



Office of the  
Auditor General  
of Canada

Bureau du  
vérificateur général  
du Canada

August 1, 2017

International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, New York 10017  
UNITED STATES OF AMERICA

**RE: Invitation to Comment – Proposed ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures***

Thank you for the opportunity to provide feedback on the above Invitation to Comment. I am responding on behalf of the Office of the Auditor General of Canada.

Our response to the specific questions posed in the Invitation to Comment is provided below.

Sincerely,

Stuart Barr, CPA, CMA  
Assistant Auditor General

Enclosure

cc. Johanna Field, CPA, CA  
Principal, Auditing and Assurance Standards Board  
Auditing and Assurance Standards Board

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

Yes, ED-540 has been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates.

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

Yes, the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates.

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

No, ED-540 is not sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk.

The proposed standard is prescriptive on procedures the auditor must perform on “low” and “not low” risk. This reduces the auditor’s discretion to apply professional judgement on nature and extent of work within these two categories. This reduction reduces scalability.

**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, 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; however, we have concerns the proposed standard may not be clearly understood and consistently interpreted and applied.

We notice the proposed requirements for the risk assessment and response make specific reference to identifying and assessing significant risks; however, the related requirements and application materials do not specifically address significant risk. Instead, the proposed standard introduces new risk classifications of ‘low’ and ‘not low’.

For instance, paragraph 10 provides the ISA 315 requirement to determine if any identified risks are significant. Also, paragraph 15 provides the ISA 330 requirement to design audit procedures which respond to risk, including significant risks; however, related requirements (par. 15 through 20) and application materials provide two tiers of procedures for application when inherent risk is assessed as either ‘low’ or ‘not low’ with no reference to significant risk.

While we have inferred the meaning of ‘not low’ to be a range of risks which includes significant risks as well as risks assessed between low and significant; for greater clarity, we recommend the Board provide guidance to introduce the new risk classifications of low and not low and clarify how the requirements to identify and respond to significant risks are addressed by the proposed requirements of ED-540. For instance; consider adding wording such as the following to paragraph 15.

*An inherent risk assessment of ‘not low’ encompasses a range of possible risk assessments which include significant risks as well as risks assessed between low and significant.*

Additionally, paragraph 13 provides requirements for identifying and assessing risk of material misstatement and the auditor is required to conclude on a risk assessment; however, there is no reference to low or not low risks. Since the proposed standard requires application based on the auditor's assessment of low or not low risks, we recommend the proposed standard require the auditor to determine whether there are any 'not low' risks. We suggest adding wording such as the following to paragraph 13.

*The auditor shall determine whether, in the auditor's judgment, any of the accounting estimates identified have sufficient complexity, use of judgements and/or estimation uncertainty to give rise to an inherent risk of not low.*

In addition, we suggest the Board integrate the new risk classifications of low and not low within conforming amendments to ISA 315, ISA 330 and ISA 500.

**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 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.

**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, there is sufficient guidance provided by paragraphs 17 to 19 to support compliance with the requirements of paragraph 15b). We reiterate the need to clarify the meaning of the 'not low' risk assessment.

**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, the requirement in paragraph 20 (and related application material in paragraphs A128–A134) appropriately establishes how the auditor's range should be developed.

Yes, this approach will 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. In particular, this approach will be more effective in situations where accounting estimates are quite large relative to overall materiality and highly sensitive to variations in assumptions thereby making it difficult to narrow the auditor's range below performance materiality.

**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?**

Yes, paragraph 23 and related application material should result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate.

#### **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, we agree the proposed conforming and consequential amendments to ISA 500 regarding external information sources, will result in more appropriate and consistent evaluations of the relevance and reliability of information from external information sources.

#### **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 have no comment on potential translation issues.

**(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.**

Yes, in our view adoption of ISA 540 [Revised] 18 months after final approval would provide sufficient time for application.