

# Supplement E 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 4

**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](#).

**Q4.** When inherent risk is not low (see paragraphs 13, 15 and 17–20):

- (a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?
- (b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?
- (c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?

#	Respondent	Comments
<b>Investors and Analysts</b>		
1.	CFA	<p><b>Specific Risk Assessment Requirements</b></p> <p>We support the proposal's specific risk assessment requirements in paragraphs 10 through 13. We believe that the requirements support more effective identification and assessment of risks of material misstatement relating to accounting estimates.</p> <p><b>Need for Better Linkage Between Audit Procedures and Audit Evidence</b></p>

		<p>We also support the requirement in the proposal for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by complexity, judgment, and estimation uncertainty in identifying and assessing risks of material misstatement. We believe this is necessary to arrive at an appropriate audit response to more complex accounting estimates, rather than just concentrating on estimation uncertainty.</p> <p>We do, however, believe that the proposal would benefit from linking the audit procedures in paragraph 15(a) when inherent risk is low, to the audit evidence required to be obtained in paragraphs 17 through 20 – along the lines of what is provided in the flowchart on the IAASB website. We believe that this will provide greater clarity and enable auditors to more effectively apply the standard.</p>
<b>Those Charged with Governance</b>		
2.	AICD	
<b>Regulators and Oversight Authorities</b>		
3.	BCBS	<p><b>1. Identifying and assessing the risks of material misstatement and evaluating identified misstatements</b></p> <p>The ED establishes requirements for identifying and assessing the risks of material misstatement in relation to accounting estimates and the auditor's responses to these risks in paragraphs 13–20. This is supplemented by Application Material in paragraphs A67–A134. The ED then addresses the evaluation of whether accounting estimates and related disclosures are misstated in paragraph 23, including the related Application Material in paragraphs A142–A146. The following sets out our detailed comments on these referenced paragraphs.</p> <p><b>1.1 Auditor assessment of complexity, judgment and estimation uncertainty</b></p> <p>Auditors should have established approaches and procedures to assess the risks of material misstatement of estimates when complexity, estimation uncertainty and significant judgments exist. The ED includes many relevant examples of complex estimates and examples of when accounting estimates are likely to have complex models in paragraph A81. Paragraph A1 includes examples of situations where accounting estimates may be required.</p> <p>Many of these estimates are material to banks, such as ECL, fair value of financial instruments, and goodwill impairment. The complexity of these estimates is high because of the use of forward-looking information, complex models and externally developed models or data, amongst other factors. This increases estimation uncertainty, which consequently increases the risks of material misstatement for these estimates. Furthermore, changes to assumptions, models and data originating from management could add to estimation uncertainty. Given the inherent challenges these particular areas bring for management (in developing the estimate) and auditors (in gathering sufficient appropriate audit evidence), ISA 540 would benefit from additional guidance.</p> <p><b>1.2 Auditor assessment when model complexity exists</b></p>

With respect to an auditor's responsibility to address the risks of material misstatement related to complex methods (or models), paragraph 17 requires auditors to verify whether the calculations are mathematically accurate and appropriately applied. The guidance should be further expanded beyond mathematical accuracy to sufficiently address the risks of material misstatement due to model complexity. For example, the Application Material after paragraph A106 should be further expanded to indicate that the auditor's approach to the testing of models could vary depending on the assessed risk of material misstatement. The approach could range from a simple model review for accounting estimates with low inherent risk, to auditing the performance of the model or independently developing an estimate based on the auditors' own assumptions and/or model (when, in the auditor's judgment, it is necessary and possible) for estimates where inherent risk is not low. Nevertheless, we would emphasise that given the nature of complex internal models within banks, it could prove to be very difficult for an auditor to independently develop their own model for ECL estimates. In that situation, the auditor should put emphasis on assessing the appropriateness of internal processes, including assumptions, controls and the reasonableness of management's ranges and point estimates, as well as the model's theoretical soundness and mathematical integrity.

In addition, the Application Material should be expanded to include criteria for auditors in their consideration of the appropriate use of a particular approach. For example:

- A simple model review could be appropriate to address accounting estimates with an assessed risk of material misstatement that is low, based on low inherent risk. This could include a review of model documentation and methodology, management's governance processes and the internal control environment.
- Auditing the performance of the model may be appropriate to address accounting estimates for which the assessed risk of material misstatement is not low. This could include reviewing management's significant assumptions (considering the appropriateness of the data used and testing its integrity), reviewing the model's theoretical soundness and mathematical integrity, re-running the model to develop an expected outcome and back-testing procedures.

### **1.3 Auditor assessment of management's use of forward-looking information**

The modelling of many accounting estimates requires management to consider forward-looking information and scenarios. Auditing forward-looking information is arguably one of the more challenging aspects of an audit and the ED provides little guidance in this area. We strongly recommend that additional audit guidance be developed for this complex area. We believe this would be helpful, not only for complex estimates in banks, but also for many of the estimates that are within the scope of ISA 540, including those identified in paragraph A1 of the ED. With reference to banks, this guidance would be relevant to the auditor's assessment of ECL accounting estimates, where there is high subjectivity, for example in management's choice of scenarios (which incorporate forward-looking information) and the related probability weights selected.

### **1.6 Scope and assessment of risk**

We support the inclusion in paragraph A73 of examples where "the risks of material misstatement may be influenced by inherent risk that is not low", and in particular that this should be the case for "accounting estimates.....such as an expected credit loss model in a financial institution that is active in different markets". Paragraph A81 also recognises that ECL estimates

		<p>are likely to be based on complex models. We note that the application of the ECL approach involves (i) a high level of complexity; (ii) the exercise of significant judgment; and (iii) high estimation uncertainty. For these reasons, we agree that the ECL assessments by banks should normally remain within the scope of ISA 540, notably because the inherent risk cannot normally be assessed as low for a bank. We make the following additional recommendations to ensure that the standard adequately emphasises the complexity of auditing ECL estimates:</p> <p>(a) Amend paragraph 13 to include the element of paragraph A73 mentioned above, except that the reference to banks using an ECL approach should not be limited to those banks active in different markets, and rather should extend to all banks. In addition, we strongly believe that the inherent risks related to ECL for banks should systematically be considered not low as a rebuttable presumption.</p> <p>(b) Include the contents of paragraph A78 within the Requirements of paragraph 13, to require auditors to consider the factors listed in paragraph A78 when assessing the risks of material misstatement. We strongly believe that the regulatory environment, including relevant regulatory requirements, should be systematically considered as part of the assessment of the risks of material misstatement. In addition, we recommend that paragraph 13 include requirements regarding appropriate documentation in relation to the identification and assessment of the risks of material misstatement, especially when inherent risk is assessed as low.</p>
4.	CEAOB	<p><b>Procedures for low vs. non low risk</b></p> <p>15. Some concerns have been raised regarding par 15, which is not consistently understood. We believe that the Board should consider adding more guidance or redrafting par.15 to state clearly whether the procedures foreseen in par. 15a) are applicable or not in cases when the inherent risk is not low. Level of work effort when an estimation is complex, due to the difficulty in obtaining reliable data and maintaining the integrity of the data.</p> <p>16. The standard (par. 15b) describes that the auditor shall perform further audit procedures when the inherent risk of the estimate is not low. For the cases where the estimates are “complex” the matters to be supported by audit evidence are described in par. 17. This paragraph only applies when a complex method is used by management or when the method otherwise involves specialized skills or knowledge; no further indication is given regarding further procedures required in case of complexity due to the difficulty or unavailability of data. In this second situation of complexity, the standard should also make sure that the auditors appropriately address the following matters:</p> <ul style="list-style-type: none"> <li>a. analysis of the relevance of the changes in method used (if any) since the last period,</li> <li>b. analysis, of the relevance in the changes operated in data sources (if any),</li> <li>c. analysis of the appropriateness of adjustments incorporated, if any, (for instance analysis of the discount/premium applied to the most comparable data obtained when exact comparable data is not available).</li> </ul> <p>The Board should clarify that the provision of par. 18c (ii) and (iii) which is applicable to “judgements” is also applicable to this situation of “complexity”.</p>

		<p>17. In par. 20 we believe the extent to which the amounts used to develop the auditor’s range should be “supported by the audit evidence” should be further clarified, taking into account that all the data cannot always be checked against external data. The meaning of this paragraph needs to be developed through further references to other standards applicable or further guidance.</p>
<p>5.</p>	<p>EBA</p>	<p><b>Nature of accounting estimates</b></p> <p>We agree with the identification of the three factors of accounting estimates (complexity, judgment and uncertainty) in paragraph 13 of the ED as the auditor shall consider these elements when identifying and assessing the risks of material misstatement. These three elements are especially relevant to the audit of ECL which is likely to involve a high degree of judgment and complexity, and not just the ‘uncertainty’ currently envisaged by ISA 540.</p> <p>We also suggest splitting paragraph 3(c)(ii) of the ED into two bullet points: (ii) select an appropriate management point estimate and (iii) make appropriate related disclosures in the financial statements. Appropriate disclosures with respect to estimation uncertainty are necessary in any case, and it is not clear why this is mentioned together with selecting an appropriate management point estimate.</p> <p><b>Identifying and assessing risks of material misstatement</b></p> <p>Although, as mentioned above, we support the proposals for auditors to consider the factors listed in paragraph 13 when identifying and assessing the risk of material misstatement, we would like to stress that we consider that ECL accounting estimates should be systematically considered to have inherent risk which is not low. We therefore believe that paragraph A73 should not limit accounting estimates influenced by inherent risk that is not low to banks active in different markets but rather extend it to all banks. The fact that a bank is active in different markets is not considered relevant as such to the assessment of the risk of material misstatement related to accounting estimates.</p> <p>ECL accounting estimates will always be ‘sensitive to the selection of different methods or to variations in the assumptions and data used’ (as referred to in paragraph 13(c) and A92) and we consider that numerous factors could create sensitivity. In such context, we believe that it would be valuable that some additional guidance was provided on how an auditor needs to consider and assess an accounting estimate’s sensitivity and how an auditor needs to document its consideration of the accounting estimate sensitivity.</p> <p>Finally, we are pleased to note that auditors should, in line with paragraph A78, consider additional relevant factors, such as regulatory requirements, when assessing the risk of material misstatements. We would however recommend having such paragraph A78 placed as a requirement in paragraph 13 of the standard rather than in its application guidance as we consider that regulatory requirements (such as specific prudential own funds requirements for banks) will significantly impact and increase the risk of material misstatements related to accounting estimates.</p> <p><b>Response to the assessed risks of material misstatements - point estimate or range</b></p> <p>The EBA welcomes the objectives-based approach in the ED for the auditor to design and perform audit procedures to respond to the identified risks of material misstatements. This approach should ensure that the auditor’s response to the risk of material</p>

		<p>misstatement is effective avoiding any so called ‘bright lines’ when audit procedures are prescribed for each reason underlying the assessed risk of material misstatement. We also believe that in order for the revised standard to be effectively implemented, this approach should be enhanced by adding in the application guidance of the ED some examples of audit procedures to be performed in order to meet the objectives.</p>
6.	ESMA	<p><b>Factors taken into account in identifying and assessing the risk of material misstatement (Q4-Q6 of the Request for comments)</b></p> <p>23. ESMA agrees that complexity, management judgment and estimation uncertainty are principal factors to be taken into account in identifying and assessing the risk of material misstatement. However, ESMA is of the view that the level of estimation uncertainty represents the first element to be taken into account when identifying and assessing the risk of material misstatement, e.g. in case of reliance on forward-looking information. Consequently, we are of the view that this thought process should be reflected in the structure of the standard that should start with the level of estimation uncertainty, continue with the management judgement before considering complexity. ESMA also notes that the order of factors is different in the body of the standard and in Appendix 2 of the ED.</p> <p><b>Responses to the assessed risks of material misstatement (Q4-Q6 of the Request for comments)</b></p> <p>26. ESMA is of the view that the structure of the requirements in the paragraphs 14-20 of the ED could be improved by more clearly addressing the two situations in paragraph 15 (i.e. specifically identifying audit procedures to be performed (a) when inherent risk is low and (b) when inherent risk is not low). Furthermore, paragraph 15(a) could explicitly require an auditor to assess whether previous audit procedures performed provide sufficient appropriate audit evidence, when inherent risk is low.</p> <p>27. While ESMA agrees with the matters of which the auditor needs to obtain audit evidence (paragraphs 17- 20 of the ED), we are of the view that they do not give an answer to the question what is sufficient appropriate audit evidence regarding cases with complexity, judgement or estimation uncertainty. We are of the view that specific audit procedures or specific practical guidance should be added to the application guidance.</p> <p>28. ESMA is of the view that paragraph 18(c)(ii) that requires the auditor to obtain sufficient appropriate audit evidence on whether changes from the previous period’s model are appropriate in the circumstances should be clarified. In particular, the guidance should address separately changes in the model and changes in the outcome of the model. Furthermore, the auditor should be required to obtain sufficient appropriate audit evidence when assessing reasons for a significant change in the model or a significant difference in the accounting estimate as well as in situations when there is a significant change in circumstances but no significant change in related accounting estimate.</p> <p>29. Furthermore, ESMA is of the view that the application guidance in paragraph A126 should be turned into requirement in paragraph 19(b). Consequently, when in the auditor’s judgment, management has not appropriately understood and addressed the estimation uncertainty; the auditor should request management to consider alternative assumptions or to provide additional disclosure relating to the estimation uncertainty, before developing its own estimate. At the same time, in our view, the IAASB should explicitly address the consequences of the auditors’ assessment that management has not appropriately understood and addressed the estimation uncertainty on the audit opinion and on reporting of key audit matters.</p>

**30. ESMA is of the view that evaluation of estimation uncertainty needs to be specified by (i) further clarifying paragraph A129 of the ED with regards to circumstances when it is appropriate to develop an auditor's point estimate and when a range and (ii) providing additional application guidance how the criteria in paragraph 20 of the ED could be met.**

**31. Finally, in our view, given that the accounting estimates are often subject to significant management judgement, the standard should include a separate requirement of obtaining relevant management's documentation regarding accounting estimates as part of obtaining sufficient appropriate audit evidence. Subsequently, taking into account the documentation received from management an auditor shall assess the appropriateness of an accounting estimate and conclude on its impact on the overall audit.**

*Risk assessment (Q4-Q6 of the Request for comments)*

1. The ED proposes a different risk model for risk assessment related to audit of accounting estimates compared to extant ISA 315. While ISA 315 broadly distinguishes between significant and non-significant risks, the ED acknowledges low inherent risk and non-low inherent risk in addition to significant risk. In our view, the ED does not describe and explain clearly and unequivocally (i) the risk level not being low and (ii) significant risk(s) and does not explain the relation between them. Consequently, ESMA encourages the IAASB to clarify further the risk model in the ED and its relation to the existing requirements of ISA 315.
2. ESMA agrees with the proposed risk assessment procedures and related activities in paragraph 10 of the ED. However, ESMA believes that the IAASB should consider that understanding of risk and related internal control related to (i) the preparation of accounting estimates and related disclosures by management as required by the respective financial reporting framework and (ii) the completeness of the estimates made by management should be explicitly considered as part of the understanding of the entity and its environment.
3. ESMA emphasises the importance of using specialised skills when auditing accounting estimates, notably when those estimates rely on complex modelling. Therefore, we welcome the requirement that the auditor needs to determine early in the audit process whether specialised skills or knowledge are required, in order to perform the risk assessment procedures, or to identify and assess the risks of material misstatement. However, we are of the view, that the importance of the use of specialised skills and knowledge should be highlighted in all phases of the audit of accounting estimates not only as part of the risk assessment. Use of specialised skills might be indispensable also during the planning stage, during performing testing of controls or substantive testing, notably in complex environment.

*Factors taken into account in identifying and assessing the risk of material misstatement (Q4-Q6 of the Request for comments)*

4. ESMA agrees that complexity, management judgment and estimation uncertainty are principal factors to be taken into account in identifying and assessing the risk of material misstatement. However, ESMA is of the view that the level of estimation uncertainty represents the first element to be taken into account when identifying and assessing the risk of material misstatement, e.g. in case of reliance on forward-looking information. Consequently, we are of the view that this thought process should be reflected in the structure of the standard that should start with the level of estimation uncertainty, continue with the management judgement before considering complexity. ESMA also notes that the order of factors is different in the body of the standard and in Appendix 2 of the ED.

Testing of effectiveness of internal controls (Q4 and Q6 of the Request for comments)

5. ESMA welcomes the application guidance in the ED on the testing of effectiveness of internal controls over the accounting estimates and over the process of their preparation. In order to ensure that the auditors are required to test internal controls over the ECL in all appropriate circumstances (such as for financial institutions), guidance currently proposed for paragraph A98 should be further expanded and incorporated in the requirements section of the standard.
6. ESMA also believes that the importance of the testing of internal controls over the accounting estimates should be highlighted when performing procedures related to risk assessment and responses to the assessed risk of material misstatement. In reference to the latter, ESMA suggests that the relevant guidance in paragraphs A48-A60 of the ED related to auditor obtaining an understanding of internal controls (paragraph 10(f) of the ED) could be linked and emphasised in the requirements related to the auditor responses to the assessed risk of material misstatement (notably to paragraph 16 of the ED).

Responses to the assessed risks of material misstatement (Q4-Q6 of the Request for comments)

7. ESMA is of the view that the structure of the requirements in the paragraphs 14-20 of the ED could be improved by more clearly addressing the two situations in paragraph 15 (i.e. specifically identifying audit procedures to be performed (a) when inherent risk is low and (b) when inherent risk is not low). Furthermore, paragraph 15(a) could explicitly require an auditor to assess whether previous audit procedures performed provide sufficient appropriate audit evidence, when inherent risk is low.
8. While ESMA agrees with the matters of which the auditor needs to obtain audit evidence (paragraphs 17- 20 of the ED), we are of the view that they do not give an answer to the question what is sufficient appropriate audit evidence regarding cases with complexity, judgement or estimation uncertainty. We are of the view that specific audit procedures or specific practical guidance should be added to the application guidance.
9. ESMA is of the view that paragraph 18(c)(ii) that requires the auditor to obtain sufficient appropriate audit evidence on whether changes from the previous period's model are appropriate in the circumstances should be clarified. In particular, the guidance should address separately changes in the model and changes in the outcome of the model. Furthermore, the auditor should be required to obtain sufficient appropriate audit evidence when assessing reasons for a significant change in the model or a significant difference in the accounting estimate as well as in situations when there is a significant change in circumstances but no significant change in related accounting estimate.
10. Furthermore, ESMA is of the view that the application guidance in paragraph A126 should be turned into requirement in paragraph 19(b). Consequently, when in the auditor's judgment, management has not appropriately understood and addressed the estimation uncertainty; the auditor should request management to consider alternative assumptions or to provide additional disclosure relating to the estimation uncertainty, before developing its own estimate. At the same time, in our view, the IAASB should explicitly address the consequences of the auditors' assessment that management has not appropriately understood and addressed the estimation uncertainty on the audit opinion and on reporting of key audit matters.
11. ESMA is of the view that evaluation of estimation uncertainty needs to be specified by (i) further clarifying paragraph A129 of the ED with regards to circumstances when it is appropriate to develop an auditor's point estimate and when a range and (ii) providing additional application guidance how the criteria in paragraph 20 of the ED could be met.

		<p>12. Finally, in our view, given that the accounting estimates are often subject to significant management judgement, the standard should include a separate requirement of obtaining relevant management's documentation regarding accounting estimates as part of obtaining sufficient appropriate audit evidence. Subsequently, taking into account the documentation received from management an auditor shall assess the appropriateness of an accounting estimate and conclude on its impact on the overall audit.</p> <p><u>Audit documentation</u></p> <p>13. ESMA is disappointed that the requirements related to the documentation of the auditing of accounting estimates do not seem to be sufficiently developed in the ED. ESMA is of the view that it would be appropriate to expand and define the documentation requirements included in the paragraph 27 of the ED as well as cross-refer them to the requirements of paragraphs 8 and A10 of ISA 230 - <i>Audit Documentation</i>. While ESMA does not support repetition of the requirements of other auditing standards, ESMA is of the view that the IAASB should consider transforming the relevant part of the application guidance specifically related to documentation of the audit of accounting estimates currently included in paragraph A158 into requirements within paragraph 27 of the ED.</p> <p>14. We are of the view that estimation uncertainty, use of judgement and complexity of accounting estimates warrant additional documentation of the work of the auditors in this area than currently proposed by the ED. While we agree with the general intention of paragraph 27 of the ED, ESMA is concerned that the requirement of paragraph 27(a) of the ED is not sufficiently specific to ensure documentation of all substantial judgements and procedures when auditing this complex and judgemental area of financial reporting.</p> <p>15. Therefore, ESMA suggests that the auditor should be required to document, with regards to all significant accounting estimates, as a minimum:</p> <ol style="list-style-type: none"> <li>a. the basis for the auditor's conclusions on the reasonableness of areas of subjective judgement (as included in paragraph 27(a) of the ED);</li> <li>b. assessment and evaluation of the accounting estimates, including their specific risk factors;</li> <li>c. significant judgements made by the auditor when assessing the accounting estimates;</li> <li>d. how professional scepticism in auditing accounting estimates was ensured; and</li> <li>e. assessment and evaluation of the factors driving potential risks related to the accounting estimates.</li> </ol> <p>ESMA is of the view that specific requirements for audit documentation of accounting estimates in ISA 540 (Revised) would specify the generic requirements in paragraph 32 of ISA 315.</p> <p>16. Finally, ESMA notes that the documentation requirements should be extended by specific requirements related to the documentation of the identification and assessment of the risk of material misstatement in relation to the accounting estimates by the auditor. This is because in our view, the reference to ISA 315 in paragraph 13 of the ED seems to be overly restrictive and might not capture documenting auditors' identification and assessment of the individual relevant factors, which the accounting</p>
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		<p>estimate is subject to. In our view, such documentation requirement is even more relevant when the auditor assesses the inherent risk of misstatement as low.</p> <p><u>Key audit matters</u></p> <p>17. ESMA appreciates the reference to the link between certain aspects of the audit of accounting estimates related to estimation uncertainty and the key audit matters in paragraph A125 of the ED. However, ESMA strongly believes that the interaction between the audit of accounting estimates (and notably the auditor work on assessment of its elements of estimation uncertainty, management judgement and complexity) and key audit matters should be further developed in the requirements section of ISA 540 (Revised).</p> <p><u>Disclosures</u></p> <p>18. ESMA welcomes the requirements of paragraph 21 on the audit of disclosures related to accounting estimates. ESMA highly appreciates the requirements of paragraph 21(a) and strongly supports the requirement that the auditor should evaluate whether the management has provided all the disclosures that not only meet the objective of the disclosure requirements but also ensure fair presentation of the financial statements as a whole. However, ESMA is of the view that this requirement could be better explained (e.g. by building on the description provided in paragraph A120 that seems to be more clear and explicit as the requirements) and further exemplified in the application guidance.</p>
7.	<b>IAIS</b>	<p>Generally, we think the requirements will support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates. In particular, we find that para. 16 and A98-A100 on internal control considerations fit well within that section.</p> <p>However, we feel the guidance material around third-party model considerations within para. A104 should be expanded, given the additional risks that management may not be fully aware of and/or have complete documentation relating to the model's limitations and features.</p> <p>Also, we think there could be a stronger link established between the associated categories of an inherent risk that is not low and a significant risk, especially as the auditor is required to meet certain requirements under other ISAs when the risk is identified as a significant risk.</p> <p>To establish a stronger link, the IAASB may want to consider:</p> <ul style="list-style-type: none"> <li>- Including the following additional wording within para. 16 to make it consistent with requirements in ISA 330 para. 15, "...the auditor shall design and perform tests of controls <u>in the current period</u> to obtain sufficient appropriate audit evidence as to their operating effectiveness."</li> <li>- Including the following additional wording at the end of the para. A76 "...including control activities <u>relevant to that specific risk</u>.", as this would better reflect the ISA 315 specific requirements linked to the fact that a risk is considered a 'significant risk'.</li> <li>- Expanding para. A76 to highlight the important ISA 315 para. 27 consideration that "In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk."</li> </ul>

		<p><b>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</b></p> <p>Yes, we support requirements for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty.</p> <p>However, we find the ISA-540 could be better worded in certain areas discussing estimation uncertainty to ensure the focus is on the extent of it and not merely its existence. Clearly, the para. 9 (a) definition of ‘accounting estimate’ highlights it is a measurement subject to estimation uncertainty, i.e. all accounting estimates will have estimation uncertainty. Consequently, when identifying, assessing and responding to the risk of material misstatement due to estimation uncertainty, the relevant consideration should appropriately be on the extent of the estimation uncertainty, not merely its existence. However, while para. 13 (c) discusses extent of estimation uncertainty, the para. 19 wording does not, and can be read as focussing more on its existence. We suggest adding wording to para. 19 to ensure the focus is properly on the extent of estimation uncertainty as the relevant consideration.</p> <p><b>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</b></p> <p>Generally, we believe there is sufficient guidance in relation to the proposed objectives-based requirements in para. 17 to 19. However, we are concerned with the potential for confusion around the use of particular nuanced key words in multiple contexts within the ED, for example:</p> <ul style="list-style-type: none"> <li>- As noted within para. A2, the notion of ‘reasonable’ that is used in various paragraphs is meant to indicate that all the relevant requirements of the applicable financial reporting framework have been applied appropriately. This definition of ‘reasonable’ is clearly meant to be different from the meaning of ‘reasonable assurance’ (para 37 in ISA 700), and is (as outlined in A3) not identical to the meaning of ‘appropriate’. However, we are concerned that the nuances being applied to these commonly used words can create confusion. The IAASB should ensure that the definitions introduced are consistently applied; we note that the use of the term ‘reasonable’ in para. A124 does not appear to be consistent with its definition in para. A2;</li> <li>- The para. 9 (f) definition of ‘outcome of an accounting estimate’ clearly highlights it is an actual monetary amount that results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by an accounting estimate. However, we note the term ‘outcome(s)’ is used in the ED in different contexts, many which are relevant for the audit of insurance contract liabilities (“range of outcomes”, “outcomes scenarios” etc.), and so this may create some confusion. Also the term ‘outcomes of the accounting estimates’ is used in para. A109 within a context that is not consistent with the para. 9(f) definition.</li> </ul> <p>We suggest this wording be revisited to increase clarity.</p>
8.	IFIAR	<p><b>Enhancement in the Exposure Draft (ED)</b></p> <p><b>6. We generally believe that the proposals in this ED are a step in the right direction and can help drive better audit quality</b></p>

		<p>by requiring auditors to perform risk assessment procedures specifically addressing factors relevant to accounting estimates. Conceptually requiring auditors to take into account the factors of complexity, judgment and estimation uncertainty and their related inherent risks when identifying and assessing the risks of material misstatement should lead to a more effective audit response, specifically in the area of complex estimates.</p> <p>The determination of whether an estimate is low inherent risk or not and which of the risk factors are relevant are key elements of the revisions proposed in the ED. The IAASB should clarify whether estimates can only be assessed as low inherent risk where none of the risk factors are relevant or whether another basis for concluding on low inherent risks is appropriate. We also believe the ED should require that the auditor documents the risk assessment determination of low inherent risk estimates.</p> <p>13. In addition, we foresee challenges in the execution of the inherent risk assessment in ED 540 as to whether inherent risk and control risk are to be assessed separately or in combination, which could lead to a different response in terms of work effort. We believe further clarification would help ensure consistency in the risk assessment procedures. Provisions described in paragraph A95 should be deleted from the ED to ensure the auditor understands that the audit response is based on inherent risk only, because A95 suggests that a combined risk assessment is permissible.</p>
<p>9.</p>	<p>IOSCO</p>	<p><b>Responses to the assessed risks of material misstatement</b></p> <p>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.</p> <p>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’.</p> <p>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.</p> <p><b>Application of testing objectives in paragraphs 15 and 17-20</b></p> <p>As stated above, we believe that the testing objectives in paragraphs 17-20 of the ED should apply to both situations where inherent risk is assessed as ‘not low’ and where inherent risk is assessed as ‘low’. For example, the appropriateness of the valuation method and assumptions, the relevance and reliability of significant data, and the accuracy of calculations (see paragraph 17) all appear to be applicable matters whether inherent risk is assessed as ‘low’ or ‘not low.’ The assessed risk should only affect the nature, timing and extent of the procedures to be applied by the auditor, not the testing objectives.</p> <p>The testing objectives in paragraphs 15 and 17-20 should be included in a single list that applies irrespective of the assessed inherent risk. This may necessitate reviewing the testing objectives and, for example, removing duplication and addressing</p>

overlap.

**Risks that relate to ‘complexity,’ ‘judgement’ and ‘estimation uncertainty’**

Paragraphs 17 to 19 of the ED would require the auditor to determine which of ‘complexity,’ ‘judgement’ or ‘estimation uncertainty’ give rise to inherent risk being assessed as ‘not low’ and then only satisfy the testing objectives under the relevant category. However, we believe that the three concepts are often not sufficiently separable to guide an effective audit response. For example, estimation uncertainty is by definition (paragraph 9(a)) a key characteristic of any accounting estimate. Furthermore, estimation uncertainty is often a function of a complex model used in the estimation process that may also require significant judgment from management. As such, it would appear that many (if not all) of the testing objectives in paragraphs 17-20 would represent relevant considerations for most (if not all) accounting estimates, including accounting estimates with a ‘low’ assessed inherent risk. However, the ED separates them into three distinct categories.

The following examples illustrate the lack of clarity as to why certain testing objectives were considered relevant to one but not the other reasons for the auditor’s risk assessment. In most of these examples we illustrate one area in which the objective may also apply but, as discussed above, we believe these objectives would apply to most (if not all) estimates, including estimates with a low assessed inherent risk:

- It is not clear why some level of data testing, as required by paragraphs 17(b) to 17(d), would not be a relevant consideration for virtually all accounting estimates that use data especially when testing how management made the accounting estimate (while we acknowledge that paragraph 18(a) directs the auditor to evaluate whether management’s judgements regarding the selection and use of the method and the significant data and assumptions are appropriate, the ED only appears to require such direct testing of data for estimates associated with inherent risk that is ‘not low’ based on the estimates’ complexity);
- It is unclear why the requirement for the auditor to obtain sufficient appropriate audit evidence about whether management has appropriately understood or interpreted significant data when the reason for the inherent risk assessment of ‘not low’ includes complexity (paragraph 17(c)) would not also apply where judgement by management is the factor that gave rise to the inherent risk assessment as ‘not low’;
- It is not clear why the testing objectives related to judgements on complex modelling when the reason for the inherent risk assessment of ‘not low’ includes judgment (paragraph 18(c)) would not also be applicable when ‘complexity’ was the factor that gave rise to the inherent risk assessment;
- It is not clear whether paragraph 18(a)(iii) should also include significant data and not just significant assumptions when assessing the consistency of information used in accounting estimates and other areas of the entity’s business activities;
- It is not clear why it would not be appropriate for the auditor to develop his or her own point estimate or range in certain circumstances when assessing whether management’s point estimate is reasonable where estimation uncertainty (paragraph 19(a)(ii)) or complex methods (paragraph 17) are the factors that gave rise to the auditor’s inherent risk assessment as ‘not low’. The auditor may decide to develop his or her own point estimate or range to challenge

management's estimate. In the ED, the development of the auditor's point estimate or range seems to only apply when management has not appropriately understood and addressed the estimation uncertainty (paragraph 19(b)) or where inherent risk is low (paragraph 15(a)(iii)).

Furthermore, we are concerned with any inference that in instances where management has not appropriately understood or addressed the estimation uncertainty of an accounting estimate, this can be overcome by the auditor's response. The auditing standards should not imply that the auditor's responses could abdicate management of their financial reporting responsibilities; and

- It is not clear why the need to consider whether adjustments to the output of the model are consistent with the reporting framework applies only under the 'judgement' concept (paragraph 18(c)(iii)) and would not also apply to estimates where the reasons for the inherent risk assessment of 'not low' include 'complexity' or 'estimation uncertainty'.

As a result of the difficulty to distinguish among 'complexity,' 'judgment' and 'estimation uncertainty', there is a risk that auditors may default to responding only to some of the reasons for the assessment given to the risk of material misstatement. In those circumstances, due to the segregated nature of the testing objectives in paragraphs 17-20, auditors might omit certain testing objectives that, while not associated with the key drivers of the auditors' risk assessment, are still important to the ultimate audit conclusion.

Alternatively, given the difficulty in distinguishing between the concepts of 'complexity,' 'judgement' and 'estimation uncertainty', auditors may default to addressing all the testing objectives in paragraphs 17-20. In that case, they may be confused by the seemingly overlapping nature of some testing objectives. For example, both paragraphs 17(a) and 18(a) require auditors to evaluate certain aspects of the appropriateness of management's selection of the methods, significant data and assumptions used in the estimation process.

Given the objective based nature of the requirements in paragraphs 17-20 and the potential overlap among the concepts of 'complexity,' 'judgment' and 'estimation uncertainty' and their related testing objectives, the Board should consider whether all (or a subset of) the testing objectives in paragraphs 17-20 should be required to be met for all accounting estimates, irrespective of the reason for the assessment of their inherent risk as 'low' or 'not low' risk, and whether or not the auditor places reliance on controls. Under such an approach, auditors would respond to the assessed risks of material misstatement by varying the nature, timing, and extent of the further audit procedures performed in response to the defined testing objectives.

While we would not support the approach in the ED of only applying the testing objectives based on which of 'complexity', 'judgement' and 'estimation uncertainty' gives rise to an assessment that inherent risk is 'not low', if the revised ISA 540 adopts that approach, the following should be made clear:

- (a) Whether the testing objectives under 'estimation uncertainty' should always apply regardless of whether inherent risk is assessed as 'low' or 'not low' and the reasons for that assessment; and
- (b) The distinction between the concepts of 'complexity', 'judgement' and 'estimation uncertainty'.

		<p><b>Risks that do not relate to ‘complexity’, ‘judgement’ or ‘estimation uncertainty’</b></p> <p>The testing objectives in the ED described in paragraphs 17-20 apply where risk is assessed as ‘not low’. These testing objectives are limited to situations in which the reasons for the assessment given to the risk of material misstatement include either complexity (paragraph 17), judgment (paragraph 18), or estimation uncertainty (paragraphs 19-20). It is not clear, and the Board should clarify, what procedures an auditor should perform when the inherent risk of an accounting estimate is assessed as ‘not low’ but for reasons other than complexity, judgment, or estimation uncertainty. It appears the standard allows for other reasons with the use of “including” when discussing the relevant factors considered in the auditor’s risk assessment in paragraph 13.</p> <p><b>Objective based requirements</b></p> <p>The “Explanatory Memorandum to ED-540” explains that the requirements in paragraphs 17-20 are not drafted in the form of procedures that shall all be performed, or a list of possible procedures from which the auditor should choose. Instead, these paragraphs contain requirements that are focused on objectives (“testing objectives”) that the procedures selected by the auditor need to accomplish.</p> <p>We are concerned that the lack of specificity as to the nature and extent of the further audit procedures that the auditor should perform, or consider performing, in connection with paragraphs 17-20 might lead to inconsistent audit approaches and an inability of regulators to enforce high-quality audits. Therefore, we ask the Board to consider providing further requirements for the audit procedures that the auditor should perform, or consider performing, to achieve the testing objectives in paragraphs 17-20.</p>
10.	IRBA	<p>Questions 4(a)</p> <p>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?</p> <p>14. The enhanced risk identification and assessment process, including the three relevant factors, introduced in paragraphs 10-13 of ED-540 will assist the auditor in identifying and assessing the risk of material misstatement, whether inherent risk is low or not.</p> <p>15. However, there are several observations that the IRBA would like to bring to the IAASB’s attention:</p> <ul style="list-style-type: none"> <li>a. Please refer to the uncertainty expressed in paragraph 12(b) above that should be addressed.</li> <li>b. Paragraph A9 of ED-540 sets out the purpose for performing risk assessment procedures. As a result, paragraph A9 should be elevated to a requirement and introduced as paragraph 10A. If it is not elevated, it may have the effect of the auditor not considering whether the understanding obtained of the entity and its environment, including its internal controls, is sufficient to identify and assess the risks of material misstatement, including determining whether, in the auditor’s judgment, any of those risks are significant risks; and plan the nature, timing and extent of further audit procedures.</li> </ul>

- c. Paragraph A39 of ED-540 provides application material on data, including data that is observed directly and derived data. Although derived data is explained, it would be beneficial to provide examples of derived data.
- d. Paragraph A49 of ED-540 notes that some accounting estimates may be significantly affected by, or subject to, complexity, the need for use of judgment by management and estimation uncertainty. It further notes that in such cases it will be more important for the auditor to understand the design and implementation of relevant controls, and also to test their operating effectiveness in addressing the assessed risks of material misstatements. The first part of this statement, as it relates to it being more important to understand the design and implementation of relevant controls, may be misleading because the auditor is always required to understand the design and implementation of relevant controls (ISA 315 (Revised), paragraphs 26(a) and A132) and this paragraph should therefore be amended.
- e. Paragraph A55 of ED-540 deals with understanding an entity's risk assessment process when the entity has such a process in place. Paragraph A55 does not deal with the situation when an entity does not have a formal risk assessment process in place, as anticipated in paragraph 17 of ISA 315 (Revised). Even though ED-540 should be read together with ISA 315 (Revised), ED-540 should also deal with the situation when an entity does not have a formal risk assessment process in place.
- f. Paragraphs A72 and A73 of ED-540 provides examples, respectively, of accounting estimates with low inherent risk and with inherent risk that is not low. These two paragraphs would be better placed as application material to paragraph 15 of ED-540, with paragraph A72 placed above paragraph A96 and paragraph A73 placed above paragraph A97.

## Question 4(b)

When inherent risk is not low (see paragraphs 13,15 and 17-20), do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgement by management and the potential for management bias, and estimation uncertainty?

- 16. We do support the requirement in ED-540 for 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. However, ED-540 only includes objective-based requirements (paragraphs 17-19) to address the three relevant factors (complexity, judgment and estimation uncertainty).
- 17. ED-540 does anticipate that there may be other relevant factors that the auditor may consider in identifying and assessing the risks of material misstatement. This is explained in paragraph A78 of ED-540.
- 18. A more robust explanation about other relevant factors should be included in the requirements of ED-540. This could be achieved by elevating paragraph A78 to a requirement and having it introduced as paragraph 13A.
- 19. In addition, it should be clarified more clearly in paragraph 15 of ED-540 that the auditor's further audit procedures shall also be responsive to those risks of material misstatement over accounting estimates that are subject to, or affected by, any other relevant factors that have been identified.

## Question 4(c)

		<p>When inherent risk is not low (see paragraphs 13,15 and 17-20), is there sufficient guidance in relation to the proposed objective-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>20. We agree with the introduction of the granular objective-based requirements contained in paragraphs 17-19 of ED-540.</p> <p>21. The objective-based requirements contained in paragraphs 17-19 of ED-540 provide good guidance to the auditor. However, there are several comments provided to us by a few technical and lead partners of banks from firms on where the guidance contained in paragraphs 17-19 and the related application material could be strengthened. Those comments are as follows:</p> <ul style="list-style-type: none"> <li>a. Regarding paragraphs 17-19 of ED-540, guidance should be provided on how the auditor should respond when an event that may affect the forward-looking inputs/variables/assumptions and ultimately the impairment provision (e.g. sovereign credit downgrade or severe devaluation in currencies) occurs after the balance sheet date, but before the audit report is signed.</li> <li>b. Paragraph 19(b) of ED-540 requires that only when in the auditor’s judgment management has not appropriately understood and addressed the estimation uncertainty shall the auditor, to the extent possible, develop an auditor’s point estimate or range. Our view is that the auditor should always be required to develop a point estimate or range when the reasons for the assessment given to the risk of material uncertainty includes estimation uncertainty. Our reason for this is that without the auditor developing a point estimate or range, the auditor may not be able to assess whether management has appropriately understood and addressed the estimation uncertainty.</li> <li>c. Regarding paragraphs 19(b) and 20 of ED-540: <ul style="list-style-type: none"> <li>i. It is noted that the more obscure the inputs/variables/assumptions are within a model to develop an impairment provision, the more difficult it will be for management and the auditor to develop a close/tight range. This, along with other obscure inputs/variables/assumptions, may adversely affect the extent of estimation uncertainty related to an impairment provision. Therefore, it is necessary that ED-540 provide more guidance on this matter as it will likely be more prevalent in developing economies.</li> <li>ii. The auditor may be required to “stress-test” each input/variable/assumption where the auditor concludes that management’s input/variable/assumption does not fall within the auditor’s range and determine the effect of that difference on the impairment provisions. The ED-540 should provide more guidance on this matter.</li> <li>iii. It is important for the auditor to test that the inputs/variables/assumptions used when calculating an impairment provision should be the same inputs/variables/assumptions as those used by management when developing budgets and considering pricing. ED-540 should provide more guidance on this matter.</li> </ul> </li> </ul> <p>22. Regarding paragraphs 13 and A74, ED-540 should provide more guidance on the extent of further audit procedures and how the auditor should respond when the auditor has identified that an accounting estimate is subject to, or affected by, more than one of the relevant factors.</p> <p>23. It is necessary for paragraph 17 of ED-540 to be cross-referenced to paragraph 8 of ISA 500 that deals with audit evidence that has been prepared using the work of a management expert. (Refer to the “editorial comments” section below.)</p>
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		<p>Significant risks</p> <p>24. Paragraph 15 of ED-540 concludes with the sentence: “The auditor’s further audit procedures shall be responsive to the reasons for the assessment given to the risk of material misstatement in accordance with paragraph 13, recognizing that the higher the assessed risk of material misstatement the more persuasive the audit evidence needs to be.” However, ED-540 does not provides sufficient guidance to auditors on the extent of further audit procedures and how the auditor should respond when the auditor has identified a significant risk. Additional guidance in this regard should be provided.</p>
11.	UKFRC	<p><b>Introducing the requirement to have regard specifically to the qualitative inherent risk factors, and in particular those of ‘complexity’ and ‘judgement’ in addition to estimation uncertainty, when performing risk assessment procedures and designing responses to those assessed risks. We believe this is essential to facilitating an appropriate audit response to more complex accounting estimates, rather than just focussing on estimation uncertainty. However, we believe the inter-relationship between the factors and how they affect the susceptibility to misstatement could be better explained - see our response to Q4 (b) and Attachment 2.</b></p> <p><b>Using the term ‘reasonable’ for both the estimate and disclosures, subject to ensuring its meaning, and that of “appropriate”, is clear as set out in paragraphs A2 and A3, which we recommend are incorporated in the definitions. We comment further on this in our response to Q4(c), including recommending that paragraph A123, which currently supports A2, is elevated to a requirement.</b></p> <ul style="list-style-type: none"> <li>• <b>Having work effort requirements expressed in an objective/outcome based manner to address different types of accounting estimate and proportionality, whilst driving more consistent and granular work to obtain sufficient appropriate audit evidence.</b></li> <li>• <b>Not requiring particular types of procedures on the basis of whether risks are significant risks. Procedures that are appropriate for ‘significant risks’ would also be appropriate for many risks that are not determined to be ‘significant risks’. This would reflect the expectations of those investors we have spoken to in our outreach.</b></li> <li>• <b>We support the focus on the factors of complexity and judgment as well as estimation uncertainty. However, in our outreach we have encountered confusion as to how these factors inter-relate. We believe the differences and inter-relationships between the factors could be further explained, so that they do not give rise to such confusion or conflation in implementation. We comment further on this, and give a suggested explanation, in our response to Q4 (b) and Attachment 2.</b></li> <li>• <b>Further guidance on internal controls that may be relevant in the audit of estimates could helpfully be provided. We comment further on this in our response to Q4(c).</b></li> <li>• <b>There is a very significant amount of application material in comparison to the number of requirements. We are concerned that some of the application material identifies actions that would be expected of the auditor in particular circumstances, but their presentation as actions the auditor ‘may’ take risks them not always being performed when appropriate and could lead to inappropriate or inconsistent practice. We strongly recommend that the IAASB review all the application material and consider whether designating potential actions by the auditor as “may” is appropriate.</b></li> </ul>

Where they represent actions that should be expected when applicable circumstances exist that should be made clearer, eliminating the “may” and/or moving the points to requirements. We comment further on this, with examples, in our response to Q4(c).

#### Identifying and assessing the risks of material misstatement

Paragraph 13 requires the auditor to “... take into account the extent to which the accounting estimate is subject to, or affected by, one or more, relevant factors, including [complexity, judgment and estimation uncertainty]”. However, there is no explicit requirement to evaluate the degree to which the estimate is subject to, or affected by, the other qualitative inherent risk factors identified in paragraph A78, which may result in them not receiving sufficient appropriate attention.

We recommend that paragraph 13 is amended to explicitly require the auditor to take into account the other inherent risk factors of ‘change’ and ‘susceptibility of material misstatement due to fraud’.

Procedures responsive to ‘change’ are already included with those for ‘judgment’ (e.g. in 18(a)(ii)) so, on this basis, the risk factor of change could be included by rewording 13(b). For example;

The need for the use of judgment by management, including to respond to circumstances giving rise to a need for changes in the method, assumptions or data used, and the potential for management bias, including with respect to methods, assumptions, and data;”

This would also address what could be perceived to be a weakening in the ED compared with extant ISA 540, which includes a more explicit requirement for the auditor to determine whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances.

Where ‘susceptibility of material misstatement due to fraud’ is identified as a relevant factor, the auditor should be directed to ISA 240.

#### Responses to assessed risks of material misstatement

Paragraph 15 sets out requirements to design and perform further audit procedures to respond to assessed risks of material misstatements. It identifies specific procedures that may be appropriate when inherent risk is low or, if it is not, directs the auditor to the requirements in paragraphs 17-20. There is a hanging paragraph at the end of 15 that requires that these further audit procedures shall be responsive to the reasons for assessment of the risk of material misstatement.

Paragraph 16 requires that “If the auditor intends to rely on controls relating to accounting estimates, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to their operating effectiveness.” Since tests of controls are “further audit procedures”, which are therefore designed and performed in accordance with paragraph 15, the requirement in the hanging paragraph in 15 also applies in relation to any such tests of controls. However, this is not stated explicitly.

We believe this presentation is ambiguous and we recommend that it is clarified that the hanging paragraph applies also in relation to tests of controls. This could be achieved by amending the hanging paragraph as follows

**“The auditor’s further audit procedures, including any tests of controls (see paragraph 16), shall be responsive to ....”**

**Estimation uncertainty**

**Paragraph 19 establishes requirements for procedures when the reasons for assessing inherent risk as not being low include estimation uncertainty. Given that estimation uncertainty is (by definition) always present, we believe that if there is an assessment that the risk of material misstatement is not low, then the risk attributable to estimation uncertainty would always be expected to be a contributing factor to that. Accordingly, we believe that paragraph 19 should always apply whenever inherent risk is not low.**

- a) *Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?*

In principle, we believe that they should. While we understand why it was not possible, it is unfortunate that the project to revise ISA 315 could not have taken place at the same time. This would have enabled the developing thinking in relation to the spectrum of risk and risk factors, and how significant risk fits within that, to have been aligned. As it is, we believe that some conforming amendments to the revised ISA 540 may be required as part of the ISA 315 revision.

- b) *Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?*

Yes. We believe it has the potential to deliver significant improvements in the identification and the design and implementation of appropriate responses by auditors to risks of material misstatement relating to accounting estimates.

However, we believe the differences and inter-relationships between the factors could be further explained, so that they do not give rise to confusion or conflation in implementation. In discussing this with Stakeholders in the UK, we have found the Table and the explanation that follows it in Attachment 2 to be helpful.

- c) *Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?*

*Balance between requirements and application material*

As stated above we support having the work effort requirements expressed in an objective/outcome based manner as this facilitates the flexibility needed to address different types of accounting estimate and proportionality, whilst driving more consistent and granular work effort to obtain sufficient appropriate audit evidence. However, there is a fairly high amount of guidance given in relation to paragraphs 17 to 19 (indeed the ED in general includes a high amount of guidance in relation to the number to requirements) and we believe that it would be appropriate to elevate some of that guidance to the requirements. For example:

A101 – When management uses a complex method, the expectation ought to be that the auditor will consider whether there were other available valuation concepts, techniques or factors, types of assumption or sources of data that, in the circumstances, might

have been more appropriate, or more generally accepted, in the context of the applicable financial reporting framework.

A105 third bullet - When the accounting estimate is based on complex legal or contractual terms, it is to be expected that the auditor would inspect the underlying contract.

A123 - We believe that, when applicable, these matters “will” be relevant in obtaining sufficient appropriate audit evidence. See also our further discussion of this in the Attachment to this letter.

A126 - We believe that when, based on the audit evidence obtained, in the auditor's judgment, management has not appropriately understood and addressed the estimation uncertainty, before the auditor moves to develop an auditor's point estimate or range, it should discuss the circumstances with management and obtain an understanding of why management has not appropriately understood and addressed estimation uncertainty. If appropriate, the auditor should ask management to consider alternative assumptions or to provide additional disclosure relating to the estimation uncertainty.

We strongly recommend that the IAASB review all the application material and consider whether designating potential actions by the auditor as “may” is appropriate. Where they represent actions that should be expected when applicable circumstances exist that should be made clearer, eliminating the “may” and/or moving the points to requirements.

We also believe that, given the importance of understanding the meaning of “reasonable” and “appropriate”, paragraphs A2 and A3 should be reworked and included as definitions of those terms.

Testing internal control

Much of the application material on internal control relates to obtaining an understanding of internal control. With regard to intended reliance on internal control, the application material in paragraph A98, which supports paragraph 16, focusses on where substantive procedures alone may not provide sufficient appropriate audit evidence at the assertion level and gives examples of such circumstances. We suggest that further guidance could be given to help the auditor when it intends to rely on internal controls that may be relevant in the audit of estimates. In particular, given the different nature of the potential misstatements that can arise from different factors, there would be merit in considering additional guidance about the types of control that may be relevant in the context of each type of misstatement, addressed in relation to each factor.

Paragraph 95 of IAPN 1000 provides a list of factors the auditor may consider in reaching a decision on the nature, timing and extent of testing of controls. Suitably adapted, these could provide a starting point for guidance to include in ISA 540.

Particularly important to accounting estimates and controls that it might be appropriate to rely on is the precision of those controls. Where complexity is a relevant risk factor, controls that the auditor may be able to rely on may have high precision, especially if, for example, the complexity relates to application of a systematic method or the integrity of significant data. In many such circumstances, the use of IT by the audited entity and related controls will be relevant.

Where judgment or estimation uncertainty are relevant risk factors, controls may have varying levels of precision and, generally, be less precise than controls for complexity. These controls will typically be performed at a higher, less granular level for judgments, recognising that there may be no definitive ‘right’ or ‘wrong’ answer and expectations are less predictable. Auditors will need to assess the level of precision when determining the extent to which it is appropriate to plan to rely on such controls to address the identified risks. Auditors will

		<p>need to exercise their own judgment in evaluating the results of testing such controls and the need for additional sources of evidence from other tests of controls or substantive tests.</p> <p>Independent monitoring of controls, such as by an internal audit function, may be a useful source of audit evidence. Another important consideration is how management responds to identified deficiencies in internal control.</p> <p>Complexity, judgment and estimation uncertainty are not mutually exclusive and inter-relationships, where they exist, also need to be taken into account when designing and performing tests of controls.</p> <p>When developing guidance on the design and performance of internal controls, it will be helpful to link this to the earlier guidance on understanding internal controls, which should be amended as necessary so that all the guidance aligns.</p>
<p><b>National Auditing Standard Setters</b></p>		
<p>12.</p>	<p>AUASB</p>	<p>ii. <b>The AUASB is not supportive of the use of the concepts of complexity, judgement and estimation uncertainty as the drivers determining the nature and extent of audit procedures. The AUASB considers that the extent of audit effort should be focused on the risk of material misstatement at the financial statement and assertion level, with the 3 factors of complexity, judgement and estimation uncertainty being considerations in the assessment of the risk of material misstatement. The auditor should then determine the most appropriate response to the assessed risk rather than being driven by a list of audit procedures. In addition, the AUASB does not support the compartmentalisation of these factors, as they are often integrated and are not mutually exclusive. For example, complexity is often a factor raising or lowering estimation uncertainty, and the application of significant judgement from management may be the response thereto. As such, as currently drafted, it would appear that many (if not all) of the “procedures” in paragraphs 17-20 would represent relevant considerations for most (if not all) accounting estimates. Compartmentalising the factors may lead to a checklist based approach which may be seen as a limitation to the IAASB objective of scalability and lead to a potential deterioration in audit quality.</b></p> <p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>As outlined in the response to question 3 above, the AUASB is not supportive of the concept of low inherent risk as the driver of audit effort. Additionally, the AUASB is not supportive of the use of the concepts of complexity, judgement and estimation uncertainty as the drivers determining the nature and extent of audit procedures. The AUASB considers that the extent of audit effort should be focused on the risk of material misstatement at the financial statement and assertion level, with the 3 factors of complexity, judgement and estimation uncertainty being considerations in the assessment of the risk of material misstatement. The auditor should then determine the most appropriate response to the assessed risk, rather than being driven by a list of audit procedures. We consider the 3 factors should not necessarily be the primary drivers of audit effort.</p>

		<p>In addition, the AUASB does not support the compartmentalisation of these factors as they are often integrated and overlapping, for example complexity is often a factor raising or lowering estimation uncertainty, and the application of significant judgement from management may be the response thereto. As such, as currently drafted, it would appear that many (if not all) of the testing objectives in paragraphs 17-20 would represent relevant considerations for most (if not all) accounting estimates. Given the difficulty in distinguishing between the concepts of 'complexity', 'judgement' and 'estimation uncertainty', auditors may default to addressing all the testing objectives in paragraphs 17-20.</p> <p>Compartmentalising the factors may lead to a checklist based approach which may be seen as a limitation to the IAASB objectives of scalability and enhanced professional scepticism (refer to Question 3). Rather, the AUASB envisages that all 3 factors along with their criteria are covered under one umbrella, with the auditor exercising professional judgement in addressing the specific risks resulting from consideration of the factors and their criteria as a whole. To this end, the AUASB is supportive of the construct and content of the requirements set out in paragraph 13 of ED ISA 540, but does not support the prescriptive nature of paragraphs 17-19. The construct and prescriptiveness of paragraphs 17-19 may result in a rules-based checklist mentality and diminished exercise of auditor's professional judgement and scepticism. The AUASB considers that much of the content included in paragraphs 17-19 should be matters for consideration rather than requirements and accordingly should be instead included as application material for the content included in paragraph 13.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>The AUASB had a mixed response to this question and notes that in some areas the guidance is too lengthy, while in other areas guidance is seen as lacking.</p> <p>While improved and additional application material may be beneficial, the AUASB considers that the current ED is verbose and overly prescriptive, leading to diminution of auditor's professional judgement. Additionally, the language and layout of the application material is more editorial and background in nature, as compared with what we expect application material to constitute - practical examples and other explanatory details and procedures that are included for the purposes of understanding, and complying with, mandatory requirements. To this end, it is becoming difficult to extract the true guidance from the "for information/background" only material. This background information should be removed from the application material and either included in appendices, similar to the approach taken in Appendix 2 of the ED, or separate illustrative guides.</p> <p>Furthermore, the AUASB considers that the supplement that was issued by the IAASB to the ED, Illustration of work effort requirements, is beneficial in understanding the flow of the standard, and accordingly believes it is beneficial to include the diagram as an appendix to the standard.</p>
13.	CAASB	<p><b>A. OVERALL COMMENTS</b></p> <p><b>We applaud the IAASB's significant effort to strengthen auditing of accounting estimates and related disclosures. We acknowledge that developing this exposure draft was a difficult task due to the complexity of the issues under consideration.</b></p> <p><b>We are supportive of many of the proposals in ED-540. We feel, however, that for ED-540 to be operational, further improvements are needed. The results of field testing conducted by Canadian practitioners showed that many had significant</b></p>

challenges with operationalizing the requirements in paragraphs 15 and 17-19 in a manner that would achieve consistency of practice and appropriate use of the auditor's professional judgment. We agree with the views expressed by our stakeholders. In particular, we are concerned that:

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

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

- (a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?

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

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

We have identified the following key issues:

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

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

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

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

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

Further, paragraph 15 contains an implied requirement for the auditor to identify and assess inherent risk as low or not low related to

accounting estimates, which we believe should be made explicit. An explicit requirement would provide clarity as to the work effort and a better logical flow to responding to the assessed risks of material misstatement. If the IAASB agrees, a new requirement could be placed immediately after paragraph 13 of ED-540, following the auditor's identification and assessment of the risks of material misstatement. Also, the second sentence of paragraph A95 would need to be amended to remove the reference to ISA 540 not implying or requiring a separate assessment of inherent risk.

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

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

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

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

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

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

Our stakeholders noted that categorizing responses into three discrete risk factors is not consistent with management's process for making estimates. Often times, management considers accounting estimates more in terms of data, assumptions and methods / models. This potential inconsistency between how management determines accounting estimates and how the auditor is asked to audit those estimates could be problematic as the auditor may ask management to provide information for audit purposes that management has not considered as part of its own process. The IAASB may look to the recently issued PCAOB Docket 43: Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements, which approaches the audit of estimates in a manner that appears to be more consistent with the way management makes their estimates.

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

- The risk factors are not mutually exclusive items. For example, some participants viewed estimation uncertainty as always present in an accounting estimate, and judgment and complexity as factors that often influence estimation uncertainty.

- The risk factors are not precisely defined. The lack of precise definitions at the outset of the standard, makes it difficult for readers to assign a meaning to the terms as they encounter them in ED-540. Including definitions may enable streamlining the large amount of application material in relation to the three factors, thus improving readability.
- The discussions of the three risk factors each refer to data, methods, and assumptions which contributes to the difficulty in distinguishing the risk factors from each other.

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

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

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

Results of the field testing demonstrated lack of clarity as to whether the risk factors are considered as having “all or nothing” conditionality, or on a spectrum (i.e., low to high), when determining the response to the assessed risks of material misstatement. Some participants interpreted the factors as either applicable or not applicable to the estimate being tested, while others interpreted the three factors being on a spectrum of low to high. Also, when a factor was considered “low” in relation to the estimate being tested, there was inconsistent interpretation from field testing participants on whether paragraphs 17-19 applied. For example, some participants believed that when an estimate was affected by complexity, but complexity was considered low, they did not need to apply paragraph 17, while others believed that because there was some complexity they did need to apply paragraph 17.

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

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

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

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

		<p>risk; and</p> <ul style="list-style-type: none"> <li>the matters in paragraph 19 to always be relevant because estimation uncertainty is always assumed to be present in estimates.</li> </ul> <p>We encourage the IAASB to provide clarity as to whether, and if so how, the work effort in paragraphs 17-19 can vary depending on the extent to which an accounting estimate is affected by the three risk factors.</p> <p>(b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Yes - we support the proposed requirement in paragraph 13 with respect to identifying and assessing risks of material misstatement in relation to accounting estimates. We believe it appropriately directs the auditor to take into account the three factors (i.e., complexity, judgment and estimation uncertainty) that are most likely to influence the assessed risks of material misstatement. However, see response to question 4(a) for comments relating to the difficulty in identifying which of the factors (complexity, judgment and estimation uncertainty) were the reasons for the assessed risks, and whether paragraphs 17-19 can be applied proportionately to the level of risk of material misstatement.</p> <p>(c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>Results of field testing indicated significant issues with the approach to responding to risks of material misstatement in paragraphs 17-19, as explained in the response to question 4(a). However, if the IAASB decides to retain the approach and the requirements, we have some suggestions for further clarity relating to the response when the reasons for the assessment given to the risks of material misstatement include complexity (paragraph 17).</p> <p>Paragraph 17(d) requires the auditor to obtain sufficient appropriate audit evidence about whether the integrity of significant data and significant assumptions has been maintained in applying the method. Our stakeholders questioned what is meant by 'integrity of significant data' and 'integrity of significant assumptions'. We believe clarity should be provided on these two phrases. For example:</p> <ul style="list-style-type: none"> <li>The "integrity of significant data" could be clarified by drawing from the application material in paragraphs A107 to A109 of ISA 315, which refers to the integrity of data or accounting records</li> <li>The "integrity of significant assumptions" could be clarified as to whether it is referring to aspects such as the judgment in the assumptions, the completeness of the assumptions, or the processes used in applying the assumption</li> </ul>
14.	CNCC-CSOEC	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 31 (Revised) and ISA 330?</p> <p>Please refer to our comments relating to question 3.</p> <p>b) Do you support the requirement In ED-540 (Revised) for the auditor to take into account the extant to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management</p>

		<p>and the potential for management bias, and estimation uncertainty?</p> <p>Yes, we support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity in making the accounting estimate, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty, although, we believe that the distinction between those three factors is a bit artificial and the auditor will not be able to connect a specific work effort to each factor.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>We consider the definition of the term "significant data", which is mentioned several times in paragraphs 17-18, to be important in the understanding of the respective requirements. We would therefore suggest moving the explanation included in paragraph A35<sup>2</sup> to the "Definitions" sections in page 31 of ED-540 or otherwise have it properly signposted.</p>
15.	HKICPA	<p>(a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>In principle, it appears to be a robust approach enabling auditors to apply the requirements to the engagement's facts and circumstances. However, it would be clearer if the IAASB elevates the first sentence in paragraph A78 to paragraph 13 so that auditors are aware that the relevant factors currently listed in paragraph 13 are not exhaustive.</p> <p>We support the suggestion of field testing and will encourage member firms to participate.</p> <p>(b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Overall, we support the requirement in paragraph 13 for the auditor to take into account the relevant factors. In paragraph A78, the guidance provides that there may be other relevant factors other than complexity, judgement and estimation uncertainty.</p> <p>We would recommend the IAASB to include further guidance on what further work or procedures the auditor should consider for other factors such as</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> matters to consider when there are changes in the requirements of the applicable financial reporting framework; impacting accounting estimates</li> <li><input type="checkbox"/> leveraging on the work carried out in other ISAs, e.g. ISA 240, ISA 250</li> </ul> <p>(c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p>

		We believe there is sufficient guidance for the requirements.
16.	IDW	<p><b>13. This paragraph requires the auditor to take into account certain factors when identifying and assessing the risk of material misstatement in relation to accounting estimates in applying ISA 315. However the first sentence prior to the requirement refers to “at the financial statement and assertion levels”. Based upon our reading of ISA 315, risks of material misstatement at the financial statement level are pervasive to the financial statements as a whole and therefore cannot be allocated to particular items or assertions in the financial statements – such as those relating to accounting estimates. However, the reference to “at the financial statement and” in the first sentence suggests that the assessment at the financial statement level ought to be applied to the consideration of the factors in relation to accounting estimates. This is not consistent with our understanding of what risk assessment at a financial statement level means. For this reason, we suggest that the noted words be deleted.</b></p> <p><b>15. Paragraph 15 refers for the first time to when “inherent risk is low” and “when inherent risk is not low”. We presume the inherent risk of material misstatement in the measurement of accounting estimates and related disclosures is meant. If that is the case, perhaps this ought to be clarified in the standard in an appropriate place. However, it is unclear what the use of the word “low” means in this context and how this concept articulates with the overall objective of the auditor in ISA 200 to reduce audit risk to an acceptably low level. We presume that “low” in this case still means “greater than an acceptably low level of risk”, or there would be a conceptual contradiction within the ISAs. This issue arises in part from the fact that the project to revise ISA 315, which would have considerable impact on risk assessments as required in ISA 540, has not yet nearly reached the same stage of completion as ISA 540. Based on previous discussions at the IAASB, the project on ISA 315 only addressed “high risks” in a preliminary fashion when seeking to deal with the identification of “significant risks”. It is therefore unfortunate that ISA 540 is introducing a new concept that has not yet been vetted at a more general level through the completion of the project to revise ISA 315. The danger is that either ISA 540 would need to be revised later due to changes to ISA 315, or worse, that the ISA 540 “tail” would wag the ISA 315 “dog” and thereby impair a good revision of ISA 315 (this has happened before, when a completed ISRE 2400 determined the content of an ISAE 3000 that was issued later, even though this was not technically warranted). For reasons of short-term practicality, we can accept the use of the term “low inherent risk” as long as its meaning is clarified (inherent risk of material misstatement in the measurement of accounting estimates and related disclosures) in the standard, the standard reconciles the term to the overall objective of the auditor (low risk is still greater than an acceptably low level of risk), and the use of this term is not set in stone for the revision of ISA 315, even if this means subsequent changes to ISA 540.</b></p> <p><b>We also note that the requirement in 15 (a) is for the auditor to determine whether the procedures in (i) to (iii) would provide sufficient appropriate evidence. Unlike in 15 (b), there is actually no requirement to perform procedures if the auditor actually determines that the procedures would provide sufficient appropriate evidence. It seems to us that paragraph 15 (a) needs to be augmented to require the performance of at least one or more of the procedures in (i) to (iii) when the auditor has determine that these would provide sufficient appropriate evidence.</b></p> <p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p>

		<p>The question is somewhat strangely put because when inherent risk is deemed not to be low, the identification and assessment of risks of material misstatement has been done. However we believe that the responses to risks of material misstatement when inherent risk is not low are more effective.</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Yes, we support the use of these factors in the auditor's work. However, the use of these factors might need to be revisited once the ISA 315 project is completed.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives- based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>In our view, there is too much guidance. The IAASB should not be writing a textbook on auditing in its standards. There is considerable room to rationalize the application material.</p>
17.	JICPA	<p>4) When inherent risk is not low (see paragraphs 13, 15 and 17–20):</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>We support that 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 relevant factors. However, we consider that further clarification is necessary about the interrelationship between the three factors (i.e. complexity, judgment and estimation uncertainty). We understand that the third sentence of paragraph 2 (“The extent to which they are subject to, or affected by, complexity and judgment is often related closely to the extent to which they are subject to, or affected by, estimation uncertainty.”) and the last sentence of paragraph A113 (“This is important so that the selection of management’s point estimate, and the development of related disclosures, is based only on estimation uncertainty.”) in ED-540 intend to explain the interrelationship between the three factors. However, it does not clarify the implication that this interrelationship has on the auditor’s procedures.</p> <p>As implied in the definition of accounting estimate (paragraph 9(a)), estimation uncertainty is an inherent characteristic of accounting estimates. Therefore, when inherent risk is not low, we cannot imagine the situation where estimation uncertainty is not included in the reasons for the assessment given to the risk of material misstatement (in other words, where paragraph 19 is not applicable).</p> <p>Based on this interrelationship, when inherent risk is not low, we expect the auditor to start with the procedures that respond to complexity and judgment factors (paragraphs 17 to 18), ending with those that pertain to estimation uncertainty, which is the inherent characteristic of the accounting estimates (paragraphs 19 and 20). This flow (paragraphs 17 to 20) is not clear from the context of ED-540. In order to assist the auditors in applying the requirements in paragraphs 17 to 20, we propose to add in Application Materials relevant to paragraph 15(b), for example, an explanation that clarifies the interrelationship between requirements in paragraphs 17 to 20.</p>
18.	MAASB	<p>(a) The ED-540 uses the term inherent risk in response to the assessed risks of material misstatements. Application material A42 of ISA</p>

		<p>200 states that the ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risk of material misstatement.” There appears to be inconsistency in the use of terminology. If the IAASB has a specific reason to specify only inherent risk, perhaps this should be made clear in the application material of the proposed standard.</p> <p>The ED-540 adopts the term “when inherent risk is not low” in paragraph 15(b). Such a concept is not defined in ISA 315 and the ED-540 also does not specify the response to “when inherent risk is not low”. The audit procedures referred to in paragraphs 17-19 only address the situation when the risk of material misstatement is assessed to be a significant risk in accordance with paragraph 13.</p> <p>In addition, there should be consequential amendments to be made to ISA 315 or ISA 330 regarding understanding control activities and responses to assessed risks in order to maintain consistency in obtaining additional persuasive audit evidence when the assessed risk of material misstatement is higher.</p> <p>(b) The AASB recommends for the IAASB to enhance paragraph 15(b) to clarify when the requirements in paragraph 17-20 would be applicable. For example, there should be clarity on whether it is required that some level of further audit procedures be performed to address all 3 factors as appropriate while more persuasive audit evidence needs to be obtained for factors resulting in significant risk; or further audit procedures are only required for factors resulting in significant risk.</p> <p>(c) Please see our comment in part (b) above and Question 1.</p>									
19.	NBA	<p><b>Three factors</b>  <b>We welcome the idea that different factors drive the work load in the standard. We wonder whether the right factors (complexity, judgment and estimation uncertainty) are chosen. In the ED, the existence of estimation uncertainty is a precondition for an estimate and it is also one of the three chosen factors. To us this is confusing.</b></p> <p><b>We recommend using the following three factors:</b></p> <table border="1" data-bbox="415 959 1507 1154"> <tr> <td data-bbox="415 959 485 1024">1.</td> <td data-bbox="485 959 915 1024">Access to data and assumptions for the estimate</td> <td data-bbox="915 959 1507 1024">Focusing on reliability and availability of data and assumptions</td> </tr> <tr> <td data-bbox="415 1024 485 1089">2</td> <td data-bbox="485 1024 915 1089">Subjectivity of the estimate</td> <td data-bbox="915 1024 1507 1089">Focusing on necessary judgement and possible management bias</td> </tr> <tr> <td data-bbox="415 1089 485 1154">3</td> <td data-bbox="485 1089 915 1154">Complexity of calculation of the estimate</td> <td data-bbox="915 1089 1507 1154">Focusing on need to use models, difficult calculations and to deploy specialists.</td> </tr> </table> <p><b>In our opinion these three factors drive estimation uncertainty for an accounting estimate, clearer differentiate between each other and it will be easier to define audit procedures than the three factors mentioned in the ED (see response to Q4b).</b></p> <p><b>Work effort</b>  <b>The workload for the three factors in the ED is ‘output driven’ (‘objective-based’). No con-crete audit procedures are specified, instead the audit evidence to be obtained is de-scribed. In general we support this approach, but we recognize that this is new and challenging to auditors. Applying this approach includes applying professional judgement and professional skepticism.</b></p>	1.	Access to data and assumptions for the estimate	Focusing on reliability and availability of data and assumptions	2	Subjectivity of the estimate	Focusing on necessary judgement and possible management bias	3	Complexity of calculation of the estimate	Focusing on need to use models, difficult calculations and to deploy specialists.
1.	Access to data and assumptions for the estimate	Focusing on reliability and availability of data and assumptions									
2	Subjectivity of the estimate	Focusing on necessary judgement and possible management bias									
3	Complexity of calculation of the estimate	Focusing on need to use models, difficult calculations and to deploy specialists.									

**Therefore different auditors might come to different conclusions what is sufficient appropriate audit evidence. In the public interest we feel that it is necessary to provide as much guidance as necessary to ascertain that auditors perform the necessary procedures. Although we already worry about the extensiveness of application material we strongly believe that it is necessary to provide detailed examples of possible procedures (see response to Q4a).**

#### **Models**

**The ED explains that it might be necessary for the auditor to develop an own model when management’s model is not appropriate. Although we understand that it might be necessary for an auditor to develop an own model to evaluate management’s point estimate , this introduces several risks:**

- **Developing an own model might endanger the independence of the auditor. There-fore guidance should be provided to avoid that the auditor takes over management responsibilities. Therefore management should provide a representation that they agree to the model of the auditor and take responsibility for the estimate, based on the model.**
- **When the auditor develops an own model, the data and assumptions used do not need to represent the data and assumptions used by management. This might be-come an issue when management provides disclosures about the estimate in the financial statements based on his own evaluation. Therefore the auditor should make sure that the disclosures are in line with his own model.**

**(see response Q4c).**

*Q4a 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?*

According to us the standard is not clear how the fact that inherent risk is higher than low relates to significant risks. According to the standards a significant risk is a risk that, in the auditor’s judgement, requires special audit consideration. Given the fact that this standard provides specific requirements for estimates that have an inherent risk that is higher than low, taking in account Paragraph 28e of ISA 315, we wonder whether this by definition is not a significant risk. We wonder whether this is intended and therefore encourage the IAASB to provide more clarity what is intended with the concept of ‘special audit consideration’

If inherent risk is not low, but risk of material misstatement is low, would this lead to the right work effort?

As mentioned in the general remarks we are of the opinion that parts of ED 540 should be transferred to ISA 315 as they relate to risk assessment (e.g. paragraph 28 of ISA 315).

Furthermore, the ED is ‘output driven’ (‘objectives-based’). No concrete audit procedures are specified, only the audit evidence to be obtained. Although we understand that this approach has been chosen, we doubt whether this is clear for auditors in practice. We recommend giving concrete examples of audit procedures to be performed in certain situations.

Further less attention could be paid to using specialized skills or knowledge. Reference could be made to ISA 620.

*Q4b Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?*

We do support the factor approach, however we do not support the specific three factors mentioned. There is overlap in the three factors and management bias is a factor included in judgment but also mentioned separately. The definition relates to estimation uncertainty only and not to the other two factors. Estimation uncertainty is a precondition for an estimate and estimation uncertainty is often caused by the other two factors. This seems to be mixed up in the ED. However, the work effort relates to the three factors. We question whether it is clear in practice which audit procedures should be performed to respond to the risks and whether the three factors really can be separated in the work effort.

We recommend reconsidering the three factors by taking the following three factors into account:

1.	Access to data and assumptions for the estimate	Focusing on reliability and availability of data and assumptions
2.	Subjectivity of the estimate	Focusing on necessary judgement and possible management bias
3.	Complexity of calculation of the estimate	Focusing on need to use models, difficult calculations and to deploy specialists.

In our opinion these three factors determine estimation uncertainty and will be easier to audit than the three factors mentioned in the ED.

*Q4c Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?*

We question whether it is clear when an auditor should develop his own point estimate or range and whether this is appropriate. This could result in a disproportionately high work effort for the auditor and an unwanted situation where the auditor performs the work that management should do. We recommend to give more guidance in the following areas: should the auditor build his own model when the model of management is not appropriate or does this go too far and can this only be done as last resort? Developing an own model might endanger the independence of the auditor. Is it appropriate to disapprove the model of the management? How should this be disclosed as this might be sensitive to disclose and will this have an effect on the auditor's opinion? (see also Q5)

If inherent risk is low, the auditor should also consider developing a point estimate or range to evaluate management's point estimate. This is not further explained. Is this realistic if inherent risk is low? We recommend to give more guidance in this area.

20.	NZAuASB	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>Objectives-based vs rules-based requirements</p>
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The NZAuASB is concerned that paragraphs 17-19 are not sufficiently objectives-based. We agree that the auditor is required to consider complexity, use of judgement by management, and estimation uncertainty, and that these factors either individually or combined affect the risk assessment and the auditor's response to the assessed risk.

Many of our respondents expressed concern that there is not sufficient flexibility within the requirements, and as drafted, these requirements, due to their granularity, will drive a compliance mentality rather than auditors using their judgement in addressing the specific risks resulting from each of the factors.

As drafted, the requirements apply to all estimates with an inherent risk assessed as "not low". The auditor uses judgement to determine the extent of work effort required. In our view, the requirement is that the auditor obtain sufficient appropriate audit evidence. The matters under paragraphs 17-19 that the auditor is required to obtain sufficient appropriate audit evidence about are in our view application material to the requirement. For example, in paragraph 17, an objectives-based requirement would be that the auditor obtain sufficient appropriate audit evidence related to management's use of a complex method (including complex modelling) or when management's method otherwise involves the use of specialised skills or knowledge. The matters indicated in paragraphs (a) – (e) are the matters that auditor may consider in obtaining sufficient appropriate audit evidence.

The above approach allows the auditor to adjust the work effort based on the level of risk along the spectrum of "not low" risk to "significant" risk.

Developing an auditor's point estimate or range

Paragraph 19(b) of ED-540 requires the auditor, to the extent possible, to develop an auditor's point estimate or range when management has not appropriately understood and addressed estimation uncertainty. Participants at our roundtable discussions noted that it is generally not common practice for the auditor to develop a range. Rather, the auditor evaluates the models, data and assumptions used by management in determining their point estimate as required by extant ISA 540. Extant ISA 540 allows the auditor to determine the appropriate further audit procedures in responding to the assessed risk of material misstatement.

The NZAuASB is concerned that the approach taken in ED-540, requiring the auditor to develop a point estimate or range, may be seen as confrontational, pitting the auditor against the preparer. In addition, ED-540 assumes a certain level of preparer sophistication. In the SME/SMP environment, in particular, the preparer may not have the sophistication necessary to understand and address estimation uncertainty. When this is the case, the requirement for the auditor to develop a point estimate or range may present an independence issue, resulting in the risk that the auditor is auditing his or her own work.

The NZAuASB believes that when, in the auditor's judgement, management has not properly understood and addressed estimation uncertainty, the auditor firstly needs to request that management consider alternative assumptions or provide additional disclosures. If management is unable or refuses to do so, the auditor should then be required to consider the possibility of developing an auditor's point estimate or range. If the auditor is unable to develop a point estimate or range, then the auditor needs to consider the impact on the audit and the auditor's opinion.

b) Do you support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?

		<p>The NZAuASB supports the requirements in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, complexity, the need for the use of judgement, including the potential for management bias, and estimation uncertainty. Feedback from practitioners indicates that these factors are generally already being considered. Often these factors are integrated and overlap. In practice each factor is not necessarily considered discretely as appears contemplated by ED-540. Rather, the auditor may design and perform procedures that do not compartmentalise the factors in this way.</p> <p>As discussed in the response to question 4(a), the NZAuASB has some concerns about the prescriptive nature of the requirements in paragraphs 17-19 to address these factors.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17-19 of ED-540? If not, what additional guidance should be included?</p> <p>As noted in the introductory comments, there are a number of sections within ED-540 that, in our view, contain unnecessary content. Either because they</p> <ul style="list-style-type: none"> <li>• state the obvious;</li> <li>• discuss fundamental concepts which in our view should be well understood by the auditor and are not specific to auditing accounting estimates; or</li> <li>• repeat issues already addressed in the exposure draft.</li> </ul> <p>This has the effect of making the standard longer than it needs to be (ED-540 includes 17 requirements and 211 application paragraphs). It also potentially detracts from the expectation that the auditor should be applying professional judgement to each engagement based on the auditor's knowledge and understanding of the entity subject to audit and its operating environment.</p> <p>In addition, we consider that the role of the auditing standard is to guide the auditor. While the NZAuASB acknowledges that it is sometimes helpful to include information about the responsibilities of management and those charged with governance, in our view, such references should be limited to essential explanatory material.</p> <p>Accordingly, the NZAuASB recommends that the IAASB carefully consider the relevance of each of the 211 application paragraphs to ED-540 with a view to determining whether the guidance is essential.</p>
<b>Accounting Firms</b>		
21.	BDO*	<p><b>Further, the interrelationship of the three factors (complexity, judgment and estimation uncertainty) is likely to result in at least two or all three of these factors being identified for each estimate which may also cause increased work effort unnecessarily.</b></p> <p>a. Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>Generally, we believe that the proposed amendments to ED-540 would result in a more effective identification and assessment of, and responses to, risks of material misstatements relating to accounting estimates. The more granular requirements included in</p>

		<p>ED-540 is helpful in identifying where the risk arises from in the accounting estimate. This promotes a more effective response in determining where to focus the audit procedures.</p> <p>When assessing risk, paragraphs 28(c) and 28(e) of ISA 315 (Revised) imply that complexity and subjectivity, or judgment, are indicative of significant risk of material misstatement. In addition, the application and other explanatory material related to low inherent risk estimates may suggest, unintentionally, that few estimates would be considered low inherent risk. As we noted in answer to question 3 above, there is also the potential for confusion due to the introduction of the concept of low risk within one particular ISA. Therefore, we suggest including more guidance, including examples, relating to accounting estimates with low inherent risk as mentioned previously.</p> <p>We also request some clarification regarding the requirements in paragraph 15 of ED-540 relating to accounting estimates assessed as having inherent risk that is not low. It is not clear whether the procedures listed in both 15(a) and 15(b) are required when the inherent risk of the accounting estimate is not low. In these instances, additional clarification on whether practitioners have the option to choose other procedures they believe appropriate to address the risks identified would be helpful. Further, the last paragraph in 15 seems somewhat out of place. We recommend having this paragraph as 15(c). The fact that several requirements in the ED-540 include sign-posting references to other requirement numbers is indicative that as currently drafted, there is a potential for confusion for readers of this particular ISA.</p> <p>b. Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>We agree with the three factors identified in the ED-540 as having the most significance relating to the audit of accounting estimates. However, we find it difficult to distinguish these factors when dealing with accounting estimates. We believe that at least two and sometimes all three of the factors will be relevant for all accounting estimates. An accounting estimate that is considered complex and includes judgment will likely include estimation uncertainty. Further, it is difficult to determine whether the separation of the three factors would lead to a reduced work effort or a refined and focused response. We suggest adding more examples to those listed in paragraph A74 of accounting estimates where only one of the factors are present and describing how the factors are interrelated.</p> <p>ED-540 encourages and directs the practitioner to consider the cause of the risk underlying the estimate, being complexity, judgment and estimation uncertainty. This is different from the extant ISA whereby the underlying components of the estimate, being the model and assumptions, were assessed instead of that assessment taking place at the estimate level. ED-540 also varies from the approach taken in the proposed Public Company Accounting Oversight Board (PCAOB) standard on auditing accounting estimates and is not congruent with the way management approaches uncertainty in their estimates, making it hard to correlate discussions and analysis with management. We recommend including guidance on performing these assessments at the estimate level as required under ED-540.</p> <p>We note that there is increased pressure from regulators on challenging management’s judgments and we suggest including practical guidance on how this can be performed when auditing accounting estimates. On the factor of judgment, additional clarification on whether there is a requirement to assess the extent of judgment exercised by any experts used in the process of</p>
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		<p>formulating or reviewing accounting estimates (whether provided by management’s experts or auditor’s experts) would also be helpful.</p> <p>c. Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>Subject to our earlier comments in 4 (b) above about the interdependence of the three factors, we agree with the approach taken by the IAASB to list the objectives under each of the three relevant factors. This allows the practitioner to tailor their audit response based on which factors are considered relevant when auditing each individual accounting estimate.</p> <p>The requirement for the auditor to develop a point estimate or a range when they have determined that management has not appropriately understood and addressed estimation uncertainty described in paragraph 19(b) seems to suggest that there could be a control deficiency. If this is the case, we suggest that ED-540 identify that a control deficiency may exist in these circumstances. Guidance on considerations the auditor may have in evaluating and responding to potential control deficiencies related to the company’s estimation process would also be helpful.</p> <p>There are various objectives listed in paragraphs 17 to 19 relating to complexity, judgment and estimation uncertainty. We suggest clarifying whether some or all of the objectives are to be addressed in responding to the risks related to these factors. Guidance regarding the level and amount of procedures to address some or all of the objectives listed would assist in determining the sufficiency of work effort. We also suggest including guidance, with examples, of the level of work effort that would be required when a SRMM is identified.</p>
22.	CHI*	
23.	DTT*	<p>As discussed in our cover letter, DTTL believes that revisions are necessary in order to more clearly address the requirements of the auditor to identify, assess, and respond to risks of material misstatement relating to auditing accounting estimates. In particular, DTTL believes ED-540 needs to be revised such that:</p> <p>(1) Paragraph 13 of ED-540 is strengthened and enhanced to incorporate the matters previously included in paragraph 17 and 18 of ED-540 (with modifications) as well as place the focus on the impact, and interplay, of the three factors in identifying and assessing risks.</p> <p>(2) A new paragraph is inserted after paragraph 14 of ED-540 which includes the strategies for auditing an accounting estimate (previously required in paragraph 15a of ED-540) and makes it clear that these are to be used in auditing all accounting estimates (including addressing all the risks of material misstatement relating to each estimate). This would help with providing necessary clarification that the strategies are appropriate for auditing all estimates, but would also focus the auditor’s attention on the need for and importance of dealing with specific responses to all risks of material misstatement identified in paragraph 13 of ED-540.</p> <p>(3) The current structure and ordering of the requirements is reconsidered as the work flow is not intuitive and will therefore not be easily understood and applied.</p> <p>The table below sets forth these recommendations in more detail. In addition, the recommendations below also encompass</p>

certain other suggestions intended to streamline the requirements (any editorial or other comments related to these paragraphs are separately addressed in **Appendix II**):

Paragraph	Action
Paragraph 9A	Include a new paragraph under the heading “Determining the Need for Specialized Skills and Knowledge.” The new paragraph would combine the proposed requirements in paragraphs 12 and 14 of ED-540 and address the need for the auditor to determine whether specialized skills or knowledge are necessary in order to effectively execute the risk assessment process for auditing accounting estimates, including identifying and assessing risks of material misstatement and designing and performing further audit procedures to respond to such risks. DTTL recommends placing this paragraph before paragraph 10 of ED-540 because of its overarching nature and notes that it may also be appropriate or necessary for engagement team members with specialized skills or knowledge to be involved in the procedures to address the requirements of paragraph 10 of ED-540.
Paragraph 10	Retain.
Paragraph 11	Retain.
Paragraph 12	Delete. Combine with paragraph 14 of ED-540 and include as paragraph 9A of ED-540.
Paragraph 13	Retain. The three factors should inform the auditor’s identification and assessment of risks of material misstatement. In addition, the matters in paragraphs 17 and 18 of ED-540 are essentially considerations of risks, and are therefore applicable in identifying and assessing risks of material misstatement. As such, DTTL suggests that the matters in paragraphs 17 and 18 of ED-540 be reworded as auditor considerations. For example, paragraph 17(c) of ED-540 currently states that “the auditor shall obtain sufficient appropriate audit evidence about the following matter...Whether management has appropriately understood or interpreted significant data, including with respect to contractual terms.” This could be re-written as part of identifying and assessing risks of material misstatement in paragraph 13(a) of ED-540 and state “...Complexity in making the accounting estimate, including...the extent to which management has appropriately understood or interpreted significant data, including with respect to contractual terms.” Furthermore, given that estimation uncertainty is an inherent characteristic underpinning all accounting estimates. The interplay between the three factors should be highlighted, as they all may have an impact on determining risks of material misstatement, but to varying degrees. It should also be made clear in paragraph 13 of ED-540 that an accounting estimate may have multiple risks of material misstatement, and that each risk may have a different level of assessed risk.
Paragraph 14	Delete. Combine with paragraph 12 of ED-540 and include as paragraph 9A of ED-540.
Paragraph 14A	Insert a new paragraph including the three strategies identified in paragraph 15(a) of ED-540.

			<p>One of the three strategies (or a combinations thereof) would be selected by the auditor as being most responsive to the identified and assessed risks of material misstatement for each accounting estimate.</p> <p>Inclusion of the three strategies would also serve to remind auditors that events occurring up to the date of the auditor's report may provide sufficient appropriate audit evidence. The ability to use this strategy to address risks of material misstatement where there is higher inherent risk is not readily apparent and masked by the complexity of paragraphs 13-19 of ED-540. DTTL believes, however, that it should be very clear that use of this strategy is permitted as, in appropriate circumstances, it can be efficient and effective.</p>
		Paragraph 15 – first sentence and last paragraph	Retain.
		Paragraph 15a	Delete, given that the focus on risks of material misstatement, and the introduction of three strategies reflected in paragraph 14A of ED-540, would allow for an appropriately focused auditor response when designing and performing further audit procedures. Application guidance can be added to explain this further as considered necessary.
		Paragraph 15b	Delete, given that the focus on risks of material misstatement, and the introduction of three strategies reflected in paragraph 14A of ED-540, would allow for an appropriately focused auditor response when designing and performing further audit procedures. Application guidance can be added to explain this further as considered necessary.
		Paragraph 16	Retain.
		Paragraph 17	Delete. Included in paragraph 13 of ED-540 above.
		Paragraph 18	Delete. Included in paragraph 13 of ED-540 above.
		Paragraph 19	Unlike paragraphs 17 and 18 of ED-540, (which essentially focus the auditor on performing procedures to address risks related to complexity and judgment), paragraph 19 of ED-540 addresses procedures related to (1) management's considerations around estimation uncertainty and (2) obtaining sufficient appropriate audit evidence. Therefore, DTTL believes that this paragraph should be broadly retained in its current form; however, the further audit procedures should be linked only to those estimates that have risks of material misstatement related to estimation uncertainty that fall towards the higher end of the spectrum of risks. Consequently, DTTL recommends that the work effort should be specific to estimates with high estimation uncertainty. <sup>1</sup> Estimation uncertainty is inherent in all accounting estimates and paragraph 7(b) of ISA 330 requires "more persuasive audit evidence the higher the auditor's assessment of risk." In this instance

<sup>1</sup> The concept of high estimation uncertainty is addressed in paragraph 9b of ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

		<p>where there is one or more risks of material misstatement associated with high estimation uncertainty as determined by paragraph 13 of ED-540 (when identifying and assessing risks of material misstatement) then DTTL suggests that the procedures in paragraph 19 of ED-540 should be required.</p> <table border="1" data-bbox="489 297 2011 654"> <tr> <td data-bbox="489 297 720 345">Paragraph 20</td> <td data-bbox="720 297 2011 345">Retain.</td> </tr> <tr> <td data-bbox="489 345 720 394">Paragraph 21</td> <td data-bbox="720 345 2011 394">Retain.</td> </tr> <tr> <td data-bbox="489 394 720 540">Paragraph 22</td> <td data-bbox="720 394 2011 540">Delete. Consider including a reference to existing requirements in paragraphs 26 and 27 of ISA 330. No need to align with “inherent risk is not low” because that concept would no longer be included in the requirements pursuant to the recommendations above (see additional commentary relating to the “Stand Back” below).</td> </tr> <tr> <td data-bbox="489 540 720 654">Paragraph 23</td> <td data-bbox="720 540 2011 654">Retain with additional application guidance describing that the assessment needs to take place at the individual accounting estimate level and then in the aggregate when considering all accounting estimates (see response to question 6).</td> </tr> </table> <hr/> <p>Note: The related application material to these requirement paragraphs would need to be realigned, amended, or deleted accordingly.</p>	Paragraph 20	Retain.	Paragraph 21	Retain.	Paragraph 22	Delete. Consider including a reference to existing requirements in paragraphs 26 and 27 of ISA 330. No need to align with “inherent risk is not low” because that concept would no longer be included in the requirements pursuant to the recommendations above (see additional commentary relating to the “Stand Back” below).	Paragraph 23	Retain with additional application guidance describing that the assessment needs to take place at the individual accounting estimate level and then in the aggregate when considering all accounting estimates (see response to question 6).
Paragraph 20	Retain.									
Paragraph 21	Retain.									
Paragraph 22	Delete. Consider including a reference to existing requirements in paragraphs 26 and 27 of ISA 330. No need to align with “inherent risk is not low” because that concept would no longer be included in the requirements pursuant to the recommendations above (see additional commentary relating to the “Stand Back” below).									
Paragraph 23	Retain with additional application guidance describing that the assessment needs to take place at the individual accounting estimate level and then in the aggregate when considering all accounting estimates (see response to question 6).									
24.	EYG*	<p><b>We support the risk-based differentiation of accounting estimates between those for which inherent risk is “low” and “not low”. However, we believe that the testing approaches that have been identified as only being applicable to estimates with “low” inherent risk are also applicable to estimates with “not low” inherent risk, and this applicability needs to be clarified in ED-540. In our view, the objective-based requirements in paragraphs 17-19 (a) that address procedures for estimates with “not low” inherent risk equate to an audit approach to test how management made the accounting estimate (see our response to Q4 (c)).</b></p> <p><b>We agree that complexity, management’s use of judgment and estimation uncertainty are relevant drivers of risks related to accounting estimates, and we support the specific consideration of these factors in the auditor’s risk assessment as well as in the design of responsive audit procedures. However, we believe that the approach to the related work effort (i.e., requiring each of these factors to be addressed separately) in paragraphs 15 and 17-19 is unnecessarily complicated and does not reflect the approach that is taken, or should be taken, in practice to designing and developing audit procedures for accounting estimates (see our responses to Q3 and Q4).</b></p> <p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>We believe that the requirements in paragraphs 13, 15 and 17-20 have the potential for supporting more effective identification and responses to risks of material misstatements for accounting estimates for which inherent risk is “not low”; however, we believe the approach is quite complicated and could be simplified without losing its intended objective. We are concerned about the practical implementation of a work effort driven by the individual applicability of the three factors of complexity, judgment and uncertainty to an accounting estimate. As noted in several places throughout the application material of ED-540 and in Appendix</p>								

2, these three factors have inherently overlapping characteristics. We are not convinced that the auditor needs to “draw lines” between the factors, as currently implied in these paragraphs, in order to design effective responses to the risks of material misstatement. To the contrary, we believe requiring the auditor to draw such clear distinctions runs the risk of auditors designing responses that are not sufficient for estimates that have “not low” inherent risk.

We include our further specific observations and suggestions related to simplifying and adjusting the approach taken in ED-540 in our responses to parts (b) and (c) of this question.

#### Significant risks

In implementing the approach in our audit methodology to prescribe procedures for accounting estimates for which inherent risk is “not low”, we reached a similar conclusion to that expressed in ED-540 related to significant risks. Specifically, the nature of the procedures applicable to the estimates for which inherent risk is “not low” are also applicable to estimates that are significant risks; the difference is in the extent of the procedures such that the auditor needs to obtain more persuasive evidence the higher the risk.

Despite our agreement with the approach taken in ED-540 for significant risks, we believe further clarification is necessary to explain how the more granular work effort in ED-540 relates to the requirement in ISA 330.21 to perform procedures specifically responsive to significant risks. When the auditor designs responsive procedures (that appropriately include tests of details when required by ISA 330.21) to achieve the objective-based requirements of paragraphs 17-20 of ED-540, it is unclear whether the requirement in ISA 330.21 also is fulfilled. If not, clarification is needed to address further considerations the auditor should take into account to develop procedures specifically responsive to the significant risk.

b) Do you support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for use of judgment by management and the potential for management bias, and estimation uncertainty?

We support the introduction of the three factors of complexity, the use of judgment by management, and estimation uncertainty as explicit considerations in identifying and assessing the risks of material misstatement for accounting estimates, including the supplemental information about these factors presented in Appendix 2 to ED-540. Understanding the underlying reasons for the risk assessments is important to designing further audit procedures that are responsive to the risks, and we believe these factors can assist in driving increased consistency in the auditor’s approach to risk assessment for accounting estimates.

Nevertheless, the wording of paragraph 13 that requires the auditor to take into account “the extent to which” the accounting estimate is subject to one or more of these factors seems to imply that the extent needs to be measured in some concrete manner, including the possibility that each factor may require a separate risk assessment of some sort. If this is the intention, we do not support such an approach because not only do these factors have inherently overlapping characteristics that makes drawing clear distinctions between them difficult and impractical, but drawing such clear distinctions is not necessary in order to design appropriately responsive audit procedures (see part (c) for our further views in this regard).

In our view, the auditor should gather information during the risk assessment procedures performed in accordance with paragraph 10 about the complexity, judgment and estimation uncertainty related to the accounting estimate, and then the auditor should take into account the nature of the estimate (which is affected by these three factors) in making the risk assessments at the assertion level for the

estimate. In designing the audit procedures responsive to the risks, the auditor should also take into account the nature of the estimate and the underlying effects of these three factors (see part (c) of this question for further views), as well as the appropriateness of management's process to make the estimate (see our response to Q1).

c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17-19 of ED-540? If not, what additional guidance should be included?

No, in our view, there is a missing critical relationship in ED-540 between the objectives-based requirements in paragraphs 17-19 and the three available testing approaches for accounting estimates for which inherent risk is "low". We believe the objectives-based requirements in paragraphs 17-19 (a) are essentially requiring the auditor to take the approach of testing how management made the accounting estimate and the data on which it is based. Further, paragraph 19 (b) requires the auditor to develop a point estimate or range when certain conditions are met. In order to bring sufficient clarity to the risk-differentiated approach in ED-540, we strongly believe it is necessary to place the objectives-based requirements in the context of the testing approaches that are proposed to only be relevant to accounting estimates for which inherent risk is "low".

Similar to our views on the testing approaches, we also believe the objectives-based requirements are not exclusively relevant to estimates for which inherent risk is "not low" as expressed in our response to Q3. Further, we do not agree that the objectives presented as applicable only when complexity or judgment is driving the inherent risk for the estimate are only applicable in those circumstances. In our view, any accounting estimate for which the auditor intends, or is required to, test how management has made the accounting estimate should involve the auditor performing procedures to evaluate the underlying method, data and assumptions (which together may be implemented into a model) of the estimate. When any of these underlying components of the estimate are more or less complex, or more or less judgmental, or subject to more or less estimation uncertainty, then the auditor's procedures to evaluate those components should be scaled accordingly to reflect the nature of the estimate.

To summarize, we suggest amendments to the approach to further audit procedures for accounting estimates for which the inherent risk is "not low" in ED-540 that include:

- Paragraph 15 (b) of ED-540 requiring the auditor to test how management made the accounting estimate and the data on which it is based by performing further audit procedures to achieve the objective-based requirements.
- Conflating the objectives-based requirements in paragraphs 17-19 (a) into a single list focused on the underlying components of accounting estimates (i.e., method, significant data, significant assumptions, model) accompanied by appropriate evaluations of estimation uncertainty that arise from these underlying components. We believe this change in structure will also provide a better basis for providing guidance on the auditor's evaluation of external information sources used by management in the preparation of estimates (see our response to Q7 for further details on our concerns about the approach taken in ED-540 to amend ISA 500).
- Removing the concept of "complex models" from the objective-based requirements in 18 (c) and converting these into an objective-based requirement related to the auditor's evaluation of management's use of modeling more broadly.
- Adding application material that explains how the procedures for the individual objectives may be scaled depending on the nature of the accounting estimate, including taking into account the information obtained during risk assessment about complexity, judgment and estimation uncertainty.

		<p>We also believe that “significant assumptions” should be a defined term in ED-540 and we are not convinced that the term “significant data” is necessary (refer to Appendix 2 for further details of our views in this regard). Refer also to our response to Q1 for our suggestions regarding additional application material for paragraph 19.</p>
25.	GTI*	<p><b>Overall, we support the identification of the factors that drive the inherent risk of estimates; however, we are of the view that the IAASB should consider how this approach can be applied in practice by auditors. Our concerns include (1) whether there is benefit to separating the factors of estimation uncertainty, complexity and judgment; and (2) how the three factors interact and if it is necessary to develop separate procedures for each of these three factors. Although the requirements addressing how the auditor obtains sufficient appropriate audit evidence for each of the three factors are expressed as matters over which the auditor should obtain sufficient appropriate audit evidence, the practical application of these requirements is that the matters will become a checklist that the auditor will work through to be “certain” of obtaining sufficient audit evidence. This may not result in the most effective and efficient approach to the audit of estimates. This level of unintended prescription in the requirements would also represent a departure from a principles-based standard.</b></p> <p><b>We are also concerned with the direction of paragraph 19(b) of ED 540, which, as currently written, would appear to suggest that if management is unable to develop a reasonable estimate, the auditors are responsible for its development. We are of the view that, in addition to blurring the line between the responsibilities of management and those of the auditor, it is not reasonable to expect, or provide the impression, that the auditor will be able to develop a range of acceptable values if management is unable to do so. If management is unable to develop a reasonable estimate, we are of the view that this would lead to a limitation of the scope of an audit that would accordingly be reflected in the audit opinion. Without the elimination of this requirement from the standard or further clarification of the intention of this requirement, it has the potential to be a fatal flaw.</b></p> <p>(a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with relevant requirements in ISA 315 (Revised) and ISA 330)?</p> <p>We are of the view that the proposed changes in ED 540 represent an improvement on extant ISA 540. However, appreciating the need for ISA 540 to be revised in a limited time frame, we question whether proposals that may result from the current ISA 315 (Revised) project will result in the need for further changes to ED 540 or if such proposals may result in a disconnect between the two standards. It is important that the IAASB ensure that there is an appropriate level of communication and coordination between these two projects as ED 540 moves towards finalization.</p> <p>We are also of the view that more guidance is required in ED 540 to assist the auditor in complying with the requirement in paragraphs 27 and 28 of ISA 315 (Revised) when determining whether the estimate is considered a significant risk. ED 540, in paragraph A76, refers the auditor to ISA 315 (Revised) but does not include consideration of the factors identified in ISA 315 (Revised) in the context of the three factors in ED 540.</p> <p>Further, when considering the nature of accounting estimates, paragraph 3 of ED 540 notes that the susceptibility of an estimate to misstatement may increase due to estimation uncertainty. ED 540 implies that the auditor should determine that management has taken steps to address estimation uncertainty. Application material in paragraphs A113 to A115 provide further guidance on</p>

management's steps to understand and address estimation uncertainty. However, this guidance does not clarify what is intended by the term "address." For example, is it sufficient for management to measure and disclose estimation uncertainty? Do management have the responsibility to minimize estimation uncertainty? We interpret this to mean, where possible, estimation uncertainty is reduced to a level below performance materiality. If estimation uncertainty cannot be reduced to a level below performance materiality, then we would interpret this to mean that estimation uncertainty should be minimized. Further, we are of the view that estimation uncertainty should be evaluated and disclosed as necessary. We would therefore recommend that additional application material is considered for ED 540 to clarify what is expected.

We understand that a potential disconnect between inherent risk and the risk of material misstatement in ED 540 has been identified through field-testing which produced the following results. An inventory provision is based on model that uses the movements in inventory to calculate the provision and the model has been assessed as complex. Under ISA 315 (Revised), the likelihood of misstatement of the provision is low and the provision has historically been below performance materiality. Under ED 540, because the model has complexity to it, the auditor might be more inclined to assess the risk of misstatement as other than low and would need to comply with paragraph 15(b) and perform incremental audit work, which may not be effective or representative of the risk.

We would therefore recommend the consideration of additional explanatory material in proposed paragraphs A72 to A74 to assist the auditor in assessing the risk of material misstatement related to an accounting estimate, specifically:

- Whether one of the factors of complexity, judgment or estimation uncertainty should be considered more prominent than the others. For example, ISA 315 (Revised) recognizes complexity and estimation uncertainty as significant risk indicators but does not recognize judgment. Should it be inferred that this factor is of less importance than the others? This may also be an issue for consideration in the IAASB's ISA 315 (Revised) project.
- Whether it is possible to identify certain factors that give rise to the risk, but still conclude that the inherent risk is low. If that is possible, is there a threshold from which it is determined that it would no longer be reasonable to conclude inherent risk is low? For example, if an estimate has an assessed inherent risk of low for complexity and estimation uncertainty and not low for judgment; could we conclude that overall inherent risk is low and thus the requirements of ED 540 paragraph 15(a)(i) – 15(a)(iii) can be applied? On the other hand, does the fact that judgment has been assessed as not low, irrespective of the overall assessment of inherent risk, mean that the requirements in ED 540 paragraph 18 must apply? Alternatively, if we have an estimate with an assessed low level of complexity, judgment and estimation uncertainty, could we conclude that the inherent risk is low or does the accumulation of the three criteria result in the determination that inherent risk is not low?

We understand that the results of field-testing have indicated that auditors have interpreted ED 540 to require the identified inherent risk of the estimate to be categorized as one of the three factors and as a result, it was difficult to apply the risk assessment and to structure a response to the risk.

(b) Do you support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?

(c) Is there sufficient guidance in relation to the proposed objective-based requirements in paragraphs 17-19 of ED-540? If not, what additional guidance should be included?

We have concerns around the drafting of the proposed requirements and how they may be practically applied. For example, ED 540 implies that the assessed risk of an estimate will always be as a result of one of the three factors. This may result in implementation issues in circumstances when it is not possible to identify only one of these factors as being the main driver of risk or, alternatively, where a factor other than the three identified is the main driver of risk.

We are of the view that it should be made clear in the application material of ED 540 that a combination of factors could be identified as the reason for the assessed risk of the estimate. Further, to assist auditors in determining which factor or factors drive the risk, examples where multiple factors drive the risk would be helpful in understanding the distinction between the three factors. We would suggest that these other examples include:

- Estimating depreciation for an entity with a large fixed asset base – for example, an entity specializing in energy distribution, which requires complex monitoring systems and processes but less judgment and typically involves a low degree of estimation uncertainty
- The estimate of future income tax assets that can be recognized – this requires considerable judgment in the assessment of future taxable profits and may present significant estimation uncertainty if projections are a long way in the future but generally require less complex systems and processes for its establishment.

Further, distinguishing between estimation uncertainty and judgment may be difficult in practice and based on the definitions included in ED 540, these two factors would appear to be very closely related. For example, where the inherent risk of an estimate is determined to be not low due to estimation uncertainty this will inherently require management to use judgment to value the estimate and conversely, where the inherent risk of the estimate is determined to be not low due to the use of judgment, estimation uncertainty must be present. We are of the view that further clarification of these factors is required in proposed ISA 540 (Revised) or that consideration should be given to combining these factors into a single concept.

In respect of the potential for other factors to be driving the risk of the estimate, the Explanatory Memorandum accompanying ED 540 clarifies that these three factors are not an exclusive list and there could be other factors driving the risk. We believe it would be helpful, if similar to the Explanatory Memorandum, this could be more plainly stated within the ED 540 itself.

Further, if an estimate was determined to be not low inherent risk at the beginning of the audit and therefore paragraphs 17-19 of ED 540 apply, but, before the issuance of the financial statements, the reason for the assessment of not low is resolved (and verified through audit procedures on subsequent events), we would assume that the inherent risk would become low (as the risk driving the not low assessment has now been eliminated) and, depending on the requirements of the financial reporting framework, the amount may no longer be considered an estimate. As such it is not clear whether the requirements in paragraph 17-19 of ED 540 would still apply. We are of the view that this should be clarified in ED 540 or should be proposed as a conforming amendment to ISA 330.

Where estimation uncertainty is determined to be the primary inherent risk of the estimate, ED 540 paragraph 19(b) requires that if the auditor concludes that estimation uncertainty has not been appropriately addressed, then the auditor must develop an independent estimate, to the extent possible, to evaluate management's point estimate. We are concerned that not only will this blur the

		responsibilities of management and of the auditor for the development of the estimate, without further guidance regarding the circumstances in which it would or would not be possible to develop an independent estimate, this requirement could be inappropriate and a fatal flaw in the standard. (Also, see our comment in Q4a above in respect of use of the term “address.”)
26.	KPMG*	<p><b>The way forward</b></p> <p><b>We recognise that:</b></p> <ul style="list-style-type: none"> <li>— <b>ISA 540 is intended to apply to all accounting estimates regardless of the assessed risk of material misstatement; and</b></li> <li>— <b>The approaches to auditing accounting estimates will generally be consistent for all types of accounting estimates, irrespective of the complexities, judgment and degree of estimation uncertainty involved in making them. Rather, it is the extent of the auditor’s work effort and persuasiveness of audit evidence needed that differentiates the audit response, which is driven by the underlying assessment of the risks of material misstatement of the estimate and the rationale for the assessment as it relates to the different components (i.e. data, assumptions and methods/models) of each estimate.</b></li> </ul> <p><b>As such, we believe the standard should prescribe the relevant approaches to auditing all accounting estimates (i.e. the approaches identified in ED-540.15(a)), and clearly articulate that, as the assessed risk of material misstatement increases, it is important the auditor responds by identifying and sufficiently understanding the risks related to different components (i.e. data, assumptions and methods/models) of each estimate that impact the assessed risk of material misstatement, and designing an audit approach that appropriately responds to these risks. The application guidance could then expand upon the challenges of auditing the more sophisticated estimates, where it may be more difficult/judgmental to determine whether the auditor has obtained sufficient appropriate audit evidence.</b></p> <p><b>To make the identification, assessment and response to risks of material misstatement more intuitive for the auditor, as well as to be consistent with how the entity makes the estimate and how audit evidence is available, we believe ED-540 needs to describe relevant risk factors for an estimate based on how they relate to the different components of the estimate (i.e. data, assumptions and methods/models), rather than how such relevant risk factors relate to complexity, judgment and estimation uncertainty. Whilst we understand there may be concerns that this proposed approach may result in duplicative guidance in the standard, we believe this could be overcome (see, for example, the proposed approach in the PCAOB’s standard).</b></p> <p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>We believe the proposed requirements are overly complicated and may be confusing for the reasons outlined in our response to question 3 above. Consequently, we do not believe they will support more effective identification and assessment of, and responses to, risks of material misstatement.</p> <p>b) Do you support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p>

		<p>We recognise the importance of developing requirements that enhance the auditor’s ability to identify relevant risk factors that have a significant impact on the identified and assessed risk of material misstatement related to estimation uncertainty and to develop an audit approach that specifically responds to those risks. However, we believe the introduction of the three risk factors above is unlikely to achieve this objective for the reasons outlined in section 3(b) of this letter. Consequently, we are not supportive of the requirements in ED-540.13.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17–19 of ED-540? If not, what additional guidance should be included?</p> <p>For the reasons outlined in 3(c) of this letter, we believe ED-540 has insufficient requirements and application guidance related to the three audit procedures that would usually be performed to respond to the identified and assessed risks of material misstatement, as described in ED-540.15(a). Our preference would be to remove the requirements to obtain sufficient appropriate audit evidence for these matters, especially given it is unclear how they can be met if the auditor is not testing management’s process for making the estimate.</p> <p>We believe ED-540 should instead focus on requirements that require a response that appropriately responds to the specific risks of material misstatement, and adding additional application guidance on the three audit procedures referred to in ED- 540.15(a) that can be used to test estimates.</p>
27.	PKF	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>Yes, subject to our comments in 3 above.</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Yes, we support this requirement. However, we have some concern that the requirement in par. 13 is included too late in the process and should form part of the requirements relating to risk assessment procedures in par. 10. See our response to 3 above.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>Yes, however refer to response in 5 regarding the auditor’s point estimate or range.</p>
28.	PWC*	<p><b>Notwithstanding our overall support, we believe that key aspects of the ISA need to be reconsidered, in particular:</b></p> <ul style="list-style-type: none"> <li>• <b>The integration of proposed, contextual, risk factors into the risk assessment framework and, in particular, as the basis for designing the audit response is unduly complicated and risks creating confusion and unnecessary challenges in</b></li> </ul>

**practical application. It does not reflect how an experienced auditor thinks about auditing an accounting estimate.**

**The proposed use of factors unduly complicates the auditor’s risk assessment**

**We believe that identifying and assessing the risks of material misstatement for account balances, classes of transactions, and disclosures at the assertion level remains appropriate. The assertions identified in ISA 315 (e.g., existence, completeness, accuracy, valuation) are the ways in which an account balance can be misstated. Complexity, judgment and estimation uncertainty are contextual factors that can influence the assessment of risk (e.g., whether a risk of misstatement at the assertion level is low, or higher, or a significant risk), as well as how best to design the approach to obtain audit evidence in response to identified risks. The factors are not, in and of themselves, “what could go wrong”.**

**For these reasons, we are concerned that:**

- **The way in which the proposed risk assessment requirement in paragraph 13 is drafted, in conjunction with the fact that the requirements in paragraphs 17-19 for the related response to assessed risks are driven by each factor, is leading to: i) a perception of the need to explicitly identify and assess risks by factor, even though complexity, judgement and estimation uncertainty are not mutually exclusive; and ii) confusion over which factors, individually or in combination, are “the reasons for the assessment given to the risk”, which is problematic as that determines the application of paragraphs 17-19.**
- **The proposed approach will require documentation of a complex matrix of the identification and assessment of each risk by: i) assertion (as required by ISA 315); and ii) then also by each of the three risk factors.**
- **There is also no clear linkage in paragraph 13 back to paragraph 10, which identifies the matters for which the auditor is required to obtain an understanding to inform the auditor’s risk assessment. There is therefore confusion about how to relate the risk factors in paragraph 13 to the understanding obtained in accordance with paragraph 10 in performing the risk assessment.**

**For all of these reasons, we believe that suggesting that the auditor make risk assessments by both assertion and factor will cause confusion and will not enhance the auditors’ risk assessment or audit response. This concern extends not only to ISA 540 but also to the proposed revision of ISA 315, where we note similar consideration is being given to the use of risk factors.**

**We strongly recommend that the proposed risk factors of complexity, the need for the use of judgement, and estimation uncertainty be positioned as useful considerations when thinking about the susceptibility of the estimate to error or fraud, or “what could go wrong”. They can usefully inform the auditor’s assessment of the identified risks of material misstatement at the assertion level, but should not be the basis for identifying those risks and how to design a response. This is consistent with how risk factors are used in ISA 240 and also how they have been incorporated into the proposed PCAOB standard.**

**A more intuitive way to organise the proposed responses to assessed risks**

**We agree that there is merit in being more specific in the standard about areas on which the auditor should obtain evidence when testing how management made the accounting estimate. This will help the auditor identify the various components of the estimation process on which it may be necessary in the circumstances to obtain audit evidence.**

However, our field testing showed that the structure of the requirements for responding to assessed risks is not intuitive. While most could reconcile the procedures they considered appropriate in the circumstance to the matters for which evidence was required to be obtained, the ED was not presented in the way that auditors think about how to design an audit approach. There was confusion over why matters were listed under certain factors rather than others in paragraphs 17-19 and a lack of clarity about how to address the inter-relationships between them. In addition, it was unclear whether paragraphs 17-19 necessarily all applied to both testing management’s process and to the auditor developing a point estimate or range independently.

Equally important, we believe there may be an unintended risk that focusing on risk “factors” and obtaining evidence about “matters” may cause the auditor to lose focus on adequately responding to the risk of material misstatement at the assertion level. More specifically, the requirements to respond to each of these factors and matters may promote a checklist approach to performing procedures without carefully thinking about whether those procedures, and evidence obtained, provide sufficient appropriate audit evidence about the specific risks of material misstatement at the assertion level.

Our field testing also found that engagement teams were confused by the differentiation between the proposed responses for “low” inherent risk and “other than low” inherent risks. This was because the approaches listed in paragraph 15 are equally applicable when designing a response to any estimate not just low inherent risk estimates.

Therefore, similar to the PCAOB’s approach, and irrespective of the level of assessed risk, we recommend that the standard include an initial requirement to establish the overall testing strategy based on one or more of the potential approaches – testing subsequent events, testing management’s process, developing the auditor’s own point estimate/range.

We also recommend that the original “matters”, set out in paragraphs 17-19 of the ED, for which the auditor is required to obtain evidence, be restructured more logically and intuitively under sub-headings of “method”, “data” and “assumptions”. These would then form revised requirements addressing the matters for which the auditor obtains evidence when testing how management made the accounting estimate and the data on which it was based. We also recommend introducing requirements that set out matters to be considered when obtaining evidence from subsequent events and when developing an auditor’s point estimate/range. In appendix 2 we illustrate how this could be achieved.

We believe a focus on complexity, judgement and estimation uncertainty, and the associated guidance included in the ED, are useful considerations that will promote more granular thinking about of “what could go wrong”, to inform the auditor’s risk assessment at the assertion level and design of appropriate responses. These factors can influence the assessment of identified risks (e.g., whether the risk of misstatement at the assertion level is low, or higher, or a significant risk) and how best to design further audit procedures to obtain evidence in response to the risk. In our field testing, teams agreed that these were important things to think about.

The factors are, however, not what could go wrong i.e., the estimate is not misstated because it is complex or needs judgement. We continue to believe that identifying and evaluating the risk of material misstatement for account balances, classes of transactions, and disclosures at the assertion level remains appropriate. The assertions identified in ISA 315 (e.g., existence, completeness, accuracy, valuation) are the ways in which an account balance can be misstated.

We are therefore concerned that the way in which paragraph 13 is drafted and, more specifically, the fact that the related response to risk requirements (paragraphs 17-19) are driven by each factor, creates an artificial structure for designing an appropriate response to

identified risks and is not straightforward to apply in practice.

Equally important, we believe there may be an unintended risk that focusing on risk “factors” and obtaining evidence about “matters”, may cause the auditor to lose focus on adequately responding to the risks of material misstatement at the assertion level. More specifically, the requirements to respond to each of these factors and matters may promote a checklist approach to performing procedures without carefully thinking about whether those procedures, and evidence obtained, provide sufficient appropriate audit evidence about the specific risks of material misstatement at the assertion level.

The results of our field testing indicated confusion about how to categorise each identified risk based on complexity, judgement and estimation uncertainty, when these factors are not mutually exclusive, as well as confusion, therefore, as to which factors are the reasons for the assessed level of risk, including how they impact that assessment individually and in combination (“the reasons for the assessment given to the risk”), which is problematic as that drives the application of paragraphs 17-19.

Based on the results from field testing, the proposed approach will result in documentation of a complex matrix of the assessment of each risk; on the one hand by assertion (as required by ISA 315) and on the other hand based on each of these three risk factors. We believe this will cause confusion and will not enhance the auditors’ risk assessment or audit response.

Our field testing also identified the following challenges in applying the new requirements:

- The focus on factors may result in the broader understanding of the entity in ISA 315, as supplemented by paragraph 10 of ISA 540, being overshadowed. There is no clear linkage in paragraph 13 back to paragraph 10 and the list of matters about which the auditor was required to obtain an understanding, to help inform their risk assessment. This may also lead to confusion about how to relate the risk factors in paragraph 13 to the understanding obtained in accordance with paragraph 10 in performing the risk assessment.
- The structure of the requirements on responding to assessed risks is not intuitive and there is a lack of clarity about how to address inter-relationships between the factors. For example, the extensive overlap between paragraphs 17 and 18 caused confusion. The distinction between, for example, paragraph 17(a) and paragraph 18(a)(i) is not clear.
- There was also confusion over why items are listed under certain factors (paragraphs 17-19). For example, there are matters about which it was expected that it would always be relevant to obtain evidence when testing management’s process e.g., the appropriateness of changes from the prior year. This is only explicitly addressed under the “judgement” factor requirement. Similarly, there was feedback that a number of matters in paragraph 17 were more broadly relevant (e.g., relevance and reliability of data or accuracy of calculations) and were not exclusive to “complexity”. There is therefore a risk of unintended consequences that if a risk factor is not deemed to be the reason for the assessed risk, that “expected” procedures, and the related audit evidence they would provide, are overlooked.

We believe it is important to maintain a strong link to the requirements of ISA 315 and ISA 330. There is a risk that the multitude of concepts being incorporated into proposed ISA 540, including the risk factors and “matters” about which the auditor needs to obtain evidence, risks confusion as to what the auditor is responding to.

We recommend that the understandability and practical application of the ISA can be enhanced by:

		<ul style="list-style-type: none"> <li>• Positioning the proposed risk factors of complexity, the need for the use of judgement and estimation uncertainty as useful considerations when thinking about the susceptibility of the estimate to error or fraud, or “what could go wrong”. They can help inform the auditor’s identification and assessment of the risks of material misstatement at the assertion level, but should not be the basis for that assessment and response. This is consistent with how risk factors are used in ISA 240 and also how they have been incorporated into the proposed PCAOB standard. See proposed paragraph 13 in appendix 2.</li> <li>• Adopting a more intuitive structure for the response to assessed risks that better reflects the way in which audits of accounting estimates are actually approached. The three approaches available to the auditor, regardless of the level of assessed risk, are those set out in paragraph 15(a). We believe an overarching requirement, similar in nature to that proposed by the PCAOB , is appropriate to direct the auditor in determining an appropriate approach to respond to the assessed risks. See proposed paragraph 15 in appendix 2.</li> <li>• Incorporating requirements that provide further direction for each of the 3 approaches, as explained further below.</li> <li>• With respect to testing events subsequent to the balance sheet date, giving this greater prominence. If this approach is capable of providing sufficient appropriate audit evidence then this would, in most cases, be the most sensible approach. A requirement to directly address obtaining evidence from this approach, that precedes requirements under other approaches, appears warranted and would also, in our view, promote an element of scalability. See proposed paragraph 15A in appendix 2.</li> <li>• With respect to testing management’s process, reorienting paragraphs 17 and 18 to individually address the method, data and assumptions. Both of the proposed ED paragraphs largely focus on these “elements” of accounting estimates but, as noted, contain significant overlap. Restructuring would, in our view, eliminate this overlap, avoid any commonly “expected” procedures being overlooked by subjective judgement as to applicability of a particular factor, and represent a more intuitive approach to thinking about how to respond to risks arising from the key elements of accounting estimates. See proposed paragraphs 15B and 17-18A in appendix 2.</li> <li>• Creating a more explicit requirement that addresses expectations of the auditor when developing their own point estimate or range. While application material discusses broadly how an auditor might go about developing their own estimate or range we think it is more helpful to indicate the expected work effort if, for example, the auditor uses management’s method or model, data or assumptions. Similarly, setting a clear benchmark in the requirements that, if the auditor uses their own method, model, data or assumptions, they need to have a reasonable basis for those selections would also be appropriate. See proposed paragraph 19B of appendix 2. Note, some further restructuring of the ordering of paragraphs 19 (estimation uncertainty), 20 (auditor ranges) and our suggested additional requirement regarding point estimates or ranges is likely necessary.</li> </ul> <p>These changes will necessarily result in amendments to the application material, including amending the guidance to align to the repositioning of complexity, need for use of management judgement and estimation uncertainty from being the reason for the risk assessment to a consideration influencing the assessment of an identified risk.</p>
29.	RSM	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>Overall, we support the concept of assessing risk and responding accordingly as outlined in ED540. It is consistent with ISA 315 and ISA</p>

330. However, we have the following concerns with the way in which this approach is outlined in ED540:

- The way in which risks are categorised seems to be a departure from the assessment of risks in ISA 315 where risks that are not considered significant in accordance with paragraph 27 are not then described as “low”.
- Notwithstanding the concept of a significant risk and the required responses thereto, ISAs generally recognise a spectrum of risk to encourage auditors to design responses appropriate to the specific risk itself rather than its categorisation. ED540 appears to categorise risks as “low” (paragraph 15(a)), “not low” (paragraph 15(b)) and “significant” (paragraph 13) but the responses to the latter two categories appear to be the same, whereas ISA 330 requires greater audit effort for significant risks. In addition, some methodologies may not have a concept of “low” and therefore this label may cause some confusion.
- In order to address the issue of “low” inherent risk and to bring ED540 into line with ISA 315’s approach to the assessment of inherent risk, we suggest the following approach:
  - o The auditor should perform risk assessment over estimates in line with paragraphs 10-13
  - o For all estimates, the auditor should perform the procedures in paragraph 15
  - o The auditor should then assess whether they have sufficient appropriate audit evidence over the estimate, or whether further procedures are necessary. This is a matter of professional judgment that depends on:
    - Whether the estimate is a significant risk; and
    - The extent to which the estimate involves complexity, judgment, or estimation uncertainty, and these risks are not adequately addressed by the procedures in paragraph 15.
  - o If further procedures are required, the auditor would perform the procedures from paragraphs 17-19 as appropriate.
- Some of the drafting in paragraph 15 could be improved. For example,
  - o The requirement to obtain audit evidence about subsequent events in paragraph 15 (a)(i) should also make clear that some of these could be assessed as non-adjusting under many reporting frameworks.
  - o Audit procedures designed to address paragraph 15(a) would often include some of the responses set out in paragraphs 17-19 but paragraph 15(b) could be read to imply that, for “low” inherent risks, those paragraphs can be ignored. However, even for a “low” risk, the auditor might want to understand whether the method is appropriate (per paragraph 17(a)) and whether the calculations are mathematically accurate (paragraph 17(e)). Arguably these are included in paragraph 15(a)(ii) but it is a little ambiguous.
  - o Consistent with the principles of ISA 315, clear reference is made to assessing the risk of material misstatement at the assertion level and we expect that this would often relate to the valuation/allocation/accuracy/presentation assertions. However, we see the possibility that auditors may assess the risk at the account balance level, albeit that this is not what ED540 requires. The risk is that all assertions might then be assessed as “not low” and unnecessary audit procedures would be performed on assertions which should have been assessed as “low”. It could be more explicitly stated, or possibly guidance added, that auditors can assess some assertions as “low” despite the complexity, judgment and

		<p>estimation uncertainty affecting the accounting estimate.</p> <ul style="list-style-type: none"> <li>• It could be more explicitly stated in paragraph 15(b) that the matters in paragraphs 17-20 rank equally in the assessment of the inherent risk of an accounting estimate.</li> <li>• We suggest that paragraph 18(a)(ii) is amended to include reference to methods, data or assumptions that should have changed but did not.</li> <li>• The definition of “significant” data and assumptions could be improved beyond that contained in paragraph A35 by clarifying which measurement of materiality is being referred to.</li> <li>• Clarification on the extent of documentation on each of the three factors in paragraphs 17-19 would be useful. For example, is it required to document the assessment of each of the three elements or is it left to each auditor’s judgment? The latter seems to be the case but more explicit clarification would help auditors.</li> </ul> <p><i>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</i></p> <p>Overall, we support the requirement for the auditor to take into account the relevant factors and they are well explained in the standard, although some clarifications would be useful as described elsewhere in this response.</p> <p>However, it could be argued that complexity and judgment are sub-sets of estimation uncertainty.</p> <p><i>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</i></p> <p>Yes, we believe that the guidance is generally comprehensive, however, we consider that there may be an issue with the apparent binary nature of paragraphs 17-19, particularly in the light of paragraph 15(b)’s statement “when applicable”.</p> <p>For example, an estimate might be assessed as “not-low” due to complexity but not judgment or estimation uncertainty. However, one or both of judgment or uncertainty might be present but not as the overriding consideration in assessing the risk of material misstatement. The current drafting implies that the impact of these other two factors could be ignored in the design of further audit procedures.</p> <p>This seems illogical and may not be the Board’s intention. We recommend that paragraph A97 be amended to make the Board’s intention on this point clear.</p>
30.	SRA	
<b>Public Sector Organizations</b>		
31.	ACAG	<p>a) <i>Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risk relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</i></p> <p>The elaboration in paragraphs 10 through 13 on the risk assessment requirements as they relate specifically to auditing estimates is</p>

		<p>useful, and is likely to assist auditors more effectively identify risks of material misstatement.</p> <p>However, whether risk responses will necessarily be any more effective is less clear.</p> <p>The 'low' and 'not low' inherent risk categories, introduced for the first time in this ED, have not been defined in the ED, nor elsewhere in the Auditing Standards (particularly ISA 315).</p> <p>The lack of detail regarding how to respond to significant risks and the generic references to obtaining 'sufficient appropriate evidence', may also still lead to inappropriate responses.</p> <p>b) <i>Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</i></p> <p>Yes, ACAG believes the factors of 'complexity', 'judgement' and 'estimation uncertainty' are useful for the auditor to consider.</p> <p>c) <i>Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</i></p> <p>ACAG believes there is sufficient guidance provided.</p>
32.	AGA	<p>a) <i>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?</i></p> <p>As noted in response to question 3, the requirements may not be effective. Risk assessments are not necessarily binary (low, other than low) so the standard should not be written assuming they are. As well, there may be other procedures auditors perform, such as data analytics.</p> <p>b) <i>Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</i></p> <p>We agree.</p> <p>c) <i>Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</i></p> <p>The guidance is sufficient.</p>
33.	AGC	<p>a) <i>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?</i></p> <p>Yes, 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;</p>

	<p>however, we have concerns the proposed standard may not be clearly understood and consistently interpreted and applied.</p> <p>We notice the proposed requirements for the risk assessment and response make specific reference to identifying and assessing significant risks; however, the related requirements and application materials do not specifically address significant risk. Instead, the proposed standard introduces new risk classifications of 'low' and 'not low'.</p> <p>For instance, paragraph 10 provides the ISA 315 requirement to determine if any identified risks are significant. Also, paragraph 15 provides the ISA 330 requirement to design audit procedures which respond to risk, including significant risks; however, related requirements (par. 15 through 20) and application materials provide two tiers of procedures for application when inherent risk is assessed as either 'low' or 'not low' with no reference to significant risk.</p> <p>While we have inferred the meaning of 'not low' to be a range of risks which includes significant risks as well as risks assessed between low and significant; for greater clarity, we recommend the Board provide guidance to introduce the new risk classifications of low and not low and clarify how the requirements to identify and respond to significant risks are addressed by the proposed requirements of ED-540. For instance; consider adding wording such as the following to paragraph 15.</p> <p>An inherent risk assessment of 'not low' encompasses a range of possible risk assessments which include significant risks as well as risks assessed between low and significant.</p> <p>Additionally, paragraph 13 provides requirements for identifying and assessing risk of material misstatement and the auditor is required to conclude on a risk assessment; however, there is no reference to low or not low risks. Since the proposed standard requires application based on the auditor's assessment of low or not low risks, we recommend the proposed standard require the auditor to determine whether there are any 'not low' risks. We suggest adding wording such as the following to paragraph 13.</p> <p>The auditor shall determine whether, in the auditor's judgment, any of the accounting estimates identified have sufficient complexity, use of judgements and/or estimation uncertainty to give rise to an inherent risk of not low.</p> <p>In addition, we suggest the Board integrate the new risk classifications of low and not low within conforming amendments to ISA 315, ISA 330 and ISA 500.</p> <p><i>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</i></p> <p>Yes, we support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty.</p> <p><i>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</i></p> <p>Yes, there is sufficient guidance provided by paragraphs 17 to 19 to support compliance with the requirements of paragraph 15b). We reiterate the need to clarify the meaning of the 'not low' risk assessment.</p>
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34.	AGNZ	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>No. Please refer to our comments in section 5 of the main submission above.</p> <p>5 Concerns around the practical consequences for auditors</p> <p>5.1 We have some concerns around the practical implications of applying ED-540.</p> <p>5.2 Our interpretation of how ED-540 will apply indicates potential for:</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> A greater burden of work for auditors;</li> <li><input type="checkbox"/> An increased “self-review” threat to independence; and</li> <li><input type="checkbox"/> An increased use of experts by auditors.</li> </ul> <p>A greater burden of work for auditors</p> <p>5.3 ED-540 could lead to a greater level of work for auditors of public sector entities, where the largest items on the balance sheet are assets recognised at fair value, such as:</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> roads and bridges;</li> <li><input type="checkbox"/> water, wastewater, and stormwater reticulation networks; and</li> <li><input type="checkbox"/> special purpose buildings such as hospitals and stadiums.</li> </ul> <p>5.4 It is unlikely that the auditor would assess those assets as being of low inherent risk (the relative size of the item(s) alone could mean it is the account area most likely to be at risk of a material misstatement).</p> <p>5.5 In many cases, it is probable that such estimates would be determined on the basis of a valuer’s report, received by management, or based on the information provided by an internal expert. Where this is the case, the most likely current approach would be to review the assumptions applied by management (or management’s expert) and assess them for reasonableness. This approach is permitted in ED-540 under paragraph 15(a)(ii), but only applies to account areas where the inherent risk is assessed as low.</p> <p>5.6 Since the trigger point under ED-540 is the assessment given to the inherent risk, land and building valuations are likely to require application of the further audit procedures referred to in paragraph 15(b). This could mean a considerable increase in work effort is required for many public sector entities.</p> <p>An increased “self-review” threat to independence</p> <p>5.7 Our observation from public sector audits is that often valuers’ reports do not contain evidence of how estimation uncertainty has been addressed. Where that is the case, under paragraph 19(b) “the auditor shall, to the extent possible, develop an auditor’s</p>
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point estimate or range”.

- 5.8 We are concerned that ED-540 may require auditors to perform work which could pose a “self-review” threat. In our view, it is not the auditor’s role to develop a model or even a point estimate. This should remain the responsibility of management. Where auditors become aware of deficiencies in an entity’s approach, this should be communicated to management and those charged with governance, but the auditor should stop short of actually calculating a figure.
- 5.9 The necessary level of work to develop an auditor’s point estimate or range could be quite onerous and it is unclear whether the additional work is required in all circumstances or just when the auditor is concerned that an estimate might be materially misstated.
- 5.10 There is also a small risk that this could become a factor in the auditors’ assessment of inherent risk and, as a result, inadvertently influence irrational behaviours (that is, lead to auditors inappropriately assessing an estimate as low risk).
- An increased use of experts by auditors
- 5.11 Application guidance paragraph A69 provides examples of estimates that auditors should be capable of assessing. Paragraph A69 also suggests that other estimates (such as expected credit losses or insurance contract liabilities) would be likely to require auditors to apply specialised skills or knowledge from outside the audit team’s collective “experience”, implying that auditors are unlikely to be able to audit such figures themselves.
- 5.12 We believe that many auditors would have the skills and knowledge required in order to obtain sufficient appropriate audit evidence relating to many accounting estimates that fall between the two extremes cited in paragraph A69. In particular, there are a number of professional service firms that carry out a range of services. It would seem unusual for them to be able to carry out valuation services on a consultancy basis, but at the same time, not be considered capable of assessing similar estimates in an audit capacity.
- 5.13 We foresee a future where auditors are increasingly required to engage an independent auditor’s expert to review and/or challenge an estimate that has been developed by an expert engaged by management. We question what added value this approach will provide for users of financial statements.
- 5.14 In our experience, a knowledgeable and experienced auditor often asks more probing questions and applies more professional scepticism than independent “experts” and also has a considerable amount of practical experience and knowledge that they are able to draw on.
- b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgement by management and the potential for management bias, and estimation uncertainty?
- Yes, we support this requirement, but these are all factors that auditors should already be considering under the existing standard. ED-540 makes the expectations more explicit, but it remains to be seen whether auditors will be any clearer in how they demonstrate that they have considered those factors.
- c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17-19 of ED-540? If not,

		<p>what additional guidance should be included?</p> <p>We have no specific comments to make on this matter, although as noted in the main body of our submission, we believe that overall the standard (and accompanying guidance) is unnecessarily complex and is too long.</p>
35.	CIPFA	<p>a) CIPFA considers that the revised requirements may avoid certain cases where, due to a misunderstanding of the requirements of extant ISA 540 or for other reasons, auditors might mistakenly assess accounting estimates as not being subject to significant risk.</p> <p>b) CIPFA considers that the 3 factor approach will capture the main elements of risk to accounting estimates.</p> <p>c) CIPFA considers that the guidance is useful and, taken together with a proper understanding of the requirements of audit evidence, will help them to achieve the objectives of the audit.</p>
36.	GAO	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>We believe that the requirements support more effective identification and assessment of risks of material misstatement (including significant risks) relating to accounting estimates. We support the proposed standard’s specific risk assessment requirements in paragraphs 10 through 13.</p> <p>However, we believe that requirements for responding to risk of material misstatement could benefit from focusing on the requirement that auditors design and perform further audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement consistent with ISA 330. For example, we believe that it may not be practicable for auditors to develop an auditor’s point estimate or range in certain situations, such as when the estimate is made using a highly complex model. Accordingly, we encourage the IAASB to provide flexibility by allowing auditors to use judgment in determining whether developing a point estimate or range will be responsive to assessed risks of material misstatement and provide sufficient appropriate evidence.</p> <p>b) Do you support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>We support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by complexity, judgment, and estimation uncertainty in identifying and assessing risks of material misstatement.</p> <p>However, in responding to risks of material misstatement and designing and performing further audit procedures, we suggest linking the audit procedures in paragraph 15(a) to the audit evidence required to be obtained in paragraphs 17 through 20. Also, the IAASB should consider grouping the guidance by procedures that evaluate evidence related to methods, data, and assumptions rather than organizing the proposed standard by the factors of complexity, judgment, and estimation uncertainty. As noted above, we have found that approach to be useful in our audits of complex estimates in the federal government and believe that it may be easier to apply than the approach described in the proposed standard. Also, we believe organizing the guidance in this way will support a scalable</p>

		<p>application of the standard.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 through 19 of ED-540? If not, what additional guidance should be included?</p> <p>As noted in our other responses, we encourage the IAASB to link the proposed objective-based requirements in paragraphs 17 through 19 of ED-540 to the procedures in paragraph 15(a).</p>
37.	INTOSAI	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>Public sector considerations:</p> <p>In general, we find the requirements to be relevant to the public sector but please also consider the following circumstance that is unique to the public sector which could be mentioned in the application material.</p> <p>Political influence within the public sector is always a relevant factor to consider when gaining an understanding of the entity and assessing risks. It is highly relevant for public sector auditors to consider political motives that could influence the management bias and ultimately the accounting estimates.</p> <p>Other comments:</p> <p>The proposed standard requires the auditor to understand accounting estimates by performing risk assessment procedures without consideration of significance to the financial statements and related disclosure. We are supportive of this approach. In making accounting estimates however, management will typically operationalize estimation activities at the class of transaction, account balance and disclosure level rather than as one overall general process for preparing estimates. As such, most risk procedures and related activities set out in paragraph 10 of the proposed standard and its supporting application guidance, commencing at paragraph 10(e), would more appropriately be considered in the context of a specific accounting estimate or class of transactions.</p> <p>Further, not all accounting estimates are significant to the financial statements and related disclosures. We recommend the same risk assessment procedures and related activities commencing at paragraph 10(e) be directed at accounting estimates that are significant to the financial statements and related disclosures. Additional guidance may be necessary to assist auditors in determining the significance of an accounting estimate relative to the financial statements and related disclosures.</p> <p>There is inconsistency in the terminology used for risks. In paragraph 13 the auditor should identify significant risks and address them. Paragraph 15, which stipulates the required audit procedures, does not address significant risks, instead it only addresses low inherent and not low inherent risks. At a conceptual level, we also note an emphasis on identifying and responding to a broader range of risks ('not low' risks), while the extant ISA and current supporting standards (ISA 315, ISA 330 and ISA 500) focus on prescribing specific audit procedures only when inherent risk has been assessed as significant. Auditors rely on the ISAs as a framework for applying their professional judgment, especially when assessing and responding to risk; however, this new emphasis along with new risk terminology which has not been defined could result in the standard not being clearly understood and consistently interpreted and applied. As such, we recommend the Board provide a discussion of this new approach for classifying risk and include conforming</p>

		<p>amendments to ISA 315, ISA 330 and ISA 500 which integrate these new concepts and terminologies.</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Public sector considerations:</p> <p>No public sector considerations requiring communication to the Board were identified.</p> <p>Other comments:</p> <p>Yes we support the requirements for the auditor to take into account the relevant factors.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>Public sector considerations:</p> <p>No public sector considerations requiring communication to the Board were identified.</p> <p>Other comments:</p> <p>The guidance appears to be sufficient.</p>
38.	PAS	<p>a) Yes, the requirements support effective identification and assessment of, and responses to, risks of material misstatement relating to accounting estimates. However, we stress the importance of coordination with the planned or potential revisions to ISA 315 to ensure terminology is consistent between the two standards (e.g. meaning of “significant risk”, determining risk of material misstatement using combined approach or separately (via inherent and control risk)).</p> <p>b) Yes, we support the requirement in ED-540 (Revised).</p> <p>c) Yes, there is sufficient guidance in relation to the proposed objectives-based requirements.</p>
<b>Preparers of Financial Statements</b>		
39.	ABA	
<b>Member Bodies and Other Professional Organizations</b>		
40.	ACCA-CAANZ	<p><b>Ensuring that the requirements in relation to the elements of estimation uncertainty, complexity and judgement are not overly prescriptive. Our members believe that, for any estimate categorized as ‘not low’ inherent risks, regulators will expect the auditor to address all three elements and, accordingly, fulfill the requirements for all three. This will drive auditors to a compliance mentality in relation to estimates as they will feel constrained to address all the issues for each of the three areas for every estimate in order to satisfy the regulatory interpretation. A compliance mindset does not improve audit quality and may reduce the exercise of professional skepticism and judgement. It is vital that the</b></p>

requirements in ED 540 are principles based. This is necessary to ensure that the standard remains valid as business activities and estimation approaches change, that work effort is applied to relevant matters and assertions, and that auditors are supported to appropriately exercise professional judgement and appropriately document their work in dealing with estimates.

- Taking a more integrated approach to assessing the risk of an individual estimate and determining the appropriate work effort. Our members expressed a view that in assessing the risk of an individual estimate, the separation of complexity, judgement and estimation uncertainty can feel artificial as, in reality, each of these feeds into each other. They suggested that the key driver of risk in an estimate is usually estimation uncertainty and that complexity and judgement are two factors to consider when determining estimation uncertainty. There may be circumstances in which judgement may be more important than estimation uncertainty, for example, a choice of presentation alternatives in which management may have biased motivation and these should be addressed by the auditor. This only further illustrates the need for a flexible and cohesive approach.

- (a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?

ED-540 introduces an either/or test of low or 'not low' inherent risk. The use of 'not-low' inherent risk does not allow for recognition of the existence of a scale of risk in relation to estimates. It will likely result in nearly all estimates being subject to the procedures in ED-540 which will significantly increase work effort without necessarily improving audit quality. The measure used to identify estimates which require additional work effort by the auditor needs to be more flexible and recognise the spectrum of risk that exists within estimates. We acknowledge the concerns that the use of significant risk in ISA 540 sets the bar too high but we believe that 'not-low' sets the bar too low. An either/or measure is not sufficiently flexible to achieve scalability and allow auditors to achieve an appropriate work effort to address the spectrum of estimates. We believe the measure used needs to be more sophisticated and based on risk of material misstatement and linked to the assertions the auditor is trying to address. It also needs to be consistent with the concepts in ISA 315 and ISA 330 to avoid confusion. There also needs to be a planned approach to incorporating changes to ISA 315 and 330 that are likely to arise from the revision project in relation to ISA 315 to maintain consistency with these standards.

As well as reconsidering the low/'not low' distinction, we believe the application guidance needs to be improved. Currently the paragraphs in A72 and A73 include examples of estimates that may be low or not low. Rather than take this approach, which again, may cause difficulty with regulators expecting the identified risks to always be low or not low, it would be more useful to have a matrix examples which show how a given estimate may be low or 'not low' (or may move along a scale of risk) depending on factors that impact the estimation uncertainty, judgement, or complexity of that estimate for different entities. This kind of matrix would assist auditors in understanding when it would be appropriate to categorise estimates as low risk. If the application guidance retains lists of examples, it would be useful for there to be more equal numbers of examples of low and not low risks to avoid giving the impression that low risk estimates are uncommon.

We are unconvinced by the confidence with which ED-540 proposes the use of inherent risk. An auditor can only observe a single outcome, which represents the residual risk of inherent risk mitigated by actual controls. From this, the auditor, drawing upon their

		<p>own experience, forms a view as to the likely residual risk or the likely inherent risk and control risk. There is a sense in ED-540 that this can be done more scientifically than is achievable in practice. While it is correct and important to discourage auditors from wrongly relying upon controls they have not tested, there is a concern that this will still happen because auditors will under-assess some risks. In addition, the lack of an objective basis for determining inherent risk may result in the auditor's judgment being challenged by regulators, who may be unfairly informed by hindsight. The concepts in ED-540 may also lead auditors to over-assess other risks, leading them to do work in areas that do not require it. Because the auditor is assessing the 'risk of material misstatement' (in accordance with ISA 315), we feel that more guidance on materiality would be useful.</p> <p>ED-540 also lacks clarity around the concept of inherent risk being used. There is a difference between the inherent risk intrinsic to an estimate, which may not be able to be 'audited away' and the inherent risk that arises from a lack of precision in management's approach in applying the financial reporting framework.</p> <p>(b) Do you support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, of affected by, on or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>As discussed in our overall comments, our members expressed a view that the separation of the factors is somewhat artificial. They view estimation uncertainty as the key determining factor with complexity and judgement and management bias feeding into the overall assessment of estimation uncertainty. While it is useful to prompt the auditor to consider the issues associated with each of these factors as set out in paragraphs 17-20, the wording in ED-540 does not provide scalability for the auditor to plan audit procedures to address the risk of material misstatement in relation to determining which of the aspects of the factors need to be addressed. There is concern that the language in paragraphs 17 to 19 may be interpreted by regulators as a need for auditors to design procedures to address all these issues in each of the three areas for every estimate, which forces a compliance mindset which may have negative consequences on audit quality.</p> <p>It would be more useful for the auditor to consider estimation uncertainty, to have scalable requirements in relation to how the auditor addresses degrees of estimation uncertainty in their work effort. Application guidance could provide detail on how the factors of complexity, judgement and management bias may impact estimation uncertainty and what matters may need to be addressed in relation to each of those factors in the auditor's procedures. In particular, greater emphasis on 'judgement' and an explicit linking between judgement and management bias would be useful. We believe that it is vital for the auditor to understand management's motivations, incentives and biases in preparing estimates in order for them to appropriately audit the estimates. This is not addressed in paragraph 18, nor in the standback section in paragraphs 22-23.</p> <p>(c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17-19 of ED-540? If not, what additional guidance should be included?</p> <p>We do not support the inclusion of paragraphs 17-19 as drafted. For the standard to be scalable the wording in relation to the objectives-based requirements need to allow for exercise of professional judgement by the auditor as to which elements of the objectives need to be addressed for any given estimate assessed as having 'not-low' inherent risk. As discussed in our overall comments above there are strong concerns about the overly prescriptive work effort in each of the three areas. As currently drafted, we believe that the wording will drive auditors to try to address all the elements of each of the paragraphs which will not</p>
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		appropriate for all estimates. The standard needs to be flexible in the determination of work effort to allow the auditor to focus their procedures appropriately to address the risk of material misstatement and maintain audit quality.
41.	AE	<p><b>(10) Where inherent risk is not low, ISA 540 requires the auditor to consider three factors, being measurement uncertainty, judgement and complexity. We question whether these three factors should be seen as equivalent in terms of importance and suggest an alternative two-step approach that focuses primarily on significant estimation uncertainty to address this issue. We draw your attention to our response to question 4 that explains this argument further.</b></p> <p><b>(11) Moreover, in some situations where the inherent risk is not low, we think that the response to the assessed risks of material misstatements could be disproportionately high. We refer to the wording of paragraph 19 (b) of the ISA 540. The explanation in paragraph A126 of the application material and the work effort that it may entail for the auditor – could be read as if ISA 540 encourages the auditor to carry out work that falls under the responsibility of management.</b></p> <p><b>Question 4a</b></p> <p>We agree that the requirements when an inherent risk is not low should support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates. As drafted, the proposed paragraph 13 of ED-540 would require the auditor to take into account – at least – these three factors specifically when complying with these requirements of ISA 315 (i.e. in assessing the risk of material misstatement attaching to an accounting estimate). Thus, this paragraph explains how ISA 315 should be applied in relation to accounting estimates, but goes further in specifically requiring the auditor to take into account one or more factors that may be relevant to the risk assessment in the case of an accounting estimate. There is also sufficient application material to help the user of the standard apply the requirements effectively.</p> <p>In relation to significant risk, the relative significance of the measurement uncertainty factor in any given accounting estimate plays the key role in the approach as included in the revised standard. In our view, on the basis of the revised definition, the final standard needs to include more material than currently proposed in the context of determining significant risk to support the auditor's compliance with paragraph 27 of ISA 315. Currently, paragraph 27 of ISA 315 is referred to, but not explained beyond consideration of complexity, need for management judgement, and estimation uncertainty amongst possible other factors. Paragraph A76 of ED-540 merely refers to ISA 315 in this context.</p> <p>The measurement of items that are subject to measurement uncertainty involves the use of one or more assumptions. The "relative precision" of an assumption is of primary relevance in determining whether an accounting estimate is, in the auditor's judgement, a significant risk. We agree that this should be specified along the lines proposed in paragraph 13 (c) and explained in paragraph A35, since when a reasonable variation in the data or assumption would materially affect the measurement of the accounting estimate, the measurement of this accounting estimate would constitute a significant risk.</p> <p>We also anticipate that the field testing exercise will provide a valuable feedback on whether the proposed requirements will lead to more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates. We applaud the IAASB for initiating this. We expect that the IAASB will evaluate the operability of the proposed new requirements based on the feedback received from the audit firms.</p>

		<p><b>Question 4b</b></p> <p>We agree with the work effort as included in paragraphs 17-19 and with the concept as proposed. It is helpful to emphasise the concepts of management judgement and complexity, particularly in light of the new accounting standards introducing greater management judgement when determining accounting estimates, as well as a greater level of complexity in relation to some techniques and methodologies being applied.</p> <p>However, one consequence of this is that it may result in “routine” estimates that can be reliably measured, but which are based on management judgement such as general accruals, or are simply complex, to be included within the scope of ISA 540. We do not believe that this is the intention, but it needs to be clear to all stakeholders.</p> <p>We also observe that the three factors proposed are rather conceptual, not equivalent in terms of importance, and very different in nature. They are also not exclusive; depending on the circumstances, they can overlap. We anticipate that this could cause practical difficulties in application and one suggestion to overcome this would be to give greater prominence to the measurement uncertainty factor compared to the others, and perhaps a reordering of the factors; making it clear that the approach is a two-step one. The first step would be to identify if an accounting estimate is subject to significant measurement uncertainty and, if the case, the accounting estimate should be dealt with in ISA 540. If, however, there is no significant measurement uncertainty, then there is no reason to treat an accounting estimate differently from any other item of the financial statements provided that the matter that distinguishes them from other items in the financial statements (their measurement uncertainty) is not significant.</p> <p><b>Question 4C</b></p> <p>We suggest considering revising the wording in paragraph 16 which considers the design and testing of controls as it is currently unclear how this paragraph derives from paragraph 15. We suggest to explicitly link paragraph 16 to paragraph 15 (b) when inherent risk is not low since paragraph 15 (a) discusses situations where the inherent risk is low - which will not be relevant in the consideration of controls.</p> <p>We consider the definition of the term ‘significant data’, which is mentioned several times in paragraphs 17-18, to be important in the understanding of the respective requirements. We would therefore suggest moving the explanation included in paragraph A35 to the requirements’ section ‘Definitions’ in page 31 of ED-540 - or otherwise have it properly signposted.</p>
42.	AICPA	<p><b>Clarity of the ED 540 Requirements</b></p> <p><b>We found that the construct of the requirements in ED 540 is overly complex and expect it will be difficult for auditors to effectively apply. While we agree that, as stated in paragraph 4 of ED 540, complexity, judgment, and estimation uncertainty are interrelated, we believe that these factors exist for all accounting estimates, albeit to varying degrees. Consequently, we think that the requirements, as written, may result in inappropriate audit response and potentially inappropriate auditor behavior (for example, using the requirements of ED 540 as support for not performing certain procedures). We cannot envision many instances where all three factors (complexity, judgment, and estimation uncertainty) would not be relevant to some extent. Rather, the auditor should focus on the scalability of the factors (for example, the risks of material misstatement might not be in complexity of the calculation but in the underlying data and the subjectivity of selecting the information).</b></p>

We recognize the potential benefits of enhancing professional skepticism by specifically considering the three underlying risk factors. However, because the risk factors are interrelated and not mutually exclusive, we are concerned that the requirement in ED 540 for the auditor to separately assess and respond to each of these three risk factors on each accounting estimate could lead to excessive work effort that is duplicative and not targeted directly towards the work effort that will mitigate the risk. An unintended consequence might be that the auditor will be focused on duplicative consideration and documentation around the assessment of the three risk factors rather than taking a more holistic view of the estimate and the risks of accuracy of the accounting estimate, the sufficiency of the related disclosures, and addressing the risks of material misstatement. Finally, we note that certain of the matters included in those factors would be relevant to the estimates deemed “low” inherent risk—that is, the matters are not exclusive to the approach for addressing “not low” risks. We believe this should be made clearer in ED 540.

#### **Work Effort and Scope**

At the core of all accounting estimates are assumptions, underlying data, a calculation, and estimation uncertainty that are inherent when predicting future events. We believe that ED 540 does not sufficiently address the disaggregation of accounting estimates into these components. This is important because each different component may be subject to significantly differing risks of material misstatement. The auditor’s responses should include procedures that are responsive to the differing risks of material misstatement.

We believe that paragraphs 26(d) and 28 of the Explanatory Memorandum provide very helpful guidance on the proposed work effort to audit accounting estimates. We recommend that these paragraphs be incorporated into ED 540 as application material, especially if the IAASB decides to retain the approach in paragraphs 17–19 of ED 540.

We are concerned that the guidance in ED 540 targeted to smaller entities may not be appropriate. The size of an entity or an audit firm should not be a determining factor in assessing the risks of material misstatement of an accounting estimate. Instead, the work effort should be driven by the risks of material misstatement related to the specific components of the estimate. Because accounting estimates with higher risks exist even in smaller entities, the current approach and related guidance for audits of smaller entities may lead some to believe that the expected level of work may be lower for a smaller entity even though the risks of material misstatement may be higher.

ED 540 bifurcates the work effort between accounting estimates assessed as “low” inherent risk and those assessed as “not low” inherent risk. We believe that this bifurcation is confusing and will not achieve the desire to address the scalability of ED 540. This is because it is not clear how the responses under the “low” inherent risk interrelate with the responses under the “not low” inherent risk. For example, the requirements in paragraph 15(a) of ED 540, which are designed for accounting estimates with “low” inherent risk, would be applicable to audits of all accounting estimates. Many of the procedures in paragraph 17 of ED 540 would likely need to be part of the auditor’s approach to testing how management made the accounting estimate (paragraph 15(a)(ii) of ED 540) and the data on which it is based—even if the estimate has been assessed as “low” inherent risk. When the estimate’s inherent risk is “not low,” we believe that the approaches to audit an estimate would be the same (that is, the strategies for testing estimates in extant ISA 540)—but that in accordance with ISA 330, the auditor would be obtaining more persuasive evidence the higher the auditor’s assessment of risk.

No. As mentioned in our response to question 3 above, we believe that the construct in ED 540 is overly complex and will create

confusion in practice. Our main concerns with respect to when the assessment of inherent risk is “not low” are as follows:

1. Extant ISA 540 has always been and should continue to be about how ISA 330 is applied when auditing accounting estimates. We further believe that paragraphs 17–20 of ED 540 were aimed at providing the auditors with considerations and not mandating specific requirements. We found it difficult to reconcile paragraph A97 of ED 540 with paragraphs 17–20 of ED 540. Specifically, how does obtaining audit evidence about events occurring up to the date of the auditor’s report, or developing a point estimate or range based on available audit evidence to evaluate management’s point estimate, interrelate with the requirements in paragraphs 17–20 of ED 540?
2. We have the following concerns with paragraph 15 of ED 540:
  - a. While auditors are already required to evaluate identified risks of material misstatements to determine if those risks of material misstatements represent a significant risk, which is based solely on inherent risk, the requirement in paragraph 15 of ED 540 to identify whether inherent risk is “low” or “not low” seems to introduce a new risk assessment criterion. It is not sufficiently clear whether an inherent risk that is “not low” is the equivalent of a significant risk. We believe that the intent is that inherent risk that is “not low” captures other risks along the inherent risk spectrum, and it should be clarified in ED 540.
  - b. While attempting to retain the extant testing strategies, the application material and specific requirements are not in ED 540. It is not sufficiently clear as to whether, when testing how management made the accounting estimate as required by 15(a)(ii), the auditor would be also required to obtain specific evidence as to the data, assumptions, and calculations. We believe it is important for ED 540 to be clear as to how the testing approaches interact with the risks identified related to the components of the estimate (including how complexity and judgments impact the risks of those estimates). The ED is not clear on this interaction.
  - c. With regard to paragraph 15(a)(iii) of ED 540, we do not understand the difference between the requirement in this paragraph to develop a point estimate or range based on available audit evidence to evaluate management’s point estimate, and the requirement in paragraph 19(b) of ED 540 for the auditor to develop an auditor point estimate or range to evaluate the reasonableness of management’s estimate, when management has not sufficiently addressed uncertainty.
  - d. The intent of paragraph 15(b) of ED 540 is not clear as to whether it is trying to express the notion that auditors may use a blended approach (of the three basic audit strategies) when inherent risk is “not low.” We believe that the revised ISA should be explicit regarding the fact that auditors may use a combination of multiple approaches to obtain sufficient appropriate audit evidence. When considered in concert with our other recommendations, we recommend simplifying paragraph 15 of ED 540 to clarify the auditor’s response regardless of the level of assessed inherent risk, as follows:
    - i. The auditor should use one or more of the three testing strategies to obtain sufficient appropriate audit evidence that is responsive to the risk(s) of material misstatement in the circumstances. Audit evidence may be the result of substantive procedures alone or a combination of substantive procedures and tests of controls, but may not be based solely on evidence from testing of controls.

		<ul style="list-style-type: none"> <li>ii. As the risk of material misstatement increases as a result of the inherent risk assessment, the auditor should identify the sources of risk (for example, data, significant assumptions, or complexity of calculations, including models), and design an audit response to the assessed risks that achieves the relevant objectives as currently drafted in paragraphs 17–20 of ED 540, most of which are likely to be relevant.</li> <li>iii. The auditor’s documentation of further audit procedures clearly should demonstrate how the audit evidence obtained is appropriately persuasive to the assessed risk of material misstatement.</li> </ul> <p>3. Paragraph 16 — An underlying theme of ED 540 is testing data integrity, particularly when using forward-looking information and the importance of considering the related controls over the data, especially with regard to auditing accounting estimates. Paragraph 26(e) of the Explanatory Memorandum indicates that the IAASB chose to develop an approach to reinforce the need to test the operating effectiveness of controls when the auditor intends to rely on those controls or when substantive evidence alone cannot provide sufficient evidence. We believe paragraph 16 and the related application material in ED 540 are insufficient to assist auditors in recognizing the circumstances in which, in today’s environment (for all industries, not only those cited in paragraph A98 of ED 540), sufficient appropriate evidence cannot be obtained for the elements of the estimate (for example, the model(s) or the data source(s)) without testing controls. Without changes to ISA 315 (Revised), ISA 330, or ISA 500 to address the overall issue of obtaining an understanding of internal control, including control activities or the design and responses to assessed risks, including when substantive procedures alone do not provide sufficient appropriate audit evidence, we believe that ED 540 and the conforming amendments to ISA 500 will not be well understood and may create confusion and inconsistent application in practice. We do appreciate certain aspects of the PCAOB proposal, which is also aimed at enhancing auditor performance in relation to accounting estimates but reinforces the need to understand controls related to estimates and drivers as part of risk assessment in Auditing Standard (AS) 2110, Identifying and Assessing the Risks of Material Misstatements. We recommend the Board reconsider this approach in addressing this important area.</p> <p>4. With regard to paragraphs 17–18 of ED 540, we believe that as drafted, these paragraphs contain excessive duplication and should be combined. For each of the matters listed in the combined paragraph, indicate whether the matter relates to complexity, judgment, or both. In addition, we have the following concerns on these paragraphs:</p> <ul style="list-style-type: none"> <li>a. There is little guidance on how to actually test management’s process; that is, what procedures may be performed (for example, how the auditor may comply with paragraph 17(c)) of ED 540. The guidance on the testing strategies from extant ISA 540 is necessary and likely should be expanded.</li> <li>b. As mentioned in the overall comments, it is not clear how ED 540 is intended to be applied in connection with ISA 330 and whether there are other assertions in an accounting estimate, other than the valuation assertion, that are subject to ISA 330. We further believe that, for example, paragraph 17 of ED 540 discusses the procedures performed on significant assumptions and data, but it is not clear whether additional work should be done in accordance with ISA 330 on assumptions and data that are not significant.</li> <li>c. There is little guidance on what is considered significant data and assumptions. The term “significant data” may not be intuitive as data is usually a fixed set of information against which assumptions are applied. We are unclear as to how the auditor would determine what data would not be tested and how significance would be assessed. Because it might be confusing to use the</li> </ul>
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term “significant data” in conjunction with significant assumptions, we suggest using “key factors” (see paragraph .09 of extant AS 2501, Auditing Accounting Estimates, of the PCAOB standards).

- d. Paragraph 18(c) of ED 540 is unclear about how these requirements relate to the standards dealing with the use of experts (ISA 620, Using the Work of an Auditor’s Expert, and ISA 500 specifically, using evidence prepared by a management’s expert). For example, does the auditor (or an auditor’s specialist) need to have an in-depth understanding of an actuarial model developed by management’s actuarial specialist?
5. With regard to paragraph 19 of ED 540, because estimation uncertainty is inherent in all accounting estimates and, in fact, is in the definition of an accounting estimate, it should not be considered as a separate risk factor. Further, we believe that paragraph 19 of ED 540 provides no incremental work to what is required by paragraph 17–18 of ED 540, and the guidance with respect to estimation uncertainty creates unnecessary duplication. Thus, we suggest that paragraph 19 of ED 540 be deleted. Further:
- a. In paragraph 19(a)(ii) of ED 540, because disclosure requirements related to estimation uncertainty are fairly limited in the accounting standards, we are concerned this requirement may inadvertently be creating an accounting disclosure requirement in the ISAs that affect all estimates more broadly. We note the same concern with paragraph 21 of ED 540. While we are supportive of the notion that additional disclosures are often critical for users to understand estimation uncertainty, for example, we believe the requirement could be more specific to estimates with higher risks (extant ISA 540 requires this for significant risks). We recommend a more refined approach that would focus the assessment of disclosures in those areas of higher risk.
- b. With respect to the auditor developing an independent estimate in paragraph 19(b) of ED 540, we believe that the ED should not take an approach whereby the auditor is required to develop a point estimate or range when management has not properly addressed estimation uncertainty. In practice, this requirement will be very difficult to complete as the auditors would be tasked with applying their own judgment in place of management’s judgment and may not have sufficient information to do so. While ED 540 seems to acknowledge the difficulty, it does not offer an alternative course of action when developing an auditor’s estimate or range is not possible. It may be helpful for ED 540 to acknowledge that in those circumstances, the auditor may not be able to obtain sufficient appropriate audit evidence.
- c. Also, this could be confused as appearing to create an accounting requirement for auditors. Instead, we recommend ED 540 require the auditor to communicate situations in which management fails to properly address estimation uncertainty as a control deficiency and consider the effect on the audit instead of developing its own estimate as a substitute. We suggest linking this requirement, as well as other requirements (such as those that relate to understanding how management addressed management’s bias in paragraph 10 of ED 540), to the requirements of the applicable financial reporting framework so that it is clear that it is management’s responsibility to comply with the financial reporting framework and not the auditor’s obligation to perform analysis in support of management’s compliance with the financial reporting framework. We further recommend linking paragraph A125 of ED 540 to the circumstances in paragraphs 19(b) of ED 540.
- (a) Additionally, there are many cases where the auditor will not be able to make an independent estimate and, in some audits, this may not be deemed the most effective approach. While the auditor can explore the consequences of changes in assumptions and measurement methods (and perhaps better understand the inherent measurement uncertainty from those sources), it is not

		clear how the auditor derived estimate or value provides more credible evidence in the typical situation.
43.	ANAN	<p>(b) The Association believes that the ED, especially paragraphs 13, 15, and 17-20, support a more effective identification and assessment of and responses to risk of material misstatement. These requirements taken together with relevant requirements in ISA 315 revised and ISA 300 sufficiently strengthen the process of identifying and assessing risks and responding to such risks in both complex and ordinary circumstances. The paragraphs also strengthen the management and auditor's use of professional judgment and assessment of estimation uncertainty involving a variety of estimation methods, assumptions and data.</p> <p>(c) ANAN supports the requirements in ED 540 revised which requires the auditors to take into account the extent to which accounting estimate is subject to or affected by simple or complex factors and the need for management to use judgment as well as the potential for management bias and estimation uncertainty. What that portends is that the auditor can no longer be arm twisted into accepting whatever management provides hook line and sinker without reflecting on its merit.</p> <p>(d) The Association believes that the ED has provided sufficient guidance in relation to objectives based on requirements in paragraphs 17-19 of the ED. The application and explanatory materials especially 101-134 will help to guide the professional accountants to deal with complexity related to management use of complex model and the nature of judgment required to be used by the professional accountants in assessing management's judgment and the nature of sufficient appropriate audit evidence that must be obtained by the professional accountants when dealing with estimation uncertainty.</p> <p>The Association, however, observed that the explanatory material and application guidance are not arranged in such a way that will make reference easy for the professional accountants that may wish to read and understand the requirements of the standard.</p>
44.	CAI	<p>Whilst the requirement to consider the relevant factors in the assessment of risk in paragraph 13 should in concept assist the auditor in the more granular consideration of the risk of material misstatement of an estimate and their response to that risk, we expect that this may be difficult to apply in practice. By their nature most estimates where the risk is assessed as not low will involve all three of the outlined factors; complexity, the level of judgement involved and estimation uncertainty.</p> <p>As set out in paragraph 15 of ED 540, ISA 330 requires the auditor to design and perform further audit procedures whose nature, timing and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level. In our view the requirement to obtain audit evidence in response to the factors in paragraph 13 is a significantly new concept that we have struggled to reconcile to the concept in ISA 330 of designing procedures that are responsive to the assessed risks of material misstatement. Our group spent a considerable amount of time reading and debating the meaning of paragraphs 14 to 19 and the related application material and therefore in our view these requirements as currently drafted are not sufficiently clear to achieve consistent and appropriate application by practitioners.</p>
45.	CAQ	<p><b>II. Risk Assessment</b></p> <p><b>Connectivity to the Risk Assessment Standards</b></p> <p><b>Any updates to extant ISA 540 should build upon the concepts in the fundamental risk assessment ISA standards for auditors to follow when planning and performing audits of accounting estimates.<sup>5</sup> There is an opportunity for better linkage between the Exposure and these other fundamental ISAs.</b></p>

As proposed, the auditor could interpret certain risk assessment requirements in the Exposure as needing to be carried out in isolation, and not in combination with the requirements of the other ISAs. ISA 315 (Revised) requires the auditor to identify and assess the risks of material misstatement (RoMMs) at the financial statement and assertion levels. ISA 330 requires the auditor to design and implement responses to the RoMMs identified and assessed by the auditor. In the explanatory memorandum in the Exposure, the IAASB asserts that ISA 540 (Revised) introduces “an enhanced risk assessment” by outlining additional factors that would inform the assessment of inherent risk relating to RoMMs for accounting estimates. This could create another layer of risk assessment incremental to the requirements of ISA 315 (Revised), which could be confusing and result in inconsistent application. Therefore, the CAQ recommends that the IAASB look to align the risk assessment requirements of the Exposure with the other foundational ISAs. For example, some of the requirements in the Exposure, such as qualitative risk factors related to risk assessment, could be incorporated as a conforming amendment to ISA 315 (Revised) to clarify how auditors should be thinking about auditing accounting estimates in their overall risk assessment. We note that the IAASB is considering wider changes to ISA 315 (Revised) as part of a separate project, and as part of that project should make sure that the requirements of both ISA 540 (Revised) and ISA 315 (Revised) still work together to achieve their objectives when finalized.

#### Assessing the Risks of Material Misstatement

The Exposure would require the auditor to make judgments based on an assessment of inherent risks that are “low” or “not low”.<sup>6</sup> The focus of the current risk assessment standards is the identification and assessment of RoMMs and the design and execution of audit procedures responsive to the identified RoMMs. While inherent risk is a component of assessing RoMMs, the Exposure seems to suggest an isolated assessment of solely inherent risk is necessary to determine the nature, timing, and extent of procedures related to accounting estimates. Assessing inherent risk is an element of the overall risk assessment; however, the Exposure, as written, may lead to an incorrect conclusion that a separate assessment is required.<sup>7</sup> While inherent risk is assessed without consideration of internal control, overall risk assessment does include the auditor gaining an understanding of internal control to provide a basis for designing and implementing responses to the assessed RoMM. The Exposure should allow for a risk assessment that includes assessment of inherent risk, without consideration of control, concurrent with gaining an understanding of internal control when assessing overall risk to design and implement the auditor’s response to the assessed RoMM.

The components of a potential significant account or disclosure may be subject to significantly differing risks. This is particularly true for accounting estimates, and may result in the need for the auditor to disaggregate a significant account to perform an effective risk assessment. The requirements of paragraph 13 of the Exposure are not clear as to how the auditor could consider the potential sources of RoMM within a significant account at a sufficiently disaggregated level, based on auditor judgment, to enable the auditor to appropriately determine the nature of audit procedures to perform. In determining the appropriate level at which to assess the RoMM for a particular account or components of an account, the auditor could consider the information presented in the footnote disclosures related to that particular account.

While there may be significant accounts or disclosures that would require the auditor to disaggregate the account to perform an effective risk assessment, there are also accounts and disclosures that would not require further disaggregation to effectively assess risk. In many cases, after considering factors such as the similarity of the nature of the accounting estimates, the consistency of management’s process for determining accounting estimates, and the sources of risk, the auditor may conclude

that certain components are sufficiently similar based on their risk, such that they do not need to be disaggregated further for purposes of designing appropriate audit procedures. Any change to the Exposure should recognize that auditor judgment is needed to determine whether or not the significant account or disclosure warrants further disaggregation to effectively assess risk.

#### Responses to the Assessed Risks of Material Misstatement

The Exposure places increased emphasis on “not low” RoMMs without discussion as to how an auditor’s response to a “not low” risk would differ from a significant risk. The identification of a significant risk (paragraph 13) is separate from the auditor’s response to RoMM (paragraphs 15-16). An unintended consequence of this could be that all estimates other than those assessed as “low” will be treated as significant risks, or conversely no risks will be treated as significant. The Exposure could be more clear as to how the auditor’s response will differ based upon whether the risk is low, not low, or significant.

The Exposure could provide more clarity that each estimate could have multiple RoMMs with different assessed levels of risk. It is also not clear whether the requirements for “low” and “not low” should be applied to all the RoMMs associated with the accounting estimate, or whether the requirements apply to each specific RoMM associated with the estimate. Since accounting estimates generally have many RoMMs with the assessment of risks at varying levels (e.g., some low, some not low, and some significant), it is unclear how the auditor would apply the requirements of the Exposure, specifically the requirements in paragraphs 15-20 related to risks that are “not low.”<sup>8</sup> If an accounting estimate has many RoMMs with varying risk assessments, paragraphs 15-20 of the Exposure may be interpreted to require auditing of both management’s process and developing an independent estimate. For example, assume the auditor determines inherent risk is “not low” per paragraph 15(b), and there is subsequent information that the auditor determines to be sufficient to use to audit the estimate. Based on a possible interpretation of paragraphs 15-20 and associated application guidance in paragraph A97, the auditor would still need to perform audit procedures to address the matters in paragraphs 17-19. This would not seem necessary given the subsequent information.

#### Determining the Nature, Timing, and Extent of Audit Procedures

Per the Exposure, it appears that the determination of whether a RoMM is “low” or “not low” is predominately based on three factors: complexity, judgment, and uncertainty.<sup>9</sup> It is likely that auditors will have a difficult time distinguishing whether the assessed risk of a RoMM is due to complexity, judgment or uncertainty due to the relationship and interconnectivity of these factors. Distinguishing which of these three factors led to the risk assessment of “not low” seems important to the auditor’s determination of the audit procedures to apply under paragraphs 15-20 of the Exposure. As a result, the Exposure is not clear on the auditor’s ability to exercise judgment in choosing the nature, timing, and extent of audit procedures. An unintended consequence of this lack of clarity could be the auditor’s performance of unnecessary procedures that do not improve audit quality. Conversely, it could also result in auditors not performing procedures that would otherwise be considered appropriate regardless of the assessed level of risk. There are certain situations where auditors would perform the same types of auditing procedures regardless of risk. Some of these procedures include testing mathematical accuracy, testing relevance and reliability of data, and evaluating for possible management bias. The Board could consider adding guidance or clarifying that auditors may judge it necessary to perform some or all the procedures under paragraphs 15-20 even if the inherent risk is assessed as low, as it is unclear as currently drafted.

		<p><b>Auditor Bias</b></p> <p><b>Paragraphs A72 and A73 of the application material in the Exposure provide examples of estimates the auditor may determine to be a “low” or “not low” RoMM. We are concerned that these examples could result in auditors having a bias that examples provided in paragraph A72 will automatically be “low” risk, and the examples in A73 will automatically be “not low” risks. The Exposure should be updated to make it clearer that the examples in A72 represent some, but not all examples of estimates that are “low” risk, and that other factors could result in an auditor determining that an estimate that is typically “low” risk, could be “not low” or even significant. Paragraph A73 should be updated to note that the examples provided represent possible indicators of “not low” risk, but are not automatic indicators of “not low” risk.</b></p>
46.	CPAA	<p>a. Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>We agree that paragraph 13 supports a more effective identification and assessment of risks. However, the requirements that follow should be based on the requirements of ISA 315, specifically regarding the risks of material misstatement identified at both the financial statement and assertion level. Likewise, paragraph 15 notes that ISA 330 requires the auditor to respond to assessed risks of material misstatement, including significant risks, at the assertion level, but then the requirements that follow are not based on the ISA 330 requirements. Assertions seem to be overlooked in the requirements that are listed and yet it would be very helpful if the risks relevant to accounting estimates relating to relevant assertions were drawn out. Instead, the requirement to address the three factors of complexity, management judgment and estimation uncertainty have effectively replaced consideration of assertions.</p> <p>We consider that the delineation between low and not low risk in paragraph 15 and between complexity, judgment and estimation uncertainty in paragraphs 17-19 does not provide a practical means of determining adequate responses to assessed risk. The outcome of these requirements may be that auditors apply a check list approach because the list of matters on which sufficient appropriate audit evidence is required is so prescriptive and extensive.</p> <p>The matters listed in paragraphs 17-19 would be better placed in application material and the three factors of complexity, judgment and estimation uncertainty not presented as mutually exclusive, but acknowledged to be overlapping and interrelated considerations.</p> <p>In addition, paragraph 19(b) suggests an increase in the auditor’s responsibility, in requiring development of a point estimate or range when management has failed to understand or address estimation uncertainty, even if it may be appropriate for the auditor to qualify their report.</p> <p>b. Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>We do support the requirement for the auditor to take into account these three factors. However, in considering the relevance and impact of these factors, it may not be necessary to separate the low risk from not low risk estimates, as the risks or absence of risk</p>

		<p>should drive the response. We do not see the benefit of an “all or nothing” approach which seems to characterise the artificial low/not low risk delineation.</p> <p>Management bias seems to be inconsistently linked to management judgement. We suggest that management bias should be included in the matters to be considered in relation to management judgement but not singled out, as it is currently in paragraph 13(b).</p> <p>c. Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>As noted above, we suggest that matters listed in the sub-paragraphs as requirements in these paragraphs would be better placed in application material. We have not identified any additional guidance which should be added, but the application material could be reviewed to see where it could be rationalised as there is some overlap in the application material provided for each of the three factors.</p>
47.	CRUF	
48.	EFAA	<p>We believe, as stated above, that more should be done to achieve greater scalability when inherent risk is not low. While we appreciate the IAASB’s intent and efforts we believe the work effort is excessively prescriptive in each of the three areas and, as a result, fails to meet the criteria of objectives-based requirements and undermines scalability. We are concerned that the requirements as presented read as though practitioners would need to address all the matters and procedures. We challenge the IAASB to reconsider whether some of the requirements are more appropriate as application guidance. Despite IAASB’s best intentions, there is a feeling of an overly prescriptive work effort in each of the three areas. The IAASB will need to work hard to change existing mind-sets which are not accustomed to objectives-based requirements. Significant effort will be necessary to explain to practitioners (in firms of all sizes) and regulators that the requirements in paragraphs 17 to 19 are not all procedures.</p>
49.	FACPCE	<p>a) In our opinion the requirements will help to identify, evaluate and respond to the risks of misrepresentation. Paragraphs 13 and 15 of the ED are important as they identify the risk factors that may affect accounting estimates. There is consistency between the risks assessed and the need to apply subsequent procedures that respond to them.</p> <p>b) We consider that it helps with the fundamentals exposed in the previous point.</p> <p>c) We consider that, although in the Draft include provisions on the use of specialist services, it would be useful to add in paragraphs 17 to 19 the need to obtain evidence of whether management used the services of a specialist in estimates for which specialized skills or knowledge are required</p>
50.	IAA	Refer to letter
51.	IAAA	<p>a) Will these requirements support more effective identification and assessment of , and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315(Revised) and ISA 330?</p> <p>Answer.</p> <p>We believe that the requirements are sufficiently explicit and clear for their application, therefore, we believe that it will ostensibly improve</p>

		<p>a more appropriate identification and consequent valuation of the risks of misreporting resulting from accounting estimates and will allow the accountants to design the appropriate responses in each circumstance.</p> <p>b) Do you support the requirement in ED540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Answer.</p> <p>Yes, we understand that the requirements contemplated in the proposed revision of the NIA in question, is clarifying for the accountant to take into consideration that the accounting estimate may be affected by the factors of complexity, administration bias especially when applying its judgment in the estimation.</p>
52.	IBRACON	<p><b>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</b></p> <p>Generally, we support many of the concepts and related guidance that have been incorporated in the proposed ED. We believe that these requirements will promote a more granular consideration of the nature and extent of what could go wrong, to inform the auditor's risk assessment at the assertion level and design appropriate responses. That includes the need for judgement and how estimation uncertainty can influence the assessment of identified risks (e.g., whether the risk of misstatement at the assertion level is low, or higher, or a significant risk) and how best to design further audit procedures to obtain evidence in response to the risk.</p> <p>Despite our agreement with the approach taken in ED-540 for significant risks, we believe further clarification is necessary to explain how the more granular work effort in ED-540 relates to the requirement in ISA 330.21 to perform procedures specifically responsive to significant risks. When the auditor designs responsive procedures (that appropriately include tests of details when required by ISA 330.21) to achieve the objective-based requirements of paragraphs 17-20 of ED-540, is the requirement in ISA 330.21 also fulfilled? If not, what other considerations should the auditor be taking into account to develop procedures specifically responsive to the significant risk? Additionally, we believe the proposed requirements are overly complex and may be confusing for the reasons outlined in question 3 above.</p> <p><b>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</b></p> <p>We continue to believe that identifying and evaluating the risk of material misstatement for account balances, classes of transactions, and disclosures <u>at the assertion level</u> remains appropriate. The assertions identified in ISA 315 (e.g., existence, completeness, accuracy and valuation etc.) are the ways in which an account balance can be misstated. Complexity, judgment and estimation uncertainty are useful considerations to think about "what could go wrong". They can influence the assessment of identified risks, but they are not the risks themselves.</p> <p>For this reason, we suggest that paragraph 13 be enhanced to incorporate the requirements of paragraph 15, and the related response to assessed risks (paragraphs 17-19) not be driven by factor. We also suggest reinforcing the focus on the impact, and interplay, of the</p>

		<p>three factors in identifying and assessing RoMM.</p> <p><b>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</b></p> <p>No. We believe it is important to maintain a strong consistency with the requirements of ISA 315 and ISA 330. There is a risk that the multitude of concepts being incorporated into proposed ISA 540, including the risk factors and “matters” about which the auditor needs to obtain evidence, could cause confusion as to what the auditor is responding to.</p> <p>We recommend that the understandability and practical application of the ISA can be enhanced by:</p> <ul style="list-style-type: none"> <li>(i) Positioning the proposed risk factors of complexity, the need for the use of judgement and estimation uncertainty as useful considerations when thinking about the susceptibility of the estimate to error or fraud, or “where things can go wrong”: They can help inform the auditor’s identification and assessment of the risks of material misstatement at the assertion level, but should not be the basis for that assessment and response. * This is consistent with how risk factors are used in ISA 240.</li> <li>(ii) Adopting a more intuitive structure for the response to assessed risks that better reflects the way in which audits of accounting estimates are actually approached.</li> <li>(iii) Giving greater prominence to testing events subsequent to the balance sheet date. In most cases, since this approach is capable of providing sufficient appropriate audit evidence, it would be the most appropriate approach.</li> <li>(iv) Creating a more explicit requirement and related guidance that addresses expectations of the auditor when developing their own point estimate or range. For example, if the auditor uses management’s method or model, data or assumptions.</li> </ul>
53.	IBR-IRE	<p>Question 4 (a)</p> <p>We are supportive of the concepts developed in ED 540 in particular the proportionality of the audit response to the risk of material misstatement of the estimate. In our view ED 540 articulates properly the audit steps to be undertaken in response to the assessed risk of material misstatement, Due to the criticality of the design of a risk-responsive audit approach, we encourage greater clarity and guidance in this area. In particular:</p> <ul style="list-style-type: none"> <li>— A better linkage between the concept of significant risk in paragraph 13 and the concept of inherent risk in paragraph 15</li> <li>— A clarification that when inherent risk is low that at least of of the procedures described in paragraph 15 (a) must be considered;</li> </ul> <p>Question 4 (b)</p> <p>We agree with the concepts put forward. However, in our view, the estimation uncertainty appears to be characteristic of the estimate that most affect the risk of material misstatement, right before management judgement. Putting complexity, judgment and estimation uncertainty at the same level gives in our view to much prominence to complexity. We believe that the greater audit risks relates to the other more subjective elements, in particular the estimation uncertainty, and that using this element as a gating consideration would help focus the audit efforts on those estimates that present the greater risk of material misstatement and accordingly, are the most relevant to the financial information.</p>

		<p>Question 4 (c)</p> <p>We suggest considering revising the wording in paragraph 16 which considers the design and testing of controls as it is currently unclear how this paragraph derives from paragraph 15. We suggest to explicitly link paragraph 16 to paragraph 15 (b) when inherent risk is not low since paragraph 15 (a) discusses situations where the inherent risk is low - which will not be relevant in the consideration of controls.</p>
54.	ICAEW	<p><b>20. It is important in cases of high estimation uncertainty to focus on the factors of judgement and complexity. When auditors are genuinely dealing with a high level of true estimation uncertainty, of whatever size, an estimate is not misstated if it is depicted properly using a representative point value that the framework requires. IAASB could make this clearer. It might also make it clearer, without losing framework-neutrality, that most frameworks refer to a representative figure in a range, rather than any number that could be at either end of the range, and that numbers are unlikely to be ‘representative’ at the outer ranges, particularly if all are equally probable. In cases such as these, the probability weighted estimate would be the mean and not the outer ranges. However, if the distribution were skewed a number further towards an outer range might be a better representation. IAASB might consider giving additional emphasis or prominence to the wording in paragraph A123 referring to management’s estimate being ‘appropriately representative of the range of reasonably possible outcomes’.</b></p> <p><b>21. We are sympathetic to those respondents who question the legitimacy of asking auditors to ‘address’ estimation uncertainty if management is unable or unwilling to do so because of the importance of maintaining auditor independence. The term ‘address’ may be deliberately broad but it may lead to inconsistencies in practice. For example, some may take the view that it is sufficient for management to simply measure and disclose estimation uncertainty, others may believe that management should, where possible, reduce estimation uncertainty to a level below performance materiality.</b></p> <p>53. We are concerned about the structure of the proposed standard. All of those we consulted believe that while the three risk factors are useful in driving thought processes in performing the analysis, driving the response through three risk factors will inevitably result in inconsistency, repetition and inefficiency. We understand that field testing has demonstrated this.</p> <p>54. Complexity, estimation uncertainty and judgement are tightly interrelated. An estimate by definition includes estimation uncertainty, and estimation uncertainty by definition involves the use of judgement, and any complex estimate therefore involves the other two. Furthermore, they are not, of themselves, risks. They are not ‘things that can go wrong’. They are categories that can help auditors think about what might go wrong. The requirement to focus the response on which of these are the main ‘drivers’, will result in practice in all three approaches being adopted in many cases, to avoid regulatory challenge. Is this what IAASB really intended? Will it normally be two out of three? Are there any situations in which IAASB can envisage it being one out of three? The distinction between the three approaches described is artificial. The extent of overlap and the interaction with financial statement assertions will result in complex and repetitive matrices analysing risk by line item, risk factor, assertion, assessed risk level and more. The use of the three risk factor model may be useful in the risk analysis process but IAASB should not force its use in driving the response.</p>

		<p>55. The PCAOB's proposals on estimates retain an existing recognisable structure while incorporating many of the new elements of the IAASB's proposals. This will lead some respondents to suggest that the PCAOB's proposals appear to be more readily workable. Calls for IAASB to restructure the proposals should not be dismissed lightly. Restructuring could be achieved in several different ways, without altering the substance of the proposals or the need for re-exposure. From a public interest perspective, it must surely be more important than ever that there is as much consistency as possible in the audit of the world's largest banks and other financial institutions and we will be urging the PCAOB to look at what it can do to bring the substance of its proposals closer to those of the IAASB.</p> <p>56. It will often be easier to adopt all three approaches. It is difficult to see how intangibles and goodwill impairments, insurance contracts and expected credit losses will ever not involve all three, and revenue recognition, litigation and regulatory sanctions (money laundering, bribery and corruption) are also likely to involve more than one.</p> <p>57. Can IAASB provide examples of specific instances in which the only relevant factor is likely to be estimation uncertainty, judgement or complexity, respectively? If it proves difficult to provide such discrete examples it does beg the question as to whether the distinction is really relevant to the response, even if it is relevant to the assessment. IAASB should pay particular attention to the results of field-testing in this area.</p> <p>58. We agree that analysis of the three factors is useful in identifying and assessing the risk, but it is less useful in determining the appropriate response. IAASB should recognise that the three-factor approach to not low IR estimates works as a thought process, but require those three factors to drive the response. Instead, IAASB should include them, or the detailed aspects thereof, in the application material. To the extent that IAASB is making genuine efforts to move towards outcomes-based objectives and requirements in standard-setting generally, this should work.</p> <p>59. IAASB should also make it clearer that the three approaches to low IR estimates may also be appropriate responses to other estimates. The important point is to perform procedures that are responsive to the risks. The requirements in paragraphs 17-19 are likely to be interpreted as individual audit procedures required to be performed depending on the driver for the estimate. Furthermore, while IAASB makes it clear that complexity, judgement and estimation uncertainty are not the only three factors to be taken into account in the risk assessment, we believe it is unlikely that any alternative or additional factors will be used in practice. We understand that field testing has demonstrated all of this.</p>
55.	ICAG	<p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>Yes, we believe that the requirements of the ED 540 are more effective to identify and assess the risk of material misstatements relating to accounting estimates. In assessing the inherent risks associated with the accounting estimates applied by management in the preparation of financial statements, the auditor has to consider the complexity and nature of the transaction or item, the judgment by management, potential for management bias, and uncertainty in estimation. All these appear to address identification &amp; assessment of risk inherent in accounting estimates.</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate</p>

		<p>is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Yes, we do support the requirement in ED 540 that the auditor has to take into account those relevant factors that affect accounting estimates in his assessment of risk inherent in accounting estimates.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>Yes, we believe that there are sufficient guidance in relation to the proposed objectives-based requirements raised in the ED 540.</p>
56.	ICAP	<p>We believe that the requirements outlined in paragraphs 13, 15 and 7-19 require further consideration and explanation.</p> <p>a) We understand that the risk assessment model envisaged under ED 540 differs from the extant ISA 315, and ED 540 requires further clarification on the risk model and its relation to the existing requirements of ISA 315 (Revised), 'Identifying and assessing the risks of Material Misstatement through Understanding the entity and its Environment'. Further, the related terms as defined in the explanatory guidance may be included in the definition section.</p> <p>b) We understand that complexity, judgment and estimation uncertainty are the three relevant factors to consider when assessing the risks related to the accounting estimates, and suggest that further explanation is included in ED 540 on the interaction of these factors.</p> <p>c) We believe that paragraphs 17-19 of the ED 540 and related application material require further clarification regarding the nature and extent of procedures to be performed, particularly in relation to the scalability and proportionality of the requirements.</p>
57.	ICAS	<p><b>Finally, we welcome the introduction of the three relevant factors of complexity, the need for the use of judgement by management and estimation uncertainty. However, we believe that it is difficult to completely separate these three factors and that there is inevitably some degree of overlap and duplication between them. In our opinion, the most important of these factors is that of estimation uncertainty and believe that it will be present in all accounting estimates. Therefore, we believe estimation uncertainty should be presented as the overriding factor in relation to accounting estimates, with complexity and management judgement presented as possible additional factors.</b></p> <p>Response 4 (a)</p> <p>We believe that it is difficult to completely distinguish between these three factors and that there is inevitably some overlap and duplication between the three definitions.</p> <p>In our opinion, estimation uncertainty is the key factor present in all accounting estimates and complexity and the use of judgement by management subsets of this overriding factor, with the possibility that one, both or none of these additional two factors might also exist. Therefore, we would prefer to see estimation uncertainty listed as the key factor with the other two factors presented as possible additional factors. That might also help address the issue of duplication and overlap within the definitions.</p> <p>Additionally, as stated earlier in this response, ISA 540 sets out how to apply ISA 315 to accounting estimates and reference to these three factors might make this identification and assessment process more effective.</p>

		<p>Response 4 (b)</p> <p>We support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors including complexity, the need for the use of judgement by management and estimation uncertainty.</p> <p>Response 4 (c)</p> <p>We have not identified any additional guidance that should be included in the proposed objectives-based requirements in paragraphs 17-19 of ED-540.</p> <p>However, we would suggest that paragraph 16, which refers to the auditor’s reliance on controls, should be linked to paragraph 15(b) as this scenario will only be relevant when inherent risk is not low.</p> <p>Finally, we would suggest that the term ‘significant data’, referred to in paragraphs 17-18, should be defined and included within the definitions section on page 31 of ED-540.</p>
58.	ICAZ	<p>When inherent risk is not low (see paragraphs 13, 15 and 17–20):</p> <p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p><b>RESPONSE</b></p> <p>Yes, the requirements compliment the application of ISA 315 and ISA 330 where the auditor is required to design and perform further audit procedures to respond to the assessed risks of material misstatement including significant risk (when inherent risk is not low at assertion level – accounting estimates)</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p><b>RESPONSE</b></p> <p>Totally support the requirement, it attempts to counter the complexities faced by auditors and help to meet the objectives of ED-540. Accounting estimates in accordance with IFRS 9 and other recent financial reporting standards will often give rise to greater estimation uncertainty, require greater use of modelling and forward-looking information, and involve the need for an enhanced control or governance environment.</p> <p>The requirement is a sound step approach to identifying risk of material misstatement in accordance with accounting estimates in terms of disclosures that explain the basis on which accounting estimates have been made and the significant judgments and assumptions involved.</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p>

		RESPONSE
59.	ICPAK	<p>Yes.</p> <p>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>Yes the requirements in the above paragraphs will support more effective identification, assessment and responses to risk of material misstatement. However, we suggest that the requirements in paragraph 18c also be included within paragraph 17 and 19. The reasoning for this is that in each of the risk reasons (being complexity, judgement and estimation uncertainty), it would be essential where a model is used, whether complex or not, for the the auditor to determine suitability of the model under the measurement principles of the financial reporting framework, changes from any previous models (historical experience and accuracy) and testing any modifications to the model for consistency with the measurement objectives).</p> <p>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</p> <p>Yes</p> <p>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</p> <p>Yes there is, subject to comments question 4(a) above.</p>
60.	ISCA	<p><b>Responses to assessed risks of material misstatement</b></p> <p><b>4.8 Whilst the IAASB concluded in ED-540 that the 3 factors (complexity, judgement and estimation uncertainty) are likely to influence the risks of material misstatement in relation to making an accounting estimate, we are of the view that it may not be necessary to perform a risk assessment of these risk factors independently given that the factors are likely to interact and influence one another in practice.</b></p> <p><b>4.9 As the new requirements in paragraphs 17 to 20 of ED-540 give the impression that these 3 factors should be assessed independently with distinct audit procedures to be carried out in response to individual factors, it appears that some of the requirements in paragraphs 17 to 20 of ED-540 overlap in certain aspects, for example, paragraphs 17(a) and 18(a)(i), and paragraphs 17(a) and 18(c).</b></p> <p><b>4.10 In essence, we are concerned that the proposed new requirements to independently assess complexity and judgement</b></p>

		<p><b>will make the risk assessment process unduly complex while not substantially changing the underlying audit procedures performed to address the risk. This may introduce unwarranted complexities especially for the small and medium practices. Furthermore, we also noted that there is no significant difference in the key audit responses that will be carried out under ED-540 compared to the actual audit procedures that were performed under the extant ISA 540.</b></p> <p><b>4.11 Instead of independently assessing the 3 factors, the auditor could consider assessing the entire estimation process holistically by examining the inputs, outputs, methodologies, assumptions and source data used. This appears to be a more objective process. Furthermore, qualitative factors including the factors of complexity, use of judgement by management and estimation uncertainty will also be considered as part of this process.</b></p>
61.	KICPA	<p>We support the ED-540's proposal to take into account three factors of complexity, the use of judgment by management, and estimation uncertainty that make important implications for risks of material misstatement when inherent risk is not low, identify certain matters that could arise from risks of material misstatement on each element basis, and design and perform further audit procedures to obtain sufficient appropriate audit evidence about the matters. The proposal provides more clarified and specific guideline to an auditor in his/her identification and assessment of and response to risks of material misstatement related to accounting estimates, thereby improving the effectiveness of auditing accounting estimates.</p> <p>In relation with the requirements in paragraphs 17-19 that are focused on objectives, such requirements would be better to be provided in a form of more detailed and clarified guidance form, taking into account their significance and difficulties auditors face in practice. With concerns that voluminous guidance makes ISAs difficult and complex, we suggest a form of non-authoritative guidance, just like IAPN, instead.</p>
62.	NASBA	<p>a) Yes.</p> <p>b) In its proposal the IAASB describes three factors that are most likely to influence the risks of material misstatement in relation to making an accounting estimate:</p> <ul style="list-style-type: none"> <li>• Complexity;</li> <li>• The need for the use of judgment by management; and</li> <li>• Estimation uncertainty.</li> </ul> <p>We believe that all three factors are interrelated and estimation uncertainty is inherent in predicting future events. Thus, although we do believe that auditors should respond to these risk factors, we do not think that requiring auditors to respond to each factor separately is necessary.</p> <p>We also think that the need for management judgment comes into play after evaluating complexity and range of estimates; thus, the order of the factors in the ED may need to be rearranged.</p> <p>c) We would like to commend the IAASB on the proposed standard's paragraphs 17 and 18 which emphasize a need for auditors to perform sufficient audit procedures, and obtain appropriate audit evidence, to address matters where management uses complex</p>

		<p>methods or models, or where management is required to apply its judgment.</p> <p>We recommend that the ED reemphasize the need to focus significant audit efforts in the areas of higher inherent risk. If the auditor determines that the inherent risk is low, the audit procedures should be tailored accordingly (e.g. auditors may consider performing substantive analytical procedures in the areas of low risk).</p>
63.	SAICA	<p>(a) Will these requirements support more effective identification and assessment of, and responses to RoMM (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</p> <p>30. All of the survey respondents agreed that the requirements in paragraph 13, together with the requirements of ISA 315 (Revised), support a more effective identification and assessment of RoMM.</p> <p>31. The application material in paragraphs A71 to A78 provides important guidance in relation to the assessment of RoMM in the context of accounting estimates; and specifically draws attention to low inherent risk and not-low inherent risk. It is helpful that specific focus is placed on significant risks (paragraphs A76 to A77), and on other relevant factors in addition to the three “main” factors (paragraph A78).</p> <p>32. The IAASB should consider including in paragraph 13 a reference to Appendix 2.</p> <p>33. SAICA’s comments relating to questions 3 and 4(b) should however be taken into account. I.e. guidance on the scalability of risk assessment procedures and related activities, and the interrelationship of the three factors for an entity where risks relating to accounting estimates have been assessed as ‘low’.</p> <p>34. Most of the survey respondents and SAICA agree that when inherent risk is assessed as ‘not low’, the requirements in paragraphs 15(b) and 17 – 20, together with the relevant requirements of ISA 330, support more effective responses to RoMM.</p> <p>35. The field testing respondents commented that the requirements resulted in a more detailed and specific response to RoMM and ensured that appropriate procedures are designed and performed. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing questions (f) and (g)).</p> <p>(b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which an accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgement by management and the potential for management bias, and estimation uncertainty?</p> <p>36. Most of the survey respondents supported the requirement and believe that the above-mentioned three factors influence the risk of material misstatement of an accounting estimate.</p> <p>37. The majority of the field testing respondents also supported the requirement and believe that the three factors influence risk of material misstatement. Two respondents indicated that their risk assessment and response were consistent with the previous year. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (e)).</p> <p>38. One survey respondent and a field testing respondent commented that there is not enough emphasis on the</p>

		<p>interrelationship between the three factors and the impact of the interrelationship on the auditor's identification and assessment of risks of material misstatement as well as the auditor's responses to those assessed risks.</p> <p>39. SAICA notes that the ED recognises under the 'Key concepts of this ISA' that the three factors are interrelated. In paragraph 13, the auditor is required to take into account the extent to which one or more of the factors affect RoMM. Paragraph 15(b) requires the auditor to perform procedures to obtain evidence about complexity, judgement and estimation uncertainty (as indicated in paragraphs 17 – 19), when applicable. These sections indicate that there could be a scenario where only one or a combination of the factors are applicable.</p> <p>40. However, we are aware of suggestions that the ED does not provide sufficient further guidance on the interrelationship of the factors and how the auditor's response to the risks are affected when more than one factor is applicable, including that the procedures relating to the objective-based requirements for each factor might overlap. The IAASB may have to consider this matter further (it would be interesting to see whether this is identified as an issue in the context of all of the comments that the IAASB receives).</p> <p>(c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 – 19?</p> <p>41. Most of the survey respondents and SAICA agree that there is sufficient guidance in relation to the proposed objectives-based requirements in ED-ISA 540.17 – 19, including the related application material.</p> <p>42. The field testing respondents commented that more applicable guidance has been provided in the proposed revised standard. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (g)).</p> <p>43. SAICA wishes to also note that the proposed objectives-based approach calls for considerable professional judgement to be exercised by the auditor, whilst at the same time allowing the auditor to scale and custom-design procedures relevant to the entity's accounting estimates that are responsive to the assessed risks of material misstatement. The IAASB could consider to also include professional judgement as part of the "Key concepts" section at the beginning of the standard (i.e. part of the "catch all" paragraphs upfront).</p> <p>44. There is the risk that should an auditor get this wrong it will significantly impact the sufficiency and appropriateness of audit evidence in the circumstances. The IAASB may receive comments from respondents that focus on this aspect and who call for more specificity in relation to the procedures that are required to be performed. It is SAICA's view that the proposed approach is appropriately principles based and allows for the standard to be applied in the numerous different circumstances that are likely to be encountered in practice.</p> <p>SAICA also considered the following additional question: Do you agree with the requirement in paragraph 16 to test the operating effectiveness of internal controls, if the auditor intends to rely on controls relating to accounting estimates, or if substantive procedures alone cannot provide sufficient appropriate audit evidence?</p> <p>45. All of the survey respondents agreed with the requirements in paragraph 16. One survey respondent supported the emphasis placed on a controls based approach in auditing accounting estimates as accounting estimates in some instances relate to more complex environments that require the selection of models, methods, assumptions and data in making those accounting</p>
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		<p>estimates; and because accounting estimates are increasingly derived from complex information technology systems and generated from large volumes of data. Both these factors lend themselves to being more efficiently and effectively audited by means of a controls based approach.</p> <p>46. The field testing respondents further commented that the applicability of the requirement would depend on the nature and size of the entity, the processes around estimates and whether internal controls are in place that can be relied upon. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (h)).</p> <p>47. SAICA agrees with the requirement in paragraph 16 to test the operating effectiveness of internal controls, if the auditor intends to rely on controls relating to accounting estimates, or if substantive procedures alone cannot provide sufficient appropriate audit evidence. The application material in paragraphs A98 to A100 provides appropriate additional guidance. Greater emphasis on performing tests of controls will however require clarity in ISA 315 (Revised) and ISA 330 on the understanding required and how this affects the nature, timing and extent of substantive procedures and the combination of tests of controls and substantive procedures.</p> <p>48. SAICA wishes to draw the IAASB's attention to a possible consistency / interpretation risk that we have encountered in South Africa around the design and performance of tests of controls in response to RoMM at the assertion level which may also have implications for the application of ED-ISA 540.16 and A98 – A100. The difference in interpretation relates to whether ISA 330.A4(a) provides for a scenario where the auditor is able to perform only tests of controls to obtain sufficient appropriate audit evidence in response to RoMM at the assertion level (for individual assertions) without also performing substantive procedures on the assertions concerned.</p>
64.	SMPC	<p><b>We support the additional clarity that has been provided in the standard, including understanding the inter-relationship between judgment, complexity and estimation uncertainty. However, these three factors are very closely interrelated and we believe that the IAASB needs to give this further consideration prior to finalization.</b></p> <p>While the three factor approach makes sense, complexity, judgment and estimation uncertainty are all closely interrelated and the distinction to a certain extent seems artificial. There is a concern that the requirement to focus the audit approach depending on which of these are the main 'driver' may result in two of the three factors being adopted in virtually all cases, and all three in many, just to avoid regulatory challenge. The IAASB could give more consideration to whether there are discrete examples in which only one factor is relevant. For example, if complexity alone is the reason behind a not low assessment of inherent risk, the auditor can successfully address this factor with the "right" audit procedures.</p> <p>In our opinion, the IAASB should consider addressing the non-accounting estimate specific issues of complexity and use of management judgement in the current project to update ISA 315 (Revised) . It is extremely important that the approach in both projects is coordinated.</p> <p>We believe that a greater emphasis on 'judgment' and an explicit linking between judgment and management bias could be included. The auditors greatest 'weapon' in auditing estimates lies in understanding management's motivations, incentives and biases in preparing estimates and this could be brought out more in paragraph 18 or the overall evaluation based on the audit procedures performed in paragraphs 22 and 23.</p> <p>While in paragraph 13, the standard makes clear that complexity, judgment and estimation uncertainty are not the only relevant factors</p>

		<p>the auditor shall take into account the extent to which the accounting estimate is subject to, there is a concern that additional factors or alternatives will not be taken into account in practice. Furthermore, while paragraph A78 includes other relevant factors, we believe that the reference to “the regulatory environment” could be expanded. For example, considering the impact of other factors, such as the geopolitical environment, technological developments or other disruptive factors when evaluating whether the estimates prepared by management are reasonable.</p> <p>We note that the paragraph 28 of the Explanatory Memorandum states that “the requirements in paragraphs 17-19 are not drafted in the form of procedures that shall all be performed, or a list of possible procedures from which the auditor shall choose. Instead, these paragraphs contain requirements that are focused on objectives that the procedures selected by the auditor need to accomplish”. Despite IAASB’s best intentions, there is a feeling of an overly prescriptive work effort in each of the three areas. The IAASB will need to work hard to change existing mind-sets which are not accustomed to objectives-based requirements. Significant effort will be necessary to explain to practitioners (in firms of all sizes) and regulators that the requirements in paragraphs 17 to 19 are not all procedures, and are intended to be objectives based requirements.</p> <p>We agree that analysis of the three factors is useful in identifying and assessing the risk, but it could be less useful in determining the appropriate response. We are concerned that the requirements have been worded to seem as though practitioners would need to address all the matters/ procedures, which could drive a compliance mind-set as regulators will interpret these as a must. The documentation of the sub-components might present practitioners with a challenge because the differences between estimation uncertainty, complexity and judgment are extremely nuanced. The IAASB should consider whether some of the material is more appropriate for application guidance rather than in the requirements.</p> <p>The use of the term “significant data” in requirement 17 (a) would benefit from clarification or perhaps a link to other relevant application material (e.g. A35, A39 – A42). The Board could consider whether it should refer to whether management has also considered different scenarios that may occur, the impact on the significant data and therefore on the final accounting estimate. The IAASB should also consider whether it intends that there is a difference between the requirement to consider if significant data is reliable (para. 17 (a)) and its integrity (para. 17 (d)). Practitioners may have difficulty distinguishing between the two.</p> <p>Paragraphs 18 and A111 use the words “intent” and “ability”, but it is not easy to understand what these mean. We encourage the Board to consider adding additional explanation of these terms.</p>
<b>Academics</b>		
65.	GC	
<b>Individuals and Others</b>		
66.	CYGNUS ATRATUS	<p><i>We have found that phrases like ‘when the reasons for the assessment include...’ to the requirements lead to a scalable standard, especially when paragraph 10 would be categorized along the same 3 sources of material misstatement.</i></p> <p><b>a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?</b></p>

		<p><i>As paragraph 10, stipulating the requirements for risk assessment have not changed significantly, we believe that the identification will not change significantly.</i></p> <p><b>b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?</b></p> <p><i>Absolutely. This provides a framework that can assist in a structured evaluation of risks. Our suggestion would be to replace estimation uncertainty with ‘sensitivity’. We feel that estimation uncertainty refers to all components of the estimate combined. The definition in 13c could then be “sensitivity, including the extent to which the outcome of the accounting estimate changes due selection of different methods, assumptions or data”</i></p> <p><b>c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?</b></p> <p><i>We have not identified caveats in the guidance provided.</i></p>
67.	NDEG	<p>4.1 We support many of the concepts and related guidance that have been incorporated, which we believe will promote a more granular consideration of the nature and extent of what can go wrong, to inform the auditor’s risk assessment at the assertion level and design appropriate responses. That includes thinking about how complexity, the need for judgement and estimation uncertainty can influence the assessment of identified risks (e.g., whether the risk of misstatement at the assertion level is low, or higher, or a significant risk) and how best to design further audit procedures to obtain evidence in response to the risk. We agree that these were important things to think about.</p> <p>4.2 The factors are, however, not “what can go wrong” i.e., the estimate is not misstated because it is complex or needs judgement. We continue to believe that identifying and evaluating the risk of material misstatement for account balances, classes of transactions, and disclosures at the assertion level remains appropriate. The assertions identified in ISA 315 (e.g., existence, completeness, accuracy and valuation etc.) are the ways in which an account balance can be misstated.</p> <p>4.3 We are therefore concerned that the way in which paragraph 13 is drafted and, more specifically, the fact that the related response to risk requirements (paragraphs 17-19) are driven by each factor creates an artificial structure for designing an appropriate response to identified risks and is not straightforward to apply in practice. We also believe there is a risk of unintended consequences that in focusing on factors and obtaining evidence about “matters”, there is the potential that the auditor might not adequately address the risk of material misstatement at the assertion level – i.e., it could drive a checklist approach to simply performing procedures without properly evaluating whether those procedures, and evidence obtained, provide sufficient appropriate audit evidence about the specific risks of material misstatement at the assertion level that have been identified.</p> <p>4.4 There is a perceived need to put each identified risk in a “bucket”, when they are not mutually exclusive, and also confusion over which factors, individually or in combination, were applicable as “the reasons for the assessment given to the risk”. This could lead to a complicated documentation “matrix” – mapping identified risks to specific risk factors and relevant assertions, which we are not sure was the intent and which we believe will cause confusion and will not add value to either the auditor’s risk</p>

assessment or design of responses.

4.5 The following challenges in applying the new requirements are identified:

4.5.i The focus on factors may result in the broader understanding of the entity in ISA 315, as supplemented by paragraph 10 of ISA 540, being overshadowed. There is no clear linkage in paragraph 13 back to paragraph 10 and the list of matters about which the auditor had to obtain an understanding over to help inform their risk assessment.

4.5.ii The structure of the requirements on responding to assessed risks is not intuitive and there is a clear perception of a failure to explain how to address inter-relationships between the factors. For example, the extensive overlap between paragraphs 17 and 18 gives rise to confusion. The distinction between, for example, paragraph 17(a) and paragraph 18(a)(i) is not clear.

4.5.iii There is also confusion over why items are listed under certain factors. For example, there are matters about which it is expected would always be relevant to obtain evidence when testing management's process e.g. the appropriateness of changes from the prior year. This is only explicitly addressed under the "judgement" factor. While this factor would normally be applicable in a majority of cases, there is a risk of unintended consequences of matters that might always be expected not being addressed if a factor is not deemed to be the reason for the assessed risk. Similarly, the relevance and reliability of data only appears under "complexity". There may be significant data that is not necessarily complex.

4.6 We believe it is important to maintain a strong link with the requirements of ISA 315 and ISA 330. There is a risk that the multitude of concepts being incorporated into proposed Revised ISA 540, including the risk factors and "matters" about which the auditor needs to obtain evidence, risks confusion as to what the auditor is responding to.

4.7 We recommend that the understandability and practical application of the ISA can be enhanced by:

4.7.i Positioning the proposed risk factors of complexity, the need for the use of judgement and estimation uncertainty as useful considerations when thinking about the susceptibility of the estimate to error or fraud, or "where things can go wrong". They can help inform the auditor's identification and assessment of the risks of material misstatement at the assertion level, but should not be the basis for that assessment and response. This is consistent with how risk factors are used in ISA 240 and also how they have been incorporated into the proposed PCAOB standard.

4.7.ii Adopting a more intuitive structure for the response to assessed risks that better reflects the way in which audits of accounting estimates are actually approached. The three approaches available to the auditor, regardless of the level of assessed risk, are those set out in paragraph 15(a). We believe an overarching requirement, similar in nature to that proposed by the PCAOB, is appropriate that directs the auditor to determine an appropriate approach to respond to the assessed risks.

4.7.iii Incorporating requirements that provide further direction for each of the 3 approaches.

4.7.iv With respect to testing events subsequent to the balance sheet date, giving this greater prominence. If this approach is capable of providing sufficient appropriate audit evidence then this would, in most cases, be the most sensible approach. A requirement to directly address obtaining evidence from this approach, that precedes requirements under other

approaches, appears warranted and would also, in our view, promote an element of scalability.

- 4.7. v Reorienting paragraphs 17 and 18 to individually address the method, data and assumptions. Both the proposed paragraphs largely focus on these “elements” of accounting estimates but, as noted, contain significant overlap. Restructuring would, in our view, eliminate this overlap, avoid any commonly expected procedures being overlooked by a subjective judgement as to applicable factor, and represent a more intuitive approach to thinking about how to respond to risks arising from the key elements of accounting estimates.
- 4.7. vi Creating a more explicit requirement that addresses expectations of the auditor when developing their own point estimate or range. While application material discusses broadly how an auditor might go about developing their own estimate or range we think it is more helpful to indicate the expected work effort if, for example, the auditor uses management’s method or model, data or assumptions. Similarly, setting a clear benchmark in the requirements that, if the auditor uses their own method, model, data or assumptions, they need to have a reasonable basis for those selections would also be appropriate. Note, some further restructuring of the ordering of paragraphs 19 (estimation uncertainty), 20 (auditor ranges) and our suggested requirement is considered necessary.