



BY E-MAIL ONLY

Prof. Arnold Schilder
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Date: July 31, 2017

Subject: COMMENTS ON THE PROPOSED INTERNATIONAL STANDARD on AUDITING
540 (Revised): Auditing Accounting Estimates and Related Disclosures

Dear Prof Schilder,

1. The International Forum of Independent Audit Regulators (IFIAR) appreciates the opportunity to comment on the International Auditing and Accounting Standards Board (IAASB) request for input on “Proposed International Standard on Auditing 540 (revised) – Auditing Accounting Estimates and Related Disclosures” (Exposure Draft). As an international organisation of independent audit oversight regulators that share the goal of serving the public interest and enhancing investor protection, IFIAR is committed to improving audit quality globally through the promotion of high-quality auditing and professional standards, as well as other pronouncements and statements.
2. IFIAR’s objectives are as follows:
 - Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.
 - Promoting collaboration and consistency in regulatory activity.
 - Initiating and leading dialogue with other policy-makers and organisations that have an interest in audit quality.
 - Forming common and consistent views or positions on matters of importance to its members, while taking into account the legal mandates and missions of individual members.
3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all, of the members of IFIAR. However, the comments are not intended to include, or reflect, all of the views that might be provided by individual members on behalf of their respective organisation.



4. Where we did not comment on certain specific matters this should not be interpreted as either approval or disapproval by IFIAR.
5. We support a holistic revision of ISA 540. Auditing accounting estimates is an area of recurring inspection findings across jurisdictions. The recent IFIAR inspection survey¹ continues to indicate that the most pervasive inspection finding within engagement performance relates to the audit of accounting estimates. The survey findings point to difficulty auditors face when assessing the reasonableness of assumptions, performing sufficient risk assessment procedures, testing the accuracy of data used, or taking relevant variables into account in the audit of accounting estimates.

Enhancement in the Exposure Draft (ED)

6. We generally believe that the proposals in this ED are a step in the right direction and can help drive better audit quality by requiring auditors to perform risk assessment procedures specifically addressing factors relevant to accounting estimates. Conceptually requiring auditors to take into account the factors of complexity, judgment and estimation uncertainty and their related inherent risks when identifying and assessing the risks of material misstatement should lead to a more effective audit response, specifically in the area of complex estimates.
7. The ED emphasizes the importance of risk assessment being performed by auditors and moves away from the concept of additional procedures to be performed only in the event of a significant risk. We support this approach and believe it is likely to lead to a more appropriate audit response being developed, even if further clarifications still would be helpful in this regard (see following paragraphs).
8. We support the inclusion in the ED of paragraph 16 that echoes the requirement of ISA 330, paragraph 8 on the need to test internal controls when the auditor intends to rely on those internal controls or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. We believe this will raise auditor awareness of the requirement to consider the importance of internal controls in designing an audit response.
9. We also support the provisions (paragraph 23 of the ED) which refer to the need to consider all evidence obtained, including contradictory evidence, and the reasonableness of any significant variations between or within management's estimate or range and those developed by the auditor (see also our comment on explanatory material in paragraph 17 below).

¹[IFIAR Survey Report](#)



Risk assessment

10. The inherent risk assessment is a key element in the determination of the work effort to be performed in the audit of the estimates. As mentioned in paragraph 7 of this letter, we support the focus placed on an improved risk assessment regarding the audit of accounting estimates. We nevertheless believe the relationship, if any, between the different types of risk factors and the risk levels used in the ED should be further explained in the standard.
11. There is a need to further align and revise provisions of the extant ISA 315 dealing with risk assessment to ensure a proper understanding of how to assess low inherent, non-low inherent and significant risks in order to ensure consistency in application by auditors.
12. The determination of whether an estimate is low inherent risk or not and which of the risk factors are relevant are key elements of the revisions proposed in the ED. The IAASB should clarify whether estimates can only be assessed as low inherent risk where none of the risk factors are relevant or whether another basis for concluding on low inherent risks is appropriate. We also believe the ED should require that the auditor documents the risk assessment determination of low inherent risk estimates.
13. In addition, we foresee challenges in the execution of the inherent risk assessment in ED 540 as to whether inherent risk and control risk are to be assessed separately or in combination, which could lead to a different response in terms of work effort. We believe further clarification would help ensure consistency in the risk assessment procedures. Provisions described in paragraph A95 should be deleted from the ED to ensure the auditor understands that the audit response is based on inherent risk only, because A95 suggests that a combined risk assessment is permissible.

Work effort

14. The auditor is required under ISA 330 to design and perform further audit procedures if the procedures described in paragraph 15 a) of the ED (to be applied in low inherent risk situations) do not provide sufficient appropriate audit evidence. We believe this requirement could be made clearer by including the guidance included in paragraph A96 of the ED in the requirements of the ED.
15. The ED focuses on three factors for the risk assessment of estimates and provides requirements relating to the audit response in respect of each of these factors. Consistent with paragraph 2, the risk factors of judgment and complexity are interrelated with the estimation uncertainty risk factor. Because the concepts are not mutually exclusive, the requirements of paragraphs 19 and



20 that are applicable to estimation uncertainty should also be applicable in situations where inherent risk is not low based on the judgment or complexity risk factors.

16. In situations where the auditor believes that management has not appropriately understood or addressed the estimation uncertainty, we believe the auditor should first ask management to provide alternative assumptions. We suggest clarifying this requirement in paragraph 19 (b) of the ED, for example, by building upon some of the guidance included in paragraph A126.

Development of a range and estimation uncertainty

17. The development of an auditor's range or point estimate (to the extent possible) is only required by the ED if the auditor believes that management has not appropriately understood or addressed the estimation uncertainty. We believe this creates a high bar for this requirement and inhibits professional scepticism as the auditor's estimate or range provides a valuable means for challenging management's estimate.
18. Paragraph A144 indicates that auditors may need "to reconsider whether sufficient appropriate audit evidence has been obtained regarding the reasonableness of the amounts within the range" in situations where there are variations in ranges or point estimates which are material. We support the inclusion of guidance to this effect as we consider it relevant to promoting the exercise of appropriate professional scepticism by the auditor. However, we recommend including further requirements in the ED in this regard.

Terminology

19. We note that the ED requires the auditor to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework. However, as acknowledged in the Explanatory Memorandum to ED, ISA 700 uses the terms "appropriate" and "adequate", not "reasonable", in relation to disclosures. We have concerns about how the inconsistencies in terminology would be applied in practice and encourage the IAASB to give this further consideration.

Conforming ISA 500 amendments

20. We support the development of guidance to further the application of professional scepticism by the auditor on the use of data from external sources as audit evidence. The notion of "publicly available information" should nevertheless be clarified in ISA 500, since it could be understood as only open and free data, which is not necessarily the case with pricing services, which are available for those paying for the use of it.



21. Given the frequency in which companies use experts to assist in developing accounting estimates and the focus of the ED on evaluating management's process, selection and judgments, we would expect more emphasis on the fact that the auditor should apply the requirements of ISA 540 when management's assumptions are developed by management or, alike, when they are developed by an expert employed or engaged by management. We would like clarification in the standards so that the auditor fully considers the necessary evidence to be obtained when following ISA 500.8 for a management's expert.

Professional scepticism

22. The guidance included in paragraph A101 around considering "whether there were alternative concepts, techniques or factors, types of assumptions or sources of data" that might have been appropriate should help drive a more sceptical auditor mind-set. However, it is not clear to us why this consideration applies only to the 'complexity' risk factor and why this questioning attitude should not be further required by the ED.

Need for post-implementation review

23. We encourage the IAASB, following completion of this project, to gather stakeholder input via a post-implementation review in order to assess whether the changes have achieved the desired effects (e.g. whether the goals have been met and whether some challenges remain).

Should you wish to discuss any of our comments, please do not hesitate to contact me or Marjolein Doblado, Chair of the IFIAR Standards Coordination Working Group.

Yours faithfully,

Brian Hunt
Chair

Cc: Frank Schneider, Vice Chair,
Marjolein Doblado, SCWG Chair
Carl Renner, Executive Director