

Agenda Item 2-D

Analysis of Responses to Question 7 of the Exposure Draft

Section I: Question included in Exposure Draft

1. The following question was asked in the exposure draft:

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 (EIS)?

Section II: Staff Analysis of Respondents' Views¹

General Observations

2. A majority² of respondents, including three Monitoring Group members, generally supported the *intent* of the conforming amendments. However, certain respondents expressed concern at the effectiveness, volume and clarity of the application material, while others called for further guidance. Respondents also commented on the location of proposed content.
3. Two respondents³ did not support the proposed change to the requirement, with one respondent⁴ uncertain that the changes were needed.
4. Some respondents, including one Monitoring Group member,⁵ cited concerns that the changes do not sufficiently address the challenges related to EIS and may not therefore achieve their desired objective.
5. The comments received have been categorized into three main areas for the purposes of this paper:
 - Definitions
 - Relevance and reliability of information from an EIS

¹ In this paper the following terms have been used:

- "A respondent" = 1;
- "A few" = 2–3;
- "Some" = 4–6;
- "Several" = 7–11;
- "Many" = 12–34;
- "Majority" = more than 50%; and
- "Significant majority" = greater than ~80%.

² *Investors & Analysts*: CFA, *Regulators*: BCBS, CEAOB, ESMA, IAIS, IRIAR, IRBA, UKFRC, *NSSs*: AUASB, CAASB, CNCC-CSOEC, HKICPA, IDW, JICPA, MAASB, NBA, NZAuASB, *Firms*: BDO, EY, GTI, KPMG, PWC, PFK, RSM, *Public Sector*: ACAG, AGC, CIPFA, GAO, PAS, AE, *Member Bodies*: AICPA, ANAN, CAI, CAAA, FACPCE, IAAA, IBR-IRE, ICAG, ICAP, ICAS, ICASL, ICAZ, ICPAK, SAICA, *Individuals & Others*: NDEG.

³ *Firms*: DTT, *Public Sector*: AGA

⁴ *Member Bodies* ACCA-CAANZ

⁵ *Firms*: EY, KPMG, *Member Bodies*: IBRACON, ICAEW, *Regulators*: IOSCO, KICPA

- Linkage of ISA 540 (Revised)⁶ and ISA 500⁷

Monitoring Group Comments

6. Three monitoring group members⁸ generally supported the intent of the conforming amendments, while one⁹ was concerned that the changes did not sufficiently address the challenges posed by external information sources. Comments made included:
- Stronger links should be made from ISA 540 to the new paragraphs in ISA 500, specifically linking to the new material on relevance and reliability;¹⁰
 - Concerns about the phrase “publicly available” because it may be interpreted too narrowly;¹¹
 - That the amendments to ISA 500 did not provide sufficient guidance on use of management experts, third-party security pricing services, or brokers.¹²
 - In respect to the auditor’s evaluation of the relevance and reliability, including accuracy and completeness, of the external information source:
 - The auditor may not always be able to test the accuracy and completeness of the external information source, and the implications of not being able to get sufficient appropriate audit evidence;¹³ and
 - The credibility of the information source should be assessed, in addition to relevance and reliability, in particular when the source is not widely used.¹⁴
 - That the ISA should include further explanation on the audit implications of management’s use of a third-party model.¹⁵
 - Suggestions that that guidance be included about the inherent subjectivity and risk of management bias in internal information sources.¹⁶
 - That there were differing views from within one monitoring group member on the need for stronger requirements and guidance on evaluating the work of a management’s expert,¹⁷ while another urged focus on material addressing assumptions developed with the assistance of management’s experts.¹⁸

⁶ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

⁷ ISA 500, *Audit Evidence*

⁸ BCBS, IAIS, IFIAR

⁹ IOSCO

¹⁰ BCBS

¹¹ IFIAR, IOSCO

¹² IOSCO

¹³ IOSCO

¹⁴ IAIS

¹⁵ BCBS

¹⁶ IOSCO

¹⁷ IOSCO

¹⁸ IFIAR

Definitions

7. Many respondents, including two Monitoring Group members,¹⁹ raised a concern over the phrase “publicly available” in the definition of EIS. Respondents highlighted that this term could be misunderstood i.e., that it only applies to freely available information, when in many circumstances information is available to a broad range of users but may involve a cost to access. It was suggested that this may give rise to an unintended limitation on the scope of information intended to be covered.

Relevance and Reliability of Information from an EIS

8. One respondent²⁰ believes the change to paragraph 7 is unnecessary as an EIS is already covered by the extant requirement i.e., information to be used as audit evidence already includes information from external sources.
9. Another respondent²¹ suggested that information from sources independent of the entity may be presumed to be reliable and that the changes would cause confusion.
10. Some respondents²² expressed a view that the proposed application material will not result in consistent application and therefore not achieve its intended objective. Reasons expressed included that the application material provides many approaches to considering the relevance and reliability without sufficient context, that the guidance is too long and not focused or that the guidance implies an information source could in fact be both a management expert and EIS.
11. Similarly, a respondent²³ noted that the volume and granularity of material could lead to an expectation of what the auditor was expected to do that may not be realistic in practice.
12. Some respondents, including one Monitoring Group member,²⁴ did not believe the application material provided sufficient guidance on use of management experts or challenges in assessing relevance and reliability of third-party security pricing services and brokers. In some cases, the PCAOB exposure draft material on pricing services was cited as a useful point of reference.
13. One Monitoring Group member²⁵ highlighted that the *credibility* of the information source should be assessed, in addition to relevance and reliability, in particular when the source is not widely used.
14. Two Monitoring Group members²⁶ commented on the need for the accuracy and completeness of information from an EIS to be considered or that it was unclear from the application material if, or how, these were relevant.
15. Various other suggestions were made for additions to application material, including:
- Further consideration of how management has evaluated the relevance and reliability of the

¹⁹ *Regulators:* CEAOB, ESMA, **IFIAR**, **IOSCO**, *NSSs:* IDW, NBA, *Firms:* GTI, PWC, *Member Bodies:* IBRACON, ICAP, AE, SMPC, *Individuals & Others:* NDEG

²⁰ *Firms:* DTT

²¹ *Public Sector:* AGA

²² *Firms:* EY, *Member Bodies:* AICPA, IBRACON, KICPA

²³ *Member Bodies:* SMPC

²⁴ *Regulators:* **IOSCO**, *Member Bodies:* AICPA, CAI, ICAEW, *Firms:* EY, KPMG,

²⁵ *Regulators:* **IAIS**

²⁶ *Regulators:* **BCBS**, **IOSCO**

source.²⁷

- The importance of expertise when it comes to integrity of data and value of different sources of evidence.²⁸
- When a third-party model is used, auditors should assess the model methodology (including theoretical soundness and mathematical integrity), the appropriateness of model inputs (e.g., data and assumptions), and validation procedures and controls over the model.²⁹
- Guidance that assists in determining the nature and extent of work that is appropriate in differing circumstances and the nature of the source and how the information is used³⁰, including when evidence may be limited³¹, whether certain sources may be deemed reliable e.g., Bloomberg³², when only a single alternative source is available that results in a materially different outcome³³, and when there are divergent market views on inputs.³⁴
- Additional examples of sources where the auditor may not be able to get access.³⁵
- When the auditor is unable to get sufficient access to evidence to evaluate the information or model from an EIS, the implications of this limitation on scope.³⁶
- Highlighting that internal information sources are more subjective and likely more at risk of inappropriate management bias compared to an EIS.³⁷
- When a management expert publishes information for more general use, how that information is to be evaluated.³⁸
- How ISAE 3402³⁹ assurance reports on controls at a service organization may be an alternative source of evidence.⁴⁰

16. A few respondents⁴¹ also called for elements of the application material to be elevated to requirements, such as the need to understand why management uses an EIS (paragraph A33)⁴². However, not all respondents making this comment specifically identified those elements they would

²⁷ Firms: GTI

²⁸ Member Bodies: ICAEW

²⁹ Regulators: **BCBS**

³⁰ Firms: EY, PWC, Member Bodies: CAQ, Individuals & Others: NDEG

³¹ Firms: PWC, Individuals & Others: NDEG

³² NSSs: NBA, Member Bodies: ISCA

³³ Firms: KPMG

³⁴ Firms: EY

³⁵ NSSs: CAASB, Member Bodies: KICPA, ICAEW

³⁶ Regulators: **IOSCO**, Member Bodies: ICAEW, ISCA SMPC, Firms: KPMG,

³⁷ Regulators: **IOSCO**

³⁸ Firms: GTI

³⁹ International Standards On Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*

⁴⁰ Member Bodies: CPAA

⁴¹ Regulators: ESMA, NSSs: HKICPA

⁴² NSSs: HKICPA

like to be elevated.

17. A respondent⁴³ noted that the changes could result in significantly more audit effort and that the process to obtaining evidence about information from an EIS may result in more assurance reporting on controls at service organizations.
18. Some respondents⁴⁴ believed that more (or clarified) guidance is needed for when the auditor and management use the same information source, in particular when there is only one source.
19. A few respondents, including one Monitoring Group member,⁴⁵ questioned the fact that the proposed changes appeared to only apply to EIS and whether they should also apply to information from sources internal to the entity.
20. A few respondents⁴⁶ also noted that the application material is too focused solely on when management uses an EIS and that additional guidance is needed for when an auditor themselves use an EIS.

Linkage of ISA 540 (Revised) and ISA 500

21. Several respondents, including one Monitoring Group member,⁴⁷ called for a more explicit linkage between ISA 540 and ISA 500, including both paragraph 7 of ISA 500 (EIS) and paragraph 8 (management expert).
22. One Monitoring Group member⁴⁸ called for clarification in ISA 500 to provide more emphasis on what is expected of the auditor when assumptions are developed by management or management's expert, highlighting that they should apply the requirements in ISA 540 in such cases. Another Monitoring Group member⁴⁹ highlighted differing views on the need for stronger requirements and guidance on evaluating the work of a management's expert.
23. Some respondents⁵⁰ suggested that the proposed changes would be better located in ISA 540 (Revised) rather than ISA 500.
24. A few respondents⁵¹ stated that it was better to wait and let the proposed project to revise ISA 500 make the changes in a more holistic manner.
25. One respondent⁵² highlighted that consideration of how management and auditors use EIS in performing data analytics was a relevant consideration as part of the future ISA 500 revision project.

⁴³ NSSs: AUASB

⁴⁴ NSSs: AUASB, CAASB, JICPA, *Firms*: KPMG, PWC, *Member Bodies*: AICPA,

⁴⁵ *Regulators*: IOSCO, NSSs: AUASB

⁴⁶ *Firms*: DTT, *Member Bodies*: AICPA, IBRACON

⁴⁷ *Investors & Analysts*: CFA, *Regulators*: BCBS, NSSs: CAASB, *Firms*: PWC, *Public Sector*: GAO, *Member Bodies*: IBRACON, *Individuals & Others*: NDEG

⁴⁸ *Regulators*: IFIAR

⁴⁹ *Regulators*: IOSCO

⁵⁰ *Firms*: DTT, EY, RSM, *Member Bodies*: AICPA, ICASL

⁵¹ *Member Bodies*: ACCA-CAANZ, AICPA NSS: CNCC-CSOEC

⁵² *Firms*: EY