

International Auditing and assurance Standards Board (IAASB)  
529 Fifth Avenue - 6th Floor  
New York, New York  
10017

01 August 2017

Dear Sirs

**Exposure Draft April 2017 – Proposed International Standard on Auditing 540 (Revised) Auditing Accounting Estimates and Related Disclosures**

PKF International Limited administers the PKF network of legally independent member firms. The PKF International network consists of member firms and correspondents in over 400 offices operating in 150 countries providing assurance, accounting and business advisory services. PKF International Limited is a member of the Forum of Firms - an organisation dedicated to consistent and high-quality standards of financial reporting and auditing practices worldwide. This letter represents the observations of PKF International Limited, but not necessarily the views of any specific member firm or individual.

We welcome the opportunity to comment on the IAASB's exposure draft – Proposed International Standard on Auditing 540 (Revised) Auditing Accounting Estimates and Related Disclosures. Our responses to the Request for Comments on the clarity, understandability and practicality of application of the requirements and related application material of ED-540 are appended to this letter.

While we recognise the substantial proposed revisions, and given the need for national due process and translation, we believe, in anticipation of the imminent effects of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* and the increased application of fair value accounting generally, there should be no undue delays in finalising the requirements and application material of this Standard.

We are supportive of the IAASB's response and continued efforts to improve the requirements and application material in light of the developments in accounting and reporting frameworks. Further, we are particularly supportive of the approach taken in ED-540 with regards to risk identification and assessment, the recognition of low inherent risk, and the scaled approach to addressing identified risks. We trust this approach will have positive implications for the review of ISA 315 and 330.

If you would like to discuss any of our comments, do not hesitate to contact me.

Yours sincerely



**Theo Vermaak**

Chairman: International Professional Standards Committee  
PKF International Limited

## Request for Comments

### Overall Questions

- 1) Has ED-540 been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates?

Yes, however, updating this ISA would likely need to be an on-going process. While we believe that the ED is appropriately updated while remaining neutral to any specific financial reporting framework, we encourage the IAASB to consider the IFRS 13 *Fair Value Measurement* Post Implementation Review which is set to close for comment on September 22, 2017.

- 2) Do the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates?

Yes.

### Focus on Risk Assessment and Responses

- 3) Is ED-540 sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk?

From an overall perspective, we believe the IAASB's intent is clear, and that ED-540 is mostly sufficiently scalable. We have some concern around the requirements in par. 10 not being particularly scalable. For example, the requirement to obtain an understanding of each of the components of internal control (par. 10 (f) should possibly be dependent on the related complexity, need for judgment and potential for bias (as referred to in par. 13), or other characteristics of the accounting estimates present. In the audit of an entity with very common and relatively uncomplicated accounting estimates, the requirements in par. 10 may be very difficult to comply with, especially for small and medium entities. While auditing is an iterative process and often difficult to describe in a linear fashion, we believe that the requirements in par. 10, as written, may not be completely scalable. The related application material provides considerations for small and medium entities, and provides further guidance which makes the requirements of par. 10 more scalable, but this is not immediately evident from the language used to state the requirements. This could further have unintended consequences regarding interpretation by audit regulators. Par. 11 on the other hand incorporates language which makes it more scalable when stating "The auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review." We suggest that par.10 should incorporate some of the considerations in par. 13 and an approach similar to that in par. 11.

Paragraph 15 (a) requires, when inherent risk is low, that the auditor determine whether one or more of the listed further audit procedures would provide sufficient appropriate audit evidence. As written, these further procedures are only relevant when inherent risk is low. However, we believe that these same procedures may provide appropriate evidence, in combination with the considerations in par. 17-20, where inherent risk is not low. We suggest that par. 15(a) be required for all estimates, with additional procedures where inherent risk is not low.

Further, the application guidance in par. A96 states that, if further audit procedures in paragraph 15(a) do not provide sufficient appropriate audit evidence, the auditor is required by ISA 330 to design and perform **other** procedures. We believe that the term "other" may not be consistent with

other ISAs or be clear enough, and suggest replacing “other procedures” with “additional procedures responsive to the circumstances”.

- 4) When inherent risk is not low (see paragraphs 13, 15 and 17–20):
- a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?

Yes, subject to our comments in 3 above.

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

Yes, we support this requirement. However, we have some concern that the requirement in par. 13 is included too late in the process and should form part of the requirements relating to risk assessment procedures in par. 10. See our response to 3 above.

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

Yes, however refer to response in 5 regarding the auditor’s point estimate or range.

- 5) Does the requirement in paragraph 20 (and related application material in paragraphs A128–A134) appropriately establish how the auditor’s range should be developed? Will this approach be more effective than the approach of “narrowing the range”, as in extant ISA 540, in evaluating whether management’s point estimate is reasonable or misstated?

Yes, subject to our comments below, the requirement in paragraph 20 and the related application material in paragraph A128 – A134 do establish how the auditors range should be developed.

However, in Section 3 of the Explanatory Memorandum, concern is mentioned over extant ISA 540 which could result in an auditor’s range that is inappropriately wide. We do not believe that this concern has been fully addressed. We suggest that the application material could more explicitly address the quantum of the range (from low to high) compared to e.g. materiality when developing an auditor’s range.

- 6) 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?

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.

### Conforming and Consequential Amendments

- 7) With respect to the proposed conforming and consequential amendments to ISA 500 regarding external information sources, will the revision to the requirement in paragraph 7 and the related new additional application material result in more appropriate and consistent evaluations of the relevance and reliability of information from external information sources?

Yes.

### Request for General Comments

- 8) In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:
- a) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-540.

No comment.

- b) Effective Date—Recognizing that ED-540 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods ending approximately 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

As indicated earlier, we encourage that there be no undue delays in releasing this Standard. We believe that 18 months would provide a sufficient period, and agree that earlier application should be permitted and encouraged.

### Glossary of terms

ED	Exposure Draft
IAASB	International Auditing and Assurance Standards Board
IESBA	International Ethics Standards Board for Accountants
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing