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Matt Waldron — Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017

Dear Mr. Waldron:

Deloitte Touche Tohmatsu Limited (DTTL) is pleased to have the opportunity to provide comments on the Exposure Draft, proposed International Standard on Auditing (ISA) 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* ("ED-540" or the "proposed standard") issued by the International Auditing and Assurance Standards Board ("IAASB" or the "Board") in April 2017.

DTTL appreciates and commends the IAASB's substantial endeavors in the development of ED-540, and the Board's concentrated and expansive efforts to solicit input from regulators and other key stakeholders, which, DTTL believes, were instrumental in providing the appropriate direction and input for the project. DTTL understands the sense of urgency with which the project was undertaken, given the impending effective date of International Financial Reporting Standard (IFRS) 9, *Financial Instruments*, and the resulting challenges related to auditing expected credit losses. DTTL acknowledges that the auditing of accounting estimates is often one of the most difficult aspects of an audit, especially if the accounting estimates are more complex, involve more use of judgment by management, and have higher levels of estimation uncertainty; however, many of the difficulties are not unique to the auditing of expected credit losses. DTTL therefore concurs with the Board's call for prompt action to further re-focus the auditor's attention on the important topic of auditing accounting estimates. DTTL also supports the fundamental approach taken in ED-540 to enhance and expand the requirements and guidance pertaining to the auditor's identification and assessment of risks of material misstatement for accounting estimates, as well as the related auditor's work effort.

Impact on Audit Quality

DTTL believes that the positive direction taken by the IAASB in enhancing and providing for a more granular risk assessment process in ED-540 will support the auditor's efforts to drive further quality improvements related to the auditing of accounting estimates. Targeting the auditor's work efforts on the risk assessment process, in particular focusing the auditor's attention on those matters that are the most difficult to audit and particularly unique to the auditing of accounting estimates, is the appropriate way forward. This approach will better encompass the anticipated changes resulting from new accounting standards that increasingly involve difficult or complex accounting estimates[1], as well as address the related scrutiny and continued interest by regulatory and audit oversight bodies and other key stakeholders in this area.

DTTL notes that challenges pertaining to the auditing of accounting estimates cannot be resolved via the standard-setting process alone. Appropriate execution by auditors of the requirements in the standards, taking into account the specific facts and circumstances relevant to the engagement and the specific estimate involved, is equally important. Auditors need to be diligent and careful in considering the nature and circumstances relevant to each individual estimate, and in planning and performing procedures that will be specifically responsive to the related risks. However, it is also the opinion of DTTL that tangible improvements in audit quality are most readily realizable when the auditing standards provide for clear, executable requirements that are capable of being understood and operationalized when auditing any type of accounting estimate. As such, DTTL is concerned that ED-540, as currently drafted, may not achieve the ultimate objective of driving improvements in audit quality due to the perceived complexity of the proposed standard and lack of clarity as to how its requirements should be adapted and applied to different types of estimates. DTTL's specific concerns in this regard are discussed below and in **Appendix I** where the responses to the questions in the IAASB's Explanatory Memorandum accompanying ED-540 are addressed.

Risk Assessment Process

DTTL concurs with the renewed emphasis and focus on the risk assessment process for accounting estimates in the proposed standard; however, DTTL does not believe that ED-540 provides the auditor with a sufficiently clear "roadmap" that sets out how to apply requirements to the various accounting estimates recognized or disclosed in the financial statements, and in the related disclosures to the financial statements. In addition to the more specific details provided in **Appendix I** (**see response to question 4**), DTTL would like to draw attention to the following overall comments:

Risk Assessment Procedures

DTTL agrees with the enhanced requirements in paragraph 10 of ED-540 that set forth the specific areas of focus relating to accounting estimates that should be addressed when obtaining an understanding of the entity and its environment, including internal control over financial reporting. This detailed and thorough understanding is instrumental in "setting the stage" for the auditor to effectively identify and assess risks of material misstatement (including as applicable, taking into account the effect of complexity, use of judgment by management, and estimation uncertainty (the "three factors")). The proper identification and assessment of risks of material misstatement is critical to effectively auditing accounting estimates, and also to scaling the necessary audit responses to be commensurate with the risks and their relative significance. In order to reinforce the scalability aspects of this requirement, DTTL believes that application material may be appropriate to clarify for the auditor that this understanding as required by paragraph 10 of ED-540 may be effectively performed at the entity-level and not necessarily at the individual estimate-level.

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[1] For the purposes of this comment letter, simple accounting estimates are those that are less complex, involve less use of judgment by management, and have lower levels of estimation uncertainty. Likewise, difficult or complex accounting estimates are those that are more complex, involve more use of judgment by management, and have higher levels of estimation uncertainty.

Complexity, Use of Judgment by Management, and Estimation Uncertainty

DTTL concurs and supports the approach taken in ED-540 that the three factors identified are necessary to be taken into account when identifying and assessing risks of material misstatement for all accounting estimates. The definition of an accounting estimate notes that “the measurement of [the monetary amount] is subject to estimation uncertainty.” Consequently, by definition, estimation uncertainty is present in all accounting estimates and this factor should therefore likely be relevant for the identification and assessment of risks of material misstatement for all accounting estimates and the related further audit procedures. However, the relevance and significance of these factors will vary from one estimate to another; for example, they may be of lesser importance when dealing with simple accounting estimates.

DTTL also believes that the three factors are interrelated and inextricably linked, and considering them in isolation will likely not be the most efficient or effective approach to identifying and assessing risks of material misstatement. As currently structured, ED-540 does not clearly articulate the interplay of all the factors throughout the risk assessment process, and this is exacerbated by the requirements in paragraphs 17-19 of ED-540 being focused on each factor in isolation. In an effort to draw out the interplay between the factors, DTTL believes that it would be beneficial to more clearly indicate that the factors addressed by paragraph 13 are to be considered collectively. DTTL further suggests that the strict delineation between each of the factors as separately described in paragraphs 17-19 of ED-540 be eliminated, as in practice, auditors often do not necessarily consider the characteristics attributed to the three factors and the related responses (as described in and required by ED-540) in a strictly linear manner (e.g., paragraph 17c attributes the interpretation of contractual terms to the factor of “complexity”; however, the interpretation of contractual terms may also in practice be viewed as “use of judgment by management”).

In addition, ED-540 is unclear as to how the three factors are “taken into account” when assessing whether “inherent risk is low” or “inherent risk is not low.” It is also unclear that once the determination of inherent risk is made, whether this determination needs to apply to all risks of material misstatement associated with the accounting estimate, or whether it is possible that there could be varying assessments of risks of material misstatement for a single accounting estimate (and if so, how the requirements of the proposed standard would then be applied). In practice, it is often the case that there are multiple risks of material misstatement relating to an accounting estimate and some will be assessed on the lower end of the spectrum, while others may be higher or significant risks.

Furthermore, when there is more complexity, more use of judgment by management, and higher levels of estimation uncertainty surrounding the making of an accounting estimate, these factors directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately the persuasiveness of the audit evidence needed. DTTL believes, therefore, that it is very difficult to prescribe required further audit procedures in order to consistently result in sufficient appropriate audit evidence about whether the accounting estimates are reasonable in the context of the applicable financial reporting framework, as this determination will always be a matter of professional judgment. Therefore, paragraphs 17-19 of ED-540 may also be viewed as limiting further audit procedures only to risks of material misstatement that result discretely from the three factors, given the construct of the paragraphs and the seemingly narrow focus of each one. It is also important for the auditor to be aware that these three factors are not necessarily the only relevant factors to be considered when identifying risks. Paragraph 13 of ED-540 makes reference to “relevant factors, including” complexity, use of judgment by management, and estimation uncertainty, thereby implying that there are other factors that may be applicable when identifying and assessing risks of material misstatement. Similarly, there is a specific reference in paragraph 26 of ED-540 to “other relevant factors" when communicating with those charged with governance. Although the guidance in paragraph A78 of ED-540 provides some indication of the other relevant factors, these may be overlooked given the emphasis that is placed on the three factors throughout the requirements of the proposed standard. Given the circumstances of the engagement, it may well be possible that the relevant factors addressed in paragraph 78 of ED-540 could be aligned with, and may need to be considered equally with, the factors of complexity, use of judgment by management, and estimation uncertainty.

Consequently, based on the matters highlighted above, DTTL believes that ED-540 should be amended. In particular, DTTL recommends a two-pronged approach to re-drafting paragraph 13 of ED-540 that will appropriately achieve the additional focus on the auditing of accounting estimates when applying ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* (ISA 315 (Revised)). First, paragraph 13 of ED-540 should be revised to allow for a more holistic and complete approach to identifying and assessing risks of material misstatement for all accounting estimates. The purpose of the enhanced requirement paragraph will be to identify risks of material misstatement at the right level and assess them appropriately, such that the further audit procedures are responsive and result in sufficient appropriate audit evidence. This paragraph and related application material should also make it more clear that for difficult or complex accounting estimates, there will likely be more risks of material misstatement and also that they are likely to be assessed as higher or significant. For simple accounting estimates, there will be fewer risks of material misstatement and they may be assessed as lower or low. Second, DTTL suggests making it clearly apparent that the auditor has overall strategies to use when auditing **all** accounting estimates, not just for those where inherent risk has been assessed as "low." DTTL strongly believes that these strategies are conceptually sound and intuitive and should be used for providing the overall approach to auditing accounting estimates, regardless of the assessed risk (**see response to question 4 in Appendix I**). By directing the auditor to perform a thorough and complete risk assessment for all accounting estimates and to design responses to the risks in the context of an overall strategy for the accounting estimate as a whole, it will not be necessary to further categorize assessed risks of material misstatement into the categories of "inherent risk is low" or "inherent risk is not low." This approach will also better align with ISA 315 (Revised), and DTTL believes it is also consistent with the revisions to ISA 315 (Revised) that are currently being contemplated by the IAASB.

Data and Assumptions

Similar to the delineation of the presentation of the three factors, the descriptions of data and assumptions have also been separated in the proposed standard. In practice, auditors often refer to and think of "data and assumptions" as a combined concept, and do not necessarily strictly bifurcate the two items. Different auditors may even have different views on whether an item is considered data or an assumption (e.g., different views may exist as to whether terms of a contract are to be viewed as "assumptions" rather than "data" in the context of a particular accounting estimate or for different types of estimates). The nature of an estimate might cause a particular item to be viewed as data in some situations, but as an assumption in others. DTTL acknowledges that the application material describes both data and assumptions; however, given the longstanding history of auditors considering these items together and the practical challenges in consistently determining their discrete categorization, DTTL believes that this application material will not adequately address the risk that the work effort requirements of ED-540 are inappropriately applied (e.g., due to inconsistencies in views as to whether an item is either data or an assumption, or both).

In addition, DTTL notes that the concepts of both data and assumptions are inconsistent in how they are discussed in paragraphs 13, 17, and 18 of ED-540. For example, paragraph 13(a) of ED-540 (which addresses complexity) does not address assumptions; however, paragraph 17 of ED-540 (which also addresses complexity) *does* address data and assumptions in sub-bullets (a) and (d), but sub-bullets (b) and (c) only address data. As there appears to be a disconnect between paragraphs 13(a) and paragraph 17 of ED-540, DTTL suggests that alignment of the concepts in 13(a)/17, 13(b)/18, and 13(c)/19 of ED-540 be reconsidered (and that both data and assumptions are consistently addressed) in conjunction with DTTL's suggestions for modifying these paragraphs (**see response to question 4 in Appendix I**).

DTTL also notes that the concept of "significant data" is introduced in paragraph 10(e)(iii) of ED-540. Unlike "significant assumptions," the term "significant data" is not used in financial reporting frameworks and therefore will not have the same level of general understanding as to what it means. DTTL does not believe that the application guidance in paragraph A35 of ED-540 provides sufficient direction to auditors as to how to identify "significant data". DTTL also notes further that the revised management representations proposed by ED-540 would require management representations about significant data. Absent a very clear definition, this would be a very challenging, if not impossible, representation for management to provide. DTTL does not believe that the concept of "significant data" is necessary for the application of ED-540. When performing procedures, the auditor should consider the data used by management to make the accounting estimate based on its nature and source, including considerations related to the relevance and reliability of the data. DTTL therefore recommends the deletion of "significant" as a qualifier to data throughout the proposed standard.

Scalability

Although DTTL acknowledges the commitment and efforts of the IAASB to introduce scalability into ED-540, DTTL does not believe that it is easily scalable in its current format. The concept relating to a spectrum of risk is grounded in ISA 315 (Revised), and auditors are already familiar with the notion that not all risks are of equal significance, with certain risks being at the lower end of the spectrum and others at the higher end, with significant risks of material misstatement being those at the far end. Auditors and firms have adopted methodologies that address the concept of a risk spectrum; however, different firms will likely have done this in different ways and may not in all cases include a specific categorization of "low inherent risk." Therefore, introducing the specific terminology of "inherent risk is low" and "inherent risk is not low," and using this determination as the driver of the auditor's response may cause confusion and differences in interpretation. DTTL believes that scalability will be more effectively addressed by the granular identification and assessment of risks of material misstatement using the approach outlined above, as well as the professional judgment of the auditor. For example, for simple accounting estimates with less complexity, lesser use of judgment by management, and lower levels of estimation uncertainty, this may lead to the identification of fewer risks or risks at the lower end of the risk spectrum; likewise, for difficult or complex accounting estimates that involve more use of judgment by management and have higher levels of estimation uncertainty, this may lead to the identification of more risks of material misstatement. **Appendix I** (**see response to question 3**) contains additional detailed observations and recommendations relating to scalability.

Linkage to Existing ISAs

In an effort to further emphasize that the requirements relating to the risk assessment process in ED-540 are <u>in addition</u> to those already encompassed in ISA 315 (Revised) and ISA 330, *The Auditor's Responses to Assessed Risks* (ISA 330), thought should be given by the IAASB to using consistent messaging when certain ISAs are "supplemental" to foundational auditing standards. For example, using the phrase "special considerations," or providing a more comprehensive lead-in to the additional requirements in ED-540, drawing more extensively from concepts in ISA 315 (Revised) and ISA 330, may be ways of more clearly emphasizing the linkage between ED-540 and other ISAs.

Consistency of Global Standards

Consistency of global auditing standards serves to enhance audit quality, and therefore serves the public interest. To that end, DTTL is aware of the recent release by the Public Company Accounting Oversight Board (PCAOB) of Proposed Auditing Standard, *Auditing Accounting Estimates, Including Fair Value Measurements and Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2017-002, June 1, 2017; PCAOB Rulemaking Docket No. 043). DTTL acknowledges the efforts of the IAASB to engage with the PCAOB, but notes the differing approaches taken to the proposed revisions to the standards addressing the auditing of accounting estimates. DTTL believes that such diversity will make it increasingly difficult to develop global audit methodologies and related implementation guidance on a consistent basis and will lead to practical challenges. In finalizing ED-540, DTTL recommends the IAASB consider the PCAOB proposal, as well as the related responses, and continue to engage with the PCAOB in order to attempt to align the final standards to the greatest extent possible.

Conclusion

While DTTL is supportive of the general direction the IAASB has taken, DTTL does believe that aspects of ED-540 should be re-visited to clarify the risk assessment and work effort to be performed by the auditor. DTTL appreciates the wide array of issues relating to the auditing of accounting estimates being addressed by the IAASB, especially in those areas most affected by complexity, the use of judgment by management, and estimation uncertainty. DTTL believes that the comments articulated in this letter will assist the IAASB as it continues its deliberations. DTTL strongly encourages the Board to continue to move forward with revisions to ED-540 as a matter of urgency.

DTTL's comments on ED-540 are addressed as follows:

Appendix I. Response to Requests for Specific Comments

Appendix II. Editorial Comments and Other Recommendations

* * * *

DTTL appreciates the opportunity to provide perspectives on ED-540 and would be pleased to discuss this letter with you or your staff at your convenience. If you have any questions, please contact me via email (cbuss@deloitte.ca) or at +1 604 640 3313.

Very truly yours,

Calvin H. Buss, FCPA, FCA
Senior Managing Director, Global Audit Quality
Deloitte Touche Tohmatsu Limited

APPENDIX I

RESPONSE TO REQUESTS FOR SPECIFIC COMMENTS

DTTL's responses to the detailed questions included in the IAASB's Explanatory Memorandum accompanying the proposed standard are set forth in this appendix. In these comments, recommended additional text is shown using **bold underline**; recommended deletions to the text are shown using double ~~strikethrough~~.

Overall Questions

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

While DTTL believes that ED-540 can be amended to better articulate the auditor's identification and assessment of risks of material misstatement as highlighted and addressed in this comment letter, DTTL agrees that the IAASB has made many enhancements to ED-540 that will allow for auditors to deal with the evolving financial reporting frameworks, including as it relates to new accounting standards where the effective date is imminent (e.g., IFRS 9).

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

DTTL concurs with the direction the IAASB has taken in strengthening the requirements and guidance surrounding the actions auditors are to take when incorporating the fundamental attitude of professional skepticism in the audit. DTTL agrees that it is not necessary to actually use the phrase "professional skepticism" throughout ED-540. This approach would ultimately necessitate ensuring similar terminology be inserted throughout the ISAs. Regardless, DTTL does not believe that the mere insertion of the words "professional skepticism" into the requirements in ED-540 would translate into clearly executable actions on the part of the auditor. DTTL believes that the enhanced and granular risk assessment process to be undertaken by the auditor in ED-540 provides for a better basis to critically challenge management's accounting estimates and develop effective audit responses. This emphasis on risk assessment in turn reinforces the underlying concept of remaining professionally skeptical.

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?

The response in this area should be read in conjunction with DTTL's comments on *Scalability* in our cover letter, as well as DTTL's proposals on restructuring ED-540 (see detailed response to question 4 below), both of which DTTL believes will improve the efforts of auditors as it relates to scaling with respect to auditing accounting estimates. Currently, the "roadmap" for auditing accounting estimates that are "simple" is not clear in ED-540, and in DTTL's opinion will lead to confusion and misapplication in practice.

DTTL also believes that providing examples of accounting estimates falling into specific inherent risk categories, such as those in paragraphs A72 (low inherent risk) and A73 (inherent risk that is not low) of ED-540, may negate the professional judgment to be applied by the auditor depending on the facts and circumstances of the engagement and different accounting estimates. These examples appear to create an expectation for the auditor to categorize and address the accounting estimates listed in these paragraphs in a prescribed manner. DTTL does not believe this is the underlying intent of the proposed standard, and would recommend striking paragraphs that suggest a prescribed response or an assumption that an accounting estimate is “simple.” In addition, these examples also create the impression that the assessment of inherent risk is at the level of the estimate as a whole and not at the risk of material misstatement level. In reality, the number and nature of individual risks of material misstatement will vary for different estimates. The requirements and related application guidance do not clearly address this point or deal with how the auditor would be expected to develop an overall strategy for auditing an estimate where the related risks of material misstatement include risks that are assessed as “low” and others that are assessed as “not low.”

Further, when reading the application material DTTL is concerned with the added emphasis placed on “Considerations specific to smaller entities.” While DTTL understands and acknowledges the use of such paragraphs throughout the ISAs to draw the auditor’s attention to specific matters that may be pertinent to certain smaller constituents, the special considerations applicable to auditing accounting estimates do not seem to lend themselves to being identified by the size of an entity. Rather, identifying and assessing risks of material misstatement is required irrespective of the size of an entity (and a very small entity could have difficult or complex accounting estimates with more complexity, involve more use of judgment by management, and have higher levels of estimation uncertainty).

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?

Please see combined response at end of question 4.

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?

Please see combined response at end of question 4.

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?

Please see combined response below.

As discussed in our cover letter, DTTL believes that revisions are necessary in order to more clearly address the requirements of the auditor to identify, assess, and respond to risks of material misstatement relating to auditing accounting estimates. In particular, DTTL believes ED-540 needs to be revised such that:

(1) Paragraph 13 of ED-540 is strengthened and enhanced to incorporate the matters

previously included in paragraph 17 and 18 of ED-540 (with modifications) as well as place the focus on the impact, and interplay, of the three factors in identifying and assessing risks.

(2) A new paragraph is inserted after paragraph 14 of ED-540 which includes the strategies for auditing an accounting estimate (previously required in paragraph 15a of ED-540) and makes it clear that these are to be used in auditing all accounting estimates (including addressing all the risks of material misstatement relating to each estimate). This would help with providing necessary clarification that the strategies are appropriate for auditing all estimates, but would also focus the auditor's attention on the need for and importance of dealing with specific responses to all risks of material misstatement identified in paragraph 13 of ED-540.

(3) The current structure and ordering of the requirements is reconsidered as the work flow is not intuitive and will therefore not be easily understood and applied.

The table below sets forth these recommendations in more detail. In addition, the recommendations below also encompass certain other suggestions intended to streamline the requirements (any editorial or other comments related to these paragraphs are separately addressed in **Appendix II**):

Paragraph	**Action**
Paragraph 9A	Include a new paragraph under the heading "Determining the Need for Specialized Skills and Knowledge." The new paragraph would combine the proposed requirements in paragraphs 12 and 14 of ED-540 and address the need for the auditor to determine whether specialized skills or knowledge are necessary in order to effectively execute the risk assessment process for auditing accounting estimates, including identifying and assessing risks of material misstatement and designing and performing further audit procedures to respond to such risks. DTTL recommends placing this paragraph before paragraph 10 of ED-540 because of its overarching nature and notes that it may also be appropriate or necessary for engagement team members with specialized skills or knowledge to be involved in the procedures to address the requirements of paragraph 10 of ED-540.
Paragraph 10	Retain.
Paragraph 11	Retain.
Paragraph 12	Delete. Combine with paragraph 14 of ED-540 and include as paragraph 9A of ED-540.
Paragraph 13	Retain. The three factors should inform the auditor's identification and assessment of risks of material misstatement. In addition, the matters in paragraphs 17 and 18 of ED-540 are essentially considerations of risks, and are therefore applicable in identifying and assessing risks of material misstatement. As such, DTTL suggests that the matters in paragraphs 17 and 18 of ED-540 be reworded as auditor considerations. For example, paragraph 17(c) of ED-540 currently states that "the auditor shall obtain

	sufficient appropriate audit evidence about the following matter…Whether management has appropriately understood or interpreted significant data, including with respect to contractual terms." This could be re-written as part of identifying and assessing risks of material misstatement in paragraph 13(a) of ED-540 and state "…Complexity in making the accounting estimate, including…the extent to which management has appropriately understood or interpreted significant data, including with respect to contractual terms." Furthermore, given that estimation uncertainty is an inherent characteristic underpinning all accounting estimates. The interplay between the three factors should be highlighted, as they all may have an impact on determining risks of material misstatement, but to varying degrees. It should also be made clear in paragraph 13 of ED-540 that an accounting estimate may have multiple risks of material misstatement, and that each risk may have a different level of assessed risk.
Paragraph 14	Delete. Combine with paragraph 12 of ED-540 and include as paragraph 9A of ED-540.
Paragraph 14A	Insert a new paragraph including the three strategies identified in paragraph 15(a) of ED-540. One of the three strategies (or a combinations thereof) would be selected by the auditor as being most responsive to the identified and assessed risks of material misstatement for each accounting estimate. Inclusion of the three strategies would also serve to remind auditors that events occurring up to the date of the auditor's report may provide sufficient appropriate audit evidence. The ability to use this strategy to address risks of material misstatement where there is higher inherent risk is not readily apparent and masked by the complexity of paragraphs 13-19 of ED-540. DTTL believes, however, that it should be very clear that use of this strategy is permitted as, in appropriate circumstances, it can be efficient and effective.
Paragraph 15 – first sentence and last paragraph	Retain.
Paragraph 15a	Delete, given that the focus on risks of material misstatement, and the introduction of three strategies reflected in paragraph 14A of ED-540, would allow for an appropriately focused auditor response when designing and performing further audit procedures. Application guidance can be added to explain this further as considered necessary.
Paragraph 15b	Delete, given that the focus on risks of material misstatement, and the introduction of three strategies reflected in paragraph 14A of ED-540, would allow for an appropriately focused auditor response when designing and performing further audit procedures. Application guidance can be added to explain this further as considered necessary.
Paragraph 16	Retain.
Paragraph 17	Delete. Included in paragraph 13 of ED-540 above.
Paragraph 18	Delete. Included in paragraph 13 of ED-540 above.

Paragraph 19	Unlike paragraphs 17 and 18 of ED-540, (which essentially focus the auditor on performing procedures to address risks related to complexity and judgment), paragraph 19 of ED-540 addresses procedures related to (1) management's considerations around estimation uncertainty and (2) obtaining sufficient appropriate audit evidence. Therefore, DTTL believes that this paragraph should be broadly retained in its current form; however, the further audit procedures should be linked only to those estimates that have risks of material misstatement related to estimation uncertainty that fall towards the higher end of the spectrum of risks. Consequently, DTTL recommends that the work effort should be specific to estimates with high estimation uncertainty.[2] Estimation uncertainty is inherent in all accounting estimates and paragraph 7(b) of ISA 330 requires "more persuasive audit evidence the higher the auditor's assessment of risk." In this instance where there is one or more risks of material misstatement associated with high estimation uncertainty as determined by paragraph 13 of ED-540 (when identifying and assessing risks of material misstatement) then DTTL suggests that the procedures in paragraph 19 of ED-540 should be required.
Paragraph 20	Retain.
Paragraph 21	Retain.
Paragraph 22	Delete. Consider including a reference to existing requirements in paragraphs 26 and 27 of ISA 330. No need to align with "inherent risk is not low" because that concept would no longer be included in the requirements pursuant to the recommendations above (see additional commentary relating to the "Stand Back" below).
Paragraph 23	Retain with additional application guidance describing that the assessment needs to take place at the individual accounting estimate level and then in the aggregate when considering all accounting estimates (**see response to question 6**).

Note: The related application material to these requirement paragraphs would need to be realigned, amended, or deleted accordingly.

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?

DTTL concurs with the approach taken by the IAASB in the development of the range as set forth in paragraph 20 of ED-540. DTTL believes that the proposed requirements to support amounts in the range with audit evidence are consistent with the ISAs overall, while allowing for the appropriate level of professional judgment to be applied by the auditor. DTTL also believes that additional guidance would be helpful to clarify as it relates to paragraph 20(a) of ED-540 that discrete audit evidence is not needed for every point within the range, but rather that the totality

[2] The concept of high estimation uncertainty is addressed in paragraph 9b of ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

of audit evidence needs to be sufficient and appropriate to support the conclusion about the reasonableness of the auditor's range overall.

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?

DTTL believes that it is beneficial to clarify that when the auditor concludes an accounting estimate is not reasonable, a misstatement exists. The clarification of the requirement in paragraph 23 and the related application material in paragraphs A142–A146 of ED-540 should result in a more consistent determination of a misstatement, especially when the auditor is required to evaluate management's point estimate as noted in paragraph A145 of ED-540.

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?

DTTL notes that the extant requirement in paragraph 7 of ISA 500, *Audit Evidence* (ISA 500), relates to the auditor considering the relevance and reliability of the information to be used as audit evidence. Audit evidence, as described in paragraph 5(c) of ISA 500, includes information "from other sources." Information from an external information source (EIS) is an "other source." Therefore, the change to paragraph 7 in the amendments to ISA 500 in ED-540 that states "…the auditor shall consider the relevance and reliability of the information to be used as audit evidence, <u>including information obtained from an external information source</u>" seems confusing and duplicative, as the use of "audit evidence" in the sentence already encompasses an EIS. Furthermore, the application material in paragraphs A26-A33 in the amendments to ISA 500 in ED-540 addresses the fundamental concepts of what makes evidence sufficient and appropriate (relevant and reliable) and how the auditor makes that determination. Therefore, inclusion of this new phrase does not seem to fit with the requirement (and if an EIS is mentioned, then it would seem to make sense to also mention audit evidence from a management expert or audit evidence that is internally generated). Therefore, DTTL suggests deleting this phrase from paragraph 7 in the amendments to ISA 500 in ED-540.

DTTL also notes that the emphasis/focus on the new application material paragraphs pertaining to EIS is heavily slanted toward when <u>management</u> uses the EIS; there is little discussion on when the auditor uses an EIS. Therefore, one could interpret the amendments to ISA 500 in ED-540 as only being relevant considerations when management uses the EIS, and the auditor uses such information as audit evidence. As the auditor may also use information from an EIS <u>that management does not use</u>, this lack of clarity may cause confusion and inconsistency in evaluating information from an EIS used as audit evidence (i.e., different treatment of information from an EIS when such information is not used by management). Moving the new application material to ISA 540 may more effectively alleviate the "gap" that currently exists related to when the auditor uses an external information source (and such gap could be more holistically addressed by the IAASB in an Audit Evidence project in the future). Furthermore, DTTL believes that placing this guidance relating to EIS in ISA 540 as opposed to ISA 500 would be of greater benefit to auditors as they would then have the relevant guidance included within the proposed standard to which EIS is applicable.

DTTL has provided additional editorial comments and recommendations in **Appendix II**.

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 ED-540.

Consistent with views expressed in this comment letter, DTTL notes that where possible the language should be as crisp and concise as possible. Opportunities to eliminate redundancies and repetitious phrases will assist in ensuring that the intention of requirements and the related application material are not "lost in translation." These suggestions are included in DTTL's listing of editorial comments in **Appendix II**.

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.

Many aspects of the proposed standard relate to risk assessment, and therefore need to be incorporated into the auditor's risk assessment process as it relates to auditing accounting estimates early in the audit process. DTTL therefore recommends that the effective date be for financial reporting periods *beginning* approximately 18 months after the approval of a final ISA. DTTL also recommends that early adoption of the proposed standard be encouraged given the imminent effective date of certain financial reporting frameworks, such as IFRS 9.

Other Areas

Applicability of ED-540 to All Estimates (paragraphs 2 and 3)

DTTL believes that enhancing the special considerations pertaining to the auditing of accounting estimates in ED-540 is responsive to dealing with evolving financial reporting frameworks. DTTL notes, however, that a more balanced approach needs to be struck in the introductory paragraphs in ED-540 so as to clarify to auditors that ED-540 is applicable across both different types of entities and accounting estimates; that is, neither the size of an entity nor the nature of the accounting estimate is the determining characteristic in how to audit an accounting estimate. ED-540 encompasses those accounting estimates that are perceived to be "simple" as well as those accounting estimates where the three factors highlighted in ED-540 of complexity, use of judgment by management, and estimation uncertainty play a greater role in the determination of risks of material misstatement.

To that end, DTTL proposes that paragraph 2 of ED-540 be amended as follows to more directly focus on what an accounting estimate is, and introduce the concept of the three factors to the auditor. DTTL also suggests that the 4th and 5th sentences (which DTTL is suggesting be deleted from paragraph 2 of ED-540) be included as application material to paragraph 13 of ED-540.

2. Many financial statement items are susceptible to an inherent lack of precision in their measurement, which is referred to as estimation uncertainty. In the ISAs, such financial statement items are referred to as accounting estimates. Accounting estimates vary widely in nature, and their measurement may also be subject to, or affected by, complexity and the need for the use of judgment by management**, as well as**~~. The extent to which they are subject to or affected by complexity and judgment is often related closely to the extent to which they are subject to or affected by estimation uncertainty. Accordingly, the auditor's identification and assessment of the risks of material misstatement relating to accounting estimates, and the auditor's responses to those assessed risks are affected by these three factors, and~~ the interrelationship among ~~them~~ **these three factors**. ~~(Ref: Para: A1, Appendix 1, Appendix 2)~~

DTTL suggests the insertion of paragraph 2A of ED-540 that would clearly highlight to the auditor that ED-540 is also relevant for those accounting estimates that are not as susceptible to the three factors identified in paragraph 2 of ED-540.

2A. Certain accounting estimates are subject to less complexity, the use of less judgment by management, and lower levels of estimation uncertainty. This ISA is also applicable when the auditor identifies and assesses risks of material misstatement, and develops the appropriate responses, relating to these accounting estimates.

In an effort to more succinctly describe the nature of those more difficult or complex accounting estimates, DTTL also recommends that paragraph 3 of ED-540 be pared down to focus attention on those underlying concepts that drive the auditor's work effort as it relates to responses to the risk assessment procedures. Much of what is highlighted in paragraph 3 of ED-540 is repeated in the requirements and will therefore already be considered by the auditor (and is therefore not necessary to also discuss in paragraph 3 of ED-540).

3. When an accounting estimate is being made, its susceptibility to misstatement may increase because of ~~the need to:~~ **considerations relating to complexity, use of judgment by management, and estimation uncertainty, or any combination thereof. In identifying and assessing risks of material misstatement for those accounting estimates that are affected by more complexity, use of more judgment by management, and higher levels of estimation uncertainty, the nature, timing, and extent of the further audit procedures designed and performed would likely be affected. In such circumstances, the further audit procedures would be designed to obtain more persuasive evidence thereby being appropriately responsive to the assessed risks of material misstatement at both the account and assertion level.**

~~(a) With respect to complexity:~~

~~(i) Apply appropriate specialized skills or knowledge in the selection, design or application of the method used to make the accounting estimate, including when the method involves complex modelling.~~

~~(ii) Appropriately consider the relevance and reliability of the data used, whether the data is obtained from internal sources or from external information sources.~~

~~(iii) Maintain the integrity of the data used.~~

~~(b) With respect to the use of judgment by management:~~

~~(i) Appropriately take into account available information when selecting methods, assumptions, or data.~~

~~(ii) Mitigate the risk of management bias.~~

~~(c) With respect to estimation uncertainty:~~

~~(i) Take appropriate steps to address estimation uncertainty.~~

~~(ii) Select an appropriate management point estimate or make appropriate related disclosures in the financial statements.~~

Objective (paragraph 8)

DTTL notes that one of the objectives when auditing accounting estimates is to "obtain sufficient appropriate audit evidence about whether the related disclosures in the financial statements are *reasonable* in the context of the applicable financial reporting framework." DTTL believes this creates an inconsistency with the rest of the ISAs and in particular with requirement paragraphs 13(a) and (e), 15, 38(iv) of ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, as the IAASB has previously used the term *adequate* to describe the auditor's work effort in the context of disclosures. DTTL recommends that the Board revert to the use of adequate as it relates to disclosures, especially considering the IAASB recent project to address disclosures in the ISAs, where this matter was not highlighted as an area to be addressed at that time. This recommendation would necessitate additional changes being made throughout ED-540.

"Stand Back" (paragraph 22)

DTTL believes the inclusion of the "stand back" as described in paragraph 22 of ED-540 is not required, as the underlying concepts are already embedded in paragraphs 25 and 26 of ISA 330. Further, it is not clear if these requirements are to be performed at the assertion level, the individual accounting estimate level, or when accounting estimates are considered more broadly when evaluating whether they are reasonable in the context of the applicable financial reporting framework. However, the "stand back" in paragraph 23 of ED-540 pertaining to the auditor's evaluation of accounting estimate misstatements based on the audit evidence gathered is appropriately included in ED-540.

Written Representations (paragraph 25)

DTTL believes that the written representations required by paragraph 25 of ED-540 to be obtained from management (and when appropriate, those charged with governance) should cover data and assumptions used in making accounting estimates and related disclosures in accordance with the requirements of the applicable financial reporting framework more generally (that is, as opposed to being limited to significant data and significant assumptions). Even though the term "significant assumptions" may currently be more generally understood by management and auditors, as pointed out above, the term "significant data" will likely not be, and this will lead to practical difficulties, inconsistencies, and challenges with respect to obtaining appropriate written representations. It is for the auditor to determine, using professional judgment, what is significant as it pertains to the data and assumptions.

Communication with Those Charged with Governance or Management (paragraph 26)

DTTL requests further clarity as to whether the communication requirements outlined in paragraph 26 of ED-540 should be limited to certain types of accounting estimates (e.g., based on materiality), or if the auditor should be communicating the required information for *all* estimates. For example, as drafted, ED-540 indicates that such communication includes "…the extent to which [all] the accounting estimates, and their related disclosures, are affected by, or subject to, complexity, the need for the use of judgment by management, estimation uncertainty, or other relevant factors."

DTTL notes that providing this additional clarity will be useful, as it is the matters that have been communicated with those charged with governance, and to which the auditor has devoted significant attention, that provide the basis for ultimately determining key audit matters (and in making such a determination, the auditor is required to take into account, among these matters, those accounting estimates that have been identified as having high estimation uncertainty). As such, DTTL believes that the requirement in paragraph 26 of ED-540 should be more closely aligned with that in paragraph 9 of ISA 701.

Terminology (paragraphs A2 and A3)

While DTTL understands the attempts by the IAASB to try and ensure that all users of ED-540 have a common basis for the application of the requirements and guidance by explaining and elaborating on the intended use of certain terminology, DTTL believes that in some instances the guidance provided is redundant and has made paragraphs long and overly complicated.

In particular, DTTL does not agree with the attempt to describe the key concept of *appropriate* in paragraph A3 of ED-540 of the application material and that the description does not connect well with the content of paragraphs 6 and 23 of ED-540. The appropriateness of audit evidence is already defined in paragraph 13(b)(ii) of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, and as such DTTL recommends deleting paragraph A3 of ED-540. DTTL is of the opinion that such a concept is used throughout the ISAs and already has a meaning that is understood by auditors.

Professional judgment plays a part in the auditor's approach to what is reasonable and appropriate, and to attempt to describe these concepts as they relate uniquely to ED-540 may call into question the intent and meaning of those terms with respect to other ISAs.

Internal Control Focus

DTTL supports the increased focus on internal control in ED-540, including the application material associated with paragraph 10 of ED-540 that elaborates on how controls may be considered when auditing accounting estimates. DTTL continues to believe, consistent with ISA 330, that the auditor should have the ability to select a substantive-only approach, as dictated by the circumstances of the engagement (and when the requirements in paragraph 8 of ISA 330 are not applicable). DTTL also supports the focus in the proposed standard on considerations by the auditor of regulatory requirements or expectations for when controls are to be tested (or at least identified as relevant such that design and implementation procedures are performed).

Appendix 1

While there is no explicit reference to IFRS in Appendix 1, DTTL believes that Appendix 1 is IFRS-measurement focused. Some of the statements made in Appendix 1 can only be accurate in the context of a particular financial reporting framework (for example, when using the leveling terminology for fair value, it may make sense in the context of IFRS and U.S. Generally Accepted Accounting Principles that both have the concept of level guidance; however, if another financial reporting framework does not use leveling, then the context of the statements would not be factual). Consequently, Appendix I as drafted may create confusion as to the accounting concepts used in the context of a particular financial reporting framework being used. DTTL recommends that Appendix 1 be drafted in a more framework-neutral manner. In doing so, this will reduce the risk of Appendix 1 becoming obsolete when there are changes to a financial reporting framework, such as IFRS or U.S. GAAP. Accordingly, DTTL has made certain drafting recommendations to Appendix 1, and these are reflected in **Appendix II** of this comment letter.

APPENDIX II

EDITORIAL COMMENTS AND OTHER RECOMMENDATIONS

DTTL has editorial comments and other recommendations with respect to ED-540 as set forth below. Certain of the proposed editorial comments and other recommendations may not be applicable depending on the outcome of the overall deliberations of the IAASB, as well as the response of the Board to the matters discussed in the cover letter and **Appendix I**. In these comments, recommended additional text is shown using **<u>bold underline</u>**; recommended deletions to the text are shown using double ~~strikethrough~~.

ISA-540 Paragraph Number	Editorial Comments and Other Recommendations
2	Amend wording to reflect that estimation uncertainty is actually defined – see paragraph 9(a) of ED-540. Many financial statement items are susceptible to an inherent lack of precision in their measurement, which is ~~referred to~~ **<u>defined</u>** as estimation uncertainty. In the ISAs, such financial statement items are referred to as accounting estimates….
3(a)(ii)	Clarify the wording as currently drafted. Appropriately consider the relevance and reliability of the data used, **<u>regardless of</u>** whether the data is obtained from internal sources or from external information sources.
4	Clarify the wording as currently drafted, and eliminate duplication of sentences and phrases. This ISA focuses the auditor's attention on designing and performing further audit procedures (including, where appropriate, tests of controls) responsive to the reasons for the assessment given to the **<u>identified and</u>** assessed risks of material misstatement, particularly when those reasons include complexity, **<u>use of</u>** judgment **<u>by management,</u>** or estimation uncertainty. ~~This ISA also recognizes that the factors of complexity, judgment or estimation uncertainty are interrelated and that there are inherent limitations in reducing estimation uncertainty beyond certain limits.~~
5	Redraft paragraph for additional clarity and deletion of words/phrases that are repeated. The application of professional skepticism by the auditor is particularly important to the auditor's work relating to accounting estimates~~. Professional skepticism also is important because there is a particular~~ **<u>as there is the</u>** risk of management bias affecting accounting estimates due to their subjective, potentially complex and uncertain nature.

6	Delete last sentence as the paragraph is merely re-stating the objective. This ISA requires an evaluation of accounting estimates based on the audit procedures performed and the audit evidence obtained. ~~In doing so, the auditor is required to evaluate whether the accounting estimates, and related disclosures, are reasonable in the context of the applicable financial reporting framework.~~
9(f) A58 A138	The phrase “underlying transaction(s)” is used in the definition relating to “Outcome of an accounting estimate.” Throughout ED-540 “transactions” is used without the “underlying” qualifier (except in two other instances – see paragraphs A58 and A138 of ED-540). Consideration should be given to deleting the word “underlying” in paragraphs 9(f), A58 and A138 of ED-540, so as to be consistent with how the phrase is used elsewhere in the proposed standard, for example, paragraphs 10(d), A18, A22, and ISA 260 (Revised) Appendix 2 – Accounting Estimates of ED-540. 9(f). Outcome of an accounting estimate – The actual monetary amount that results from the resolution of the ~~underlying~~ transaction(s), event(s) or condition(s) addressed by an accounting estimate. A58. The segregation of duties between those committing the entity to the ~~underlying~~ transactions and those responsible for making the accounting estimates, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services. For example, in the case of a large financial institution, relevant segregation of duties may consist of an independent function responsible for estimation and validation of fair value pricing of the entity’s financial products staffed by individuals whose remuneration is not tied to such products. A138. When the financial statements are prepared in accordance with a fair presentation framework, the auditor’s evaluation as to whether the financial statements achieve fair presentation include the consideration of the overall presentation, structure and content of the financial statements, and whether the financial statements, including the related notes, represent the ~~underlying~~ transactions and events in a manner that achieves fair presentation.
10(a)	The objective in paragraph 8 of ED-540 only refers to the “related disclosures,” yet in paragraph 10(a) of ED-540 there is a reference to “related presentation and disclosure requirements.” Consistency is recommended throughout ED-540 where disclosures are mentioned. The requirements of the applicable financial reporting framework relevant to accounting estimates, including the recognition criteria, measurement bases and the related ~~presentation and~~ disclosure requirements.

10(d)	The terms "revise" accounting estimates (e.g., paragraphs 10(d) and A21 of ED-540) and "re-estimate" accounting estimates (for example, paragraph A61 and A65 of ED-540) have been used interchangeably. Consistency is recommended throughout the proposed standard. Terms to be addressed also include "re-estimating," "re-estimation" and "re-estimated"
10(e)(i)	Paragraph A30 of ED-540 discusses that management may design and implement specific controls around models used for making accounting estimates, yet there is no reference to control activities in the related requirement. Additionally, Paragraph 12 of Extant 540 discusses whether the method for making the accounting estimates have been applied consistently, however this concept is not as clear in ED 540. Recommend additional wording be added to paragraph 10(e)(i) of ED-540 to address these issues and emphasize the importance of controls and achieve consistency with the application material. The methods used, how they are selected or designed, and how they are applied **including the consistency of their application**, including the extent to which they involve modelling**, and the related control activities, as applicable**;
10(e)(iii)	This is the first instance of the use "significant data" in the requirements, yet there is no cross-reference to the related guidance in paragraph A35 of ED-540 The process used to select data, including the source(s) of that data and how management identifies significant data; (Ref: Para. **A35,** A39–A42)
10(e)(v)	Paragraph 3(b)(ii) of ED-540 uses the word "mitigate" for describing management bias. The wording should be aligned with the more commonly used wording in the proposed standard of "addressed" and such wording should be used consistently. (ii) ~~Mitigate~~**Address** the risk of management bias.
10(e)(vii	DTTL suggests additional clarity in this paragraphs as to the auditor's considerations as to whether or not the outcome of management's process is appropriate or not (e.g., if management decided that no change was necessary, however the auditor decided a change was necessary), as well as the responsibility of the auditor in such a circumstance. Additionally, DTTL believes that the wording in this paragraph should be modified in order to provide clarity as to the meaning, as follows. (vii) How management has addressed the need for a change from the prior period in the methods, assumptions or data used, and if **management has made a change**~~so~~, the nature of, and reasons for, such

	changes. (Ref: Para. A47).
10(f)	Additional clarity needed to reflect that this requirement may already have been addressed when complying with ISA 315 (Revised). Each of the components of internal control as they relate to making accounting estimates**, to the extent an understanding of these components of internal control has not already been obtained**.
11	Recommend additional wording be added to clarify the purpose of the retrospective review. DTTL also notes the change in the use of the word “prior” in extant paragraph 9 of ISA 540 to “previous” in paragraph 11 of ED-540. If there is no underlying reason for this change, DTTL recommends reverting back to the extant terminology to avoid any confusion as to the reason or intent of the change. (Note this editorial comment affects numerous paragraphs throughout the proposed standard) …. The review is not intended to call into question judgments about ~~previous~~ **prior** period accounting estimates that were appropriate based on the information available at the time they were made**, instead the review informs the auditor in applying professional judgment about the validity of the process undertaken by management**.
13(a)(ii)	The phrase “obtain[ing] relevant and reliable data and maintaining the integrity of that data” used in the requirement should be consistent with the phrase in the related application material (paragraph A82 of ED-540). Further, paragraph 3 of ED-540 highlights “maintain[ing] the integrity of the data used” as a separate bullet, yet in paragraphs 13(a)(ii) and A82 of ED-540, it is not a separate sub-bullet. Recommend aligning these three paragraphs. DTTL also recommends that in order to clarify what is meant by “maintaining the integrity of [that] data” an example be added, such as the following: For example; by testing the operating effectiveness of relevant controls within the applicable information technology systems
17(b)	When referring to relevant and reliable data in paragraph 3(a) of ED-540 as it relates to complexity, there is no reference to “significant” data. It is not clear why the requirement in paragraph 17(b) of ED-540, therefore, refers only to “significant” data. DTTL suggests deleting “significant” as it would be important to obtain audit evidence about the relevance and reliability of data if it gives rise to a risk of material misstatement (regardless of whether it was deemed “significant” data or not). (Refer also to the discussion on “*Data and Assumptions*” in our cover letter). (b) Whether ~~significant~~ data is relevant and reliable….

18(a)(iii)	As currently drafted, the requirement to extend the auditors procedures to obtaining sufficient appropriate audit evidence about whether significant assumptions are consistent with assumptions used in other areas of the entity's business activities is very broad and open-ended. DTTL believes that the evidence required to be obtained to address this requirement should be limited to the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit (similar to the requirement in paragraph 14(b) of ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*). Whether significant assumptions are consistent with each other and with those used in other accounting estimates or with assumptions used in other areas of the entity's business activities. **The other areas of the entity's business activities are limited to those areas of which the auditor has knowledge as obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit.**
19(b)	DTTL believes that it is likely that a control deficiency exists when management has not appropriately understood and addressed estimation uncertainty, and that the requirement therefore needs to be expanded to address the auditor's consideration of control implications. When, based on the audit evidence obtained, in the auditor's judgment, management has not appropriately understood and addressed the estimation uncertainty, the auditor shall, to the extent possible, develop an auditor's point estimate or range to enable the auditor to evaluate the reasonableness of management's point estimate and the related disclosures in the financial statements that describe the estimation uncertainty. **When management has not appropriately understood and addressed the estimation uncertainty, the auditor shall evaluate whether a deficiency in internal control exists, and where appropriate communicate in accordance with ISA 265, Communicating Deficiencies in Internal Control to Those Charged With Governance and Management [Footnote]** **[Footnote] Paragraphs 7-11 of ISA 265**
27	DTTL believes that it would be helpful for additional clarity to be provided in the requirement in paragraph 27 (and the related application material) as to the documentation that would be needed to evidence how the requirements have been addressed, in particular with respect to supporting judgments that inherent risks are low and the requirements of paragraphs 17-21, which DTTL believes should be called out more specifically. DTTL further notes that the documentation requirement should be more closely aligned with paragraphs 8 and 24 of ED-540, as well as the

	language in paragraph 37(a) of ISA 700 (Revised). The audit documentation shall include: (a) The basis for the auditor's evaluation of the reasonableness of the accounting estimates**, whether recognized or disclosed,** and related disclosures **in the context of the applicable financial reporting framework**; and (b) Indicators of possible management bias, if any, and the auditor's evaluation **of the implications on the audit and** ~~thereof~~ in forming the auditor's opinion **to obtain reasonable assurance about** ~~on~~ whether the financial statements as a whole are **free from** material~~ly~~ misstate~~d~~**ment, whether due to error or fraud**.
A1	The following matters are noted as it pertains to paragraph A1 of ED-540. (1) Lead-in. Clarify that the estimates are those that are both included or disclosed in the financial statements (2) DTTL believes that "outcome of long term contracts' may not be sufficiently clear and may mean different things; for example does it relate to the percentage of completion used to determine revenue, or does it relate to the need to assess whether a provision is required because a long-term contract is onerous, or is there another meaning? DTTL recommends that this bullet be clarified or additional examples provided to add clarity. (3) Edit to clarify that the financial instruments are those that are both complex and not traded in an active market (4) DTTL recommends striking the words "goodwill and" because goodwill itself is not evaluated, it is a residual balance. (5) DTTL recommends that an example be provided of an "infrastructure asset valuation" as it is not clear what is encompassed by this bullet. In addition, DTTL also suggests that other relevant examples be added to the application material; for example situations relating to revenue recognition (e.g., allocation of transaction price to performance) and impairment of long-lived assets. Examples of situations where accounting estimates may be required **to be included or disclosed in the financial statements** include: • …. • Outcome of long term contracts. • ….. • Financial instruments, including complex financial instruments **or those** that are not traded in an active market.

- ….
- Assets or liabilities acquired in a business combination, including ~~goodwill and~~ intangible assets.
- …
- Infrastructure asset valuation.

A4

DTTL recommends that the following edit be made because judgments inform the decisions of management.

> Accounting estimates are monetary amounts that may be classes of transactions or account balances recognized in the financial statements, but also include accounting estimates used in disclosures or used to make ~~judgments~~ **decisions** about whether or not to recognize or disclose a monetary amount.

A5

The following edits are proposed:

(1) Delete "significant" as it implies that one should only test the assumptions or data if significant, but this may not necessarily be the case, also the phrase that has been used is "significant data or significant assumptions," with data being noted first.

(2) Insert "making" for consistency with similar use of phrases in ED-540.

(3) Delete "item" and use "component" for consistency within the paragraph, and to clarify that the approach being referred to relates to developing a point estimate for a component

(4) Provide a more relevant example

> An auditor's point estimate or range may be developed for an accounting estimate as a whole (for example, the expected credit losses for a particular loan portfolio or the fair value of different types of financial instruments), or a component of an accounting estimate (for example, an amount to be used as ~~a significant assumption or significant~~ data **or an assumption** for **making** an accounting estimate). A similar approach may be taken by the auditor in developing an amount or range of amounts in evaluating ~~an item of~~ data or an assumption **of a component of an accounting estimate** (for example, **developing a range of lives to evaluate the entity's determination of the** ~~an~~ estimated useful life of an asset).

A7

The following edits are proposed to the application material:

(1) Insertion of a reference to complexity, as DTTL believes that the lack of precision in the measurement of accounting estimates can also lead to complexity

(2) Other editorial suggestion.

	Financial reporting frameworks often call for neutrality, that is, freedom from bias. The inherent lack of precision in the measurement of accounting estimates gives rise to the need for the use of judgment by management**, as well as result in added complexity when measuring the accounting estimate**. Such judgment may be influenced by unintentional or intentional management bias (for example, as a result of motivation to achieve a desired profit target or capital ratio). The susceptibility of an accounting estimate to management bias increases with the extent to which there is a need for judgment in making the accounting estimate. Management bias may be difficult to detect at an account level and may only be identified when considered in **relation to** groups of accounting estimates, all accounting estimates in aggregate, or when observed over a number of accounting periods.
A11	DTTL recommends, in addition to the editorial suggestions related to punctuation, that the guidance in extant paragraph A13 of ISA 540 be incorporated into the paragraph A11 of ED-540 to improve the context of this guidance. Obtaining an understanding of the requirements of the applicable financial reporting framework provides the auditor with a basis for discussion with management and, where applicable, those charged with governance**,** about how management has applied those requirements relevant to the accounting estimates, and about the auditor's determination of whether they have been applied appropriately. This understanding also may assist the auditor in communicating with those charged with governance when the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be the most appropriate in the circumstances of the entity. **In addition, obtaining an understanding of the requirements of the applicable financial reporting framework assists the auditor in determining whether it, for example:** • **Prescribes certain criteria for the recognition, or methods for the measurement of accounting estimates.** • **Specifies certain criteria that permit or require measurement at a fair value, for example, by referring to management's intentions to carry out certain courses of action with respect to an asset or liability.** • **Specifies required or suggested disclosures.**
A12	Suggested edits to provide clarity for what "determined directly" means, as this is not a phrase used elsewhere in the ISAs and it will therefore be unfamiliar.. For certain accounting estimates, financial reporting frameworks may prescribe or provide guidance on the basis for selecting management's point estimate, which

	may be, for example, the most likely outcome or a discounted probability-weighted expected value. Depending on the circumstances, it may be possible for the accounting estimate to be determined directly **(for example, there is only one option or source from which to select or determine the point estimate)** or it may be possible to select a management point estimate only after considering alternative assumptions or the range of possible measurement outcomes.
A13	DTTL believes that the application material as drafted implies that *assumptions* prescribed by the financial reporting framework always give rise to estimation uncertainty, which DTTL does not believe is accurate. Further, DTTL believes the context of extant paragraph A15 of ISA 540 is not captured in paragraph A13 of ED-540. Suggested edits are noted below (in addition to reformatting the paragraph for further clarity): Financial reporting frameworks may specify criteria for, or guidance on, the disclosure of information concerning ~~judgments,~~ assumptions~~,~~ **and judgments,** or other sources of estimation uncertainty relating to accounting estimates. **Examples where the financial reporting framework requires the disclosure of information include:** • **Significant assumptions to which the accounting estimate is particularly sensitive, or** • **Situations where the financial reporting framework does not permit recognition of an accounting estimate when there is a high degree of estimation uncertainty but instead requires that certain disclosures be made in the notes to the financial statements.**
A14	Recommendations encompass inserting wording to clarify that (a) regulatory factors include relevant regulatory frameworks, and (b) management bias may occur relating to achieving compliance with regulatory requirements. There are also other editorial suggestions. Obtaining an understanding of the regulatory factors that are relevant to accounting estimates (for example regulations established by banking and insurance regulators) may assist the auditor in **, identifying any relevant regulatory framework, and** determining whether the regulatory framework: • Addresses conditions for the recognition, or methods for the measurement, of accounting estimates, or provides related guidance thereon; • Specifies, or provides guidance about, **necessary or expected** disclosures in addition to the requirements of the applicable financial reporting framework; or • Provides an indication of areas for which there may be a potential for management bias **in making**

	accounting estimates in amounts that will result in achieving compliance with ~~to meet~~ regulatory requirements.
A15	DTTL recommends that the example be deleted as it is confusing and not necessary in order to understand the application material. Obtaining an understanding of the applicable regulatory factors may also highlight requirements for regulatory purposes that are not consistent with requirements of the applicable financial reporting framework, which may indicate potential risks of material misstatement. ~~For example, for certain financial statement items, the measurement basis for regulatory capital maintenance purposes may require earlier recognition of losses than the measurement basis required by the applicable financial reporting framework.~~
A16 and A17	DTTL proposes edits to provide further clarity as to what aspects underlying the accounting estimate would need to be understood in order to assist “the auditor in understanding the measurement basis,” and “the nature and extent of disclosures.” Further, DTTL believes this understanding may only assist the auditor with discussion regarding certain of the accounting estimates. There is also duplication with paragraph A17 of ED-540, and DTTL recommends combining the two guidance paragraphs. An edit has also been proposed in order to more closely align the wording with paragraph 11 of ISA 315 (Revised). Obtaining an understanding of the nature of accounting estimates that the auditor expects to be included in the entity’s financial statements**, together with an understanding of the applicable financial reporting framework,** assists the auditor in understanding the measurement basis of such accounting estimates and the nature and extent of disclosures that may be relevant**, as well as an understanding of whether the accounting estimates are complex to make, require significant judgment by management, or have high estimation uncertainty**. Such an understanding provides the auditor with a basis for discussion with management about how management has made **certain of** the accounting estimates. The auditor may obtain an understanding of the accounting estimates that the auditor expects to be included in the financial statements through the auditor’s: • Understanding of the nature of the entity, including the nature of the assets and liabilities and other financial statement items that it would be expected to have, given the nature of its operations, ownership and governance structures**,** ~~and~~ **types** of investments, the way it is structured and financed, its objectives and strategies and related business risks; • ...
A19	DTTL believes that management’s knowledge of the implementation of business strategies in both *prior* and

	current periods could be relevant to accounting estimates, accordingly the following edit is recommended. Management's identification of transactions, events and conditions that give rise to the need for accounting estimates is likely to be based on: • ... • Management's knowledge of the implementation of business strategies~~ in the current period~~. • ...
A20	DTTL recommends that paragraph A20 of ED-540 be deleted because it is repetitive of what is already stated in paragraph 10(d) of ED-540.
A21	Editorial recommendation to eliminate superfluous wording and improve clarity. Inquiries of management about changes in circumstances ~~may~~ **<u>that may give rise to the need for new or revised accounting estimates</u>** include, for example, whether: • The entity has engaged in new types of transactions ~~that may give rise to accounting estimates~~. • Terms of transactions ~~that give rise to accounting estimates~~ have changed. • Accounting policies relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework ~~or otherwise~~. • Regulatory or other changes outside the control of management have occurred ~~that may require management to revise, or make new, accounting estimates~~. • New conditions or events have occurred ~~that may give rise to the need for new or revised accounting estimates~~.
A23	As previously discussed (**see response to Question 3 in Appendix I**), the perception given by the heading "Considerations specific to smaller entities" is that smaller entities have estimates with low inherent risk. DTTL acknowledges that the intent is to focus on those less complex entities, many of which happen to be smaller. DTTL recommends that in each instance where there are specific considerations relating to smaller entities, that the lead-in could perhaps be more descriptive, for example, "In less complex entities, many of which may be smaller, obtaining …." This is a repeat comment for the following guidance paragraphs – paragraphs A44, A60, A100, and A110 of ED-540.

	Additionally edits are recommended to (1) align wording with drafting conventions used in the application material relating to the auditors work effort and related actions and (2) provide additional clarity as to what "accordingly" means. **In less complex entities, many of which may be smaller,** ~~O~~**o**btaining this understanding ~~for smaller entities is often~~ **may be** less ~~complex~~ **complicated** as ~~there are~~ **the nature of the underlying** business activities and transactions **may often be simpler** ~~be less complex~~. Further, often a single person, for example the owner-manager, identifies the need to make the accounting estimates and the auditor's inquiries may be focused ~~accordingly~~ **toward that person**.
A24	Editorial suggestions to provide additional clarity and consistency. … • Selecting appropriate accounting policies and prescribing estimation processes, including appropriate estimation or valuation methods, including, where applicable, **the use of** models. • …. • Periodically reviewing the circumstances that give rise to the accounting estimates and re-estimating **the accounting estimate** as necessary.
A27 and A28	DTTL recommends reordering these paragraphs as paragraph A28 of ED-540 describes what a model is, yet paragraph A27 of ED-540 already refers to a model, namely Black Scholes.
A29	DTTL recommends that the lead-in be re-worded for additional clarity. In relation to the second and third bullet point of paragraph A29 of ED-540, DTTL noted the usage of the term "difficult." As this term is relative, DTTL suggest that guidance as to how to assess this criteria will be of benefit to auditors. A model is **more likely to be** complex when: • The method it applies requires specialized skills or knowledge; • Relevant and reliable data needed for use in the model is **more** difficult to obtain; • The integrity of the data is **more** difficult to maintain; • It exhibits a significant degree of complexity in its design or operation, which may, for example, involve more extensive use of information technology or large volumes of data; or • It uses multiple data sources or assumptions with **more** complex-interrelationships.
A30	DTTL recommends revising paragraph A30 of ED-540 to provide additional clarity as well as to make other editorial

changes. These proposed edits address primarily the following matters:

(1) Eliminate redundancies in the sentence addressing complex models, as well as including an example of the need to focus on complex controls.

(2) Delete the example pertaining to insurance contract liabilities and instead include an example that is related to the example previously included in the paragraph, namely the expected credit loss model.

(3) Factors for the auditor to consider in obtaining an understanding of the model should not be limited to control *activities*, rather all controls are to be considered.

(4) Sub-bullets three and four addressing considerations relating to the data and assumptions do not assist with the entity's validation of the model itself, as these are inputs used in the model. Accordingly, the lead-in to the sub-bullets has been amended.

(5) Sub-bullet four addresses assumptions; however, DTTL believes that the assessment should address both the assumptions made, and used. An additional sub-bullet has been added to cover this consideration. The sub-bullets have also been re-ordered as management would likely make the assumptions, before using them in the model.

(6) The overlays made by management could be subject to management bias. Wording inserted to the application material to remind the auditor of this consideration.

(7) It is for the auditor to determine the *key* parameters using professional judgment. In obtaining an understanding the auditor should be evaluating all the parameters documented by the entity.

Management may design and implement specific controls around **a** model used for making accounting estimates, whether **such model is** management's own model or an external model. . ~~Controls that address complexity around models are more likely to be relevant to the audit when the model used is complex, such as an expected credit loss model or a model used for the~~ **When the model itself has an increased level of complexity, such as an expected credit loss model, controls that specifically address complexity are likely more relevant to the audit, for example, understanding the controls around the integrity of the calculations when valuing**~~ation of~~ **the fair value of financial assets**~~insurance contract liabilities~~. Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and of related control**s** ~~activities~~ include the following:

- How management determines the relevance and accuracy of the model;
- The validation or back testing of the model, including whether the model is validated prior to use and revalidated at regular intervals to determine whether it remains suitable for its intended use. The entity's

	validation of the model**<u>, and the related inputs,</u>** may include evaluation of: o The model's theoretical soundness; o The model's mathematical integrity; o The accuracy and completeness of the data and appropriate assumptions used in the model;~~ and~~ o **<u>Whether</u>** appropriate assumptions have been made**<u>; and</u>** o Whether the appropriate data **<u>and assumptions are</u>** ~~is~~ used in the model; • How the model is appropriately changed or adjusted on a timely basis for changes in market or other conditions and whether there are appropriate change control policies over the model; • Whether adjustments, also referred to as overlays in certain industries, are made to the output of the model~~ and~~ **<u>,</u>**whether such adjustments are appropriate under the circumstances and in accordance with the requirements of the applicable financial reporting framework. **W<u>here the adjustments are inappropriate or not in accordance with the requirements of the applicable financial reporting framework, whether such adjustments are the indicators of possible management bias</u>**; and • Whether the model is adequately documented, including its intended applications, limitations,~~ key~~ parameters, required data and assumptions, the results of any validation performed on it and the nature of, and basis for, any adjustments made to its output.
A31	Recommended edit provides additional clarity when using an internally developed model in which the output, in this case the accounting estimate, may have a greater susceptibility to material misstatement. When providing an example, DTTL does not believe that referring to [all] internally developed models is appropriate to address the circumstances, rather the example should instead refer to complex models. For example, an internally developed depreciation model for a simple accounting estimate is unlikely to have material misstatement. Estimates may have greater susceptibility to material misstatement relating to the use of models in certain circumstances. For example, in cases when management has developed a **<u>complex</u>** model internally and has relatively little experience in doing so, or uses a model that applies a method that is not established or commonly used in a particular industry or environment.
A33	It is noted that the application material for *significant assumptions* is included in paragraph A35 of ED-540 which is subsequent to the use of the phrase in this

	paragraph, therefore DTTL recommends a cross-reference to the related guidance paragraph. An additional editorial suggestion is also noted. ... • How the assumptions are consistent with other matters **<u>that are</u>**: o ... • ... • How management identifies significant assumptions **<u>(see paragraph A35)</u>**
A35	DTTL noted that while the first instance of the terms "significant data" and "significant assumptions" is used in requirement paragraph 10(e)(iii) and 10(e)(ii) of ED-540, respectively, these terms are actually first used in the application material paragraph A5 of ED-540 relating to an example for definition of an auditor's point estimate or auditor's point range. DTTL recommends that since the concepts of data and assumptions are fundamental to the ED-540, this paragraph addressing the terms be moved to under the heading "Key Concepts."
A36	Certain valuation techniques selected may work in a liquid market, but may not work in an illiquid market, and as such DTTL recommends an edit to convey this understanding as a statement of fact. Further, DTTL believes that it is not clearly understood what is meant by "prices achieved," and that an example may be appropriate. An editorial suggestion related to punctuation has also been proposed. Some financial reporting frameworks require different accounting treatments depending on the level of activity in the market. Estimation uncertainty increases and valuation is more complex when the markets in which financial instruments**<u>,</u>** or their component parts are traded become inactive. Valuation techniques selected when market information ~~was~~**<u>is</u>** available may not provide appropriate valuations in times of stress. However, even where markets are inactive, prices achieved**<u>, for example the price at which a financial instrument is traded,</u>** may still provide relevant evidence about fair value. ...
A38	DTTL recommends the edits below based on the following observations (1) First bullet. Delete the words "in such circumstances" as the circumstances are already referred to in the lead-in to the paragraph, namely "[w]hen markets are inactive or illiquid." Delete the second sentence as it has already been encompassed in paragraph A37 of ED-540. (2) Second bullet. (a) Clarifying that the circumstances when the valuation technique is selected refers to both when

	the model is being adapted or developed. (b) Combine with third bullet. (3) Third bullet. Delete and combine the second and third bullets, with a common lead-in. Delete the last sentence related to "sensitivity analysis," as a sensitivity analysis is not used to determine ranges. (4) Fifth bullet. Delete the words "in such circumstances" as the circumstances are already referred to in the lead-in to the paragraph, namely "[w]hen markets are inactive or illiquid." When markets are inactive or illiquid, the auditor's understanding of how management selects assumptions may include understanding whether management has: • Implemented appropriate policies for adapting the application of the method ~~in such circumstances~~. ~~Such adaptation may include making model adjustments or developing new models that are appropriate in the circumstances~~; • Resources with the necessary skills or knowledge to o **<u>A</u>**~~a~~dapt or develop a model, ~~if necessary~~ on an urgent basis **<u>if needed</u>**, including selecting the valuation technique that is appropriate in **<u>both</u>** ~~such~~ circumstances; o Determine the range of outcomes, given the uncertainties involved~~, for example by performing a sensitivity analysis~~; ~~• The resources to determine the range of outcomes, given the uncertainties involved, for example by performing a sensitivity analysis~~ • The means to assess how, when applicable, the deterioration in market conditions has affected the entity's operations, environment and relevant business risks and the implications for the entity's accounting estimates, in such circumstances; and • An appropriate understanding of how the price data from particular external information sources may vary ~~in such circumstances~~.
A39	DTTL notes that a distinction is made in the lead-in between factual data and derived data, yet the examples of data listed do not make a similar distinction. DTTL recommends that the distinction be removed, as it is unnecessary. If the concept is retained, DTTL recommends that the examples be similarly split in order to assist the auditor in identifying the underlying nature of the data.
A40	Paragraph 13 of ED-540 requires the auditor to identify and assess risks of material misstatements. In doing so the auditor obtains an understanding of the entity and its environment, and in the context of accounting estimates, this includes the process used to select the data, including the sources. To that end DTTL believes it is important to

	understand the data sources, but not in the context of risks associated with respect to relevance and reliability of the data itself, but rather as it relates to the identification and assessment of risks of material misstatements. Further the relevance and reliability of data is not addressed in paragraph 10(e)(iii) of ED-540. See edits proposed below: … Understanding the source of the data used to make the accounting estimates may help the auditor in **identifying and assessing risks of material misstatement.**~~understanding the risks with respect to the relevance and reliability of the data~~.
A41	One of the matters the auditor may consider in obtaining an understanding of the data relates to the "nature of the data" (refer to the first bullet of paragraph A41 of ED-540). DTTL believes further clarity on what the "nature of the data" actually represents is necessary; for example, internal or external data, factual data, or derived data, developed internally, by management's expert, or is it a reference to external information sources? Additionally, the fifth bullet refers to "when *this* involves handling large volumes of data," it is unclear what *this* is referring to. See proposed edit below to address the latter comment. • … • The complexity of the information technology systems used to obtain and process the data, including when **the information technology systems** ~~this involves~~ handl**e**~~ing~~ large volumes of data.
A42	DTTL does not believe that the second bullet reflected in paragraph A42 of ED-540 appropriately describes the transfer of data between systems and accordingly suggests re-wording the application material and adding another bullet to address modifications to data. DTTL recommends for clarity that a separate bullet address the automated calculations, and the related example. DTTL also recommends that the last sentence of the second bullet be separately reflected in order to highlight the risks relating to controls over the maintenance of the integrity and security of the data. When making an accounting estimate involves large volumes of data or otherwise involves complex processing, management may make extensive use of information technology. In such cases, controls relevant to the audit are likely to include general IT controls and application controls. Such controls may address risks related to: • The complete and accurate extraction of data from the entity's records or from external information sources; ~~and~~ • **The appropriateness of any modifications to the data;**

	• <ins>**Automated or manual interfaces that allow for the transfer of data between various systems;**</ins> ~~The complete and accurate flow of data through the entity's information systems and the appropriateness of any modification to the data used in making accounting estimates,~~ • <ins>**Automated calculations,**</ins> such as the translation of data into a different currency~~.~~ ~~Controls to maintain the integrity and security of the data are also likely to be relevant to the audit~~.<ins>**; and**</ins> • <ins>**The maintenance of the integrity and security of the data.**</ins>
A43	DTTL has proposed edits that address the following matters as it relates to paragraph A43 of ED-540: (1) Lead-in. DTTL believes that there should be a reference to paragraph A33 of ED-540 where it is noted that when management's expert makes or identifies assumptions to assist management in making the accounting estimate, such assumptions become management's assumptions. (2) First bullet. The example relating to the evaluation of the likely outcome of applying complex contractual terms could be applicable to many estimates, and is not necessarily indicative of an expert; therefore, DTTL suggests deleting. (3) Final paragraph. DTTL noted that within this paragraph, reference is made only to an increase in control risk, it is DTTL's view that the failure by management to apply the required specialized skills or knowledge may increase risks of material misstatements. (4) DTTL believes that the last phrase in paragraph A33 of ED-540, "Assumptions may be made or identified by a management's expert to assist management in making the accounting estimates. Such assumptions, when used by management, become management's assumptions." would be better suited in paragraph A43 of ED-540, as this paragraph is discussing experts. Management may have, or the entity may employ individuals with, the skills and knowledge necessary to make the accounting estimates. In some cases, however, management may need to engage an expert to make, or assist in making, them <ins>**(see paragraph A33)**</ins>. This need may arise because of, for example: • The specialized nature of the matter requiring estimation, for example, the accounting estimate may involve measurement of mineral or hydrocarbon reserves in extractive industries ~~or the evaluation of the likely outcome of applying complex contractual terms~~. • ...

	A failure by management to apply the required specialized skills or knowledge, including engaging an expert when management does not otherwise have access to an individual with such skills and knowledge, increases ~~control risk~~ **risks of material misstatements**.
A44	DTTL does not believe that this paragraph provides guidance to the auditor in addressing the requirements of paragraph 10. Rather it highlights the benefits for management of having early discussions with the auditor about complex estimates. While DTTL agrees that such discussions may be helpful to management in highlighting the need for a management expert, DTTL does not believe that such guidance should be included in an auditing standard.
A45 and A46	DTTL noted that the phrase "significant sources of data" has been used in paragraph 45 of ED-540 (fourth bullet), yet in paragraph 46 of ED-540 (first bullet) the phrase is "sources of significant data." The phrases have two different meanings; therefore, it is unclear what the intent is of the IAASB. DTTL recommends that the concepts be aligned and consistently used. •
A47	DTTL recommends the edits noted below to address the following matters: (1) As drafted, management may only change the method for certain reasons, there is no permitted flexibility. DTTL recommends inserting wording to allow for additional reasons given supportable facts and circumstances (2) DTTL believes that management should not be placed in a position to support why they did not change the method. Discussing the reasons for no change in the method with management is, instead part of the auditor's understanding in determining as to whether or not the continued use of the method is appropriate. In evaluating how management makes the accounting estimates, the auditor is required to understand the extent to which management has identified and addressed the need for change in the methods, assumptions or data used. If management has changed the method for making an accounting estimate, it is important that management can demonstrate that the new method is more appropriate, or is itself a response to changes in the environment or circumstances affecting the entity, or to changes in the requirements of the applicable financial reporting framework or regulatory environment **or another reason suitably supportable by management**. It is also important that **the auditor understands** ~~management can demonstrate,~~ when no change has been made, ~~that~~ **whether** the continued use **by management** of the previous methods, assumptions and data is appropriate in view of the current

	environment or circumstances (for example, whether management's assumptions about marketplace transactions or price quotes reflect fair value when there is reduced market activity).
A49	DTTL believes that the last sentence infers that understanding the design and implementation of relevant controls is an appropriate response to address assessed risks of material misstatements, which would be inconsistent with the requirements of ISA 330. See proposed edits to provide clarity. Some entities may have a wide range of accounting estimates, some of which may be significantly affected by, or subject to, complexity, the need for use of judgment by management, and estimation uncertainty. In such circumstances, there may be an increased need for the application of specialized skills or knowledge, and management may make extensive use of information technology in making the estimates. In such cases, it will likely be more important for the auditor to understand the design and implementation of relevant controls **that address the assessed risks of material misstatement.** ~~, and~~**.** **It may** also **be appropriate** to test the~~ir~~ operating effectiveness **of the relevant controls** ~~in addressing the assessed risks of material misstatements~~.
A50	DTTL notes that the wording used in the first sentence is not consistent with how ISA 315 (Revised) discusses the understanding of internal control, including the control environment. The following edits are proposed: The auditor's understanding of the control environment relevant to making accounting estimates ~~includes consideration of the influence that the elements of the control environment would be expected to have on the risks of material misstatement. This~~ may include, for example, whether: • Management, with the oversight of those charged with governance, has created and maintained a culture of transparency and proper ethical behavior; and • The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control and whether those other components are not undermined by deficiencies in the control environment.
A51	DTTL does not believe the footnote cross-reference is correct, and it should be to paragraph A76 of ISA 315 (Revised).
A55	DTTL notes that the first sentence is a requirement – see paragraph 16 of ISA 315 (Revised). The remainder of the paragraph is guidance. See proposed wording changes. **As required by ISA 315 (Revised), i**~~I~~f the entity has a risk assessment process, the auditor is required to obtain

	an understanding of the process and its results in relation to the entity's accounting estimates~~,~~**.** **This understanding may** includ**e**~~ing~~ how management determines the risks to be managed arising from changes in: • The requirements of the applicable financial reporting framework related to the accounting estimates; • The availability or nature of data sources that are relevant to making the accounting estimates or that may affect the reliability of the data used; • The entity's information systems or IT environment; and • Key personnel.
A56	The fifth bullet appears to discuss management's responsibilities in terms of external information sources. DTTL recommends deleting this wording as it is unnecessary. With respect to the entity's information system relevant to making accounting estimates, it may be appropriate for the auditor to obtain an understanding as to whether: • ... • When using external information sources, management considers and appropriately addresses the risks related to processing or recording the data, ~~recognizing management's responsibility for appropriately reconciling and challenging the data from those sources~~; and • ...
A57	DTTL believes that paragraph A57 of ED-540 is a factual statement and would be better located as a lead-in to the section as to why auditors need to understand information systems (i.e., above paragraph A56 of ED-540).
A58	DTTL believes that there should be further context around the reference to the cross-references (paragraphs A30 and A42 of ED-540) in the last bullet, as neither of those paragraphs relate only to control activities.
A60	Refer to the comment above in paragraph 23 of ED-540 regarding amending the lead-in to paragraphs addressing "Considerations specific to smaller entities." Edits made to highlight that controls are typically performed by an owner-manager in a smaller entity, but that does not necessarily mean they are of a limited nature. In addition, where the owner-manager is making the estimate, it appears redundant to state that the owner-manager may have significant influence over the determination of the estimate. Further management bias is considered because it is a risk, edits proposed to clarify that point.

	In **less complex entities, many of which may be** smaller ~~entities~~, accounting estimates may be ~~generated~~ **made** outside the general ledger **and recorded in the general ledger by journal entries. In such instances, the** controls over the~~ir development~~ **making of accounting estimates** ~~may be limited~~ **are generally performed by the owner-manager**~~, and an owner-manager may have significant influence over the determination~~. The owner-manager's role in making the accounting estimates **is likely** ~~may need~~ to be taken into account by the auditor ~~both~~ when identifying the risks of material misstatement**,** ~~and when~~ **including** considering the risk of management bias. ISA 315 (Revised) includes specific considerations to smaller entities that the auditor might find helpful in obtaining an understanding of the components of internal control as it relates to making accounting estimates.
A61 - Heading	DTTL noted that the heading above paragraph A61 of ED-540 is in bold, and there is no corresponding heading above the requirement paragraph 11 of ED-540. This is inconsistent with the formatting in the proposed standard. A heading, at the appropriate level, should either be inserted above paragraph 11 of ED-540 or the heading level should be amended in the application material
A61	Editorial suggestion to provide additional clarity in the lead-in paragraph and the second bullet. DTTL believes that the third and fourth bullets overlap and should be combined. The last phrase of the fifth bullet should be deleted as it is vague and not really pertinent to the risk assessment process. A review of the outcome or re-estimation of accounting estimates made in previous periods (retrospective review) assists in identifying and assessing the risks of material misstatement, specifically in circumstances when previous period accounting estimates have an outcome through transfer or realization of the asset or liability **in the current period**, or are re-estimated for the purpose of the current period. Through performing a retrospective review, the auditor may obtain: • Information regarding the effectiveness of management's previous estimation process, from which the auditor can obtain insight about the likely effectiveness of management's current process. • Audit evidence that is pertinent to the re-estimation, in the current period, of **accounting estimates that existed in** previous period**s** ~~accounting estimates~~. • Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. • Information regarding the complexity and estimation uncertainty pertaining to the accounting estimates. • Information regarding the susceptibility of accounting estimates to, or that may be an indicator of, possible

	management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions**.** ~~and in determining the nature, timing and extent of further audit procedures.~~
A62	DTTL believes this paragraph provides a better lead-in to the section. Recommend including it before A61. Other edits suggested for clarity. A retrospective review may be performed over accounting estimates made for prior period financial statements but also for accounting estimates made **for** ~~over~~ several periods or a shorter period (such as half-yearly or quarterly). …
A64	DTTL proposed edits to clarify that the review is retrospective. Further, DTTL believes that data was inadvertently omitted from the paragraph and is relevant when performing a retrospective review. The auditor may judge that a more detailed **retrospective** review is required for those accounting estimates that have changed significantly from the previous period, or for those accounting estimates for which the inherent risks were not low in the previous periods. As part of the detailed **retrospective** review, the auditor may pay particular attention, when possible, to the effect of **data and** significant assumptions used in making the previous estimates. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.
A66	DTTL proposes a drafting change to improve clarity. A difference between the outcome of an accounting estimate and the amount recognized in the previous period's financial statements does not necessarily represent a misstatement of the previous period's financial statements. However, ~~it~~ **such a difference** may **represent a misstatement** ~~do so if~~, for example, **if** the difference arises from information that was available to management when the previous period's financial statements were finalized, or that could reasonably be expected to have been obtained and taken into account in the preparation of those financial statements. …
A67	Wording is proposed to improve the "linkage" to the requirement in paragraph 11. …. During the course of the audit, **including when performing risk assessment procedures and related activities,** the auditor may identify a need for specialized skills or knowledge to be applied in relation to **auditing** one or more aspects of the accounting estimates.
A68	DTTL notes that in paragraph A68 of ED-540 there is a reference to the judgment of management in the sixth

	and seventh bullets. It is requested that additional clarity be provided as to whether it is the judgment of management or the auditor's judgment that is being referred to.
A69	DTTL recommends that the third sentence of the paragraph be clarified such that it is clear whether or not this is also an example. In addition, DTTL believes that individuals with specialized skills or knowledge may be involved for all active banking institutions, not just those that are internationally active. Recommend the following edits be made: Many accounting estimates do not require the application of specialized skills or knowledge. For example, for most audits it is unlikely that specialized skills or knowledge would be necessary for an auditor to evaluate a bonus accrual or inventory obsolescence. However, ~~for~~ **when auditing** expected credit losses of an ~~internationally~~ active banking institution or the insurance contract liability for an insurance entity, the auditor is likely to conclude that it is necessary to ~~apply~~ **involve individuals with appropriate** specialized skills or knowledge.
A70	DTTL questions the relevance of the first sentence and recommends that it be deleted. Further DTTL recommends that the second sentence be combined with paragraph A67 of ED-540
A73	Recommend the following edits to provide further clarity, and ensure technical accuracy in ED-540 (see similar proposed edits relating to level 3 inputs in paragraphs A81 and A88 of ED-540). DTTL also recommends striking the example relating to the valuation of goodwill, because goodwill is not itself the subject of the evaluation rather it is the residual balance Instead it may be relevant to refer to the valuation of intangible assets acquired in a business combination. DTTL has also proposed adding another example. For some accounting estimates, the auditor's assessment of the risks of material misstatement may be influenced by inherent risk that is not low. Examples may include: • ... • Accounting estimates for which a complex model is used or for which there are assumptions or data that cannot be observed directly in the marketplace (**fair values using** level 3 **inputs** ~~fair values~~). • ... • ~~Valuation of goodwill in a business combination.~~ • **Valuations subsequent to business combinations, such as an annual impairment assessment**

A74	The following edits are proposed for further clarity. It is important to qualify whose judgments are being referred to (i.e., the auditor's use of professional judgment, or the use of judgment by management). The reasons for the auditor's assessment of the risks of material misstatement **relating to an accounting estimate** may result from one or more of the factors of complexity, judgment and estimation uncertainty. For example: (a) Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to involve high estimation uncertainty and significant subjectivity **by management** in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities. (b) An accounting estimate for an **inventory** obsolescence **allowance** ~~provision~~ for an entity with a wide range of different inventory types may require complex systems and processes, but may involve little judgment and the estimation uncertainty may be low, depending on the nature of the inventory. (c) ....
A80	DTTL notes that the application material refers to "valuation attributes." While this terminology is used in subsequent application material, it is not defined or further explained in the proposed standard. Consideration should be given to including the description in paragraph 4 of Appendix 1 to ED-540 in the application material.
A81	The examples in this paragraph are intended to be examples of estimates that are likely to involve complex models. DTTL notes however that the first and last bullets are rather estimates where the determination (and auditing) of the assumptions is likely to be the more complex or difficult aspect. For example, a cash flow model may not be very complex, but the assumptions about future revenues may be. DTTL therefore recommends deleting the first and last bullets. The second bullet refers to "historical experience data"; DTTL suggests that additional clarity be provided in order to determine whether this is factual data (historical data) or derived data (historical experience data). Examples of accounting estimates for which complex models are likely to be used include:

	• ~~An impairment loss for goodwill or an intangible asset, which may require expectations about future cash flows from the business, asset or a group of related assets to be developed based on historical data and forward looking assumptions.~~ • An expected credit loss, which may require expectations of future credit repayments and other cash flows, based on **consideration of** historical experience data and **the application of** forward looking assumptions. • **Valuation of** ~~A~~**a**n insurance contract liability, which may require expectations about future insurance contract payments to be projected based on historical experience and current and assumed future trends. • ~~A level 3 fair value based on cash flow projections and historical market related data.~~
A82	The following edits are recommended: (1) Lead-in – edits to align with paragraph 13(a)(ii) (2) First bullet. Edit to address why the data may be more susceptible to misstatements. (3) Second bullet. DTTL would like clarification on why the data is only relevant in making a fair value estimate. Also recommended that the bullet follows the construct of other bullets in paragraph A82 of ED-540. (4) Third bullet. Clarify that the auditor may test the operating effectiveness of these controls. (5) Fifth bullet. DTTL does not believe there is appropriate linkage between the volume of data and the risk it may be inappropriately used. Suggest deleting the last sentence Risks of material misstatement related to complexity in making accounting estimates may arise when such complexity leads to greater difficulty in obtaining **relevant and reliable data and** ~~, or in~~ maintaining the integrity of~~, relevant and reliable~~ **that** data, stemming from one or more of the following: • The reliability of the data source. Data from certain sources may be more reliable than from others. For example, data obtained from internal systems outside the general and subsidiary ledgers may be more susceptible to misstatements **than data obtained from the general and subsidiary ledgers,** because in some entities it may be difficult to determine whether there were appropriate controls and governance over ~~that~~ data **obtained from outside the general and subsidiary ledgers**. • Data from an external information source**. Such data** may be less relevant in making a fair value estimate if it is not based on observable market transactions. For example, it may be less relevant when it is based

	on brokers' quotes that reflect brokers' subjective judgments in the context of an inactive market. In addition, for confidentiality or proprietary reasons, some external information sources will not (or not fully) disclose information that may be relevant in considering the relevance and reliability of the data they provide, such as the sources of the underlying data they used or how it was accumulated and processed (including any controls over the process). It may be more difficult to consider the relevance and reliability of such data than in the case of data from more transparent external information sources. • The integrity of the information systems. Data that is used to make the accounting estimates may be processed by information systems**. In order to maintain the integrity of the information systems,** ~~that may require~~ effective general IT controls, and controls over the flow of data through the system **are necessary**. **In such circumstances the auditor will likely identify these controls as relevant to the auditor's understanding and may also determine that it is necessary to test their operating effectiveness.** • A complex organizational structure or a lack of integration between systems in different parts of the entity may give rise to difficulty in reliably and consistently aggregating. • The volume of data or the source of the data, including data that comes from a wide variety of sources. ~~This may lead to the risk that the data may be inappropriately used, or may be incomplete or from an incorrect data set.~~
A83	The following edits are recommended: (1) Lead-in. Judgment may be used to develop both appropriate and inappropriate assumptions. Delete "appropriate." (2) First bullet. Edit made to encompass both when management decides not to use and does not consider using an expert. (3) First Sub-bullet. Edit made to address that the method selected by management may either not comply or may be inappropriate. (4) Second Sub-bullet. Insert an additional risk related to assumptions. (5) Second bullet. Delete as management bias is an underlying factor to consider when auditing all accounting estimates. (6) Third bullet. Delete reference to judgment as the lead-in already indicates that these are risks of material misstatement relating to judgment. Judgment may be used by management in the selection or application of appropriate methods, the selection or development of ~~appropriate~~ assumptions, and the

	selection or interpretation of data. The risks of material misstatement related to judgment involved in making accounting estimates may relate to one or a combination of the following: • A lack of experience or competence by management, including a lack of availability to management of necessary skills or knowledge. These factors may result in risks related to the selection of inappropriate methods, assumptions and data. When management lacks the competence or experience in a certain area and ~~decides not to~~ **<u>does not</u>** use a management's expert, there may be a risk that: o The method selected may not **<u>be appropriate or</u>** comply with the applicable financial reporting framework. o **<u>The assumptions used are not appropriate in the context of the measurement objectives and other requirements of the applicable financial reporting framework.</u>** o Management may select a data source that is not relevant and reliable. • ~~Indicators of management bias~~. • The extent to which the applicable financial reporting framework does not specify the appropriate valuation approaches, concepts, techniques and factors to use in the estimation method ~~and therefore may require significant judgment~~.
A84	DTTL noted that in paragraph A84 of ED-540 the phrase "high degree of judgment was introduced." DTTL recommends there be guidance to explain what the difference is between "significant judgment" as used in paragraph A83 (and elsewhere in ED-540) and a "high degree of judgment" used in the paragraph below as well as in paragraph A85 of ED-540. DTTL also recommends that an example be provided for the last bullet, so as to be consistent with other bullets. Edits are proposed to clarify that the examples are applicable to those estimates that have risks of material misstatement related to management using a high degree of judgment. Examples of accounting estimates that are likely **<u>to have risks of material misstatement related</u>** ~~to be subject~~ to **<u>management using</u>** a high degree of judgment include the following: • Accounting estimates that are based on expected future cash flows for which there is uncertainty regarding the amount or timing. • Accounting estimates that are based on complex contractual terms. For example, the determination of cash inflows or outflows arising from commercial supplier or customer rebates may depend on very complex contractual terms that require specific

expertise or competence **to understand or interpret**.

- Accounting estimates with a long forecast period.

A86	DTTL recommends that additional clarity be given as to what the variation is that is being referred to; i.e., variation between companies, from one period to the next. DTTL suggests that factors (or potentially "matters") be used instead of variables, consistent with the usage of the term in the first sentence. DTTL also recommends that the wording in this paragraph be aligned with the definition.
A88	Deleted "material" as the phrase "material disclosure" is not defined or commonly used within the ISAs. Editorial suggestion to provide additional clarity (see similar proposed edits relating to level 3 inputs in paragraphs A73 and A81of ED-540). The risks of material misstatement related to estimation uncertainty may relate to one or **both** ~~a combination~~ of the following: • The applicable financial reporting framework, which may require: o The use of a method to make the accounting estimates that inherently has a high level of estimation uncertainty. For example, the financial reporting framework may require the use of a **fair value using** level 3 **inputs** ~~fair value~~. o The use of assumptions that inherently have a high level of estimation uncertainty, such as future cash flows for a long-term contract, assumptions that are based on data that is unobservable and are therefore difficult for management to develop or the use of the various assumptions that are interrelated. o Disclosures about estimation uncertainty. There may be a risk of material misstatement related to the failure to make a ~~material~~ disclosure ~~about~~ **related to** estimation uncertainty.
A92	DTTL believes that changes in assumptions when using a sensitivity analysis will always result in some level of sensitivity. Further it is not clear whether this paragraph is referring to an analysis being performed by the auditor or management. DTTL also recommends that guidance be added to address what the focus of the auditor's attention should be, as currently drafted this remains open-ended. The following edits are suggested: A sensitivity analysis **performed by the auditor**~~may~~ demonstrate**s** ~~that~~ the ~~accounting estimate is~~ sensitivit**y**~~e~~ **of the accounting estimate** to one or more assumptions that then become the focus of the auditor's

	attention. **<u>This focus may result in additional risks of material misstatement being identified.</u>**
A94	The final wording of Paragraph A94 states "…thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively." This wording appears to be somewhat similar with ISA 330.7(a)(iii); however, it may also be interpreted as having a different meaning (as the words are not consistent). DTTL suggest adding the parenthetical from ISA 330.7(a)(iii) or including a more specific reference to Paragraph 7 of ISA 330.
A96	DTTL believes that the sentence as drafted needs to be re-worded to more accurately reflect the objective of ISA 330. ~~If the further audit procedures in paragraph 15(a) do not provide sufficient appropriate audit evidence, t~~**<u>T</u>**he auditor is required by ISA 330 to design and perform **<u>further</u>** ~~othe~~r **<u>audit</u>** procedures **<u>whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. In doing so, if the further audit procedures in paragraph 15(a) do not provide sufficient appropriate audit evidence, the auditor would be responsible for designing and implementing other procedures in order to achieve the objective of ISA 330. [Footnote]</u>** **<u>[Footnote] Paragraph 3 of ISA 330.</u>**
A97	DTTL believes the last sentence of paragraph A97 of ED-540 is unnecessary. When inherent risk is not low, this ISA does not specify the nature of the further audit procedures to be performed to respond to the assessed risk of material misstatement. Procedures such as obtaining audit evidence about events occurring up to the date of the auditor's report, testing how management made the accounting estimate, developing an auditor's point estimate or range, or performing other types of substantive analytical procedures, may assist the auditor in obtaining audit evidence about the matters in paragraphs 17–19. ~~However, such procedures need to be designed to address the matters in paragraphs 17–19.~~
A98	DTTL is unclear in the first bullet why volume of transactions is an indicator that substantive procedures alone are insufficient and suggest that additional explanation as to *<u>why</u>* volume would indicate such. Likewise, DTTL believes similar clarity is needed around the third bullet.
A104	DTTL recommends aligning the guidance with that in paragraph A30 of ED-540, which deals with the auditor's initial understanding of the validity of models.

A106	DTTL believes that data can also be sourced from management's expert and this should be separately identified. Further, when determining the integrity of data and assumptions, the auditor would need to make sure it is reliable, in doing so the auditor may compare the data and assumptions with an external information source. DTTL recommends that the linkage be reinforced. Data may be developed internally, or may be obtained from **management's expert or** an external information source. When obtaining audit evidence about the integrity of data and assumptions, it may be appropriate for the auditor, **when assessing the reliability of such data and assumptions,** to compare the data and assumptions with an external information source.
A109	DTTL noted that while the requirement in paragraph 18(a)(ii) of ED-540 and the heading above the application material paragraphs A108 and A109 of ED-540 refer to *significant* data and *significant* assumptions, the application material paragraphs refer only to data and assumptions. It is unclear if this is intentional or if the application material needs to be aligned with the requirement.
A113	DTTL recommends the deletion of the last sentence of paragraph A113 of ED-540. As previously mentioned, DTTL believes that the three factors of complexity, the use of judgment by management, and estimation uncertainty are interlinked and cannot be discretely separated. In particular, DTTL does not believe it is appropriate to state that the selection of management's point estimates is based solely on estimation uncertainty. To determine an appropriate management point estimate, and related disclosures, it is necessary to understand the sources of inherent variability in the measurement outcomes, the extent of that variability, and the range of reasonably possible measurement outcomes. It also is necessary for management to identify and address the effects of complexity and judgment in the measurement process that increase the susceptibility of the accounting estimate to misstatement. ~~This is important so that the selection of management's point estimate, and the development of related disclosures, is based only on estimation uncertainty~~
A114	DTTL believes the last sentence of the paragraph requires additional clarity. It appears that the intent is for the auditor to request support for a consideration that was not as yet performed by management, either because management is unable or unwilling. In such an instance, while there is nothing preventing the auditor from making the request, it is unlikely that anything will be forthcoming. In such an instance the auditor should consider the impact on the auditor's further audit procedures and whether there is a control

	deficiency that warrants communication with those charged with management and management; therefore, additional wording reflecting these considerations is recommended.
A116	DTTL has proposed edits to reflect terminology that is used throughout ED-540. DTTL also proposes language to align management's point estimate with that of the definition in paragraph 9(e) of ED-540. Management's point estimate is not a "range of reasonably possible outcomes" as stated in the paragraph. When preparing the financial statements, it also is important for management to determine that the estimation uncertainty has been properly **disclosed** ~~depicted~~ **in accordance with the applicable financial reporting framework.** ~~This includes the selection of an appropriate point estimate and the related disclosures in the financial statements that describe the estimation uncertainty. For this purpose, a~~**A**n appropriate management point estimate is an amount that **is selected by management for recognition or disclosure in the financial statements as an accounting estimate and is in accordance with the applicable financial reporting framework** ~~appropriately represents the range of reasonably possible outcomes, and appropriate~~ **The** related disclosures **may** describe the extent of the variability in reasonably possible measurement outcomes.
A123	DTTL believes calculations may not only be applied in developing the outputs, consequently edits are proposed to clarify the wording in the application material. ... • The calculations applied in ~~developing the outputs from~~ the measurement process were mathematically accurate. • ...
A124	DTTL believes thatthe first sentence of paragraph A124 in ED-540 is inconsistent with the paragraph A123 as it implies that the assessment of what is reasonable extends beyond the requirements of, or the context of the applicable financial reporting framework. DTTL does not agree with this, and further notes that this sentence is also inconsistent with the requirement in paragraph 21 and the guidance in paragraph A2 which explains that "reasonable" is considered in the context of the framework. When determining whether the disclosures are reasonable in the context of a fair presentation framework, one of the auditor's considerations would be whether disclosures beyond the specified requirements of the framework are necessary to achieve fair presentation based on the specific facts and circumstances, i.e., the auditor would not be able to conclude that the requirements of the fair presentation framework have been addressed if

	additional disclosures are required to achieve fair presentation. DTTL is also not clear how this would work for a compliance framework and what the basis would be for the auditor's determination that additional disclosures are required beyond the framework's requirements. DTTL therefore recommends deleting the first sentence of paragraph A 124 and further recommends that he second sentence be added after the bullet list in paragraph A123 of ED-540 (as a separate paragraph).
A126	DTTL believes that the focus from the auditor's perspective should be on whether or not management appropriately addressed estimation uncertainty. The response of the auditor is based on management's actions. DTTL also believes that where management hasn't appropriately addressed estimation uncertainty, a request for management to enhance the disclosures around estimation uncertainty is not an appropriate response to amend what is essentially a scope limitation. In such circumstances the auditor should also consider the impact on the auditor's further audit procedures and whether there is a control deficiency that warrants communication with those charged with management and management. The recommendations have been noted as follows: When the auditor believes that management has not appropriately ~~understood or~~ addressed estimation uncertainty, the auditor may consider requesting management to consider alternative assumptions ~~or to provide additional disclosure relating to the estimation uncertainty~~. **In these circumstances the auditor is required by ISA 265, *Communicating Deficiencies in Internal Control to Those Charged With Governance and Management*, to determine if the internal control deficiency identified is a significant deficiency such that it is required to be communicated to those charged with governance and management.**
A128	DTTL does not understand why paragraph A128 was included in ED-540 and recommends that it be deleted. As drafted, it implies that the requirements of ISA 520 are always to be applied when developing an auditor's point estimate or auditor's range; however no additional context is provided as to how to do so in the context of addressing the requirements of ISA 540, and it will therefore be confusing to auditors as to what is expected or required. DTTL also does not believe that it is appropriate for application material to include requirements in this way. DTTL also believes that t is contrary to the approach of the ISAs to specifically designate a further audit procedure as being specifically a "substantive analytical procedure" .
A140	DTTL recommends further edits to the application material to better describe the circumstances when the auditor would apply procedures addressing the matters

	relating to more than one factor. For example, **when identifying and assessing risks of material misstatement relating to an assertion,** the auditor ~~may have~~ identifie**s**~~d~~ that the ~~only~~ reason**s** for ~~an~~ **the**~~-assessed~~ risk**s** of material misstatement ~~is~~ **are** the need for the use of judgment by management **and estimation uncertainty** in making the accounting estimate. ~~However, w~~**W**hile performing procedures to address the matters in paragraph**s** 18 **and 19**, as applicable, **and in order to respond to the assessed risks of material misstatement where inherent risk is not low,** the auditor ~~may~~ discover**s** that the accounting estimate is more complex than originally contemplated,~~ –~~**. This** indicat**es**~~ing~~ that the assessment of the risk**s** of material misstatement ~~may need~~ **needs** to be revised (that is, the reasons for the assessment now include complexity)**, as required by paragraph 15(b)**. Therefore, the auditor needs to perform additional audit procedures to address the matters in paragraph 17, as applicable. ISA 315 (Revised) contains further guidance on revising the auditor’s risk assessment.
A143	Edits recommended to clarify that the auditor’s determination goes to whether there is sufficient appropriate audit evidence to draw a conclusion relating to whether management’s point estimate falls within the auditor’s range. Paragraphs A113 to A118 provide guidance to assist the auditor in evaluating management’s selection of a point estimate to be included in the financial statements. Based on the audit evidence obtained, the auditor may conclude that there is sufficient appropriate audit evidence supporting a point estimate that does not differ from management’s point estimate. When the auditor uses a range, and provided that the auditor’s range only includes amounts that are supported by audit evidence obtained and the auditor has evaluated **such a range** to be reasonable as required by paragraph 20 of this ISA, the auditor may determine that **there is sufficient appropriate audit evidence to conclude that** management’s point estimate falls within the auditor’s range. In either of these situations, the auditor may **also** conclude that the accounting estimate is reasonable in the context of the applicable financial reporting framework.
A149	DTTL believes the statement that where “there is intention to mislead, management bias is fraudulent in nature” is a legal determination, the outcome of which may vary by jurisdiction. See recommended edits below: Management bias may be more difficult to detect at an account level than when considering groups of accounting estimates or all accounting estimates, or when observed over a number of accounting periods. Although some form of management bias is inherent in subjective decisions, in making such judgments there may be no intention by management to mislead the users of financial statements. When, however, there is intention to

	mislead, management bias ~~is~~ **may be** fraudulent in nature**, however such an interpretation would be made in the context of the laws and regulations in the applicable jurisdiction. In such instances the auditor may consider the need to obtain legal advice.**
A153	DTTL believes that as constructed the second sentence of paragraph A153 of ED-540 implies that as part of obtaining the written representations relating to significant data and significant assumptions, the auditor is required to consider the need to obtain representations about specific accounting estimates. The requirement in paragraph of 25 of ED-540 discusses those written representations as two discrete items. Further the lead-in to the application material refers to *significant* data and *significant* assumptions, yet the fourth bullet refers to [all] assumptions, and data. There appears to be an inconsistency as to what is required in the written representation. (See additional discussion regarding the deletion of the word *significant* in “Written Representations (paragraph 25)” in **Appendix I**). The following edits are made to address the comments highlighted: ISA 580 discusses the use of written representations. ~~In obtaining w~~**W**ritten representations **are required to be obtained from** ~~that~~ management and, when appropriate, those charged with governance, **about whether they** believe the methods**,** ~~and significant~~ data and ~~significant~~ assumptions used in making the accounting estimates and their related disclosures are appropriate~~, t~~**. T**he auditor is **also** required to consider the need to obtain representations about specific accounting estimates. …
A157	Communications with regulators or prudential supervisors may highlight information that is relevant to identifying, assessing and responding to risks of material misstatement (i.e., not limited to only identification). For example, in some jurisdictions, financial institution regulators seek to cooperate with auditors to share information about the operation and application of controls over financial instrument activities, challenges in valuing financial instruments in inactive markets, expected credit losses, and insurance reserves while other regulators may seek to understand the auditor’s views on significant aspects of the entity’s operations including the entity’s costs estimates. This communication may be helpful to the auditor in identifying**, assessing and responding to** risks of material misstatement.
A159	DTTL notes the last sentence that includes a reference to paragraph A147 for examples of indicators of possible management bias. For consistency, should this sentence should be included in all application material paragraphs where there is a reference to the

	indicators, including, but not limited to, paragraphs A83 and A85 of ED-540?
Appendix 1, paragraph 9	DTTL recommends deleting the word "statement" from the paragraph. See the following edit. Some measurement bases require the use of monetary amounts at initial recognition that reflect the cost paid or consideration given (and transaction costs) for a<u>**n**</u> ~~statement~~ asset acquired or built, and the consideration received (less transaction costs) for a liability incurred or assumed, based on the terms of the transactions that gave rise to them (historical cost).
Appendix 1, paragraph 15	As noted in **Appendix I** to our comment letter, DTTL recommends the following edit be made so that Appendix 1 is drafted in a more framework neutral manner: The amount recoverable from disposal may be required to be determined based on a fair value measurement or at net realizable value, and may require estimation. Similarly the amount recoverable from use (<u>**defined in certain financial reporting framework as "**</u>value in use<u>**"**</u>) will ordinarily require estimation. There can also be complex considerations relating to the appropriate unit of account.
Appendix 1, paragraph 17	DTTL notes that the concept of economic consumption of economic benefits exists for IFRS as well as other financial accounting frameworks, such as U.S. Generally Accepted Accounting Policies (U.S. GAAP). However, the guidance for U.S. GAAP refers to depreciation as a method of allocation, not valuation which may cause confusion to the user of the Appendix, as the measurement bases addressed in Appendix 1 are intended to be framework neutral. Similar observations are made as it relates to the concepts of decline or residual considerations.
Appendix 1, paragraph 19	As noted in **Appendix I** to our comment letter, DTTL recommends that Appendix 1 be drafted in a more framework neutral manner. The definition of fair value is as contemplated by IFRS, and may not necessarily be used by all financial reporting frameworks. DTTL recommends that this definition be used as an example of an objective of a fair value measurement. See the following recommended edits: <u>**Under some financial reporting frameworks a**</u> ~~The~~ fair value measurement basis requires measurement of the price for which an asset would have been sold, or a liability transferred, in an orderly transaction (or, if no such transaction has occurred, in an assumed transaction) between market participants in an active market at the measurement date. The objective of <u>**such**</u> a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current

	market conditions **(i.e., an exit price). Under other financial reporting frameworks the objective of a fair value measurement may be to reflect a current entry price.**
Appendix 1, paragraph 20	As noted in **Appendix I** to our comment letter, DTTL recommends the following edits be made so that Appendix 1 is drafted in a more framework neutral manner: Financial reporting frameworks often establish a 'fair value hierarchy' that categorises the inputs used to measure fair value into ~~three~~ levels and gives priority to using those in the higher levels over using those in lower levels. The purpose of doing so is to increase consistency and comparability in fair value measurements and related disclosures. Quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date and that are not subject to adjustment, provide the most relevant evidence of fair value and are included in the highest level of the hierarchy (these are **often referred to as** level 1 inputs).
Appendix 1, paragraph 21	As noted in **Appendix I** to our comment letter, DTTL recommends the following edits be made so that Appendix 1 is drafted in a more framework neutral manner: If a level 1 input is not available or accessible, it may be possible to measure the fair value using other observable inputs, such as quoted prices for similar items in an active market or quoted prices for identical items in a non-active market or other inputs observed in or corroborated with active markets (e.g., interest rates, yield curves, implied volatilities or credit spreads) ~~(such other observable inputs are level 2 inputs)~~.
Appendix 1, paragraph 22	As noted in **Appendix I** to our comment letter, DTTL recommends the following edits be made so that Appendix 1 is drafted in a more framework neutral manner: Otherwise, it may be necessary to measure the fair value, sometimes using discounted cash flow techniques, based on the best information available in the circumstances, including unobservable inputs to the extent observable inputs are not available, and taking into account all information about market participant assumptions that is reasonably available ~~(unobservable inputs are level 3 inputs)~~.
Appendix 1, paragraph 23	DTTL recommends that paragraph 23 be deleted as it is not necessary within the context of Appendix 1.
Appendix 1, paragraph 24	As noted in **Appendix I** to our comment letter, DTTL recommends the following edits be made so that Appendix 1 is drafted in a more framework neutral manner: Some measurement bases require the use of monetary amounts that reflect the present value of the future cash flows that the entity will obtain

	from using and disposing of an asset (value in use) or will incur in fulfilling its obligations inherent in a liability (fulfilment value). For example, value in use **as defined above** is ~~frequently~~ used **in some financial reporting frameworks** to test for impairment (see paragraph 15). ….
Appendix 1, paragraph 26	As noted in **Appendix I** to our comment letter, DTTL recommends the following edits be made so that Appendix 1 is drafted in a more framework neutral manner: Valuation techniques within the market approach typically use prices and other relevant information generated by market transactions involving identical or similar assets, liabilities or groups of assets and liabilities, such as businesses. Examples include the use of valuation techniques for measuring fair value that use **quoted prices in active markets for identical assets or liabilities** ~~level 1 and level 2 inputs~~ and valuation techniques for measuring fair value of real estate by reference to comparable properties.
Appendix 2	In order to be consistent with the order in which the three factors are discussed throughout ED-540, DTTL recommends reordering the paragraphs such that layout addresses complexity, followed by use of judgment by management, and then estimation uncertainty. DTTL also notes that the phrase "use of judgment by management" should be used consistently throughout Appendix 2 to add clarity and to align with the use of the phrase in ED-540.
Appendix 2, paragraph 4	DTTL notes that the definition of estimation uncertainty does not align with that in paragraph 9(c) of ED-540. See the following proposed edits. Estimation uncertainty is the **susceptibility of an** ~~inherent uncertainty that makes~~ accounting estimate~~s~~ ~~susceptible~~ to a**n inherent** lack of precision in ~~their~~ **its** measurement. …
Appendix 2, paragraph 7	DTTL noted a reference to "residual estimation uncertainty" – this concept is not addressed in the proposed standard and should therefore be deleted from **Appendix 2**.

Conforming and Consequential Amendments – ISA 260 (Revised), *Communication with Those Charged with Governance* **Paragraph Number**	**Editorial Comments and Other Recommendations**

Appendix 2 – Accounting Estimates	DTTL recommends that the IAASB review and align the wording in this Appendix upon finalization of the proposed standard. Areas identified for possible improvement include: • Third Sub-bullet. There is a reference to "presentation" (in the context of addressing disclosures), yet this term is not used consistently throughout ED-540. DTTL suggests a conformed approach. • Sixth Sub-bullet. There is a reference to "significant data and assumptions." ED-540 refers to "significant assumptions." Terminology and phrases should be aligned. • Sixth Sub-bullet. DTTL questions whether the use of "reasonable" is appropriate when referring to how data and assumptions are described for the purpose of ISA 260 (Revised), *Communication with Those Charged with Governance*, (ISA 260 (Revised)) Appendix 2. When referring to paragraph A35 of ED-540, reasonable is used in terms of variations in the data or assumptions and how such a variation would materially affect the measurement of the accounting estimate, which is inconsistent with the context this term is used in ISA 260 (Revised) Appendix 2. DTTL believes that term should be consistently used in the context of data and assumptions. • Eleventh Sub-Bullet. DTTL believes that there is duplication as it relates to disclosures, as it is already addressed in the third sub-bullet. As drafted the sub-bullet also does not align with objective of ED-540.
Conforming and Consequential Amendments – ISA 500, *Audit Evidence* **Paragraph Number**	**Editorial Comments and Other Recommendations**
7 & A31	As noted in our response to Question 7, DTTL suggests removing the edit to paragraph 7. However, if the proposed edit is retained, DTTL believes that the wording in existing paragraph A31 of ISA 500 should be re-considered to better align with the terminology pertaining to an *external information source* in paragraph 7 of the amendments to ISA 500 and include specific mention of an "external information source".
A1A	DTTL believes that determining whether an individual or organization meets the definition of a management expert is more than an "important consideration" as to whether an individual or organization is acting as an external information sources; rather it is the basis for making the distinction. It is the understanding of DTTL that if the definition of "management's expert" is met per paragraph 6(c) of ISA 620, *Using the Work of an Auditor's Expert*, then the information used by management would not be considered to be from an external information source. DTTL also suggests including the wording that the source may in fact <u>not be</u> an external

information source, as this phrasing aligns with what is already included in paragraph A1C.

Other conforming edits are also proposed below:

> In preparing the financial statements, management may make use of information obtained from an external information source **<u>or may make use of</u>** ~~An important consideration in~~ ~~determining whether an individual or organization is acting as an external information source is whether the individual or organization meets the definition of~~ a management's expert **[footnote].** ~~with respect to that information.~~ Indicators that an **individual or organization** ~~external organization~~ may be acting as an external information source rather than as a management's expert **<u>in relation to information used by the entity in preparing the financial statements</u>** include the following: …
>
> **<u>[Footnote]: Paragraph 6(c) of ISA 620.</u>**

A1C

DTTL recommends edits to paragraph A1C of the amendments to ISA 500 in ED-540 as it relates to the following matters:

(1) Lead-in. Edits to clarify the language.

(2) First bullet. Clarification to highlight that an external organization may make use of generally available information in delivering the service to management, but that the objective of the service is to provide information specifically tailored for the entity and will necessarily involve entity-specific information, data and assumptions.

(3) Second bullet. Clarification, an estimate is not calculated, but rather is determined through a process (which might involve one or more calculations).

> Depending on the facts and circumstances, an individual or organization may, in ~~respect of~~ **<u>relation to</u>** any particular set of information, be either an external information source or a management's expert**,** but not both. Professional judgment may be needed to determine whether <u>a</u>**<u>n individual or organization</u>** ~~specific organization~~ is acting as an external information source or as a management's expert ~~with respect to~~ **<u>in relation to</u>** a particular set of information. For example:
>
> - An external organization may be acting as an external information source with respect to data about real estate prices for a particular geographical region that it makes generally available to the public and that management uses in preparing the financial statements. The same external organization may ~~at the same time be acting~~ **<u>also serve</u>** as a management's expert ~~for the same entity~~ in providing management with a valuation service with respect to the entity's real estate portfolio. **<u>When delivering the valuation service, the external organization may make use of the same information that is made generally available. However, when acting as a management's expert and performing the valuation service,</u>**

the deliverable will be specifically tailored for the entity's facts and circumstances and will involve entity-specific information, data or assumptions. Such deliverable will also not be made generally available to the public.

- Some actuarial organizations publish mortality tables for general use which, when used by an entity, may **be considered to** be information from an external information source**.**~~, while t~~**T**he same actuarial organization may **also serve as**~~be~~ a management's expert**, for example** when ~~helping~~ **engaged by** management to **determine** ~~calculate~~ the pension liability for several of ~~its~~**the entity's** pension plans.
- ...

A33B

DTTL notes in this paragraph and throughout the conforming amendments to ISA 500 in ED-540 that the phrases "provided by," and "obtained from" have been used interchangeably. DTTL believes the meaning is the same in the context used and that the phrases should be conformed and consistently used. DTTL also proposes deleting the phrase "from [the] external information sources" as it is repetitive and already included in the lead-in to the bulleted list. (Additionally, there may be other amendments to ISA 500 that have used "provided by" that need to be aligned for consistency.) See proposed edits below:

Depending on the circumstances, the following factors may be important ~~considerations in~~ **when considering or evaluating** ~~about~~ the relevance and reliability of information obtained from an external information source:

- The nature and authority of the external information source used by the entity. For example, a central bank or government statistics office with a legislative mandate to provide industry information to the public is likely to be an authority for certain types of information;
- The ability of management to influence the information obtained ~~from the external information sources~~;
- The competence and reputation of the external information source with respect to~~ that particular type of~~ **the** information;
- Past experience of the auditor with the reliability of the information **obtained** ~~provided by the external information source~~;
- ...
- The entity's controls over the information obtained ~~from external information sources~~;
- ...
- The nature and extent of disclaimers or other restrictive language relating to the information

	obtained; and • Whether information is available regarding the appropriateness of techniques, assumptions and inputs applied by the external information sources in developing the information obtained.
A33C	DTTL believes that paragraph A33C of the amendments to ISA 500 in ED-540 should be more closely aligned with the discussion relating to the reliability of information in paragraph A31 of ISA 500, in particular the first bullet (which paragraph is not presented in ED-540). Additionally, DTTL believes that a better connection needs to be made between the concept of reliability that is discussed in the first sentence and consideration of accuracy and completeness in the second sentence. As discussed in paragraph A31 of ISA 500, reliability is broader than just the accuracy and completeness of information.
A33D	DTTL believes that further guidance should be provided to expand on how different types of information would influence the nature, timing and extent of procedures to "test management's use of the sources." This is an area that is challenging in practice and therefore additional guidance would be very helpful.
A33E	DTTL believes that the latter part of paragraph A33E of the amendments to ISA 500 of ED-540 is worded in such a manner that implies the reliability of the information is required to be specifically or discretely tested; DTTL believes rather that reliability of the information is addressed in designing procedures to support conclusions about whether sufficient appropriate audit evidence has been obtained. See the following recommended edits: The observability of inputs and complexity of methods used to generate the information **obtained** from the external information source may also influence the auditor's considerations related to the reliability of information **obtained** from the external information source, including considerations related to ~~the nature and extent of procedures to perform~~ **the procedures that may be performed** to **obtain sufficient appropriate audit evidence about**~~test thereliability of that~~ **such** information.
A33F	DTTL suggests the following clarifications are necessary: (1) First bullet. As drafted, the phrase "test the controls and processes, techniques, and assumptions used" implies the testing of operating effectiveness applies to processes, techniques, and assumptions in addition to testing relevant controls, which DTTL does not believe is required or intended. Rather DTTL believes that in identifying and assessing the related risks of material misstatement, the auditor would be expected to understand the processes, techniques and assumptions (noting also that there would

	be more than one assumption), and identify and understand the relevant controls. In responding to the risks, the auditor may decide to, or may determine that it is necessary to, test the operating effectiveness of relevant controls, which is addressed in the second bullet (2) Third bullet. Additional clarity is needed to explain the intention or meaning of this consideration, as its relevance to the auditor's consideration of the relevance and reliability of information is not apparent. (3) Fourth bullet. DTTL believes that this paragraph is overly specific and should be redrafted more generally with an example relating to security prices. See suggested edits for this final bullet. ~~As part of the~~ **In** consider**ing**~~ation of~~ the relevance and reliability of information from external information sources, one or more of the following **procedures** may be **appropriate** ~~relevant~~: • ... • ~~When the~~ **Performing a comparison of** information ~~received~~ **obtained** from the external information source **with information obtained** ~~relates to security prices, obtaining~~ ~~an independent price~~ from another **independent** information source**, for example, when the information from the external information source is a security quote, obtaining price quotes for the same securities from another independent external information source and comparing the two.**
A33H	This paragraph requires additional clarity: (1) First sentence. It's not clear what the auditor is using the information for; this understanding is necessary to put the guidance in context. (2) Third sentence. When using "in such cases" it is not clear whether the auditor should be referring to the first sentence where there is one source and provider, or to the second sentence where there is a reference to obtaining additional audit evidence. (3) Fourth sentence. The guidance to access a different source does not appear to make sense given that the first sentence indicates that there is only one source and provider.