

Supplement D to Agenda Item 2

Preliminary Analysis of Responses to Question 6 of the Exposure Draft

Section I: Question included in Exposure Draft

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

Q6. *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?*

Section II: Staff Analysis of Respondents' Views¹

Requirement

2. Many respondents, including two Monitoring Group members,² were of the view that paragraph 23 and the related application material will lead to a more consistent determination of a misstatement, while a few respondents³ had opposing views. One respondent was of the view that paragraph 23 will result in more consistent determination of misstatements, but not for disclosures related to accounting estimates, particularly qualitative disclosures.⁴ A few respondents⁵ believed that additional guidance was needed on the auditor's evaluation of qualitative disclosures.
3. The respondents who were of the view that paragraph 23 and the related application material will not lead to a more consistent determination of a misstatement noted that the determination of materiality is open to interpretation and has not been sufficiently considered within the Exposure Draft of Proposed ISA 540 (ED-540),⁶ particularly for those misstatements that represent judgmental differences rather than factual misstatements.
4. Other respondents⁷ were of the view that the determination of misstatements will continue to present a practical challenge, particularly for those misstatements that represent judgmental misstatements rather than factual misstatements. It was noted that ED-540 does not provide sufficient guidance on the auditor's assessment and evaluation of misstatements that arise as a result of a difference in judgement.

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 *Regulators: BCBS, IAIS, IRBA, UKFRC, NSSs: IDW, MAASB, NBA, Firms: DTT, Pubic Sector: AGC, CIPFA, INTOSAI, PAS, Member Bodies: ANAN, CAI, FACPCE, IAA, ICAG, ICAS, ICAZ, ICPAK, KICPA, SAICA*

³ *NSSs: AUASB, Member Bodies: ACCA-CAANZ*

⁴ *Firms: EYG*

⁵ *Firms: EYG, Member Bodies: ICAS*

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

⁷ *NSSs: MAASB, NZAuASB, Member Bodies: ICAP, Pubic Sector: ACAG*

5. Many respondents, including one Monitoring Group member,⁸ also noted support for the various provisions of the stand-back requirement in paragraph 23. However, these respondents were also of the view that:
- ED-540 should clarify whether the evaluation should be done at an individual estimate or overall level;⁹
 - The linkage with ISA 700 (Revised)¹⁰ paragraph 13(c) should be clarified;¹¹ and
 - A more explicit requirement to consider ISA 705 (Revised)¹² in situations where the auditor is unable to obtain sufficient appropriate audit evidence should be included after paragraph 23.¹³
6. Respondents also noted that:
- The requirement in paragraph 23 applies to disclosures as well as amounts recorded in the financial statements, but the applicable application material related to disclosures appears to be scattered throughout ED-540. It was therefore suggested to bring application material together in one section.¹⁴
 - The last sentence of paragraph 23 appears to be misplaced because it addresses the implications of the auditor not obtaining sufficient appropriate audit evidence (which seems to be more closely related to evaluations performed in paragraphs 21 and 22 of ED-540).¹⁵
 - The determination required in paragraph 22(c) of ED-540 should be part of paragraph 23 because this determination relates to the assessment of whether a misstatement exists.¹⁶

Application Material

7. A few respondents, including one Monitoring Group member,¹⁷ noted support for the application material related to paragraph 23, particularly paragraphs A144-A146. The Monitoring Group member¹⁸ specifically supported the inclusion of paragraph A144 to promote the exercise of appropriate professional scepticism by the auditor.
8. Another Monitoring Group member¹⁹ was of the view that paragraphs A142-A146 could be further enhanced, and should be moved to the requirements, as these paragraphs are fundamental to ED-540. This Monitoring Group member was also of the view that paragraph A3 and paragraphs A142-A146 should be cross referenced to ISA 450,²⁰ paragraphs 10-13.
9. Respondents provided several areas where further guidance would be useful, including:

⁸ *Regulators: CEAOB, IFIAR, Pubic Sector: AGNZ, GAO, Firms: EYG, GTI, PWC, RSM, Member Bodies: IBR-IRE, ICAEW, SMPC, Individuals & Others: NDEG, NSSs: CAASB, PWC, Investors & Analysts: CFA,*

⁹ *NSSs: CAASB, Firms: GTI, PWC, Member Bodies: ICAEW, SMPC, Individuals & Others: NDEG*

¹⁰ *ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements*

¹¹ *NSS: CAASB, Firms: EYG, PWC, Member Bodies: IBR-IRE, ICAEW, SMPC*

¹² *ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report*

¹³ *Firms: RSM*

¹⁴ *NSSs: NZAuASB*

¹⁵ *Firms: EYG*

¹⁶ *Firms: KPMG*

¹⁷ *Regulators: IFIAR, Individuals & Others: NDEG, Investors & Analysts: CFA*

¹⁸ *Regulators: IFIAR*

¹⁹ *Regulators: BCBS*

²⁰ *ISA 450, Evaluation of Misstatements Identified during the Audit*

- Materiality and the evaluation of judgmental differences vs. factual misstatements.²¹
- The misstatement of disclosures, including qualitative disclosures.²²
- Examples on the use of point estimates and ranges, and how misstatements are calculated.²³
- How the outcome of auditor's range or point estimate interacts with the level of materiality and the effect on auditor's report.²⁴
- How the auditor addresses differences that are multiples of materiality.²⁵
- How to evaluate the effect of uncorrected misstatements relating to judgments.²⁶
- Explicitly addressing the consequences when management has not appropriately understood estimation uncertainty on the auditor's opinion and key audit matters.²⁷
- The relationship between materiality and estimation uncertainty.²⁸
- Additional guidance on using an auditor's range to evaluate management's point estimate.²⁹
- An explanation what is meant by reasonableness in the context of the applicable financial reporting framework.³⁰
- The relationship to ISA 200,³¹ paragraph 17 and the auditor's opinion.³²

²¹ *NSSs: AUASB, NZAuASB, Member Bodies: ACCA-CAANZ*

²² *Firms: EYG, Member Bodies: ACCA-CAANZ, ICAS*

²³ *NSSs: AUASB, Public Sector: ACAG*

²⁴ *Public Sector: ACAG, Regulators: EBA, BDO*

²⁵ *Regulators: IRBA, Member Bodies: SAICA*

²⁶ *Regulators: **BCBS***

²⁷ *Regulators: ESMA*

²⁸ *NSSs: NBA*

²⁹ *Firms: BDO*

³⁰ *Public Sector: AGA*

³¹ *ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

³² *Member Bodies: SMPC*