encourage the IAASB to clarify that the audit approach for accounting estimates classified as low inherent risk is unchanged. The bifurcation of and understanding as to what is meant by "low" and "not low" is critical. Our hope is that in the case of SMEs "low" is interpreted as a broad category, perhaps to capture accounting estimates that many SMPs currently classify as "moderate". Hence It is essential for the IAASB to include greater clarification on what is meant by low inherent risk and the link between inherent risk and risk of material misstatement. It might help if the application material acknowledged that there's considerable overlap between when inherent risk is low and 'simple' or 'non-complex' estimates and that the threshold should be at the higher end of complexity, judgment and estimation uncertainty. Furthermore, we feel it would be helpful if the IAASB could provide more detail on the examples of estimates that might be considered low inherent risk, and those which are not, and how they might be dealt with under various scenarios. These SME examples might best be placed in a separate staff publication which could also explain how the standard can be applied efficiently to SME audits and the expected, modest, level of documentation.

		We believe SME auditors may sometimes be in a position to identify accounting estimates with low inherent risk without having to perform all of the work steps required under the ED (para. 10). These steps seem excessive and unnecessary and deserve careful consideration as to whether they meet the criteria of scalability.
49.	FACPCE	Answer 3) Yes. The ED clearly develops the work of the auditor when the risk is low differentiating it from when the risk is not low. In case of low risk, it proposes to perform one or more procedures that it identifies, further clarifying that if they do not provide sufficient and appropriate audit evidence, the auditor will design and carry out other procedures.
50.	IAA	Refer to letter
51.	IAAA	We understand that the amendments to be incorporated are sufficiently scalable for an accountant of financial statements, specifically for the evaluation of accounting estimates, in accordance with the current information standards on the matter.
52.	IBRACON	We believe that the ED-540 is a good start in addressing scalability. Scalability is, in our view, best addressed by establishing principles-based standards and allowing auditors to apply them by tailoring to the circumstances and facts of each audit, modifying the nature, timing and extent of procedures to be responsive to the assessment of risk. However, we have some concerns related to the requirement to assess inherent risk as low or not low. We do not believe that introducing a threshold of "low inherent risk" would be appropriate. Paragraph 15(a), in exempting low inherent risk ("less complex") estimates from the detailed requirements in paragraphs 17-19, may appear to create a perception, of "less work". The approach set out in paragraph 15 (a) should be available to any estimate, not only for those with a low inherent risk. Removing the low risk threshold will, in our view, also eliminate the very significant potential for subjective disagreements between auditors and audit inspection bodies as to the auditor's determination of whether a risk is, or is not, subject to "low inherent risk". We also believe that a more prominent focus on testing events subsequent to the balance sheet date, when those provide sufficient appropriate audit evidence, alone, would boost the perception of scalability. We suggest that the application material should better illustrate scalability in responding to assessed risks.
53.	IBR-IRE	**However, we would like to comment on the proposed paragraphs 13 and 15, aiming at making ISA 540 more scalable by introducing the concept of low inherent risk and by requiring that the auditor, when dealing with accounting estimates with low inherent risk, determines whether one or more specific further audit procedures that may provide sufficient appropriate audit evidence in the circumstances. For inherent risk that is not low, the auditor is required to design further audit procedures to obtain audit evidence about matters relating to complexity, judgment or estimation uncertainty, to the extent these factors are the reasons for the assessed risks of material misstatement.** Due to its length, the numerous steps to be contemplated by the auditor and the many references to regulated industries, we are concerned that ED 540 will trigger the perception that it is ill-suited for less complex engagements. In particular, we note that — Paragraph 3 seems to imply that the characteristics mentioned are inherent to every estimates. Further the relevance of an estimate to the stakeholders in assessing the financial situation or performance of the entity does not seem to be an element considered in the risk assessment process. As such there is a risk that the risk assessment process focuses too much on the inherent

		characteristics of the estimate rather than its usefulness to the users of the financial information and the specific set of facts and circumstance surrounding the estimate; — The enquiries of management mandated in paragraph 10 (e) are complex and far reaching as part of the risk assessment phase when dealing with a non-complex environment; — The requirements to obtain an understanding of each elements of internal controls in par. 10 (f) for each estimate are far reaching and onerous when dealing with less than complex estimates. Also the limitations in the design and operating effectiveness of internal controls in a less complex environment are not acknowledged; and — The challenges to performing a look-back exercise in paragraph 11 in a less complex environment are thus not acknowledged.
54.	ICAEW	**More is needed to achieve scalability, but not all of it in ISA 540** **10. Using the inherent risk (IR) assessment as a threshold will be a key issue for some respondents who will question IAASB's approach. The assessment of IR per se is not well developed either in these proposals or in other ISAs. ISA 315 on risk assessment mentions in passing the assessment of IR in the context of estimates and other references are limited to a few in ISA 200. We understand the need not to overload ISA 315 but the revision of that ISA needs to be aligned with the revision of this one. The idea that conforming amendments will be made to ISA 540 after ISA 315 has been finalised does not sit well with the nature and extent of these proposals. More is needed somewhere on IR, distinguishing between low and not low IR, IR and the risk of material misstatement and IR and significant risk.** **11. We make numerous references in this response to a need for more examples and guidance, and we acknowledge that we are asking a lot. We make no apology for this and have not made these points carelessly. We are asking for a lot because a lot is needed. To ask for these proposals, or any ISA, to serve the largest of financial institutions and the smallest of audits may be asking too much. We do not underestimate the extent of IAASB effort involved in arriving at a position intended to cover both extremes, from the simplest depreciation calculation to the most complex of financial instruments and expected credit losses (ECL), but we believe that more detail is needed at both ends of the scale, not all of it in ISA 540.** **12. At the upper end of the scale, auditors of banks, insurers and other financial institutions might be forgiven for thinking that IAASB has lost sight of the original objective of the project, which was to deal with IFRS 9 issues. 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 ECL under IFRS 9 and technical provisions under IFRS 17 is thin.** **13. We have heard repeated calls for more specific guidance for the audit of banks and insurers, and we therefore 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 also in favour of an IAPN for this sector.**

		14. At the other end of the scale, it is difficult to avoid the impression that the proposals are over-engineered in some respects. We sense that while IAASB would like the low IR category to be perceived as the principal means by which scalability has been achieved, this ignores the fact that the financial statements of many SMEs include not low IR estimates. **15. We do not believe that IAASB intends to make extensive changes to the ways firms approach the audit of low IR estimates and IAASB should make this clearer. To the extent that it does intend to enhance the approach to such estimates, it should highlight those enhancements. The required response to low IR estimates does not appear to represent a significant change from the status quo . However, more work does appear to be required to assess the risk associated with such estimates - only in many cases to arrive at the same place as before. Even where it is obvious that the estimate is low IR, all of the paragraph 10 requirements still apply. Explaining this to our members will be a tall order. IAASB needs to do what it can to emphasise the benefits to practitioners and the clients they serve, to prevent a perception arising that the only benefits will accrue to regulators of larger audit firms.** **16. The need for implementation material prepared by IAASB for the benefit of smaller firms and the SMEs they serve has never been clearer. Currently, IAASB provides examples of estimates that 'are' low IR, rather than a nuanced discussion. We urge IAASB to consider setting a precedent in this case by developing a staff publication. This should explain and illustrate the practical application of the proposed requirements, enhance the existing examples and provide further examples of estimates that might be considered low IR in some situations and not in others and how, most importantly, auditors might respond to them in practice. This would encourage consistency of application and avoid any perception of rule-making.** **17. The behaviour of auditors and regulators is critical, as always, to successful implementation. There is as much of a risk that some auditors will always try to shoehorn estimates into the low IR bucket and ignore the rest of the ISA, as there is a risk that others might seek to avoid that bucket, for exactly the same reason, i.e. a perception that regulators will automatically treat anything in the low IR bucket as suspect. Practitioners from small and large firms alike fear that expectations will arise about which types of estimate fits into which bucket and how big each bucket should be relative to the other. As with the rebuttable presumptions regarding the risks associated with fraud and revenue recognition, and significant and non-significant risks, firms also fear they will waste effort by being driven to treat low IR estimates as if they were not low IR.** **18. We are not comfortable with IAASB's proposal to deal with the inconsistency with ISA 700 resulting from the change to the objective for disclosures from 'adequate' to 'reasonable' during the post-implementation review of reporting standards. It is a substantive issue that should be resolved prior to finalisation.** 39. We sense that while IAASB would like the low IR category to be perceived as the principal means by which scalability has been achieved, this ignores the fact that the financial statements of many SMEs include not low IR estimates. 40. Even a simple loan, not at market rates, can arguably involve complexities and judgements. The accounting regime for smaller entities in the UK, based on the IFRS for SMEs, distinguishes between 'basic' and 'other' financial instruments and there are fears that regulatory pressure will mean that an estimate will need to be very low IR, or virtually no risk (if such a thing exists) before auditors can safely categorise it as low IR. Some suggest that the trigger should be at the higher end of complexity, judgement and

		estimation uncertainty to prevent the low IR category becoming redundant and IAASB might consider incorporating some nuance to this effect in the application material. 41. The behaviour of auditors and regulators is critical, as always, to successful implementation. There is as much of a risk that some auditors will always try to shoehorn estimates into the low IR bucket and ignore the rest of the ISA, as there is a risk that others might seek to avoid that bucket, for exactly the same reason, i.e. a perception that regulators will automatically treat anything in the low IR bucket as suspect. Practitioners from firms of all sizes fear that expectations will arise about which types of estimate fits into which bucket and how big each bucket should be relative to the other. As with the rebuttable presumptions regarding the risks associated with fraud and revenue recognition, and significant and non-significant risks, firms also fear they will waste effort by being driven to treat low IR estimates as if they were not low IR. 42. In discussions about low IR estimates, the language used often reverts to 'complex' and 'simple'. We are aware that IAASB considered these terms and rejected them but it might be worth explaining in application, surround or implementation material that while there is considerable crossover between the 'low IR' and 'simple' or 'non-complex' estimates, they are not the same thing. 43. The proposed response to low IR estimates does not appear to represent a significant change from the status quo. However, more seems to be required for the assessment of such risks, even where it is obvious that the estimate is low IR, because all of the paragraph 10 requirements still apply. Explaining this approach to our members will be a tall order. IAASB needs to do what it can to emphasise the benefits to practitioners and the clients they serve, to prevent a perception arising that the only benefits will accrue regulators of larger audit firms. Possible ways of doing this include the following: • making it clear that while many estimates in SME financial statements will fall to be classified as low IR, the increasing use of fair value accounting means that not all estimates in SME financial statements can be assumed to be low IR. IAASB should provide examples of the many industries in which SME financial statements are likely to incorporate several material not low IR estimates, such as those in the print, media and film industries; • additional discussion of the principles governing the determination of what might constitute a low IR estimate, bearing in mind the potential for the confusion between or conflation of inherent risk, significant risk and business risk. 44. UK regulators note – although it is not widely reported – that auditors often do too much in irrelevant areas, sometimes because of this type of confusion. Many firm methodologies, including those marketed commercially and/or provided by training consortia or professional bodies, no longer analyse risk using 'low, medium or high' categories, having moved in line with ISAs some time ago to focus on significant risks. The change in mind set that will be required to implement the shift to low IR estimates and all others, should not be underestimated. 45. We have concerns about the IR assessment generally. A key issue that will lead some respondents to question IAASB's low IR threshold approach is the assessment of IR per se. ISA 315 on risk assessment mentions in passing the assessment of IR in the context of estimates but there are very few other references to IR within ISAs, most of them in ISA 200. More is needed somewhere on the nature of IR and its assessment. We understand the need not to overload ISA 315 but the revision of that ISA needs to be aligned with the revision of this one, and the idea that conforming amendments will be made to ISA 540 after ISA 315 has been finalised does not sit well with the nature and extent of these proposals.

		46. ISAs currently subsume the IR assessment into the overall risk assessment and the only discrete reference to IR is in A39 of ISA 200 which states: For example, [inherent risk] may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk.' 47. IAASB might also consider aligning this with paragraph 13 of the proposed ISA by referring in to the fact that management judgement and potential for management bias may also influence inherent risk. 48. More detail should be provided on the examples already given of low IR estimates. For example, depreciation is unlikely to be assessed as a low inherent risk in parts of the public sector. Lists of additional examples are unlikely to be helpful because of the potential for use and misuse thereof by auditors and regulators alike, but what would be helpful is more detail on the existing examples. 49. Performing work on management's process is the most common technique adopted where it is available as an option, in preference to developing an independent estimate or reviewing subsequent events. IAASB should make it clear that auditors should not automatically choose this option simply because it is available, regardless of the quality of management's process, or because another route, is less straightforward, especially if the alternative route might produce better quality audit evidence. Where appropriate, this would demonstrate the exercise of scepticism and reduce the emphasis on corroborative evidence. 50. Currently, paragraph 10 (f) refers to the need under ISA 315 for auditors to understand the components of controls in relation to estimates. The extensive related application material mostly apples to larger audits and the only reference to the need for auditors to understand controls relevant to the audit (which is all ISA 315 actually requires) is in A100 and even then only in the context of 'very small entities'. The absence of reference to controls 'relevant to the audit' in paragraph 10f has the effect of overstating the case. A100 errs on the side of caution in this respect: controls may not be relevant to the audit in audits of any size. 51. Enhancing the application material relating to controls might involve: • suggesting that auditors consider whether a substantive approach alone is likely to be sufficient for not low IR estimates; • emphasising the ISA 315 statement that enquiries of management alone are insufficient to obtain an understanding of internal control; • suggesting that auditors obtain an understanding of the level at which controls operate, and how this is likely to prevent or detect material misstatement. 52. With regard to documentation, the IR assessment takes auditors to ISA 330 for low IR estimates, and leaves the rest in ISA 540. Auditors will need to focus more on why the evaluation was made, not on what it was, although they should have been doing this under the extant standard. However, if we are correct in believing that there is no intention to significantly change existing behaviour regarding documentation, and that only the trigger has changed (i.e. the IR assessment, rather than whether something is a significant risk), IAASB could make it clearer than it does that no such change is intended.

55.	ICAG	Yes, we believe that the ED 540 is sufficiently scalable with respect to auditing accounting estimates, even when the inherent risk is low.
56.	ICAP	We believe that the scalability of the requirements of the ISAs is the key consideration in the context of the audit of smaller and low risk entities. We are of the view that the requirements as contained in ED 540 would be too detailed for the audit of SMEs, as ED does not indicate to what extent audit procedures and other requirements can be scaled for small and low risk entities. We also understand the more prescriptive approach of the ED 540 as compared to the principle based approach of extant 540 may cause lesser use of professional judgment and greater emphasis on the tick box approach, unless the guidance on scalability of the requirements of the ED 540 is given further consideration. In addition to the above, the ED 540 introduces the concept of 'low inherent risk' and explains the same in the context of audit of accounting estimates. We suggest that IAASB considers the appropriate placement of 'low inherent risk' in the ISAs, as it is relevant to various other areas of the audit. Further, evaluation by IAASB and guidance material is required in view of the possible practical difficulties, including scalability, which may arise with the inclusion of low inherent risk concept along with the 'not low inherent risk' classification in the ED 540.
57.	ICAS	**We acknowledge the IAASB's efforts to make ED-540 scalable however we do have some concerns over whether the desired level of scalability has been achieved and these have been highlighted in our responses to the Overall Questions below.** We welcome the IAASB's recognition of the need to make ED-540 scalable to ensure that its requirements are proportionate for all audits. We do however have concerns over whether the desired level of scalability has been achieved. Within our response we have used the term 'less complex entities' which will include a considerable number of, but not all, SMEs, as well as some larger, less complex, entities. One particular area of concern is the inclusion of the section on the 'Risk assessment procedures and related activities' within paragraph 10 of ED-540. We are aware that ISA 540 establishes how ISA 315 should be applied specifically to accounting estimates, but, what is not clear, is how this will work in practice for less complex entities and, in particular, whether the requirements of paragraph 10 will need to be considered in addition to what is already required in ISA 315 when the risk of material misstatement in relation to accounting estimates is not significant. As a result, we would welcome some clarification on the interaction between ISA 540 and ISA 315 in this respect. We believe that this is a particularly important issue as we are aware that ISA 315 is also currently under revision and failure to ensure that the intended relationship and interaction between these two standards is clear could lead to inconsistencies in the way the standards are interpreted and some significant conceptual challenges. There may also be a need for greater clarification over the relationship between the level of significant risk, as referred to in paragraph 13 of ED-540, and the level of inherent risk in ED-540, i.e. 'low' or 'not low', and how this impacts on the work effort, as prescribed in paragraphs 14-20, and the extent to which it interacts with the requirements of ISA 330. Additionally, from a practical perspective there may be other factors that will affect the successful implementation of this revised standard on the audits of less complex entities. For instance, in the UK, the new financial reporting regime has resulted in some of these less complex entities having to deal with more subjective valuations and, as a result, additional work is required by the auditors to verify these valuations. However, the risk of a misstatement in these subjective valuations might be insignificant in terms of the extent of external third-party interest

		in, or scrutiny of, these entities' financial statements. The revised standard could benefit from clear guidance on the extent of work effort that would fulfil the standard's requirements in such circumstances. We do accept that this is an issue that stems from the requirements of the financial reporting framework but it does have consequences for the audit. We would also highlight that the examples provided of accounting estimates where the risk of material misstatement may be based on low inherent risk may not be the most appropriate (per paragraph A72). For example, we believe that there may be an increase in the risk of management bias where the profitability of the entity may directly impact upon the accounting estimate. i.e. management profit-related bonus, and, as a result, inherent risk is not low. To avoid any possible misinterpretation of these examples, we suggest that a statement should be inserted within paragraph A71 that emphasises the need for the auditor to consider the specific facts and circumstances of an accounting estimate before concluding as to whether the associated inherent risk is low or not low. Finally, we would suggest that the wording in paragraph 15 (a) is clarified where it states ''when inherent risk is low, the auditor shall determine whether one or more of the following further audit procedures would provide sufficient appropriate audit evidence regarding the assessed risk(s) of material misstatement''. The use of the word 'whether' suggests to some that the auditor may choose not to do any further audit procedures but, to others, that at least one of the procedures should be performed. We recommend that the IAASB should clarify its intention on this requirement.
58.	ICAZ	Yes, ED – 540 encourages auditors when dealing with accounting estimates with low inherent risk, to determine whether one or more specific further audit procedures will provide sufficient appropriate audit evidence in the circumstances as per paragraph 15 of ISA 540 Revised. Also given the enhanced requirements on risk assessment which will make the ED scalable to differing circumstances.
59.	ICPAK	Paragraphs 15 of the ED provides very useful guidance on how the auditor can apply a varying degree of audit procedures to the audit of accounting estimates depending on whether inherent risk is low or not. Specifically, the types of audit procedures set-out under paragraph 15(a) are sufficiently clear to provide the auditor with 3 possible audit responses to accounting estimates with low inherent risk. However, rather than use 'low vs. not low inherent risk' terminology, which can be subjective and ambiguous, it may be preferable to define accounting estimates that are clearly not of 'low inherent risk' upfront (i.e. define complexity, judgement and estimation uncertainty) as included within paragraphs 17 – 19 of the ED
60.	ISCA	Use of inherent risk as the basis to direct work efforts in ED-540 3.1 ED-540 introduces a concept of using inherent risk as the basis to direct work efforts while ISA 330, The Auditor's Responses to Assessed Risks requires the auditor to design audit procedures in response to assessed risks of material misstatement and significant risks, with little mention of inherent risk. The apparent misalignment between the 2 standards might create unnecessary confusions. 3.2 In this respect, the IAASB may wish to relook into the 2 standards and align the auditor's responses to assessed risks, where necessary. 3.3 If the IAASB eventually concludes on the use of inherent risk to direct work efforts subsequent to further deliberation, more clarifications could be provided in the basis of conclusion to explain the decision. The concept of inherent risk should be consistently explained in both standards. We would like to highlight that this is a crucial step in the audit planning process as it will have broader implications on how auditors should assess significant risks and inherent risks.

61.	KICPA	We believe that the proposed ED-540 distinguishes between when inherent risk is low (e.g. depreciation estimation) and from when the risk is not low (e.g. expected credit loss models) regarding risks of material misstatement related to estimation, thereby making it possible for an auditor to perform further audit procedures, tailored to the nature of estimation uncertainty, driving us to conclude that the ED is sufficiently scalable.
62.	NASBA	We believe the IAASB should consider adding additional clarity to paragraph 15 (a) when inherent risk is low.
63.	SAICA	22. Although the majority of the survey respondents agreed that the ED is sufficiently scalable with respect to auditing accounting estimates when inherent risks are assessed as "low", one survey respondent expressed a strong view that this is not the case in respect of the risk assessment procedures and related activities – these requirements are detailed and extensive, which is appropriate for complex, highly judgemental accounting estimates that are subject to higher estimation uncertainty. 23. The above-mentioned view was confirmed by the views of the field testing respondents. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing questions (a), (b), (d) and (f)). 24. SAICA suggests that the IAASB consider that the requirements and application material of the ED could be further scaled in respect of the risk assessment procedures and related activities. For example, it may not be necessary for the auditor to obtain the same level of understanding, including for each of the components of internal control, for less complex accounting estimates than for more complex accounting estimates. ISA 315 (Revised) paragraph A3 states that the auditor applies professional judgement to determine the extent of the understanding required and that the primary consideration is whether the understanding obtained is sufficient to meet the objective of the ISA. The auditor should therefore be able to apply more judgement in respect of the extent of understanding required for purposes of performing the risk assessment, which provides the basis for the auditor's further audit procedures depending on the nature and extent of the entity's accounting estimates. 25. The IAASB should further be mindful that although a clear distinction is made between "When inherent risk is low" and "when inherent risk is not low", there is, apart from paragraph A96, no application material (or no clear application material) relating to the work effort linked to "When inherent risk is low". The approaches in ED-ISA 540 (Revised).15(a) have been retained from extant ISA 540.13, which include related application material. The IAASB should consider whether some of that application material could be retained in the revised standard, adapted as required to the context of low inherent risk. SAICA also considered the following additional question: Is the ED sufficiently scalable with respect to auditing accounting estimates when inherent risk is assessed as 'not low' (i.e. in terms of providing a sufficient "step-up" in terms of the further audit procedures that would be required to obtain sufficient appropriate audit evidence in the circumstances)? 26. All of the survey respondents agreed that the ED is sufficiently scalable with respect to auditing accounting estimates when inherent risk is assessed as 'not low'. 27. SAICA agrees with the objective-based requirements that the auditor has to achieve based on the applicability of one or more of the three factors. It is suggested that the terms 'low' and 'not low' should be defined or described as these terms may not be specifically used in a firm's methodology.

		28. The field testing respondents also stated that their work effort for risks assessed as 'not low' were similar to the previous year but required more documentation. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing questions (e), (f) and (g)). 29. Overall, SAICA appreciates the proposed change in approach that is being introduced in this ED as a mechanism to make the requirements of the standard scalable (i.e. the distinction between "when inherent risk is low" and "when inherent risk is not low"). The IAASB should seek to apply this approach, as may be relevant and applicable, or adapted as necessary, to other standard-setting projects.
64.	SMPC	**Overall, we appreciate the relative conciseness of the requirements' section and welcome the IAASB's attempts to make ISA 540 (Revised) scalable and the proposed approach in as far as it would ensure accounting estimates assessed as low inherent risk are not subject to inappropriate audit procedures. We broadly support the notion of low inherent risk as a threshold, but strongly believe that to foster consistent treatment of accounting estimates it will need to be explained more thoroughly, and its relationship to the risk of material misstatement further explored. In addition, not all SMEs accounting estimates will be assessed as low inherent risk. It is therefore critical that the IAASB examines how there could be further scalability in the approach, as these issues are not sufficiently addressed with just the introduction of the threshold.** **We are concerned that ED-540 is over-engineered in some respects, in particular for SMPs. IAASB implies, but does not state, that the intention is not to make extensive changes in the audit of accounting estimates when inherent risk is low and that this is how the ISA achieves scalability. However, it is clear from the requirements that despite the structural similarity between the extant standard and the proposals with regard to low inherent risk estimates, considerably more is in fact required, even for low inherent risk estimates. We do not believe that IAASB is in a position to unwind the potentially disproportionate complexity for some SME audits and we therefore strongly recommend that further SME examples should be included in a separate staff publication. The publication should also cover (a) the link between inherent risk and risk of material misstatement, (b) how the standard can be applied efficiently specifically to smaller audits, such as highlighting the additional work now required for low risk estimates, as well as giving examples how the new requirements for other estimates can be applied efficiently, and (c) examples of the types of documentation that might be appropriate in SME audits. Guidance on the demonstration of professional skepticism when auditing accounting estimates would be particularly helpful for SME auditors where the estimate is complex and management has used data and assumptions in a model. This is an emerging area for many SMEs and their auditors.** SME financial statements include non-low IR estimates The SMPC fully appreciates the IAASB's recognition of the need to consider scalability as many audits performed world-wide concern smaller and less complex entities. While many accounting estimates in SME financial statements will be assessed as low inherent risk, this will not be the case with all of them. We note above 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. We broadly support the notion of low inherent risk as a threshold, but also strongly believe that there could be further scalability in the approach when the inherent risk is not low. For example, it should be made clear that the three procedures listed for low inherent risk estimates (paragraph 15 (a))

		may also be appropriate to other estimates - what is important is that the procedures designed and performed are an appropriate response to the specific risks. Overall, we are concerned that ED-540 is over-engineered in some respects, in particular for SMPs, if the intention is not to make extensive changes in the audit of accounting estimates when inherent risk is low, . For example, whilst it may not appear that the required response to low inherent risk accounting estimates is a significant change from the extant ISA 540, the proposals give the impression that a substantial increase in work is required to assess the risk associated with many estimates (especially the requirements in paragraph 10), only in many cases to arrive at the same place as before. For instance, for a small business, an auditor may simply conduct their own point estimate and compare it to the result provided by management, without needing to necessarily understand all of the intricacies the latter have used to come up with their own estimate. The proposed standard now requires an understanding of what management did, which may not contribute to any additional (or more persuasive) evidence to the audit and just represents additional work effort. We are also concerned about the additional documentation that will be needed for practitioners to demonstrate how they meet all the requirements, especially as this could be easy to criticize under a regulatory inspection environment. As a result, the cost/ benefit of the changes are likely to be disproportionate for many SMPs and may not enhance audit quality i.e. there needs to be an appropriate balance between the time spent undertaking audit procedures and level of documentation. The low IR threshold Some SMPs methodologies may have moved in accordance with the ISAs to focus on significant risks, but some firms still use low, medium and high inherent risk. If firms use the words “low”, “moderate”, and “high” for the assessment of inherent risk, “not low” could be seen as very wide including both moderate and high. The scope of “low” and “not low” is unclear from the proposals and more is needed on what is involved in a low IR assessment. It is essential for the Board to include greater clarification on what is meant by low inherent risk and the link between inherent risk and risk of material misstatement. There is a concern about which types of estimate fit in which ‘bucket’ and the size of these relative to each other. In particular, practitioners may waste time and effort trying to either fit, or not fit, an accounting estimate in one ‘bucket’. It would be useful if the application material acknowledges that there is considerable crossover between when inherent risk is low and ‘simple’ or ‘non-complex’ estimates. Consideration could also be given to whether there is a way of indicating in the application material that the trigger should be at the higher end of complexity, judgment and certainly estimation uncertainty. In our view, it would be helpful if the IAASB could provide more detail on the examples of estimates that might be considered low inherent risk (A72), and others which are not (A73), and how they might be dealt with under various scenarios. We recommend that further SME examples could be included in a separate staff publication, but additional lists in the standard may not be helpful given the potential for misuse by practitioners and regulators and the length of the proposed standard. The staff publication could also cover the link between inherent risk and significant risk of material misstatement, how the standard can be applied efficiently to smaller audits and the expected level of documentation, so it is clear for both practitioners and regulators. There can be circumstances where auditors may be in a position to identify accounting estimates as being of low inherent risk without having first performed all the work steps required under proposed paragraph 10 of the ED, which are excessive. In particular, the requirements to understand each of the components of internal control as they relate to making accounting estimates (paragraph

		10(f)), is not clear about the fact that controls auditors are required to understand are only those relevant to the audit. We therefore suggest this aspect be revisited to establish whether scalability in the required risk assessment procedures could be improved. We acknowledge and welcome the material in A10, A23 and A60 in relation to smaller entities, which are generally considered helpful, although may still need some refinement. For example, the first sentence of A23 makes two references to “less complex”.

Academics		
65.	GC	
Individuals and Others		
66.	CYGNUS ATRATUS	Based on our experience there will be implementation issues with the concept of scalability. The standard does not contain a definition of what constitutes 'low' risk. As a result the extensiveness of documentation / substantiation regarding 'low' risk is unclear. Therefore, we suggest abandoning the concept of 'low' risk. We expect that the decomposition of estimates in complexity, judgement and sensitivity will be sufficient to achieve scalability.
67.	NDEG	3.1 We recognise the need to better articulate how the requirements of ISA 540 can be applied in a scalable manner to the very broad range of estimates that fall within the scope of the Standard. We also acknowledge that many audits of financial statements of smaller entities will often consist of "simpler" estimates. However, it is important that the ISA focuses on the nature of the estimates and not the size of the entity being audited, as even smaller entities will often have more complex estimates. 3.2 It is not clear whether the "low risk" would apply at the ROMM level or at the assertion level. Further, would it apply to all estimates or all risks attached with every estimate. This needs to be clarified. 3.3 We suggest that the application material could better illustrate scalability in responding to assessed risks through providing further explanation and examples about what may be involved in obtaining sufficient appropriate audit evidence for simpler accounting estimates. For example, in relation to a non-complex (or "simple") estimate, how events occurring up to the date of the auditor's report may provide robust evidence about the estimate. Or, if testing management process, how re-performing a simple straight forward calculation, such as depreciation, or an analytical procedure to develop a point estimate for a simple, straightforward calculation, such as a payroll expense, may be appropriate. 3.4 Recognising that risks exist along a spectrum, we believe it is preferable to reinforce the principle, as set out in the second part of paragraph 15, that the higher the assessed risk the more persuasive the audit evidence needs to be. This could be brought to life in examples within the application material. 3.5 We also believe that a more prominent focus on testing events subsequent to the balance sheet date, when those provide sufficient appropriate audit evidence, would boost the perception of scalability.