



**The Institute of
Chartered Accountants
of Pakistan**

**CA
PAKISTAN**

HEAD OFFICE

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(Submitted electronically)

Technical Director
International Auditing and Assurance Standards Board (IAASB)
529, Fifth Avenue, 6th Floor
New York, USA

Comments on Exposure Draft, Proposed ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures

The Institute of Chartered Accountants of Pakistan (ICAP) is pleased to comment on the Exposure Draft, Proposed ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures (the ED) published by the International Auditing and Assurance Standards Board (the IAASB) in April 2017.

We fully support IAASB's focus and efforts to update and improve extant ISA 540. We acknowledge that improvements envisaged in the ED 540 will contribute positively in enhancing the audit quality. However, there are areas in the ED 540 which we believe require further consideration and refinement, so as to make the requirements more relevant, understandable and effective for implementation.

Our responses detailed by the questions contained in the ED, are presented in the 'Appendix' to this letter.

We hope our comments are helpful to the IAASB's deliberation on the ED.

Should you require further clarification on our comments, please contact the undersigned at sohail.malik@icap.org.pk

Yours truly

Sohail Malik
Director Technical Services

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

We understand that IAASB initiated the project to address the issues relevant to the audits of financial institutions, as well as ISA 540 more broadly. We support the IAASB approach in addressing the limitations of extant ISA 540 with the publication of ED 540, with the objective to make the auditing requirements relevant in the current business environment and financial reporting landscape.

In view of the IAASB project, we feel that ED 540 is mainly focused on the auditing accounting estimates that would generally relate to the financial institutions. We understand that the forward looking information will be more complex to audit, and specific guidance may be included in the ED 540 in relation to the audit of Expected Credit Loss (ECL) model for impairment under International Financial Reporting Standard 9 '*Financial Instruments*'. In addition to this, we believe that further guidance is required within ED 540 to address the scalability of the requirements based on the particular type of the entity (for example, different in size, complexity, nature of operations etc.).

We understand that in the context of current financial reporting environment, the requirements of ED 540 will upwardly effect the time and resources required for both the practitioner and the client. In consideration of this we believe that the strategy may be developed to communicate and educate the client of the evolving and enhanced auditing requirements, including the ED 540.

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

The ED 540 contains references to the professional skepticism and we support IAASB's approach to reinforce the need for professional skepticism when auditing accounting estimates.

However, we believe that the requirements to apply professional skepticism should be further emphasized and included in ED 540, along with guidance and explanatory material. This would assist in improving the understanding and practical application of the professional skepticism when auditing accounting estimates, consequently leading to enhanced audit quality and meeting the stakeholders' expectations.

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

We believe that the scalability of the requirements of the ISAs is the key consideration in the context of the audit of smaller and low risk entities. We are of the view that the requirements as contained in ED 540 would be too detailed for the audit of SMEs, as ED does not indicate to what extent audit procedures and other requirements can be scaled for small and low risk entities.

We also understand the more prescriptive approach of the ED 540 as compared to the principle based approach of extant 540 may cause lesser use of professional judgment and greater emphasis on the tick box approach, unless the guidance on scalability of the requirements of the ED 540 is given further consideration.

In addition to the above, the ED 540 introduces the concept of 'low inherent risk' and explains the same in the context of audit of accounting estimates. We suggest that IAASB considers the appropriate placement of



'low inherent risk' in the ISAs, as it is relevant to various other areas of the audit. Further, evaluation by IAASB and guidance material is required in view of the possible practical difficulties, including scalability, which may arise with the inclusion of low inherent risk concept along with the 'not low inherent risk' classification in the ED 540.

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?

We believe that the requirements outlined in paragraphs 13, 15 and 7-19 require further consideration and explanation.

- a) We understand that the risk assessment model envisaged under ED 540 differs from the extant ISA 315, and ED 540 requires further clarification on the risk model and its relation to the existing requirements of ISA 315 (Revised), '*Identifying and assessing the risks of Material Misstatement through Understanding the entity and its Environment*'. Further, the related terms as defined in the explanatory guidance may be included in the definition section.
- b) We understand that complexity, judgment and estimation uncertainty are the three relevant factors to consider when assessing the risks related to the accounting estimates, and suggest that further explanation is included in ED 540 on the interaction of these factors.
- c) We believe that paragraphs 17-19 of the ED 540 and related application material require further clarification regarding the nature and extent of procedures to be performed, particularly in relation to the scalability and proportionality of the requirements.

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?

We understand that the ED 540 requires the auditor to develop a point estimate or a range to evaluate management's point estimate, whereas the extant ISA 540 requires the auditor to reduce the range to what is reasonable. We believe that further to the proposed amendments, additional guidance is required in relation to various practical aspects including circumstances under which an auditor's range is developed, how an auditor's range is utilized in evaluating management's point estimate, the application of evaluation of point estimate with a range, and the interaction of the auditor's range with the materiality determined by the practitioner.



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?

We acknowledge that the paragraph 23 and related application material provide guidance regarding the determination of misstatement. However, we believe that the consistent determination of a misstatement may continue to be a practical challenge, as it would be subject to variations owing to the experience and familiarity factors.

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?

We appreciate that the conforming amendments to paragraph 7 of ISA 500 ‘*Audit Evidence*’ provide further clarity in relation to information used as audit evidence obtained from an external source. However, we believe that limiting the proposed amendment to the information that is available to the public as mentioned in paragraph A1 of ISA 500 requires reconsideration, as this will narrow the scope of external source information. We also suggest that further explanation is provided as to how the requirements should be applied to the internal and external information sources.

GENERAL COMMENTS

1. 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 in Pakistan, as ISAs are adopted in English and are not translated.

2. 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.

We believe that the extended time period i.e. of at least 18 months after approval of the final ISA, would be a sufficient period for the effective implementation of the ISA.