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Institut des Réviseurs d'Entreprises

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M. Matt WALDRON
Technical Director IAASB

Posted as comment on:
www.ifac.org

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Dear M. Waldron,

Re IAASB Exposure draft ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures*

The *Institut des Réviseurs d'Entreprises/Instituut van de Bedrijfsrevisoren* ("IRE-IBR") is pleased to have the opportunity to provide its comments on the Exposure Draft *ISA 540 (Revised) Auditing Accounting Estimates and Related Disclosures* issued by the International Auditing and Assurance Standards Board (IAASB).

IRE-IBR welcomes the initiative of the IAASB to revise ISA 540 enhancing the auditor's identification and assessment of the risks of material misstatement for accounting estimates.

In general, we endorse the response given by Accountancy Europe.

However, we would like to comment on the proposed paragraphs 13 and 15, aiming at making ISA 540 more scalable by introducing the concept of low inherent risk and by requiring that the auditor, when dealing with accounting estimates with low inherent risk, determines whether one or more specific further audit procedures that may provide sufficient appropriate audit evidence in the circumstances. For inherent risk that is not low, the auditor is required to design further audit procedures to obtain audit evidence about matters relating to complexity, judgment or estimation uncertainty, to the extent these factors are the reasons for the assessed risks of material misstatement.

Please find our more detailed response hereafter.

Sincerely,



Tom MEULEMAN
Vice-President

Question 1

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

We recognized the efforts made to revise IAS 540 to address the evolution of the financial reporting framework, in particular the International Financial Reporting Standards. We note that ED 540 incorporates various concepts that are of relevance in the context of the adoption of IFRS 9. We further note that several other recent standards such as IFRS 15 and IFRS 16 require a greater use of estimates and judgment but are rarely illustrated in ED 540.

Question 2

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

ED 540 integrate certain elements that should be helpful in promoting professional skepticism. However, we do not believe professional skepticism is prominently addressed in ED 540. In our view the application of professional skepticism is not necessarily addressed within individual standards but should be part of a comprehensive approach combining standard-setting, education and potentially, the development of a professional skepticism framework. While D 540 is a step in the right direction, we encourage the IAASB to continue to investigate appropriate avenues to strengthen the application of professional skepticism by auditors.

Question 3

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

Due to its length, the numerous steps to be contemplated by the auditor and the many references to regulated industries, we are concerned that ED 540 will trigger the perception that it is ill-suited for less complex engagements. In particular, we note that

- Paragraph 3 seems to imply that the characteristics mentioned are inherent to every estimates. Further the relevance of an estimate to the stakeholders in assessing the financial situation or performance of the entity does not seem to be an element considered in the risk assessment process. As such there is a risk that the risk assessment process focuses too much on the inherent characteristics of the estimate rather than its usefulness to the users of the financial information and the specific set of facts and circumstance surrounding the estimate;
- The enquiries of management mandated in paragraph 10 (e) are complex and far reaching as part of the risk assessment phase when dealing with a non-complex environment;
- The requirements to obtain an understanding of each elements of internal controls in par. 10 (f) for each estimate are far reaching and onerous when dealing with less than complex estimates. Also the limitations in the design and operating effectiveness of internal controls in a less complex environment are not acknowledged; and



- The challenges to performing a look-back exercise in paragraph 11 in a less complex environment are thus not acknowledged.

Question 4

When inherent risk is not low (see paragraphs 13, 15 and 17–20):

- a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?**
- b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?**
- c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?**

Question 4 (a)

We are supportive of the concepts developed in ED 540 in particular the proportionality of the audit response to the risk of material misstatement of the estimate. In our view ED 540 articulates properly the audit steps to be undertaken in response to the assessed risk of material misstatement, Due to the criticality of the design of a risk-responsive audit approach, we encourage greater clarity and guidance in this area. In particular:

- A better linkage between the concept of significant risk in paragraph 13 and the concept of inherent risk is paragraph 15
- A clarification that when inherent risk is low that at least of of the procedures described in paragraph 15 (a) must be considered;

Question 4 (b)

We agree with the concepts put forward. However, in our view, the estimation uncertainty appears to be characteristic of the estimate that most affect the risk of material misstatement, right before management judgement. Putting complexity, judgment and estimation uncertainty at the same level gives in our view to much prominence to complexity. We believe that the greater audit risks relates to the other more subjective elements, in particular the estimation uncertainty, and that using this element as a gating consideration would help focus the audit efforts on those estimates that present the greater risk of material misstatement and accordingly, are the most relevant to the financial information.



Question 4 (c)

We suggest considering revising the wording in paragraph 16 which considers the design and testing of controls as it is currently unclear how this paragraph derives from paragraph 15. We suggest to explicitly link paragraph 16 to paragraph 15 (b) when inherent risk is not low since paragraph 15 (a) discusses situations where the inherent risk is low - which will not be relevant in the consideration of controls.

Question 5

Does the requirement in paragraph 20 (and related application material in paragraphs A128–A134) appropriately establish how the auditor’s range should be developed? Will this approach be more effective than the approach of “narrowing the range”, as in extant ISA 540, in evaluating whether management’s point estimate is reasonable or misstated?

In our view the requirement of paragraph 20 and its related application material will lead to a more effective approach than the current “narrowing the range” approach.

However, we are concerned by the suggestion of the IAASB that the auditor carries out the work that is the responsibility of management as included in paragraph 20 and A127. In our view, the standard should reinforce the essential role and responsibility of management in developing estimates and in demonstrating how they have addressed the estimation uncertainty. The auditor should only proceed with developing a point of estimate if and only if management is unable to provide such information. In addition, the guidance material should acknowledge the fact that in certain instances, the auditor might not be able to “compensate” for the absence of management’s analysis. In that case it would be useful to outline the impact on the audit report.

We note that the IAASB rightly acknowledges that in certain instance the auditor’s range could be a multiple of materiality.

Question 6

Will the requirement in paragraph 23 and related application material (see paragraphs A2–A3 and A142–A146) result in more consistent determination of a misstatement, including when the auditor uses an auditor’s range to evaluate management’s point estimate?

In our view the evaluation of the reasonableness of the accounting estimate should be done in the context of the auditor expressing an opinion on the financial information taken as a whole. The current wording may give too much prominence to the estimate as such.

Question 7

With respect to the proposed conforming and consequential amendments to ISA 500 regarding external information sources, will the revision to the requirement in paragraph 7 and the related new additional application material result in more appropriate and consistent evaluations of the relevance and reliability of



information from external information sources?

We agree with the proposed conforming and consequential amendments to ISA 500 regarding external information sources. The revision to the requirement in paragraph 7 and the related new additional application material, should help lead to more appropriate and consistent evaluations of the relevance and reliability of information from external information sources. It is important to think about information.

Question 8

In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:

- a) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-540.**
- 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.**

Question 8a

Words such as “may” or “could” may, when translated, lead to different interpretations and meanings. The use of consistent terminology throughout the standards is particularly important to avoid difficulties in the eventual translation of the text. The IAASB has generally used “may” throughout its standards, and thus consistency would be appropriate going forward.

We also recommend changing the word ‘reasonable’ to ‘appropriate’ when referring to disclosures. We refer to paragraph 21. As noted in paragraph A2, the word ‘reasonable’ means ‘all the relevant requirements of the applicable financial reporting framework have been applied appropriately’ whereas the term ‘appropriate’ includes also the element of judgement which is important when deciding what disclosures to make about the accounting estimates. Indeed, according to paragraph A3 ‘appropriate’ both conforms with the requirements of the applicable financial reporting framework and considers judgements that are consistent with the measurement bias in the applicable financial reporting framework.

