

Supplement A to Agenda Item 2

Preliminary Analysis of Responses to Question 1 of the Exposure Draft

Section I: Question included in Exposure Draft

1. The following question was asked in the Exposure Draft:
 1. *Has ED-540 been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates?*

Section II: Staff Analysis of Respondents' Views¹

General Observations

2. Many of respondents, including one Monitoring Group member,² indicated generally that the Exposure Draft of Proposed ISA 540 (ED-540)³ has been appropriately updated to deal with evolving financial reporting frameworks and their effect on the auditing of accounting estimates, particularly complex estimates. Respondents commented positively in varying degrees on the focus in ED-540 on the use of complex models, forward-looking information, testing of internal controls, and the importance of disclosures, while also noting that additional requirements or guidance in these areas may be helpful.
3. However, various levels of concern were expressed about whether ED-540 sufficiently addressed the unique issues presented by the introduction of the expected credit loss (ECL) model or issues in the audits of entities in the insurance industry. This is discussed further in the section "Comments on Sector-Specific Guidance" below.
4. Some respondents⁴ commented in various ways about the framework-neutral position of the ISAs, either noting the challenges in including requirements linked to a specific framework, or indicating that the expanded requirements and application material in ED-540 allow the standard to remain principles-based in dealing with evolving financial reporting frameworks.
5. One respondent⁵ noted that the principles-based nature of the ISAs means that ISA 540 (Revised) cannot, nor should it attempt to, address in detail all the various emerging accounting requirements, including those relating to specific industries. However, this respondent believed that there is a need for separate guidance to help apply the standard to different types of complex estimates, and expressed support for the IAASB to develop International Auditing Practice Notes

¹ In this paper the following terms have been used:

- "A respondent" = 1;
- "A few" = 2–3;
- "Some" = 4–6;
- "Several" = 7–11;
- "Many" = 12–34;
- "Majority" = more than 50%; and
- "Significant majority" = greater than ~80%.

² *Regulators: IAIS, IRBA, NSSs: HKICPA, IDW, NBA, Firms: BDO, DTT, EYG, PKF, RSM, Public Sector: ACAG, AGC, CIPFA, GAO, PAS, Member Bodies: AE, ANAN, FACPCE, IAA, IBR-IRE, ICAG, ICAP, ICAZ, ICPAK, KICPA, SAICA*

³ Proposed ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

⁴ *Member Bodies: CAI, SAICA, Firms: GTI, PWC, Individuals & Others: NDEG*

⁵ *Regulators: UKFRC*

(IAPN) or other publications as appropriate. Some respondents had similar views,⁶ with varying suggestions as to the form and content of such guidance.

6. One respondent⁷ indicated that, although ED-540 has been appropriately updated to deal with the evolving nature of the International Financial Reporting Standard (IFRS), the IAASB needs to ensure that the scope of the revised standard remains appropriate in view of the fact that other financial reporting frameworks may not have changed significantly.
7. One respondent⁸ supported targeted amendments to extant ISA 540,⁹ with explicit links to ISA 315 (Revised)¹⁰ and ISA 330¹¹ that would address recent inspection findings and relevant changes to financial reporting frameworks rather than overhauling the entire standard.
8. A number of respondents believed that ED-540 was overly focused on auditing complex accounting estimates (e.g., ECL and other estimates in the financial sector). Of the respondents expressing this view noted that ISA 540 (Revised) also needs to focus on considerations relevant to accounting estimates in the non-financial sector,¹² or believed that the standard needs to be more balanced to make it more scalable and relevant to entities in different industries and of varying sizes.¹³
9. Some respondents¹⁴ noted that additional examples or guidance could be provided related to areas that were the subject of other recently accounting pronouncements issued, such as revenue recognition (IFRS 15), leases (IFRS 16) and insurance contracts (IFRS 17 – see “Comments on Sector-Specific Guidance” below).
10. A few respondents¹⁵ observed that accounting estimates in the public sector are becoming increasingly complex, and recommended that additional examples or guidance be provided to adequately address auditing issues relating to estimates for public sector organizations.
11. A couple respondents¹⁶ noted that the increasingly complex financial reporting regime is relevant not only to auditors but to preparers, and had various suggestions in this regard.

Comments on Sector-Specific Guidance

12. Although supportive of the overall project and the IAASB’s efforts to improve the auditing of accounting estimates for all estimates, a few respondents (including two members of the Monitoring Group)¹⁷ noted their interest in, or preference for, a focus on issues for audits of financial institutions or entities in the insurance industry.

⁶ *Regulators:* IRBA, *Member Bodies:* AICPA, CAI, ICAEW, *NSSs:* AUASB

⁷ *NSSs:* IDW

⁸ *Member Bodies:* AICPA

⁹ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

¹⁰ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

¹¹ ISA 330, *The Auditor’s Responses to Assessed Risks*

¹² *NSSs:* AUASB, CAASB, *Member Bodies:* ACCA-CAANZ

¹³ *NSSs:* AUASB, CAASB, *Member Bodies:* CPAA, EFAA, SMPC

¹⁴ *Firms:* BDO, *Member Bodies:* AE, CAI, IBR-IRE, ICAS, SMPC

¹⁵ *NSSs:* NZAuASB, *Public Sector:* AGA, INTOSAI

¹⁶ *Member Bodies:* ICAEW, ICAS

¹⁷ *Regulators:* **BCBS**, ESMA, **IAIS**

13. A few respondents¹⁸ noted that the IAASB had considered addressing specific issues relating to the audit of financial institutions in a separate International Auditing Practice Note, and strongly urged the IAASB to continue to pursue this guidance as a matter of priority or be prepared to provide such guidance as part of its implementation monitoring efforts.
14. A member of the Monitoring Group¹⁹ strongly encouraged the IAASB to consider on a priority basis the further development of application or guidance, such as an IAPN, to better address the specific considerations around auditing insurance contract liabilities.
15. Some respondents²⁰ supported a need for, or consideration of, additional guidance for the auditing of ECL models under IFRS 9²¹ or insurance contracts under IFRS 17, either in ISA 540 (Revised) or in a separate publication such as an IAPN.

¹⁸ *Regulators:* ESMA, *Member Bodies:* AE, ICAEW

¹⁹ *Regulators:* **IAIS**

²⁰ *Member Bodies:* ICAEW, NASBA, *NSSs:* CNCC-CSOEC, MAASB, *Firms:* BDO, *Public Sector:* CIPFA,

²¹ IFRS 9, Financial Instruments