

# Supplement F to Agenda Item 2

## Preliminary Analysis of General Comments on the Exposure Draft

### Section I: Introduction

1. Respondents<sup>1</sup> to the Exposure Draft (ED) included overall or general comments in their letters that were not directly attributable to the questions posed in the ED. This paper is an analysis of those significant comments received, categorized into the following sections:
  - Section II: Overall support;
  - Section III: Readability and navigation;
  - Section IV: Relationship with ISA 315 (Revised);<sup>2</sup>
  - Section V: Requirements not related to a specific question in the Exposure Draft; and
  - Section VI: Other.

### Section II: Overall support

2. Many of respondents, including four Monitoring Group members, indicated their support for the overall project and applauded the IAASB's efforts to improve the audit of accounting estimates.<sup>3</sup>

### Section III: Readability and Navigation

3. Comments on the readability and navigation of the Exposure Draft of Proposed ISA 540 (ED-540)<sup>4</sup> included that:
  - It is complex and lacks clarity on how to adapt the requirements;<sup>5</sup>
  - The requirements are not sufficiently objectives based or are too granular or prescriptive;<sup>6</sup> and

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<sup>1</sup> 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%.

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>3</sup> *Regulators: BCBS, CEAOB, IAIS, IFIAR, IOSCO, NSSs: CNCC-CSOEC, HKICPA, IDW, Firms: DTT, EYG, GTI, KPMG, PwC, RSM, Public Sector: ACAG, CIPFA, GAO, Member Bodies: AE, AICPA, CAI, EFAA, IAA, IAAA, IBRACON, IBR-IRE, ICAEW, ICAP, NASBA, SAICA, SMPC, Academics: GC, Investors & Analysts: CRUF*

<sup>4</sup> Proposed ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>5</sup> *Firms: DTT, KPMG, PWC, Member Bodies: NASBA*

<sup>6</sup> *NSSs: AUASB, Public Sector: ACAG, Individuals & Others: NDEG*

- The application material is lengthy and repetitive<sup>7</sup>.
4. Suggestions to address the readability issues include:
- Removing material considered specific to certain types of accounting estimates or industries, such as financial services, and including it outside of the standard;<sup>8</sup> and
  - Removing application material that is considered 'educational'.<sup>9</sup>

#### Section IV: Relationship with ISA 315 (Revised)

5. Respondents had the following comments on the connection to ISA 315 (Revised):
- Request to clarify the risk model in ED-540 relative to the current requirements in ISA 315 (Revised),<sup>10</sup> including more guidance on the interrelationship between the different types of risk factors and the risk levels used in ED-540,<sup>11</sup> and whether the requirements in paragraph 10 (Risk assessment) are incremental to ISA 315 (Revised) or were considered a secondary risk assessment;<sup>12</sup>
  - The importance of coordination between the ISA 315 (Revised) Task Force and the ISA 540 Task Force;<sup>13</sup>
  - Calls to revise ISA 315 (Revised) before revising ISA 540;<sup>14</sup>
  - Suggestion to move guidance in ED-540 that applies more broadly to the risk assessment to ISA 315 (Revised);<sup>15</sup>
  - Use the phrase 'special considerations' or providing a more comprehensive lead-in to the additional requirements in ED-540, drawing more extensively from concepts in ISA 315 (Revised) and ISA 330;<sup>16</sup> <sup>17</sup> and
  - Streamline the requirements in both standards into one standard.<sup>18</sup>

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<sup>7</sup> *Those Charged with Governance*: AICD, *Regulators*: ESMA, *NSSs*: NBA, NZAuASB, *Public Sector*: AGNZ, *Member Bodies*: ACCA - CAANZ, CPAA

<sup>8</sup> *NSSs*: AUASB, *Member Bodies*: AE, IBR-IRE

<sup>9</sup> *NSSs*: IDW, NBA

<sup>10</sup> *Investors & Analysts*: CFA, *Regulators*: ESMA, *Firms*: KPMG, *Member Bodies*: NASBA, *Public Sector*: AGNZ

<sup>11</sup> *Regulators*: **IFIAR**

<sup>12</sup> CAASB, CHI, KPMG

<sup>13</sup> *NSSs*: CAASB, *Member Bodies*: AE, IBR-IRE

<sup>14</sup> *NSSs*: IDW, *Public Sector*: ACAG

<sup>15</sup> *Firms*: EYG, *NSSs*: NBA

<sup>16</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>17</sup> *Firms*: DTT

<sup>18</sup> *Member Bodies*: ISCA

## Section V: Requirements not related to a specific question in the Exposure Draft

### Scope

6. One respondent indicated that the focus of the application of the standard is too narrow and that the application material does not adequately include considerations for the public sector.<sup>19</sup> Another respondent requested clarification on whether accounting estimates for which the outcome is expected to be known during the audit are within the scope of this standard.<sup>20</sup>

### Nature of Accounting Estimates

7. A few respondents were supportive of the reference to ‘accounting estimates being subject to inherent limitations’, but noted that the standard could make it more explicit as to the limitations this places on preparers and auditors.<sup>21</sup>

### Objective

8. A couple of respondents, including one Monitoring Group member, were supportive of the change in the objective paragraph to obtaining sufficient appropriate audit evidence that disclosures are ‘reasonable’.<sup>22</sup> Others noted that the objective should be changed back to ‘obtaining sufficient appropriate audit evidence that disclosures are adequate’, as ‘reasonable’ is inconsistent with ISA 700 (Revised).<sup>23</sup> <sup>24</sup> A couple of respondents suggested conforming amendments to ISA 450,<sup>25</sup> ISA 700 (Revised), and ISA 705 (Revised)<sup>26</sup> so that the wording is aligned with ISA 540 (Revised).<sup>27</sup>
9. One Monitoring Group member noted concerns about the inconsistent use of the terms ‘appropriate’, ‘adequate’, and ‘reasonable’ throughout the standard.<sup>28</sup>

### Definitions

10. Respondents suggested to include a definition of:
- Significant data;<sup>29</sup>
  - Significant assumptions;<sup>30</sup>
  - Specialized skills and knowledge;<sup>31</sup> and

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<sup>19</sup> *Public Sector:* AGNZ

<sup>20</sup> *Member Bodies:* ISCA

<sup>21</sup> *Member Bodies:* AE, IBR-IRE, SMPC

<sup>22</sup> *Regulators:* **BCBS**, Individuals & Others: NDEG

<sup>23</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>24</sup> *Firms:* DTT, EYG

<sup>25</sup> ISA 450, *Evaluations of Misstatements Identified During the Audit*

<sup>26</sup> ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

<sup>27</sup> *Firms:* EYG, *Regulators:* UKFRC

<sup>28</sup> *Regulators:* **IFIAR**

<sup>29</sup> *NSSs:* CAASB, CNCC- CSOEC, *Member Bodies:* AE, ICAS

<sup>30</sup> *NSSs:* CAASB, NZAuASB, *Firms:* EYG

<sup>31</sup> *NSSs:* CAASB

- Further audit procedures.<sup>32</sup>
11. Other respondents were of the view that the reference to ‘significant’ as it relates to data should be removed throughout the standard as all data would need to be considered.<sup>33</sup>
  12. One Monitoring Group member suggested to clarify the term ‘monetary amount’ used in the definition of accounting estimate.<sup>34</sup>

### Risk Assessment

13. A couple respondents supported the more granular risk assessment as it will drive further audit quality improvements,<sup>35</sup> as well as a few others who supported the addition of regulatory factors in paragraph 10(b).<sup>36</sup>
14. One respondent thought the three risk factors of complexity, judgment and estimation uncertainty should be introduced in paragraph 10(c),<sup>37</sup> while another respondent thought that paragraph 10(c) should be removed as it is inconsistent with ISA 315 (Revised).<sup>38</sup>
15. There were mixed views on paragraph 10(f) of ED-540 (obtaining an understanding of each of the components of internal control):
  - One respondent suggested reverting back to ‘relevant controls’ as some of the components of internal control are covered under other parts of paragraph 10;<sup>39</sup>
  - Another respondent thought that obtaining an understanding of each of the components of internal control is not needed before completing the initial risk assessment;<sup>40</sup> and
  - Another respondent thought it should be conditional based on complexity.<sup>41</sup>
16. Some respondents, including one member of the Monitoring Group, noted their support for the increased focus on internal controls, both in paragraph 10 (risk assessment) and paragraph 16 (testing operating effectiveness).<sup>42</sup> Another Monitoring Group member commented that they generally support the content of paragraphs 10, 16 and the related application material but that an explicit reference to evaluating the design effectiveness of controls was missing in paragraph 16.<sup>43</sup>

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<sup>32</sup> NSSs: CAASB

<sup>33</sup> Firms: DTT, EYG

<sup>34</sup> Regulators: **IOSCO**

<sup>35</sup> Firms: DTT, BDO, PKF

<sup>36</sup> Regulators: EBA, Firms: DTT, EYG

<sup>37</sup> Regulators: UKFRC

<sup>38</sup> Firms: EYG

<sup>39</sup> Firms: EYG

<sup>40</sup> Public Sector: AGNZ

<sup>41</sup> NSSs: IDW

<sup>42</sup> Regulators: CEAOB, **IFIAR**, Firms: DTT, Public Sector: CIPFA

<sup>43</sup> Regulators: **BCBS**

## Disclosures

17. Some respondents noted their support for the increased focus on disclosures as they are so important to the users' understanding of estimation uncertainty.<sup>44</sup> While one Monitoring Group did support the focus on disclosures, they noted that the guidance was scattered throughout the standard and recommended it be brought together in one section.<sup>45</sup> A couple of respondents were of the view that ED-540 did not adequately emphasize the importance of appropriate disclosures.<sup>46</sup>
18. One respondent commented that paragraph 21(a) is unclear and appears to go beyond the requirements in ISA 700 (Revised).<sup>47</sup>

## Stand Back Requirement

19. A few respondents supported paragraph 22,<sup>48</sup> with a few respondents, including one Monitoring Group member suggesting it should be applicable to all accounting estimates.<sup>49</sup> The Monitoring Group member also noted that the stand back requirement:
  - Should include reassessing the appropriateness of any reliance on controls; and
  - The effect of any changed assessment on the nature, timing and extent of audit procedures<sup>50</sup>.
 One respondent did not support the requirement as they were of the view that it is already covered in ISA 330.<sup>51</sup>
20. Some respondents supported the overall stand back in paragraph 23, especially the reference to considering all audit evidence obtained, whether corroborative or contradictory.<sup>52</sup>

## Written Representations

21. Some respondents, including one Monitoring Group member, supported the enhancements to paragraph 25,<sup>53</sup> with a couple respondents commenting that it should refer to 'data and assumptions' instead of 'significant data and significant assumptions'.<sup>54</sup>
22. A couple of respondents noted that the reference to 'reasonable' should be removed as it is more appropriate for management representations to address whether the relevant requirements of the applicable financial reporting framework have been appropriately applied in the preparation of the accounting estimates and the related disclosures.<sup>55</sup>

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<sup>44</sup> *Investors & Analysts: CFA, Regulators: EBA, NSSs: JICPA, Those Charges with Governance: CRUF, Member Bodies: ICAEW*

<sup>45</sup> *Regulators: BCBS*

<sup>46</sup> *Public Sector: AGNZ, Member Bodies: ACCA - CAANZ*

<sup>47</sup> *NSSs: CAASB*

<sup>48</sup> *Regulators: IOSCO, IRBA, Member Bodies: SAICA*

<sup>49</sup> *Regulators: IOSCO, IRBA*

<sup>50</sup> *Regulators: IOSCO*

<sup>51</sup> *Firms: DTT*

<sup>52</sup> *Investors & Analysts: CFA, Regulators: BCBS, CEAOB, Firms: DTT, Member Bodies: ICAEW*

<sup>53</sup> *Regulators: BCBS, Firms: DTT, EYG, KPMG*

<sup>54</sup> *Firms: DTT, EYG*

<sup>55</sup> *Firms: EYG, KPMG*

## Communication with Those Charged With Governance or Management

23. There was some support, including one member of the Monitoring Group, for paragraph 26.<sup>56</sup> One respondent indicated it wasn't clear whether matters should be communicated for certain types of accounting estimates or all accounting estimates, and that the requirement should be more closely aligned to paragraph 9 of ISA 701.<sup>57 58</sup>

## Documentation

24. There were some calls for clarification on the expectations for documentation on the risk assessment procedures, the reasons for the assessed risk of material misstatement, the response to the assessed risk of material misstatement, the stand back, and the auditor's consideration of management bias.<sup>59</sup> One Monitoring Group member commented that the standard should specifically require:
- Documentation on the process for assessment and classification of inherent risk ('low' or 'not low'), the reasons for that classification and responses to the assessed risks of material misstatement;
  - Retaining a copy of the model used in the audit file; and
  - When there is a large number of complex valuation models for different items, the auditor should perform testing using his or her own independent models or clearly document management's models and the testing performed on them.<sup>60</sup>

## Appendices

25. Comments specific to the Appendices within ED-540 were:
- Delete both appendices as the material was repetitive and included fundamental concepts already understood by auditors;<sup>61</sup>
  - Delete Appendix 1 as it is accounting related and includes content considered educational;<sup>62</sup>
  - Redraft Appendix 1 in a more practical, framework-neutral manner;<sup>63</sup> and
  - Move the appendices out of the standard into separate guidance.<sup>64</sup>

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<sup>56</sup> *Investors & Analysts:* CFA, CRUF, *Regulators:* **BCBS**, , IRBA, *Member Bodies:* SAICA

<sup>57</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>58</sup> *Firms:* DTT

<sup>59</sup> *Firms:* EYG, RSM, *NSSs:* ACCA-CAANZ, *Member Bodies:* ISCA, SAICA, *Individuals & Others:* NDEG

<sup>60</sup> *Regulators:* **IOSCO**

<sup>61</sup> *NSSs:* NZAuASB, *Public Sector:* AGNZ

<sup>62</sup> *Firms:* KPMG

<sup>63</sup> *Firms:* DTT, *NSSs:* NBA

<sup>64</sup> *Public Sector:* GAO, *Member Bodies:* AICPA

## Section VI: Other

### Move Application Material to Requirement

26. Respondents highlighted several paragraphs in the application material, or parts thereof, that should be moved to the requirements:
- A2, defining the term ‘reasonable’;<sup>65</sup>
  - A135, that paragraph 21 applies regardless of whether the auditor is required to perform procedures under paragraph 19;<sup>66</sup> and
  - A158, documentation.<sup>67</sup>

### Calls for Additional Guidance

27. Respondents identified the following areas where further guidance could be useful:
- Disclosures;<sup>68</sup>
  - Management bias throughout the process of the audit;<sup>69</sup>
  - Written representations;<sup>70</sup>
  - Communications with those charged with governance or management;<sup>71</sup>
  - Key audit matters;<sup>72</sup>
  - Sampling, identification of differences to investigate and evaluating errors;<sup>73</sup>
  - Financial instrument valuation;<sup>74</sup> and
  - Expanding on the current application material around ‘reasonable’<sup>75</sup>, reviewing the outcome of valuation attributes<sup>76</sup>, use of an expert in auditing expected credit loss models<sup>77</sup>, and categorizing risks;<sup>78</sup> and
  - More prominence to ‘overlays’ in the risk assessment section.<sup>79</sup>

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<sup>65</sup> *Regulators:* **BCBS**, CEAOB, ESMA

<sup>66</sup> *Public Sector:* AGNZ

<sup>67</sup> *Regulators:* ESMA, IRBA, *Member Bodies:* SAICA

<sup>68</sup> *Investors & Analysts:* CFA, *Regulator:* EBA, UKFRC

<sup>69</sup> *Investors & Analysts:* CFA, *Regulators:* ESMA

<sup>70</sup> *Regulators:* **BCBS**

<sup>71</sup> *NSSs:* CAASB, *Regulators:* EBA

<sup>72</sup> *Regulators:* ESMA

<sup>73</sup> *Regulators:* **IOSCO**

<sup>74</sup> *Regulators:* **IOSCO**

<sup>75</sup> *NSSs:* IDW

<sup>76</sup> *Regulators:* UKFRC

<sup>77</sup> *Regulators:* EBA

<sup>78</sup> *Member Bodies:* ACCA - CAANZ

<sup>79</sup> *Regulators:* EBA

### Alignment with PCAOB

28. Many respondents encouraged closer convergence and alignment to the recently issued Public Company Accounting Oversight Board (PCAOB) Docket 43: *Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements*, which approaches the audit of accounting estimates in a manner that appears to be more consistent with the way management makes their accounting estimates.<sup>80</sup>

### Field Testing

29. Some respondents noted support for field testing ED-540 and encouraged close follow up on any issues identified,<sup>81</sup> while one respondent cautioned the IAASB to balance the feedback received from field testing against feedback received from other stakeholders.<sup>82</sup>

### Post Implementation Review

30. One Monitoring Group member and a few other respondents suggested a post implementation review of this standard to assess whether the changes have achieved the objectives.<sup>83</sup>

### Education for Other Stakeholders

31. A couple of respondents noted that the IAASB has a role to play in educating other stakeholders in the financial reporting supply chain about the coming changes related to this standard.<sup>84</sup>

### Drafting

32. Many drafting suggestions were received which will be taken into account when the Task Force has decided on a way forward.

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<sup>80</sup> *Investors & Analysts:* CFA, *Firms:* DTT, EYG, GTI, PWC, RSM, *Preparers Of Financial Statements:* ABA, *Member Bodies:* AICPA, CAQ, ICAEW, NASBA, *NSSs:* CAASB

<sup>81</sup> *Investors & Analysts:* CFA, *Member Bodies:* AE, IBR-IRE, ICAEW

<sup>82</sup> *Regulators:* UKFRC

<sup>83</sup> *Regulators:* CEAOB, **IFIAR**, *Public Sector:* ACAG, *Member Bodies:* ICAEW

<sup>84</sup> *Member Bodies:* ICAEW, SMPC