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Washington, DC 20548

July 25, 2017

Mr. Matthew Waldron  
Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, NY 10017

**GAO’s Response to the International Auditing and Assurance Standards Board’s April 2017 Exposure Draft, Proposed International Standard on Auditing 540 (Revised), *Auditing Accounting Estimates and Related Disclosures***

Dear Mr. Waldron:

This letter provides GAO’s response to the exposure draft, Proposed International Standard on Auditing (ISA) 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* (ED-540). GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

We support the International Auditing and Assurance Standards Board’s (IAASB) efforts to update the standards for auditing accounting estimates. However, we believe that the proposed standard could benefit from linking the audit procedures in paragraph 15(a) to the audit evidence required to be obtained in paragraphs 17 through 20. We believe that this approach will increase the clarity of the standard and will make it easier for auditors to effectively apply. Further, we suggest that the IAASB consider grouping the guidance in paragraphs 17 through 20 by procedures that evaluate evidence related to methods, data, and assumptions. We have found this approach to be useful in our audits of complex estimates in the federal government and believe that it may be easier to apply than the approach described in the proposed standard, which is organized by the factors complexity, judgment, and estimation uncertainty.

Our responses to IAASB’s specific questions follow. We believe that our suggestions will enhance the consistency of the standard with those promulgated by other standard setters.

**Specific Comments**

*Overall Questions*

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

We support the IAASB’s efforts to update ED-540 to address evolving financial reporting frameworks as they relate to accounting estimates. As indicated above, we agree with the requirements related to obtaining sufficient appropriate audit evidence in paragraphs 17 through 20. However, we believe that these requirements should be linked to the audit procedures in paragraph 15(a).

We also support the IAASB's efforts to update the objective of auditing accounting estimates and related disclosures. In addition, we support the requirement in paragraph 21, but we encourage the IAASB to provide additional application guidance related to paragraph 21(a), such as examples of the circumstances in which management might provide disclosures beyond those specifically required by the framework that are necessary to achieve the fair presentation of the financial statements as a whole.

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

We agree that the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates. We support the enhanced risk assessment requirements and the requirements to "stand back" and evaluate audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence.

*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?**

We believe that auditors should determine whether one or more of the audit procedures listed in paragraph 15(a) would provide sufficient appropriate evidence whether inherent risk is low or not low. In our view, the standard will be scalable if auditors assess and respond to risk of material misstatement and focus on the standard's objective to obtain sufficient appropriate evidence.

**4) When inherent risk is not low (see paras. 13, 15, and 17 through 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?**

We believe that the requirements support more effective identification and assessment of risks of material misstatement (including significant risks) relating to accounting estimates. We support the proposed standard's specific risk assessment requirements in paragraphs 10 through 13.

However, we believe that requirements for responding to risk of material misstatement could benefit from focusing on the requirement that auditors design and perform further audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement consistent with ISA 330. For example, we believe that it may not be practicable for auditors to develop an auditor's point estimate or range in certain situations, such as when the estimate is made using a highly complex model. Accordingly, we encourage the IAASB to provide flexibility by allowing auditors to use judgment in determining whether developing a point estimate or range will be responsive to assessed risks of material misstatement and provide sufficient appropriate evidence.

- b) Do you support the requirement in ED-540 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?**

We support the requirement in ED-540 for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by complexity, judgment, and estimation uncertainty in identifying and assessing risks of material misstatement.

However, in responding to risks of material misstatement and designing and performing further audit procedures, we suggest linking the audit procedures in paragraph 15(a) to the audit evidence required to be obtained in paragraphs 17 through 20. Also, the IAASB should consider grouping the guidance by procedures that evaluate evidence related to methods, data, and assumptions rather than organizing the proposed standard by the factors of complexity, judgment, and estimation uncertainty. As noted above, we have found that approach to be useful in our audits of complex estimates in the federal government and believe that it may be easier to apply than the approach described in the proposed standard. Also, we believe organizing the guidance in this way will support a scalable application of the standard.

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

As noted in our other responses, we encourage the IAASB to link the proposed objective-based requirements in paragraphs 17 through 19 of ED-540 to the procedures in paragraph 15(a).

- 5) Does the requirement in paragraph 20 (and related application material in paras. A128 through 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?**

We support the approach for establishing how the auditor's range should be developed, as it focuses on determining whether the range is reasonable rather than prescribing how to narrow the range.

- 6) Will the requirement in paragraph 23 and related application material (see paras. A2 through A3 and A142 through A146) result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate?**

We support the requirement in paragraph 23 to consider all the relevant audit evidence obtained, whether corroborative or contradictory. We also support the guidance in the related application material that notes when the auditor may conclude that the accounting estimate is reasonable and when the auditor should reconsider whether sufficient appropriate audit evidence has been obtained.

## *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?**

We support the proposed conforming and consequential amendments to ISA 500, *Audit Evidence*, regarding external information sources, including the following:

- The definition of external information source including application material to assist the auditor in determining whether audit evidence was from an external information source.
- Application material regarding factors related to the relevance and reliability of information obtained from an external information source, specific material on fair value measurements, and when management and the auditor use the same information source.

We also suggest that ED-540 reference ISA 500, paragraph 8, which discusses requirements for information to be used as audit evidence that has been prepared using the work of a management's expert. We believe that emphasizing the requirements for evaluating the work of a management's expert, as applicable, when auditing the accounting estimate will help ensure audit quality.

## *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.**

We are not providing comments in response to this question.

**(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.**

We believe that an 18-month transition period for the effective date is appropriate.

## **Other Comments**

While we appreciate the IAASB's efforts to provide an abundance of guidance to assist auditors in applying the standard, we suggest moving the information contained in the appendix to a separate guide or tool to increase the clarity and usability of the standard.

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Thank you for the opportunity to comment on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact me at (202) 512-3133 or [dalkinj@gao.gov](mailto:dalkinj@gao.gov).

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a long horizontal stroke at the end.

James R. Dalkin  
Director  
Financial Management and Assurance