



# ISA 540 (Revised): Overview of Responses

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IAASB Meeting, New York

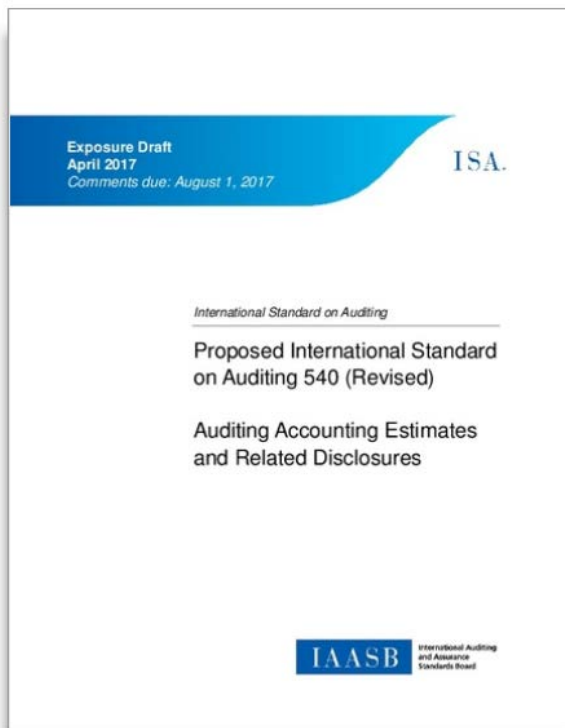
Agenda Item 9

September 2017

**IAASB**

**International Auditing  
and Assurance  
Standards Board**

# Exposure Draft



- Published: April 20, 2017
- Comment deadline: August 1, 2017
- 67 responses received:
  - Monitoring Group letters received: BCBS, IAIS, IFIAR, IOSCO

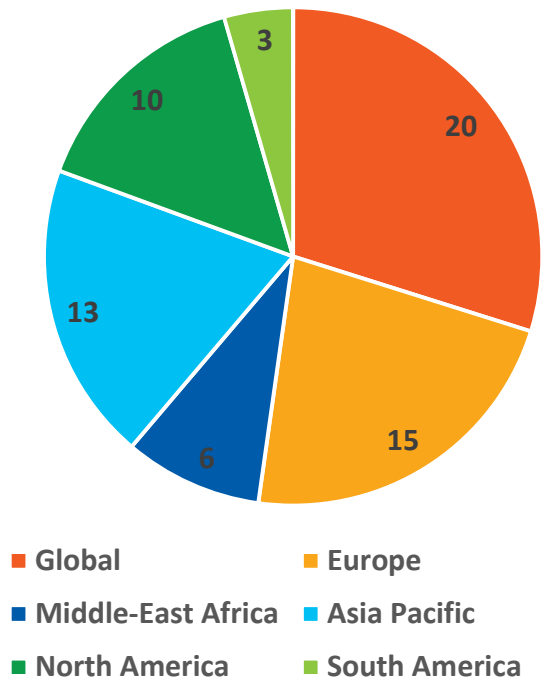
## Exposure Draft

- The ED requested responses to eight questions covering how ED-540 addresses:
  - Evolving financial reporting frameworks (Q1)
  - Professional skepticism (Q2)
  - Scalability (Q3)
  - Risk assessment and response (Q4), including views on the risk factors and the objectives-based requirements
  - Ranges (Q5)
  - Determination of misstatements (Q6)
  - Conforming and consequential amendments to ISA 500 (Q7)
  - Translations and effective date (Q8)

# Responses

Total	67
Regulators and Oversight Authorities	9
National Auditing Standard Setters	9
Accounting Firms	10
Member Bodies and Other Professional Organizations	25
Public Sector Organizations	8
Preparers of Financial Statements	1
Those Charged with Governance	1
Academics	1
Investors	1
Individuals and Others	2

**Geographic Areas**



## Comment Letter Analysis - Current Status

- Task Force has commenced analyzing the comment letters:
  - Searching for themes and key decision points for the IAASB
  - Using Nvivo to assist with analysis (<http://www.qsrinternational.com/what-is-nvivo>)
- The analysis is ongoing and based on an initial reading of the letters
- Quotes in this presentation are used to illustrate specific points of view but are not intended to represent an overall view
- Further analysis and Task Force recommendations will be presented to the Board in the IAASB's October and December 2017 meetings

## Views on IAASB's Objective

- Much support for the IAASB's objectives in revising ISA 540

*“ESMA welcomes the IAASB’s efforts to address in the ED the consequences of the evolution of the financial reporting framework on the audit of accounting estimates.” (ESMA)*

*“We agree with the objectives of the project as set out in ED-540 and we appreciate the efforts that have been undertaken to modernise and enhance the requirements of ISA 540. We also recognise the challenge of drafting a standard that is sufficiently scalable, addresses the challenges currently faced by auditors and is future-proof to the extent possible.” (KPMG)*

## Views on Clarity of the Standard

- Concerns around the clarity/readability/operability of the standard
  - Complex wording and sentence structure may result in the potential for inconsistency or difficulty in application
  - Volume of application material (certain respondents found AM too long, others liked the volume or sought further guidance)
  - Flow chart helpful and suggested to include as an appendix in the final standard
- Connectivity of ISA 540 to other standards can be enhanced
  - For example, ISA 315 (Revised), ISA 330, and ISA 500

*“Many of our stakeholders found the application material in the proposed standard complex, resulting in readability and navigation difficulty. We believe that if certain requirements could be written to provide more clarity as to what is expected of the auditor, it would alleviate the need for extensive application material in the standard...” (CAASB)*

## Views on Clarity of the Standard

- Too complicated for simple accounting estimates
  - Additional guidance on what response is required for “low IR” accounting estimates would be helpful
- Certain respondents asked the IAASB to consider the PCAOB’s proposed standards because:
  - It might address concerns about complexity and readability
  - Alignment of auditing standards



## Views on Risk Factors

- Risk factors (complexity, judgment and estimation uncertainty)
  - Support to consider the risk factors but concerns about how they are applied in the risk assessment process and response
  - The concerns include, amongst others, (1) the interrelationships between the factors, including a view that estimation uncertainty is always present (2) confusion about the correlation of assumptions, data and method to the three risk factors and (3) how “other” factors affect the RoMM and the response to the assessed RoMM
  - Interrelationship between risk factors and ISA 315 (Revised)

*“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.” (ICAEW)*

*“In our view, by focusing the standard on “what can go wrong” due to complexity, judgment and estimation uncertainty, the standard provides a better basis for the application of professional skepticism when auditors deal with the measurement of accounting estimates and making related disclosures.” (IDW)*

## Views on Risk Factors – Work Effort

- Unclear whether procedures in paragraph 15(a) can be used for ‘other than low’ accounting estimates
- Certain respondents had significant concerns with how the factors related effort but on balance most seemed to be supportive of making sure the auditor’s response was responsive to the factors giving rise to the ROMM
- Structuring the work effort by risk factor is overly complex and may therefore result in inconsistencies, repetition and inefficiencies
  - Lack of specificity in procedures to be performed
  - Implications of interrelationship between risk factors
  - Not clear why matters were listed under certain factors rather than others (e.g. reliability of data)
- Suggestions to focus on data, assumptions and model/method instead of risk factors

## Views on Risk Factors – Work Effort

*“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.” (IOSCO)*

*“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.” (ESMA)*

## Views on Risk Factors – Field Testing

- Field testing performed by firms (BDO, GTI, KPMG, PWC), NSS (Canada) and Member bodies (SAICA)
- Field testing indicated similar issues
  - Difficulty in applying the risk factors in practice
    - Not intuitive, i.e., not how you would approach auditing an estimate
    - Overly complicated, lacking in clarity and difficult to operationalize
    - Unclear which procedures to perform to meet objectives in paragraphs 17-20

*“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” (PWC)*

*“The majority of the field testing respondents described that the requirements improved their [risk] assessment in that it was documented in more detailed, resulted in a better understanding and a more effective response to the assessed risks (the right work in the right areas). It highlighted more clearly the risk factors and considerations.” (SAICA)*

## Views on Scalability

- Low inherent risk threshold
  - Certain respondents support the threshold but are of the view that more guidance is needed, others are not supportive because
    - Difficult to operationalize, unclear what response is required for “low IR” accounting estimates
    - Perception that the ED requires a separate assessment of IR and therefore creates a new requirement that goes beyond ISA 315 (Revised) and ISA 200.
  - If maintained, more guidance needed on, for example, how to distinguish between low IR and ‘not low IR’?
  - Alternatives for low inherent risk threshold
    - Bring out scalability through further examples in the application material
    - Implementation material for SMPs
- Risk assessment procedures are too prescriptive for simple accounting estimates

## Views on Other Topics

- Point estimates and ranges
  - Certain respondents support the auditor's development of a point estimate or range, while others see practical challenges or raised concerns
    - When management does not adequately address EU, the auditor should not be responsible for developing a range
  - More guidance needed in cases when range is multiples of materiality
- Audit documentation
  - Various suggestions for matters that should be documented
  - Others were concerned at the potential for additional documentation requirements based on the approach in the ED

## Views on Other Topics

- Disclosures
  - Support for focus on disclosures, certain respondents asking for more guidance on testing disclosures relating to estimates
- Amendments to ISA 500 (External Information Sources): generally supportive
  - Suggestions to improve conforming amendments, for example, consider deleting/ clarifying “publicly available”
- Professional skepticism
  - Respondents were generally supportive of additional focus on professional skepticism. Certain respondents (e.g., regulators) suggested the use of stronger words such as “challenge” and “question” in the requirements and application material.

## Views on Other Topics

- Terminology
  - Consistency and appropriateness of the use of “reasonable” or “adequate”
- Stand-back requirement
  - Should this apply to all accounting estimates?
- Public sector – calls for specific guidance
- Support for planned March 2018 approval
  - Particularly due to implementation of IFRS 9
- Support for proposed effective date and option to early adopt



## Views from Monitoring Group/Regulators

- Support finalizing standard quickly given IFRS 9 implementation
- Mixed views in other areas
  - For example, support for objective-based work effort linked to factors and threshold from IAIS, UKFRC but concerns from IOSCO, IFIAR
- More guidance needed
  - How to test a model, evaluate the point estimate, testing controls
- Stronger requirements around documentation and ranges
- Professional skepticism: focus on challenging management's assumptions
- Develop IAPNs for financial institution specific estimates/ complex estimates (insurance contracts, ECL)
  - CNCC published guidance on IFRS 9 for credit institutions
- Elevate certain application material to requirements

## Views from Practitioners

- Low inherent risk threshold is unclear
  - Relationship of low inherent risk to materiality is unclear
- Response to the RoMM is overly complicated, lacking in clarity and difficult to operationalize
  - Interrelationship between factors is complicated
  - Not intuitive as not linked to components of estimate (data, assumptions, model/method)
  - Suggestion to carefully consider the PCAOB's proposed standard on accounting estimates
- With respect to SMPs
  - Not sufficiently scalable – threshold is over engineered
  - Too complicated for simple estimates
  - More guidance on how to apply ISA 540 in SMP/SME environment would be useful

## Views from NSS and Member Bodies

- Mixed views on threshold
  - More clarity needed or find other ways to achieve the desired objective of scalability
- Response to assessed RoMM is overly complex and challenging to apply – confirmed by field testing
- The three factors difficult to separate and unclear how other risk factors affect RoMM and response to assessed RoMM
- Standard is too long/ hard to understand
  - Construct of requirements is overly complex and difficult to apply
  - Move “educational” application material to appendix
- More AM needed for SMP and simple estimates
- Some material from ISA 540 fits better in ISA 315 (Revised)

## PCAOB Proposal

- The PCAOB proposal:
  - Replaces three existing standards (AS 2501, AS 2502, and AS 2503) with a single standard that includes an emphasis on applying professional skepticism
  - Builds on the three existing substantive approaches to auditing estimates
  - Further integrates the risk assessment standards to focus auditors on estimates with greater risk of material misstatement
  - Updates standards in light of developments in auditing practices for fair value of financial instruments

<https://pcaobus.org/Rulemaking/Docket043/2017-002-auditing-accounting-estimates-proposed-rule.pdf>

## Matter for IAASB Consideration

1) What additional issues have IAASB members identified?

## Matter for IAASB Consideration

2) Recognizing the preliminary analysis of comments performed to date, what views do the IAASB members have on the direction that should be taken regarding the threshold of low/not low inherent risk?

## Matter for IAASB Consideration

- 3) Recognizing the preliminary analysis of comments performed to date, what views do the IAASB members have on the direction that should be taken regarding:
- a) How the risk factors should be taken into account in the risk assessment (para. 13)?
    - i. Identifying at the assertion level vs. identifying at the risk factor level
  - b) How best to structure the requirements related to the response to RoMM (paras 15-20)?
    - i. Retain risk factor focus but redraft to simplify
    - ii. Focus on testing strategies and data, assumptions and method/model
    - iii. Other suggestions?

## Next Steps

- Further analysis of comment letters
- Deliberation by Task Force – Immediately after Board meeting
- IAASB October 2017 meeting
  - Analysis of comment letters
  - Discuss issues and propose way forward for risk assessment and work effort
- IAASB December 2017 meeting
  - Remainder of issues arising from comment letters
  - First read of the proposed final standard





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