

31 July 2017

Professor Arnold Schilder  
Chair  
International Auditing and Assurance Standards Board  
529 5<sup>th</sup> Avenue  
New York, New York 10017  
UNITED STATES OF AMERICA

Dear Professor Schilder

**IAASB Exposure Draft ISA 540 Auditing Accounting Estimates and Related Disclosures**

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the Exposure Draft ISA 540 (the ED). The views expressed in this submission represent those of all Australian members of ACAG.

Overall ACAG agrees with the revised intent of the ED.

However, we have concerns that this standard will be issued before ISA 315 *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*, which we believe should establish the risk assessment framework for ISA 540.

ACAG also notes that this standard appears to be more prescriptive in nature than the existing suite of auditing standards, rather than being principles based, and questions whether this was the intent of the IAASB.

Additionally, the level of effort required of auditors and consequently, preparers, is greater than that required from the preparers applying comparative accounting standards. ACAG recommends that preparer requirements be embedded only in the accounting standards, to help achieve compliance and consistency in application.

We have identified some areas of the ED which could be improved or refined to help with the practical application of this standard.

ACAG recommends conducting a post implementation review of the standard to identify and address practical application issues faced by auditors.

ACAG appreciates the opportunity to respond and trust that you find our comments useful.

Yours sincerely



Andrew Greaves  
Chairman

**ACAG Financial Reporting and Auditing Committee**

cc Professor Simnett AO, Chair Australian Auditing and Assurance Standards Board

## Comments

### Overall Questions

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

Yes, the Exposure Draft ISA 540 (the ED) addresses the key points.

However, the ED could include more examples, other than those related to financial instruments, to help auditors apply the concepts in the ED for all estimates.

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

ACAG agrees the 'stand back' requirement in paragraph 22 reinforces the principle of professional scepticism. While auditors may currently be 'standing back' and assessing whether sufficient appropriate audit evidence has been obtained, this may not be appropriately documented and evidenced on the audit file, and the ED's requirements should ensure the auditor's thought processes are more explicitly documented.

We caution however that the ED may be interpreted to limit the use of professional scepticism when the inherent risk of the accounting estimate is assessed as low, as the prescriptive requirements of the paragraph apply only to situations where the risk is assessed as not low.

### 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?**

In theory the separation of required responses according to assessed risk and, where risk is not low, according to whether, all or a combination of factors exist, provides a useful framework. In this respect, the ED is scalable in as much as it limits or expands audit considerations to relevant matters.

In saying that, ACAG does not believe the ED is as scalable in practice as the theory may allow. In practice most estimates, unless clearly immaterial:

- have higher than low inherent risk ratings and further audit procedures will therefore always be required
- involve a combination of judgement, complexity and estimation uncertainty—these three elements being inextricably linked, and the first two being causally related to the third. In practical terms therefore, it may be difficult to discern or unwind and analyse each element in isolation, potentially leading to most estimates being designated as 'significant' risks.

It would be useful to include in the standard further guidance on what factors, alone or in combination, may lead the auditor to judge the risk as significant.



**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 risk relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330)?**

The elaboration in paragraphs 10 through 13 on the risk assessment requirements as they relate specifically to auditing estimates is useful, and is likely to assist auditors more effectively identify risks of material misstatement.

However, whether risk responses will necessarily be any more effective is less clear.

The 'low' and 'not low' inherent risk categories, introduced for the first time in this ED, have not been defined in the ED, nor elsewhere in the Auditing Standards (particularly ISA 315).

The lack of detail regarding how to respond to significant risks and the generic references to obtaining 'sufficient appropriate evidence', may also still lead to inappropriate responses.

- b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?**

Yes, ACAG believes the factors of 'complexity', 'judgement' and 'estimation uncertainty' are useful for the auditor to consider.

- 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?**

ACAG believes there is sufficient guidance provided.

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

Yes, ACAG believes that the requirement establishes how the auditor's range is to be developed.

ACAG also recommends that paragraph 20 be amended to include point estimate or an additional requirement for when the auditor develops the point estimate.

- 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?**

Paragraph A145 clarifies a misstatement as the difference between management's point estimate and the nearest point of the auditor's range. ACAG believes this will be

challenging for auditors to practically apply, especially when the range can be multiples of materiality as provided for in para A134. ACAG questions the appropriateness of the range being multiples of materiality.

ACAG recommends additional clarification on the interplay between the auditor's range and materiality, as well as practical examples to help auditors:

- practically apply this concept (multiples of materiality)
- determine at what point a material misstatement arises. ACAG also recommends that this requirement include a documentation consideration, as documentation of the auditor's evaluation of whether the accounting estimate is reasonable will be critical.

### **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?**

ACAG believes sufficient requirements already exist in ISA 500 Audit Evidence to evaluate the relevance and reliability of information from external sources. However, ACAG believes there is some merit in calling out this requirement, as it will reinforce the message that external information should be assessed for relevance and reliability, rather than simply accepted because it is external (i.e. just because it is externally sourced information doesn't mean it is correct).

### **Request for General Comments**

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

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

Not applicable.

- 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.**

ACAG does not believe this standard should be issued and effective prior to the revised ISA 315 given their inter-relationship. If ISA 540 were issued prior to revised ISA 315, there would be potential inconsistencies in the audit approach taken given the different terminology from the current ISA 315 and the move away from consideration of 'significant risks' and 'risks of material misstatement'.

ACAG further notes that there is inconsistency in the application date. Para 7 states that the effective date is for 'periods beginning' whereas the question is for 'periods ending'.

ACAG believes the effective date for 'periods beginning' would be more appropriate given the additional work effort required by both the preparers and auditors in complying with this standard.

