

# Agenda Item 2-F.6

## Analysis of General Comments on the Exposure Draft

### Section I: Introduction

1. Respondents<sup>1</sup> to the Exposure Draft (ED) included overall or general comments in their letters that were not directly attributable to the questions posed in the ED. This paper is an analysis of those significant comments received, categorized into the following sections:
  - Section II: Overall support;
  - Section III: Readability and navigation;
  - Section IV: Relationship with ISA 315 (Revised);<sup>2</sup>
  - Section V: Requirements not related to a specific question in the Exposure Draft; and
  - Section VI: Other.
2. Given the variety of topics included in this paper the Monitoring Group's views are discussed in each section, when applicable.

### Section II: Overall support

3. Many of respondents indicated their support for the overall project and applauded the IAASB's efforts to improve the audit of accounting estimates.<sup>3</sup> One Monitoring Group Member preferred the IAASB to have focused on issues for audits of financial institutions as that would have enabled the audit challenges for the audit of expected credit losses to be fully addressed in sufficient detail.<sup>4</sup>

#### *Monitoring Group Responses*

4. The four Monitoring Group members<sup>5</sup> who responded indicated their support for the overall project. One Monitoring Group member<sup>6</sup> noted that the Board should give priority to follow up projects to address:

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<sup>1</sup> 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%.

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>3</sup> *Regulators: BCBS, CEAOB, IAIS, IFIAR, IOSCO, NSSs: CNCC-CSOEC, HKICPA, IDW, Firms: DTT, EYG, GTI, KPMG, PwC, RSM, Public Sector: ACAG, CIPFA, GAO, Member Bodies: AE, AICPA, CAI, EFAA, IAA, IAAA, IBRACON, IBR-IRE, ICAEW, ICAP, NASBA, SAICA, SMPC, Academics: GC, Investors & Analysts: CRUF*

<sup>4</sup> *Regulators: BCBS*

<sup>5</sup> *Regulators: BCBS, IAIS, IFIAR, IOSCO*

<sup>6</sup> *Regulators: IOSCO*

- Sampling, identification of differences to investigate and evaluate errors;
- Use of the auditor's own experts; and
- Specific guidance on financial instrument valuation and related areas.

### Section III: Readability and Navigation

5. Comments on the readability and navigation of the Exposure Draft of Proposed ISA 540 (ED-540)<sup>7</sup> included that:
  - It is complex and lacks clarity on how to adapt the requirements;<sup>8</sup>
  - The requirements are not sufficiently objectives based or are too granular or prescriptive;<sup>9</sup> and
  - The application material is lengthy and repetitive<sup>10</sup>.
6. Suggestions to address the readability issues include:
  - Removing material considered specific to certain types of accounting estimates or industries, such as financial services, and including it outside of the standard;<sup>11</sup> and
  - Removing application material that is considered 'educational'.<sup>12</sup>

### Section IV: Relationship with ISA 315 (Revised)

7. Respondents had the following comments on the connection to ISA 315 (Revised):
  - Request to clarify the risk model in ED-540 relative to the current requirements in ISA 315 (Revised),<sup>13</sup> and whether the requirements in paragraph 10 (Risk assessment) are incremental to ISA 315 (Revised) or were considered a secondary risk assessment;<sup>14</sup>
  - The importance of coordination between the ISA 315 (Revised) Task Force and the ISA 540 Task Force;<sup>15</sup>
  - Calls to revise ISA 315 (Revised) before revising ISA 540;<sup>16</sup>
  - Suggestion to move guidance in ED-540 that applies more broadly to the risk assessment to ISA 315 (Revised);<sup>17</sup>
  - Use the phrase 'special considerations' or providing a more comprehensive lead-in to the

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<sup>7</sup> Proposed ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>8</sup> *Firms*: DTT, KPMG, PWC, *Member Bodies*: NASBA

<sup>9</sup> *NSSs*: AUASB, *Public Sector*: ACAG, *Individuals & Others*: NDEG

<sup>10</sup> *Those Charged with Governance*: AICD, *Regulators*: ESMA, *NSSs*: NBA, NZAuASB, *Public Sector*: AGNZ, *Member Bodies*: ACCA - CAANZ, CPAA

<sup>11</sup> *NSSs*: AUASB, *Member Bodies*: AE, IBR-IRE

<sup>12</sup> *NSSs*: IDW, NBA

<sup>13</sup> *Investors & Analysts*: CFA, *Regulators*: ESMA, *Firms*: KPMG, *Member Bodies*: NASBA, *Public Sector*: AGNZ

<sup>14</sup> CAASB, CHI, KPMG

<sup>15</sup> *NSSs*: CAASB, *Member Bodies*: AE, IBR-IRE

<sup>16</sup> *NSSs*: IDW, *Public Sector*: ACAG

<sup>17</sup> *Firms*: EYG, *NSSs*: NBA

additional requirements in ED-540, drawing more extensively from concepts in ISA 315 (Revised) and ISA 330;<sup>18 19</sup> and

- Streamline the requirements in both standards into one standard.<sup>20</sup>

#### *Monitoring Group Responses*

8. Two Monitoring Group members had the following comments on the connection to ISA 315 (Revised):
- Include more guidance on the interrelationship between the different types of risk factors and the risk levels used in ED-540;<sup>21</sup> and
  - Strengthen the link between ISA 315 (Revised), ISA 330 and ISA 540.<sup>22</sup>

### **Section V: Requirements not related to a specific question in the Exposure Draft**

#### **Scope**

9. One respondent indicated that the focus of the application of the standard is too narrow and that the application material does not adequately include considerations for the public sector.<sup>23</sup> Another respondent requested clarification on whether accounting estimates for which the outcome is expected to be known during the audit are within the scope of this standard.<sup>24</sup>

#### **Nature of Accounting Estimates**

10. A few respondents were supportive of the reference to ‘accounting estimates being subject to inherent limitations’, but noted that the standard could make it more explicit as to the limitations this places on preparers and auditors.<sup>25</sup>

#### **Objective**

11. One respondent supported the change in the objective paragraph to obtaining sufficient appropriate audit evidence that disclosures are ‘reasonable’.<sup>26</sup> Others noted that the objective should be changed back to ‘obtaining sufficient appropriate audit evidence that disclosures are adequate’, as ‘reasonable’ is inconsistent with ISA 700 Revised).<sup>27,28</sup> A couple of respondents suggested conforming amendments to ISA 450,<sup>29</sup> ISA 700 (Revised), and ISA 705 (Revised)<sup>30</sup> so that the

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<sup>18</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*

<sup>19</sup> *Firms*: DTT

<sup>20</sup> *Member Bodies*: ISCA

<sup>21</sup> *Regulators*: **IFIAR**

<sup>22</sup> *Regulators*: **BCBS**

<sup>23</sup> *Public Sector*: AGNZ

<sup>24</sup> *Member Bodies*: ISCA

<sup>25</sup> *Member Bodies*: AE, IBR-IRE, SMPC

<sup>26</sup> *Individuals & Others*: NDEG

<sup>27</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>28</sup> *Firms*: DTT, EYG

<sup>29</sup> ISA 450, *Evaluations of Misstatements Identified During the Audit*

<sup>30</sup> ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*

wording is aligned with ISA 540 (Revised).<sup>31</sup>

### *Monitoring Group Responses*

12. One Monitoring Group member<sup>32</sup> supported the change in the objective paragraph to obtaining sufficient appropriate audit evidence that disclosures are 'reasonable'. Another Monitoring Group member<sup>33</sup> noted concerns about the inconsistent use of the terms 'appropriate', 'adequate', and 'reasonable' throughout the standard.

### **Definitions**

13. Respondents suggested to include a definition of:
- Significant data;<sup>34</sup>
  - Significant assumptions;<sup>35</sup>
  - Reasonable;<sup>36</sup>
  - Specialized skills and knowledge;<sup>37</sup> and
  - Further audit procedures.<sup>38</sup>
14. Other respondents were of the view that the reference to 'significant' as it relates to data should be removed throughout the standard as all data would need to be considered.<sup>39</sup>

### *Monitoring Group Responses*

Monitoring Group members suggested that:

- The term 'monetary amount' used in the definition of accounting estimate should be clarified;<sup>40</sup>
- The terms 'Fair presentation framework' and 'compliance framework', as used in paragraph 21, should be cross-referenced to the definitions in ISA 200;<sup>41</sup> and
- The term 'reasonable' should be defined;<sup>42</sup>

### **Risk Assessment**

15. A few respondents supported the more granular risk assessment as it will drive further audit quality

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<sup>31</sup> *Firms: EYG, Regulators: UKFRC*

<sup>32</sup> *Regulators: BCBS*

<sup>33</sup> *Regulators: IFIAR*

<sup>34</sup> *NSSs: CAASB, CNCC- CSOEC, Member Bodies: AE, ICAS*

<sup>35</sup> *NSSs: CAASB, NZAuASB, Firms: EYG*

<sup>36</sup> *Regulators: CEAOB, ESMA*

<sup>37</sup> *NSSs: CAASB*

<sup>38</sup> *NSSs: CAASB*

<sup>39</sup> *Firms: DTT, EYG*

<sup>40</sup> *Regulators: IOSCO*

<sup>41</sup> *Regulators: IOSCO*

<sup>42</sup> *Regulators: BCBS*

improvements,<sup>43</sup> as well as a few others who supported the addition of regulatory factors in paragraph 10(b).<sup>44</sup>

16. One respondent thought the three risk factors of complexity, judgment and estimation uncertainty should be introduced in paragraph 10(c),<sup>45</sup> while another respondent thought that paragraph 10(c) should be removed as it is inconsistent with ISA 315 (Revised).<sup>46</sup>
17. There were mixed views on paragraph 10(f) of ED-540 (obtaining an understanding of each of the components of internal control):
  - One respondent suggested reverting back to ‘relevant controls’ as some of the components of internal control are covered under other parts of paragraph 10;<sup>47</sup>
  - Another respondent thought that obtaining an understanding of each of the components of internal control is not needed before completing the initial risk assessment;<sup>48</sup> and
  - Another respondent thought it should be conditional based on complexity.<sup>49</sup>
18. A few respondents noted their support for the increased focus on internal controls, both in paragraph 10 (risk assessment) and paragraph 16 (testing operating effectiveness).<sup>50</sup>

#### *Monitoring Group Responses*

19. Three Monitoring Group members<sup>51</sup> noted their support for the increased focus on internal controls, both in paragraph 10 (risk assessment) and paragraph 16 (testing operating effectiveness). However, one of the monitoring group members suggested that:<sup>52</sup>
  - Examples of matters to consider when obtaining an understanding of an entity’s internal control environment should be included;
  - The audit procedures necessary to obtain an understanding of the internal control over accounting estimates, including for audits of smaller entities, should be described; and
  - Paragraph 16 should be enhanced by adding that the auditor needs to evaluate the design of controls related to accounting estimates and include consideration of control deficiencies identified and an assessment of the impact of such deficiencies on the audit.

#### **Disclosures**

20. Some respondents noted their support for the increased focus on disclosures as they are so important

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<sup>43</sup> *Firms:* DTT, BDO, PKF

<sup>44</sup> *Regulators:* EBA, *Firms:* DTT, EYG

<sup>45</sup> *Regulators:* UKFRC

<sup>46</sup> *Firms:* EYG

<sup>47</sup> *Firms:* EYG

<sup>48</sup> *Public Sector:* AGNZ

<sup>49</sup> *NSSs:* IDW

<sup>50</sup> *Regulators:* CEAOB, *Firms:* DTT, *Public Sector:* CIPFA

<sup>51</sup> *Regulators:* **BCBS, IAIS, IFIAR**

<sup>52</sup> *Regulators:* **BCBS**

to the users' understanding of estimation uncertainty.<sup>53</sup> A few respondents were of the view that ED-540 did not adequately emphasize the importance of appropriate disclosures.<sup>54</sup>

21. One respondent commented that paragraph 21(a) is unclear and appears to go beyond the requirements in ISA 700 (Revised).<sup>55</sup>

#### *Monitoring Group Responses*

22. One Monitoring Group respondent<sup>56</sup> supported the focus on disclosures but were of the view that the guidance was scattered throughout the standard and that this reduces the cohesiveness and understandability of the guidance and could undermine the importance attached to the auditor's responsibilities for disclosures. They therefore recommend to bring the guidance together in one place, and if this is not possible, to include cross references between the paragraphs dealing with disclosures.

#### **Stand Back Requirement**

23. A few respondents supported paragraph 22,<sup>57</sup> with one respondent suggesting it should be applicable to all accounting estimates.<sup>58</sup> One respondent did not support the requirement as they were of the view that it is already covered in ISA 330.<sup>59</sup>
24. Some respondents supported the overall stand back in paragraph 23, especially the reference to considering all audit evidence obtained, whether corroborative or contradictory.<sup>60</sup>

#### *Monitoring Group Responses*

25. One Monitoring Group member<sup>61</sup> supported paragraph 22 but also noted that the stand back requirement:
- Should be applicable to all accounting estimates;
  - Should include reassessing the appropriateness of any reliance on controls; and
  - The effect of any changed assessment on the nature, timing and extent of audit procedures.
26. Another Monitoring Group member supported the overall stand back in paragraph 23, especially the reference to considering all audit evidence obtained, whether corroborative or contradictory.<sup>62</sup>

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<sup>53</sup> *Investors & Analysts: CFA, Regulators: EBA, NSSs: JICPA, Those Charges with Governance: CRUF, Member Bodies: ICAEW*

<sup>54</sup> *Public Sector: AGNZ, Member Bodies: ACCA - CAANZ*

<sup>55</sup> *NSSs: CAASB*

<sup>56</sup> *Regulators: BCBS*

<sup>57</sup> *Regulators: IRBA, Member Bodies: SAICA*

<sup>58</sup> *Regulators: IRBA*

<sup>59</sup> *Firms: DTT*

<sup>60</sup> *Investors & Analysts: CFA, Regulators: CEAOB, Firms: DTT, Member Bodies: ICAEW*

<sup>61</sup> *Regulators: IOSCO*

<sup>62</sup> *Regulators: BCBS*

## Written Representations

27. Some respondents supported the enhancements to paragraph 25,<sup>63</sup> with a few respondents commenting that it should refer to ‘data and assumptions’ instead of ‘significant data and significant assumptions’.<sup>64</sup>
28. A few respondents noted that the reference to ‘reasonable’ should be removed as it is more appropriate for management representations to address whether the relevant requirements of the applicable financial reporting framework have been appropriately applied in the preparation of the accounting estimates and the related disclosures.<sup>65</sup>

### Monitoring Group Responses

29. One Monitoring Group member supported the enhancements to paragraph 25.<sup>66</sup>

## Communication with Those Charged With Governance or Management

30. There was some support for paragraph 26.<sup>67</sup> One respondent indicated it was not clear whether matters should be communicated for certain types of accounting estimates or all accounting estimates, and that the requirement should be more closely aligned to paragraph 9 of ISA 701.<sup>68, 69</sup>

### Monitoring Group Responses

31. One member of the Monitoring Group supported paragraph 26.<sup>70</sup>

## Documentation

32. There were some calls for clarification on the expectations for documentation on the risk assessment procedures, the reasons for the assessed risk of material misstatement, the response to the assessed risk of material misstatement, the stand back, and the auditor’s consideration of management bias.<sup>71</sup>

### Monitoring Group Responses

33. One Monitoring Group member<sup>72</sup> commented that the standard should specifically require:
- Documentation on the process for assessment and classification of inherent risk (‘low’ or ‘not low’), the reasons for that classification and responses to the assessed risks of material misstatement;
  - Retaining a copy of the model used, by management or the auditor, in the audit file; and

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<sup>63</sup> Regulators: **BCBS**, Firms: DTT, EYG, KPMG

<sup>64</sup> Firms: DTT, EYG

<sup>65</sup> Firms: EYG, KPMG

<sup>66</sup> Regulators: **BCBS**

<sup>67</sup> Investors & Analysts: CFA, CRUF, Regulators: **BCBS**, IRBA, Member Bodies: SAICA

<sup>68</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

<sup>69</sup> Firms: DTT

<sup>70</sup> Regulators: **BCBS**

<sup>71</sup> Firms: EYG, RSM, NSSs: ACCA-CAANZ, Member Bodies: ISCA, SAICA, Individuals & Others: NDEG

<sup>72</sup> Regulators: **IOSCO**

- When there is a large number of complex valuation models for different items, the auditor should perform testing using his or her own independent models or clearly document management's models and the testing performed on them.

## Appendixes

34. Comments specific to the Appendixes within ED-540 were:

- Delete Appendix 1 as it is accounting related and includes content considered educational;<sup>73</sup>
- Redraft Appendix 1 in a more practical, framework-neutral manner;<sup>74</sup> and
- Move the appendixes out of the standard into separate guidance.<sup>75</sup>

## Section VI: Other

### Move Application Material to Requirement

35. Respondents highlighted several paragraphs in the application material, or parts thereof, that should be moved to the requirements:

- A135, that paragraph 21 applies regardless of whether the auditor is required to perform procedures under paragraph 19;<sup>76</sup> and
- A158, documentation.<sup>77</sup>

### Calls for Additional Guidance

36. Respondents identified the following areas where further guidance could be useful:

- Disclosures;<sup>78</sup>
- Management bias throughout the process of the audit;<sup>79</sup>
- Communications with those charged with governance or management;<sup>80</sup>
- Key audit matters;<sup>81</sup>
- Expanding on the current application material around 'reasonable'<sup>82</sup>, reviewing the outcome of valuation attributes<sup>83</sup>, use of an expert in auditing expected credit loss models<sup>84</sup>, and

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<sup>73</sup> Firms: KPMG

<sup>74</sup> Firms: DTT, NSSs: NBA

<sup>75</sup> Public Sector: GAO, Member Bodies: AICPA

<sup>76</sup> Public Sector: AGNZ

<sup>77</sup> Regulators: ESMA, IRBA, Member Bodies: SAICA

<sup>78</sup> Investors & Analysts: CFA, Regulator: EBA, UKFRC

<sup>79</sup> Investors & Analysts: CFA, Regulators: ESMA

<sup>80</sup> NSSs: CAASB, Regulators: EBA

<sup>81</sup> Regulators: ESMA

<sup>82</sup> NSSs: IDW

<sup>83</sup> Regulators: UKFRC

<sup>84</sup> Regulators: EBA

categorizing risks;<sup>85</sup> and

- More prominence to ‘overlays’ in the risk assessment section.<sup>86</sup>

#### *Monitoring Group Responses*

37. Monitoring Group member requested further guidance be included on the following matters:

- Written representations;<sup>87</sup>
- Sampling, identification of differences to investigate and evaluating errors;<sup>88</sup> and
- Financial instrument valuation.<sup>89</sup>

#### **Alignment with PCAOB**

38. Many respondents encouraged closer convergence and alignment to the recently issued Public Company Accounting Oversight Board (PCAOB) Docket 43: *Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements*, which approaches the audit of accounting estimates in a manner that appears to be more consistent with the way management makes their accounting estimates.<sup>90</sup>

#### **Field Testing**

39. Some respondents noted support for field testing ED-540 and encouraged close follow up on any issues identified,<sup>91</sup> while one respondent cautioned the IAASB to balance the feedback received from field testing against feedback received from other stakeholders.<sup>92</sup>

#### **Post Implementation Review**

40. A few other respondents suggested a post implementation review of this standard to assess whether the changes have achieved the objectives.<sup>93</sup>

#### *Monitoring Group Responses*

41. A monitoring group member also suggested a post implementation review of this standard to assess whether the changes have achieved the objectives.<sup>94</sup>

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<sup>85</sup> *Member Bodies:* ACCA - CAANZ

<sup>86</sup> *Regulators:* EBA

<sup>87</sup> *Regulators:* **BCBS**

<sup>88</sup> *Regulators:* **IOSCO**

<sup>89</sup> *Regulators:* **IOSCO**

<sup>90</sup> *Investors & Analysts:* CFA, *Firms:* DTT, EYG, GTI, PWC, RSM, *Preparers Of Financial Statements:* ABA, *Member Bodies:* AICPA, CAQ, ICAEW, NASBA, *NSSs:* CAASB

<sup>91</sup> *Investors & Analysts:* CFA, *Member Bodies:* AE, IBR-IRE, ICAEW

<sup>92</sup> *Regulators:* UKFRC

<sup>93</sup> *Regulators:* CEAOB, **IFIAR**, *Public Sector:* ACAG, *Member Bodies:* ICAEW

<sup>94</sup> *Regulators:* **IFIAR**

### **Education for Other Stakeholders**

42. A couple of respondents noted that the IAASB has a role to play in educating other stakeholders in the financial reporting supply chain about the coming changes related to this standard.<sup>95</sup>

### **Drafting**

43. Many drafting suggestions were received which will be taken into account when the Task Force has decided on a way forward.

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<sup>95</sup> *Member Bodies: ICAEW, SMPC*