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IAASB Deputy Director  
International Auditing and Assurance Standards Board  
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United States of America

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Dear Mr. James

**Proposed International Standard on Auditing 540 (Revised) Auditing Accounting Estimates  
and Related Disclosures**

Chartered Accountants Ireland (“the Institute”) is pleased to respond to *Exposure Draft, Proposed International Standard on Auditing 540 (Revised) Auditing Accounting Estimates and Related Disclosures* (“ED 540”). We welcome the International Auditing and Assurance Board’s (“IAASB”) ED 540 and we consider that the principles and procedures described in ED 540 are likely to reflect the practice already incorporated in the detailed methodologies of many audit firms.

We are supportive of the expressed intentions of IAASB to develop an auditing standard which seeks to enable auditors to respond appropriately to evolving financial reporting frameworks. While acknowledging the IAASB’s work in this regard we also have some concerns in relation to the extent to which this has been achieved in ED 540 and we articulate those in answer the consultation questions below.

We have the following general comments to make in relation to ED 540 in addition to our responses to the specific questions asked in the consultation paper. These are:

1) *Further consideration needed in relation to new concepts introduced in ED 540:*

We note the introduction in ED 540 of the new concepts of assessing inherent risk as ‘low’ and ‘not low’ as well as the analysis of the factors influencing the risks of material misstatement in relation to an accounting estimate; complexity, the level of judgement involved and estimation uncertainty. We consider that it will be necessary for IAASB to develop these concepts more fully and provide further

clarity as to their application. We provide some additional comments in this regard in answer to question 4 of ED 540 below.

2) *Balance between a principles approach and granular requirements:*

It is evident that, in developing ED 540, the IAASB has faced a challenge of managing the balance between providing auditors with principles to apply to the audit of accounting estimates as well as providing sufficiently granular requirements to ensure that auditors consistently apply those principles to specific accounting estimates. We consider that the standard should remain principles based and applicable to any accounting estimate. It may therefore be necessary for IAASB to develop separate guidance in relation to the application of those principles to specific accounting estimates for example in the format of International Auditing Practice Notes (IAPNs).

3) *Continuous review required:*

The approach taken by ED 540 will require continuous review of ISA 540 (Revised) after publication, in particular because of the following features of ED 540:

- (a) ED 540 includes more granular requirements than the extant version of this standard. The maintenance of this level of detail will require ongoing review of the ISA 540 (Revised).
- (b) As ED 540 seeks to meet the needs of auditors in relation to evolving financial reporting frameworks, the revised standard will require ongoing and continuous review to ensure it keeps pace with the ongoing evolution of global financial reporting frameworks.
- (c) We are keenly aware that the modern accounting standards, for example IFRS 9, which ED 540 intends to address, have not been implemented in most jurisdictions to date. Therefore it is likely that the experience of implementing those accounting standards may give rise to as yet unforeseen implications for auditors in their consideration of the ensuing accounting estimates. Consequently it will be necessary to review the ISA 540 (Revised) as the practical implementation of modern financial reporting frameworks takes place. Similarly, as we note in answer to question 1 below, we are strongly supportive of testing of ED 540, to the extent possible, before the final publication of ISA 540 (revised).

In addition to the general comments set out above we have considered the individual questions asked in the ED 540 and our responses to those questions are set out below.

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

We note from paragraph 5 of the explanatory memorandum to ED 540 that IAASB concluded that "a holistic revision of ISA 540 should be undertaken" rather than focusing solely on "audits of financial institutions arising from IFRS 9". We also note from paragraph 7 of the explanatory memorandum the IAASB purpose of "modernising ISA 540 for evolving financial reporting frameworks" and from

paragraph 3 that outreach by IAASB has included meetings with representatives of the International Accounting Standards Board (“IASB”). Accordingly, we understand that the revisions to ISA 540 have had a fair degree of focus on the major evolution in accounting for loan impairment under IFRS 9. We wish to make two points arising from this.

Firstly, we suggest that the revised ISA 540 should expressly note the areas where the "evolution of accounting frameworks" has already occurred and has added to and formalised the level of estimation required. We make this suggestion given the significant changes in revenue recognition arising from IFRS 15, the significant changes in the recognition and measurement of assets and liabilities arising from leasing contracts under IFRS 16, together with the imminence of more standardised measurement of insurance liabilities under IFRS 17 and new updated guidance of the measurement of uncertain tax positions under IFRIC 23, many involving estimation. For example, the list of examples of estimates at paragraph A1 of ED 540 is quite similar to the current ISA 540 and might benefit from adding some of the newer areas of estimation required by the updated requirements of IFRS and other accounting frameworks. We also consider that ongoing liaison with representatives of IASB, during the process of finalising ISA 540 (Revised), should assist in ensuring it keeps pace with evolving accounting frameworks as far as possible.

Secondly, we note from the annual reports of public companies that the process of adopting the new accounting standards such as IFRS 9 and IFRS 15 can be quite complex and protracted, and indeed in the majority of cases has not yet been completed. Consequently, there is a lack of experience with the actual methodology and systems by which entities will make the estimates required by these standards. In this context, we suggest that the IAASB consider how best to road test the proposals of ED ISA 540 to ensure, as far as possible, that its requirements will be fit for the purpose of auditing how entities make these estimates.

As noted above in our general comments, we consider it important for the revised ISA 540 to contain generic principles which can be applied to any accounting estimate. It would be appropriate for IAASB to develop separate guidance in relation to specific accounting estimates to support the application of the revised ISA 540.

**Question 2: Do the requirements and application material of ED-540 appropriately reinforce the application of professional scepticism when auditing accounting estimates?**

The application of professional scepticism to the audit of accounting estimates is essential. On balance, it is our view that ED 540 does appropriately reinforce the application of professional scepticism through requirements and guidance which, although not always explicitly referring to the concept of professional scepticism, require the appropriate mindset of the auditor. We welcome the inclusion of paragraph 23 and the requirement for the auditor to “stand back” and perform an overall evaluation of the audit evidence obtained whether corroborative or contradictory. However, additional guidance could be included earlier in ED 540 referencing how the auditor may deal with contrary evidence when it is discovered in performing the procedures and prior to the overall evaluation stage.

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

On balance we are not concerned with regard to the degree of scalability of the standard. We believe that even for a small entity “an audit is an audit” and when a relatively small entity has complex estimates in its financial statements then ED 540 applies in all its granularity, unless the auditor determines that there is low inherent risk in the estimate, and this is appropriate.

We note however that scalability is not addressed in the standard itself other than through the ‘low risk’ / ‘not low risk’ threshold. The terminology ‘low risk’ and ‘not low risk’ has not previously been used in ISAs and therefore we consider it necessary, in introducing this new concept, to make conforming amendments to the ISA 300 and ISA 315 as appropriate to reflect the concept of ‘low risk’ and ‘not low risk’ in these risk focused standards. It will also be necessary to include further application guidance to ensure consistent application of this threshold by auditors.

**Question 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?***
- 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 judgement by management and the potential for management bias, and estimation uncertainty?***
- 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?***

Whilst the requirement to consider the relevant factors in the assessment of risk in paragraph 13 should in concept assist the auditor in the more granular consideration of the risk of material misstatement of an estimate and their response to that risk, we expect that this may be difficult to apply in practice. By their nature most estimates where the risk is assessed as not low will involve all three of the outlined factors; complexity, the level of judgement involved and estimation uncertainty.

As set out in paragraph 15 of ED 540, ISA 330 requires the auditor to design and perform further audit procedures whose nature, timing and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level. In our view the requirement to obtain audit evidence in response to the factors in paragraph 13 is a significantly new concept that we have struggled to reconcile to the concept in ISA 330 of designing procedures that are responsive to the assessed risks of material misstatement. Our group spent a considerable amount of time reading and debating the meaning of paragraphs 14 to 19 and the related application material and therefore in our view these requirements as

currently drafted are not sufficiently clear to achieve consistent and appropriate application by practitioners.

***Question 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 the extant ISA 540, in evaluating whether management’s point estimate is reasonable or misstated?***

We are broadly supportive of the proposed amendments to remove the requirement to ‘narrow the range’ when developing an auditor’s range. As a result of now only including ‘reasonable outcomes’ as opposed to ‘all possible outcomes’ this should result in more appropriately defined and narrow ranges.

We consider the addition of further application material to clarify what is meant by ‘supported by the audit evidence’ would be beneficial. This expanded guidance should include, at a minimum, reference to ISA 500 Audit Evidence.

***Question 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?***

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.

***Question 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?***

We welcome the proposed amendments to ISA 500 as the use of external information sources is becoming more prevalent due to the increasing complexity of accounting estimates. However, we consider the related application guidance is not sufficiently clear regarding when some of the audit procedures in relation to third party information need to be undertaken. Any revised guidance should ensure that the procedures expected are practical and workable.

In line with our comments above we consider that field-testing of ED 540 will be essential to ensuring that the final revised standard supports auditors fully in achieving the objectives of the standard.

If there are any matters raised by us in this letter which you would like to discuss further we will be happy to do so. In that regard, please contact me directly at [karen.flannery@charteredaccountants.ie](mailto:karen.flannery@charteredaccountants.ie) or at + 353 1 637 7389.

Yours Sincerely



Karen Flannery

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