



National Association of State Boards of Accountancy

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August 1, 2017

Mr. Matt Waldron
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue
New York, NY 10017

Re: Proposed International Standard on Auditing 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

Dear Mr. Waldron:

We appreciate the opportunity to offer comments on the Proposed International Standard on Auditing 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* (ED).

The National Association of State Boards of Accountancy's (NASBA) mission is to enhance the effectiveness and advance the common interests of the Boards of Accountancy that regulate all certified public accountants and their firms in the United States and its territories.

NASBA continues to monitor the IAASB's standard developments closely because of the potential impact of international auditing standards on development and adoption of auditing standards from the AICPA Auditing Standards Board in the United States. NASBA representatives attend the IAASB Board and Consultative Advisory Group's meetings, and NASBA is actively represented at the AICPA Auditing Standards Board.

NASBA has an additional interest in IAASB standards inasmuch as Rule 10-3 of the Uniform Accountancy Act (UAA) Model Rules ("Applicable standards") requires licensees to "follow standards issued by other professional or governmental bodies including international standards setting bodies with which a licensee is required by law, regulation or the terms of engagement to comply." Indeed, at least six State Boards of Accountancy have already expressly adopted IAASB auditing and assurance standards by reference¹ in their respective accounting rules. Thus, changes in IAASB standards may perforce result in changes to state laws. Individual and firm licensees who fail to comply with IAASB standards when applicable may be subject to State Board discipline. See Uniform Accountancy Act Section 10(a)(6) (licensees can be disciplined for "violation of professional standards").

¹ Michigan, (MICH. ADMIN. CODE R 338.5102); North Carolina, (21 N.C.A.C. 8N.0410), Ohio (OAC Ann. 4701-9-03; OAC Ann. 4701-9-10), Oregon (OAR 801-005-0010), Pennsylvania (34 Pa. Code § 125.3), and Wisconsin (Wis. Adm. Code Accy. 6.101).

We offer the following comments on the ED.

GENERAL COMMENTS

We understand that in developing the proposed standard, the IAASB aims to achieve the following:

- enhance requirements for risk assessment procedures to include specific factors related to accounting estimates, namely: complexity, judgment, and estimation uncertainty;
- set a more detailed expectation for the auditor's response to identified risks of material misstatement related to accounting estimates, including enhancing the auditor's application of professional skepticism; and
- scalability regardless of the size or sector of the business or audit firm.

We would like to commend the IAASB on its efforts to develop a revised standard on auditing accounting estimates and related disclosures. The increasing complexity of financial instruments creates new risks which need to be assessed and addressed by auditors. In addition, recent accounting standards on fair value measurements, expected credit loss and other financial reporting standards mandate new accounting and disclosure requirements which contain disclosures that need to be audited. Thus, we would like to express our overall support for recognizing a need for updating the existing standard.

Notwithstanding the above, we wish to emphasize the following matters:

Overall Structure and Clarity of the Exposure Draft

- a) We found that the ED is extremely complex and not easy to follow. We recommend that the IAASB consider the Public Company Accounting Oversight Board's recent proposal on *Auditing Accounting Estimates, Including Fair Value Measurements* to simplify its proposal and to eliminate unnecessary differences for auditors. We also recommend either adding additional guidance in the current IAASB proposal or providing an explicit linkage to the auditing guidance on use of specialists.
- b) We believe that there should be a better linkage between ISA 540 and ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and Its Environment* and ISA 330, *The Auditor's Responses to Assessed Risks*.
- c) We recommend including additional application guidance on auditing internal controls and management's process of developing estimates.
- d) Paragraph A1C of the Application and Other Explanatory Material prescribes use of the management expert. In some situations there may be limited public information available for determination of an independent estimate, which could create a challenge for

differentiation between a management expert and external information source. Further application guidance may be required to elaborate further on such issues.

OVERALL QUESTIONS

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

We understand that one of the goals of the proposed standard is to enable the auditor to address audit risks arising from the management's adoption of the evolving financial reporting framework, when applicable. To achieve this objective, we recommend including additional application guidance to assist auditors in addressing relevant risks and developing appropriate audit procedures (e.g. application guidance on the expected credit loss model).

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

Yes, we agree that the requirements and application material will add clarity to reinforce the application of professional skepticism when auditing accounting estimates.

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?*

We believe the IAASB should consider adding additional clarity to paragraph 15 (a) when inherent risk is low.

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

- a) *Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?*

Yes.

- 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?*

In its proposal the IAASB describes three factors that are most likely to influence the risks of material misstatement in relation to making an accounting estimate:

- Complexity;
- The need for the use of judgment by management; and
- Estimation uncertainty.

We believe that all three factors are interrelated and estimation uncertainty is inherent in predicting future events. Thus, although we do believe that auditors should respond to these risk factors, we do not think that requiring auditors to respond to each factor separately is necessary.

We also think that the need for management judgment comes into play after evaluating complexity and range of estimates; thus, the order of the factors in the ED may need to be rearranged.

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 would like to commend the IAASB on the proposed standard's paragraphs 17 and 18 which emphasize a need for auditors to perform sufficient audit procedures, and obtain appropriate audit evidence, to address matters where management uses complex methods or models, or where management is required to apply its judgment.

We recommend that the ED reemphasize the need to focus significant audit efforts in the areas of higher inherent risk. If the auditor determines that the inherent risk is low, the audit procedures should be tailored accordingly (e.g. auditors may consider performing substantive analytical procedures in the areas of low risk).

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?

Paragraph 128 of the ED prescribes that "whether the auditor develops a point estimate or uses an auditor's range, the auditor is designing and performing a substantive analytical procedure." The statement is confusing since the appropriate audit procedure could be also be designed as a test of details. It is also not clear if an auditor is expected to develop a range that is below the tolerable misstatement amount calculated as part of the materiality determination.

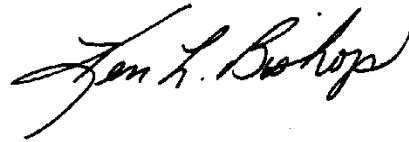
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Again, we appreciate the opportunity to comment on the Exposure Draft.

Sincerely,

Handwritten signature of Telford A. Lodden in black ink.

Telford A. Lodden, CPA
NASBA Chair

Handwritten signature of Ken L. Bishop in black ink.

Ken L. Bishop
NASBA President and CEO