Supplement G
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 6

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.

Q6. Will the requirement in paragraph 23 and related application material (see paragraphs A2–A3 and A142–A146) result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate?

#	Respondent	Comments
Investors and Analysts		
1.	CFA	
Those Charged with Governance		
2.	AICD	
Regulators and Oversight Authorities		
3.	BCBS	**Identifying and assessing the risks of material misstatement and evaluating identified misstatements** **We believe that the revisions to ISA 540 (Revised) will result in a more consistent determination of a misstatement than is done today. That said, the Committee recommends additions that we see as helpful to the identification and assessment of misstatements and the use of an auditor's range to evaluate management's point estimate, with reference to paragraphs 13–20 and 23, and the Application Material in paragraphs A67–A134 and A142–A146.**

		In the Committee's view, misstatements identified during the course of the audit of an accounting estimate should be communicated to, and corrected by, management as soon as possible (sufficiently in advance of the closure of the audit process). This will help minimise the impact that a misstatement, if uncorrected, would have on the fair presentation of the financial statements. Timely communication of misstatements is especially important within banks, where correcting misstatements may involve modifying highly complex models (or model inputs) and updating significant management judgments. **The Committee further recommends that the final standard cross reference to ISA 450, Evaluation of Misstatements Identified during the Audit, paragraph A3, which contains application guidance on distinguishing misstatements for the purpose of the auditor's evaluation, including misstatements arising from differences in facts, judgments and projections. In addition, the Application Material in ISA 540 paragraphs A142–A146 should be enhanced by referencing ISA 450 paragraphs 10–13, and providing guidance on how to evaluate the effect of uncorrected misstatements on the financial statements when judgments are involved. Currently guidance is included only when projections are involved and the auditor is expected to develop a range of possible outcomes as a basis of comparison with management's range or point estimate. Additional guidance is needed because, in our view, it will often not be possible for auditors to develop an independent range as a basis of comparison for complex estimates, such as ECL.** **Lastly, the Committee views the Application Material in paragraphs A142–A146 as fundamental to the final standard, and recommends that the IAASB move this guidance to the level of Requirements.** **Our additional recommendations pertain to identifying and assessing the risks of material misstatements, as they relate to complexity, judgment and estimation uncertainty (including assessing complex models, forward-looking information, management's point estimate within a range, and third-party models/data), and the scope of ISA 540). These recommendations are set out in Annex 1.**
4.	CEAOB	
5.	EBA	**Finally, we also suggest that some of the elements of the ED could be strengthened and further clarified. In particular, with regards to the auditor's response to the risk of material misstatement, it is important that more guidance is provided on how the outcome of the use of an auditor's own range or point estimate interacts with the level of the materiality applied in the audit and how this may be reflected in the audit report.** **In addition, we support connecting the results of this audit procedure with the level of the materiality applied in the audit (paragraphs A144 and A145) and in particular, that the standard includes more guidance on how the outcome of the use of an auditor's own range or point estimate interacts with the level of the materiality applied in the audit and how this may be reflected in the audit report.**
6.	ESMA	<u>*Risk assessment (Q4-Q6 of the Request for comments)*</u> 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. 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. *Audit documentation* 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 - *Audit Documentation*. While ESMA does not support repetition of the requirements of other auditing standards, ESMA is of the view that the IAASB should consider transforming the relevant part of the application guidance specifically related to documentation of the audit of accounting estimates currently included in paragraph A158 into requirements within paragraph 27 of the ED.

		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. 15. Therefore, ESMA suggests that the auditor should be required to document, with regards to all significant accounting estimates, as a minimum: a. the basis for the auditor's conclusions on the reasonableness of areas of subjective judgement (as included in paragraph 27(a) of the ED); b. assessment and evaluation of the accounting estimates, including their specific risk factors; c. significant judgements made by the auditor when assessing the accounting estimates; d. how professional scepticism in auditing accounting estimates was ensured; and e. assessment and evaluation of the factors driving potential risks related to the accounting estimates. ESMA is of the view that specific requirements for audit documentation of accounting estimates in ISA 540 (Revised) would specify the generic requirements in paragraph 32 of ISA 315. 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 estimate is subject to. In our view, such documentation requirement is even more relevant when the auditor assesses the inherent risk of misstatement as low. *Key audit matters* 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). *Disclosures* 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.
7.	IAIS	Yes, we believe the requirement in paragraph 23 and related application material in para. A2–A3 and A142–A146 will result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate.
8.	IFIAR	**9. We also support the provisions (paragraph 23 of the ED) which refer to the need to consider all evidence obtained, including contradictory evidence, and the reasonableness of any significant variations between or within management's estimate or range and those developed by the auditor (see also our comment on explanatory material in paragraph 17 below).** **Work effort** **14. The auditor is required under ISA 330 to design and perform further audit procedures if the procedures described in paragraph 15 a) of the ED (to be applied in low inherent risk situations) do not provide sufficient appropriate audit evidence. We believe this requirement could be made clearer by including the guidance included in paragraph A96 of the ED in the requirements of the ED.** **15. The ED focuses on three factors for the risk assessment of estimates and provides requirements relating to the audit response in respect of each of these factors. Consistent with paragraph 2, the risk factors of judgment and complexity are interrelated with the estimation uncertainty risk factor. Because the concepts are not mutually exclusive, the requirements of paragraphs 19 and 20 that are applicable to estimation uncertainty should also be applicable in situations where inherent risk is not low based on the judgment or complexity risk factors.** **16. In situations where the auditor believes that management has not appropriately understood or addressed the estimation uncertainty, we believe the auditor should first ask management to provide alternative assumptions. We suggest clarifying this requirement in paragraph 19 (b) of the ED, for example, by building upon some of the guidance included in paragraph A126.** **18. Paragraph A144 indicates that auditors may need "to reconsider whether sufficient appropriate audit evidence has been obtained regarding the reasonableness of the amounts within the range" in situations where there are variations in ranges or point estimates which are material. We support the inclusion of guidance to this effect as we consider it relevant to promoting the exercise of appropriate professional scepticism by the auditor. However, we recommend including further requirements in the ED in this regard.**
9.	**IOSCO**	
10.	IRBA	26. The requirement in paragraph 23 and related application material in ED-540 will result in a more consistent determination of the misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate. 27. However, with reference to paragraph A144 of ED-540, the variation in the auditor's range may be significant and multiples of

		materiality. Therefore, it is necessary for ED-540 to provide more guidance on how the auditor addresses a significant variance that is multiples of materiality. This is particularly relevant in the financial services audit environment. 28. We support the inclusion in paragraph 23 of ED-540 that the auditor shall consider all relevant audit evidence obtained, whether corroborative or contradictory.
11.	UKFRC	We believe they will help, but see also our comments above in response to questions 2 and 5.
National Auditing Standard Setters		
12.	AUASB	The term 'reasonable' is used throughout the ED and paragraph 20 requires the auditor's range to be reasonable when used to evaluate management's point estimate. While paragraph A2 describes the concept of 'reasonable', it is subjective and general in nature. The AUASB believes it would be beneficial for the IAASB to provide more guidance and key considerations to facilitate practical application of the term 'reasonable'. The AUASB considers that an auditor would develop their own range if considered optimal from a "gathering of sufficient appropriate audit evidence" perspective and as an independent check to management's outcome, but it should not be a requirement to do so in order meet the requirements of ED ISA 540. The development of a range or a point estimate for reporting purposes is the responsibility of the preparer. The AUASB is concerned that the designation of responsibilities between the auditor and management is sometimes unclear, which may lead to confusion and potentially an increase in scope of auditor's responsibilities if applied in practice. The AUASB considers that the standard is inappropriately tending to shift the onus from preparer to auditor. Where the auditor develops their own point estimate or range to evaluate reasonableness of an estimate, as a replacement for management's point estimate or range, as indicated by paragraphs 19(b) and A127, this may limit the exercise of professional scepticism and judgement and may be detrimental to audit quality. Where the auditor develops its own point estimate or range as an independent check to management's outcome, this is considered appropriate. The AUASB considers that this distinction should be clearly articulated in the standard. ED 540 needs clarification that in circumstances where sufficient and appropriate audit evidence cannot be obtained from management, then the auditor will assess the impact of this and it may result in a modification to the opinion in the auditor's report based on a scope limitation. Additionally, the AUASB considers that further guidance is needed to clarify the expectations of when an auditor's range should be developed and how that range is utilised in evaluating management's point estimate. The AUASB does not consider that the requirement in paragraph 23 with the associated guidance will result in a more consistent determination of a misstatement. 5.1 Ranges exceeding materiality It is not clear whether the ED is introducing the concept that all ranges need to be within materiality – which for some estimates would not be possible. Some estimates are complex, involve a significant amount of judgement and can include significant estimation uncertainty. In such circumstances, the estimation uncertainty can lead to a range of possible outcomes that can be many multiples of materiality. In reality, it may not be possible to reduce the residual estimation uncertainty and bring greater precision to an estimate that is inherently imprecise under the applicable financial reporting framework. In the ED, this appears to be addressed in paragraph 20(b) where "other requirements of the applicable financial reporting framework" can be read as referring to materiality. This reference diminishes the exercise of auditor's professional scepticism and professional judgement. The AUASB acknowledges that this may well stem from the regulator concerns regarding how

		auditors are using auditor's professional scepticism and professional judgement in the establishment of their ranges and thresholds and holding to them consistently. In practice it is unlikely that ranges set are always within materiality, especially as management's or auditor's experts engaged by auditors or management (e.g. valuers) do not take materiality into consideration when they set their ranges. The AUASB considers that the standard requires clarity where ranges exceed materiality. Furthermore, the application material could be expanded to address the types of considerations auditors use in the establishment of setting ranges and thresholds, and mechanisms through which an auditor documents and reconsiders those thresholds in the conduct of the audit. Where necessary, the implications of these, when outside parameters, should be linked to the possible audit report outcomes. 5.2 Substantive analytical procedure Paragraph A128 assumes that where an auditor develops a point estimate or uses an auditor's range, the auditor is performing a substantive analytical procedure for which ISA 520 is the reference point for further audit requirements. The AUASB identifies that many practitioners do not consider their development of a point estimate or range to be a substantive analytical procedure but rather a hybrid of test of detail and substantive analytical procedure, which the exposure draft does not address. (For example, when testing derivatives a sample would be tested through independently determining a point estimate or reasonable range). Furthermore, the AUASB suggests that a 'hierarchy' could be built into the standard to guide auditors on when the use of a point estimate or range is most appropriate. 5.3 Misstatements The AUASB considers that the determination of materiality is still open to interpretation and has not been sufficiently considered within the ED, particularly for those misstatements that represent judgemental differences rather than factual misstatements. The AUASB considers that a greater volume of principle based examples would be helpful in the application material, or within an Appendix, on the use of the point estimate or range and how misstatements are calculated. Visual examples of how the range applies in paragraph A145 could be beneficial.
13.	CAASB	Yes – we support the "stand-back" requirements in paragraph 23, but our stakeholders made the observation that its linkage with the broader requirement in paragraph 13(c) of ISA 700, Forming an Opinion and Reporting on Financial Statements, needs to be clarified. For clarity, we suggest including a cross-reference in ISA 540.23 to ISA 700.13(c), with some guidance to explain the relationship. This would provide an appropriate lead-in to the important requirement that follows in the second sentence, which states "In making this evaluation, the auditor shall consider all relevant audit evidence obtained whether corroborative or contradictory." Further, we suggest clarifying whether paragraph 23 applies to all estimates, with inherent risk of low and not low. Results of field testing showed varied interpretations.
14.	CNCC-CSOEC	Paragraph 23 requires the auditors to evaluate •whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated•. Whereas we agree with using the term •reasonable• when referring to accounting estimates, we consider that In relation to disclosures, the term •reasonable• should be changed for •appropriate•, since the element of judgment Is important with regard to accounting estimates and related disclosures.
15.	HKICPA	See comments in Q5.

		We consider the requirement in paragraph 20 and related application material provide sufficient guidance for developing a point estimate or a range. In paragraph A94 of extant ISA 540, there is guidance for auditors to refer to 'performance materiality' when evaluating the reasonableness of management's point estimate. We consider it useful to include similar guidance in the revised standard. We also recommend that the IAASB explicitly states, in the last bullet point of paragraph A131, that any reference made to other comparable conditions, transactions, events or markets should be based on 'observable references' (i.e. not hear-say). As previously noted in comments to Q3 above, we would recommend IAASB to clarify if the guidance in relation to developing the auditor's range would also be applicable in the situation when the inherent risk is low and is required to develop a point estimate or range in accordance with paragraph 15(a)(iii).
16.	IDW	We believe that the requirement in paragraph 23 and related application material will result in a more consistent determination of misstatements - in particular when the auditor uses his or her own range to evaluate management's point estimate.
17.	JICPA	No response
18.	MAASB	The AASB is of the view that the requirement in paragraph 23 and related application material will result in more consistent determination of a misstatement. Similar to question 5, the AASB notes the practical challenges in applying this requirement. However, there may be unintended consequences of this requirement as the management may tend to rely on the auditor's range.
19.	NBA	We assume that this will be the case. Is it made clear how to deal with big differences between the management's point estimate and the auditor's point estimate or range? In paragraph A144 is stated that this does not necessarily has to be a misstatement. However, if there are big differences, the auditor should reconsider the audit evidence. In paragraph A145 is stated that the difference between the management's point estimate and the nearest point of the auditor's range is the misstatement. Isn't this contradictory? The relationship between materiality and estimation uncertainty is not fully explained. We recommend to develop more guidance in this area.
20.	NZAuASB	In our view, consistent determination of misstatements will continue to present a challenge, particularly for those misstatements that represent judgemental misstatements rather than factual misstatements. In relation to determining misstatements, ED-540 does not provide sufficient guidance on the auditor's assessment and evaluation of misstatements that arise as a result of a difference in judgement. As it relates to estimates, for those misstatements identified as judgemental, the auditor may be less likely to request management to make an adjustment. Guidance that addresses the auditor's considerations in relation to judgemental misstatements would be helpful, for example, the auditor's considerations when determining whether to request management to adjust for a judgemental misstatement.

		The requirement in paragraph 23 applies to disclosures as well as amounts recorded in the financial statements. However, applicable application material appears to be scattered throughout ED-540. For example, paragraphs A124-A125 discuss what the auditor may do when the auditor concludes that disclosure of estimation uncertainty is not reasonable in light of the circumstances and facts involved. In our view, this guidance would be more appropriately included in the discussion of misstatements. Similarly, paragraphs A135-A138 address disclosures related to accounting estimates. We consider that a robust discussion (within one section rather than in separate sections in the application material) of the auditor's considerations when determining the reasonableness of disclosures (in addition to those relating to estimation uncertainty) would significantly enhance the standard and lead to more consistent determination of misstatements related to disclosures
Accounting Firms		
21.	BDO*	We support the proposed changes in determining whether a misstatement exists and the amount of the misstatement. This approach will lead to more consistency in determining the misstatement relating to an accounting estimate. We propose including additional guidance when using an auditor's range to evaluate management's point estimate. This will also be helpful in assessing management bias as we would expect management's point estimate to be closer to the middle of the range rather than the outer edges of the range. We also suggest adding a more explicit example to convey what is required and what constitutes a misstatement where the auditors' range is wider than materiality. Further, we also recommend changes to the wording in the application material, specifically paragraphs A144 and A145, to clarify the requirements when differences exist between management's point estimate or range and the auditor's point estimate or range. We note that from a reader's perspective there is some inconsistency in the application and other explanatory material where there is a separate section on misstatements compared to the requirements where paragraph 23 is included in the Overall Evaluation Based on Audit Procedures Performed section.
22.	CHI*	
23.	DTT*	DTTL believes that it is beneficial to clarify that when the auditor concludes an accounting estimate is not reasonable, a misstatement exists. The clarification of the requirement in paragraph 23 and the related application material in paragraphs A142–A146 of ED-540 should result in a more consistent determination of a misstatement, especially when the auditor is required to evaluate management's point estimate as noted in paragraph A145 of ED-540.
24.	EYG*	• **Paragraph 23, which has been extended to include specific evaluation of disclosures related to accounting estimates, does not provide any application material related to the auditor's identification and evaluation of misstatements in qualitative disclosures. Qualitative disclosures are particularly prevalent in management's disclosures about accounting estimates and such disclosures can be challenging to evaluate (see our response to Q6).** • **We do not support including in the requirements of ED-540 the auditor's evaluation of whether disclosures beyond those required by the applicable financial reporting framework are necessary (see our response to Q6).** <u>Determination of misstatements</u> We believe that the application material in paragraphs A142-A146 is helpful as it relates to determining misstatements in accounting

		estimates. In particular, paragraph A145 is quite clear as to how misstatements are to be calculated in comparison to an auditor's point estimate or auditor's range, and this guidance should result in a consistent determination of misstatements when an auditor's point estimate or range is used in evaluating the estimate. However, we do not believe that paragraph 23 will result in more consistent determination of misstatements in disclosures related to accounting estimates, particularly qualitative disclosures. As noted in paragraph A2 of ED-540, the applicable financial reporting framework typically requires qualitative disclosures about accounting estimates, including how they are made and the degree of estimation uncertainty related to them. Evaluating the nature and extent of management's disclosures against the criteria of the financial reporting framework, which may be objective-based, can be quite challenging in practice, including as it relates to identifying misstatements in those disclosures. In ED-540, paragraph 23 does not have any application material that addresses or assists with identifying misstatements in qualitative disclosures, which in our view is a critical gap in in light of the fact that the evaluation in paragraph 23 has been specifically extended to include evaluation of disclosures. <u>Supporting explanations of reasonable and appropriate in paragraphs A2-A3</u> We find it useful that paragraphs A2 and A3 provide explanations of the terms "reasonable" and "appropriate" in the context of management's compliance with the applicable financial reporting framework. In Appendix 2 to this letter, however, we raise further questions about the use of the term "reasonable" as it relates to the auditor's evaluation of disclosures and we encourage the IAASB to consider the implications of this change in terminology more holistically across the ISAs. <u>Other observations about the evaluation of the reasonableness of accounting estimates and related disclosures</u> • We support the addition to paragraph 23 regarding the consideration of all relevant audit evidence, whether corroborative or contradictory, as we express in our response to Q2. However, we believe the last sentence of paragraph 23 appears to be misplaced because it addresses the implications of the auditor not obtaining sufficient appropriate audit evidence. These implications seem to be more closely related to evaluations performed in paragraphs 21 and 22 of ED-540. • We do not believe the determination of whether disclosures beyond those required by the financial reporting framework, which is currently included in paragraph 21 of ED-540, should be included in the requirements of ED-540. Including this evaluation in the requirements, in our view, de-emphasizes the importance of the auditor's evaluation of whether the disclosures are in accordance with the requirements of the financial reporting framework, which we believe is challenging in itself, as previously noted. We also contend that the need for the auditor to focus on the disclosures in the context of the applicable financial reporting framework is further evidenced by certain initiatives by accounting standard-setters, such as the International Accounting Standards Board's disclosure effectiveness project, that recognize the challenges for management to prepare informative and tailored disclosures while achieving the right balance in the detail of such disclosures. Because paragraphs 13 and 14 of ISA 700 (Revised) address the auditor's evaluation of fair presentation of the financial statements, including the disclosures, we believe it would be more appropriate for the application material in ED-540 to address and explain the relationship of the required overall evaluation of estimates and related disclosures to the evaluation of fair presentation in ISA 700 (Revised). In this regard, we believe such application material would be best placed in support of the overall evaluation in paragraph 23 of ED-540 and not paragraph 21, which addresses the separate evaluation of whether sufficient appropriate audit evidence has been obtained.

25.	GTI*	We welcome the introduction of paragraph 23 of ED 540, requiring the auditor to evaluate whether the accounting estimate and the related disclosures are reasonable in the context of the financial reporting framework. We believe that this will promote professional skepticism in the audit of estimates. However, we are unclear whether this requirement would require the assessment to be performed on an estimate-by-estimate basis or as an overall test over the body of estimates; although the use of the plural would imply that it is the latter. If the intention is to evaluate the body of estimates on an overall basis, we are of the view that application material should be developed to indicate that there may be circumstances when in addition to performing the overall evaluation, an estimate may be sufficiently complex that it would be appropriate for the auditor to perform an individual stand back analysis on that estimate.
26.	KPMG*	We are generally supportive of the requirement in paragraph 23 and its related application material. We believe that the determination required in paragraph 22(c) – i.e. whether management's decisions relating to the recognition, measurement, presentation and disclosure of these accounting estimates are in accordance with the applicable financial reporting framework – should be part of paragraph 23. This is because this determination relates to the assessment of whether a misstatement exists. With respect to the auditor's range – see our comment in the response to question 5 above, paragraph b(1).
27.	PKF	It is difficult to assess whether these requirements will yield a more consistent determination of a misstatement. While we understand the reason for not defining "reasonable", we do believe that this may have consequences in practice, resulting in a lack of clarity. It is not entirely clear how "reasonable" in the context of the application of the relevant reporting framework compares to identifying a material misstatement.
28.	PWC*	If an auditor's point estimate or a range is considered to be a substantive analytic (paragraph A128), it would be inconsistent to use a point estimate or range to identify a misstatement as described in the guidance in paragraphs A143 to A145. However, if an auditor's point estimate or a range is considered, as we believe, to be a test of detail, we support the application material in paragraphs A142-A146, in particular paragraph A145. When the auditor develops a range that includes reasonably possible outcomes supported by the audit evidence and management's point estimate falls outside of that range, the misstatement cannot be anything other than the difference between management's point estimate and the nearest point on the auditor's range. Any suggestion that the misstatement is to a particular point in the auditor's range implies the auditor is capable of developing a point estimate, which in many cases is not possible and the reason why a range was developed. Further, auditors cannot be expected to introduce more precision than is inherent in the requirements of the applicable financial reporting framework. Similarly, when management's point estimate does fall within the auditor's range then we agree that there is no misstatement. It is important that the auditor understands how management selected their point estimate and, taking into consideration the audit evidence obtained, whether such selection is consistent with the audit evidence. Any obvious indicator of bias or selection of an amount within a range that is inconsistent with audit evidence obtained or decisions taken with respect to other accounting estimates should be challenged. We therefore support the related application material (A147-A152) addressing potential bias. With respect to paragraph 23, it is unclear whether the requirement sets an expectation of determining that each accounting estimate is

		reasonable or misstated, as opposed to "the accounting estimates and related disclosures" collectively. The language used is not clear as is the positioning of the requirement relative to paragraph 22, which clearly and explicitly states that it applies to "each" accounting estimate (that is subject to paragraphs 17-19). In our view this evaluation has to be for each accounting estimate. Each estimate is being subject to procedures to enable the auditor to reach that conclusion. The "collective" assessment of reasonableness, including consideration of bias, can only take place when considering the financial statements as a whole, and that is, correctly, best addressed in ISA 700. See our recommendations in appendix 2.
29.	RSM*	We particularly like the "stand back" requirements in paragraphs 22 and 23. Professional firms often try to encourage their audit teams to stand back from the detailed work and consider the audit evidence as a body of work. These requirements should therefore result in a better overall assessment of whether the accounting estimate is reasonable and hence more consistency. We consider that a more explicit requirement to consider ISA 705 in situations where the auditor is unable to obtain sufficient appropriate audit evidence should be included after paragraph 23. In addition, we consider that paragraph 24 could be amended so that it is clear that it includes both intentional and unintentional bias.
30.	SRA	
Public Sector Organizations		
31.	ACAG	Paragraph A145 clarifies a misstatement as the difference between management's point estimate and the nearest point of the auditor's range. ACAG believes this will be challenging for auditors to practically apply, especially when the range can be multiples of materiality as provided for in para A134. ACAG questions the appropriateness of the range being multiples of materiality. ACAG recommends additional clarification on the interplay between the auditor's range and materiality, as well as practical examples to help auditors: • practically apply this concept (multiples of materiality) • determine at what point a material misstatement arises. ACAG also recommends that this requirement include a documentation consideration, as documentation of the auditor's evaluation of whether the accounting estimate is reasonable will be critical.
32.	AGA	We note that the auditor is required to evaluate "reasonableness in the context of the applicable financial reporting framework" but it is unclear what "in the context" means, without specific application guidance, and in particular "reasonable" may lead to auditors having to be held to a higher standard than what is their role – the auditor does not simply need to determine whether the estimate in the financial statements is presented in accordance with the requirements of the applicable financial reporting framework, but instead or in addition the auditor has to evaluate whether the estimate is "reasonable." Better wording is already in paragraph A2 and should be used the main text of the standard i.e. the auditor shall evaluate whether the estimates have been presented in accordance with the requirements of the applicable financial reporting framework. The audit standard should not put auditors into the circumstance where the evidence is that the estimate is presented in accordance with the requirements of the applicable financial reporting framework, but it may not be considered "reasonable," unless that is the clear intent

		of IAASB. If that is the intent, the standard should state it, or perhaps indicate that "an estimate presented in accordance with the requirements of the applicable financial reporting framework is reasonable, unless the conditions in ISA700.18 apply: financial statements prepared in accordance with a fair presentation framework do not achieve fair presentation." The introduction of the concept of "reasonable" has created a new category between "in accordance with the requirements of the applicable financial reporting framework" and "fair presentation."
33.	AGC	Yes, paragraph 23 and related application material should result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate.
34.	AGNZ	The guidance given is helpful in a limited number of instances, but might not work for all situations. In the public sector, for example, many accounting estimates cannot be based on (or influenced by) external information, because there is none. We believe that more consideration should be applied to the identification of examples of external information sources (amendments to paragraph A33F in ISA 500). For example, it could also apply to information from national statistics organisations that provide information supporting the estimates that entities prepare, such as demographic indices used to estimate pension liabilities or construction indices used in valuations of infrastructure assets.
35.	CIPFA	CIPFA considers that the ED-540 material is easier to understand and provides better support for evaluating whether management's point estimate is reasonable or misstated.
36.	GAO	We support the requirement in paragraph 23 to consider all the relevant audit evidence obtained, whether corroborative or contradictory. We also support the guidance in the related application material that notes when the auditor may conclude that the accounting estimate is reasonable and when then auditor should reconsider whether sufficient appropriate audit evidence has been obtained.
37.	INTOSAI	Public sector considerations: No public sector considerations requiring communication to the Board were identified. Other comments: Yes, the requirement in paragraph 23 and related application material are expected to result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate.
38.	PAS	Yes, the requirement in paragraph 23 and related application material will assist in more consistent determination of a misstatement.
Preparers of Financial Statements		
39.	ABA	
Member Bodies and Other Professional Organizations		
40.	ACCA-CAANZ	No. ED-540 does not distinguish between factual misstatements and judgmental misstatements and the different inherent issues with the two: for example, a judgmental misstatement may be more difficult to challenge. There is also little discussion around the consideration of disclosures in considering misstatements. ED-540 also lacks discussion of materiality which is key in the determination and evaluation of

		misstatements. Due to the challenging nature of the misstatements which may occur in relation to estimates, i.e. judgmental misstatements or disclosure misstatements, it would be appropriate for additional guidance in applying materiality to the audit of estimates. The focus of the requirements and application material appears to be on numerical calculation and determination where, due to the nature of estimates, an approach focused on the numbers does not account for all aspects of an estimate or the related disclosures.
41.	AE	Pursuant to ISA 200, the auditor is required to obtain sufficient appropriate audit evidence to reduce the audit risk to an acceptably low level. ISA 200 paragraph 17 establishes this as a prerequisite to obtaining reasonable assurance and to enabling the auditor to draw reasonable conclusions on which to base the auditor's opinion. The proposed wording in paragraph 23 requires the auditor to evaluate "whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated". It would be useful to have clarity as to how this requirement ties into the auditor's opinion. The only other ISA that deals specifically with a line item in the financial statements is ISA 501. Moreover, we agree with using the term 'reasonable' when referring to accounting estimates. However, in relation to disclosures we recommend changing the word ''reasonable'' to ''appropriate'' Please refer to our response in question 8 (a). We also suggest placing paragraph 23 after paragraph 24 which deals with the auditor's evaluation whether there are indications of possible management bias.
42.	AICPA	No response
43.	ANAN	In the opinion of the Association, the ED has provided enough guidance that will take care of the likely problems to be encountered since the standard requires that the management point estimate to be selected must represent the range of reasonable possible outcome of the measurement process and how the accounting estimate was developed with the requirement to explain the nature, extent and sources of the estimation uncertainty. Furthermore, the auditor is to ascertain whether the data and assumptions used in making the accounting estimate are consistent with each other and are in agreement with those used in other accounting estimates or areas of the entity's business activities. These are all contained in paragraphs A2-A3 and A142- A146 which among others also provide guidance to assist the auditor in evaluating management's selection of a point estimate to be included in the financial statements.
44.	CAI	Subject to the points already raised in this letter, we welcome the additional guidance that is included in paragraph 23 (and related application guidance) of ED 540. We believe that guidance provides additional information to auditors in determining and evaluating misstatements.
45.	CAQ	
46.	CPAA	Paragraph 23 does not provide sufficient clarity around evaluation of misstatements and how the auditor's point estimate or range is used to evaluate management's point estimate, however the application material does address this issue fairly clearly. The impact of the auditor's range being many multiples of materiality as discussed in paragraph A134 is not adequately addressed in the application material.
47.	CRUF	
48.	EFAA	We have no comments to make.

49.	FACPCE	We believe that the requirement and the application material allow a more consistent determination.
50.	IAA	Refer to letter
51.	IAAA	Only once the requirements of paragraph 23 proposed in the draft are implemented will their effectiveness be known with certainty; However, we are motivated by the procedures contemplated in both paragraph 23 and in the contents in the paragraphs of the application material.
52.	IBRACON	We support the application material in paragraphs A142-A146. When the auditor develops a range that includes reasonably possible outcomes supported by the audit evidence and management's point estimate falls outside of that range, the misstatement cannot be anything other than the difference between management's point estimate and the nearest point on the auditor's range. Similarly, when management's point estimate does fall within the auditor's range then we agree that there is no misstatement. It is important that the auditor understands how management selected their point estimate and, taking into consideration the audit evidence obtained, whether such selection is consistent with the audit evidence. Any indicator of bias or selection of an amount inconsistent with audit evidence obtained or decisions taken with respect to other accounting estimates should be challenged. We therefore support the related application material (A147-A152) addressing potential bias. With respect to paragraph 23, it is unclear whether the requirement sets an expectation of determining that each accounting estimate is reasonable or misstated, as opposed to "the accounting estimates and related disclosures" collectively. The language used is leading to confusion as is the positioning of the requirement relative to paragraph 22, which clearly and explicitly states applies to "each" accounting estimate (that is subject to paragraphs 17-19). Additionally, we understand that it is important to clarify when the auditor concludes an accounting estimate is not reasonable, a misstatement exists. This clarifying will help in a more consistent determination of misstatement, especially when is needed to evaluate management's point estimate.
53.	IBR-IRE	In our view the evaluation of the reasonableness of the accounting estimate should be done in the context of the auditor expressing an opinion on the financial information taken as a whole. The current wording may give too much prominence to the estimate as such.
54.	ICAEW	**22. The proposed 'stand back' in paragraph 23 is important. There are few other areas in which ISAs mandate a stand back for such a specific category and this proposal sets something of a precedent. It is therefore important that it is as clear as possible. At present, proposed paragraph 23 does not make it clear whether it relates to individual estimates or estimates collectively. It can be read as applying to either or both. In ISA 330 the response is at the assertion level for an estimate or group or class thereof. This type of ambiguity may satisfy the need to build consensus in the short term but it is a recipe for inconsistency thereafter and we strongly suggest that IAASB resolves it before finalisation.** 65. The proposed 'stand back' in paragraph 23 is important. There are few other areas in which ISAs mandate a 'stand back' for such a specific category and this sets something of a precedent. It is therefore important that it is as clear as possible. At present, proposed paragraph 23 does not make it clear whether it relates to individual estimates or estimates collectively. It can be read as applying to either or both. In ISA 330 the response is at the assertion level for an estimate or group or class thereof. This type of ambiguity may satisfy the need to build consensus in the short term but it is a recipe for inconsistency evermore thereafter and

		we strongly suggest that IAASB resolves it before finalisation. 66. While auditors should form an overall view on the reasonableness of individual estimates, bias may not be evident at the individual estimate level (although it may be for ECL and certain technical provisions). We think that an overall emphasis should be on the ISA 700 'stand back' for the financial statements as a whole, rather than at a collective 'estimates' level. IAASB might also give simple and more complex examples of the use of different assumptions (about growth rates for example) used within the same organisation to support estimates in different areas.
55.	ICAG	Yes, we believe so as long as general guidance is provided.
56.	ICAP	We acknowledge that the paragraph 23 and related application material provide guidance regarding the determination of misstatement. However, we believe that the consistent determination of a misstatement may continue to be a practical challenge, as it would be subject to variations owing to the experience and familiarity factors.
57.	ICAS	We believe that the requirement in paragraph 23 and related application material should result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate. However, we would propose that the term 'reasonable' when used to describe disclosures in paragraph 23, should be replaced by 'adequate' to be consistent with the wording agreed during the IAASB's disclosures project when referring to disclosures. As per our response to question 2 above, one area where we believe further enhancement could be made is to include additional guidance in relation to how the auditor should evaluate qualitative disclosures. In relation to certain accounting estimates such disclosures are extremely important to allow the user to properly assess the uncertainty surrounding the recognition and measurement of certain elements of the financial statements.
58.	ICAZ	Yes, the application material coupled with an auditor's use of auditor's range to evaluate management's point estimate helps to identify misstatements arising due to fraud or error as per ISA 450 resulting in more consistent determination of a misstatements.
59.	ICPAK	Yes it will
60.	ISCA	No response
61.	KICPA	We are for IAASB's decision to include a requirement to consider all relevant audit evidence obtained, whether corroborative or contradictory. The related application material would sufficiently enhance an auditor's professional skepticism when auditing accounting estimates and result in more consistent determination of a misstatement as well.
62.	NASBA	No response
63.	SAICA	57. Also refer to our comments in relation to question 5, above. 58. Most of the survey respondents and SAICA agree that the requirements in paragraph 23 and related application material will result in a more consistent determination of whether an accounting estimate is reasonable or misstated, including when the auditor uses an auditor's range to evaluate management's point estimate.

		59. One survey respondent commented that paragraph A144 uses the term "significant" which is open to interpretation and may not be applied consistently. It was suggested that additional guidance and examples should be provided of when a variation would be considered significant. The guidance and examples should also relate the concept of a 'significant variance' to that of materiality.
64.	SMPC	We note that the only other ISA that deals specifically with a line item in the financial statements is ISA 501 . However, ISA 501 stops short at requiring the auditor to obtain sufficient appropriate audit evidence on, or evaluating reasonableness of, the single line item. Pursuant to ISA 200 , the auditor is required to obtain sufficient appropriate audit evidence to reduce the audit risk to an acceptably low level. ISA 200.17 establishes this as a prerequisite to obtaining reasonable assurance and to enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. The proposed wording in para. 23 requires the auditor "… based on the audit evidence obtained" to evaluate "whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated". Explanation of the relationship between the two standards and the auditor's opinion on the financial statements as a whole would be helpful, as it may be unclear as to whether such "reasonableness evaluation" could constitute some form of piecemeal opinion. In addition, there is a lack of reference to the concept of materiality in the ED which directly impacts all of the requirements mentioned in paragraph 23 and its related application material A2-A3 and A142-A146. We believe that the proposed paragraphs 22 and 23 should make clear whether they relate to individual estimates or estimates collectively. Logically paragraph 23 of the ED should follow the auditor's step back evaluation as to whether there are indications of possible management bias, and so might be more appropriately located subsequent to paragraph 24. It could also be questioned, that if it makes sense to expressly have a stand-back provision why this is not a requirement in other ISAs. In our opinion, an overall emphasis would be more appropriate in ISA 700 to stand back on the financial statements as a whole, rather than at a collective estimates level.
Academics		
65.	GC	
Individuals and Others		
66.	CYGNUS ATRATUS	In our experience this determination is performed consistently in the field. We do not object to the requirements.
67.	NDEG	6.1 We strongly support the application material in paragraphs A142-A146, in particular paragraph A145. When the auditor develops a range that includes reasonably possible outcomes supported by the audit evidence and management's point estimate falls outside of that range, the misstatement cannot be anything other than the difference between management's point estimate and the nearest point on the auditor's range. Any suggestion that the misstatement is to a particular point in the auditor's range implies the auditor is capable of developing a point estimate, which in many cases is not possible and the reason why a range was developed. 6.2 Similarly, when management's point estimate does fall within the auditor's range then we agree that there is no misstatement. It is

		important that the auditor understands how management selected their point estimate and, taking into consideration the audit evidence obtained, whether such selection is consistent with the audit evidence. Any obvious indicator of management bias or selection of an amount within a range that is inconsistent with audit evidence obtained or decisions taken with respect to other accounting estimates should be challenged. We therefore support the related application material (A147-A152) addressing potential bias. 6.3 With respect to paragraph 23, it is unclear whether the requirement sets an expectation of determining that each accounting estimate is reasonable or misstated, as opposed to "the accounting estimates and related disclosures" collectively. The language used is leading to confusion as is the positioning of the requirement relative to paragraph 22, which clearly and explicitly states applies to "each" accounting estimate (that is subject to paragraphs 17-19). 6.4 In our view this evaluation has to be for each accounting estimate. Each estimate is being subject to procedures to enable the auditor to reach that conclusion. The "collective" assessment of reasonableness, including consideration of management bias, can only take place when considering the financial statements as a whole, and that is, correctly, best addressed in ISA 700. 6.5 We suggest that more application guidance including practical examples be given to bring out the requirements of paragraph 22 & 23 more clearly.