ISA 540 (Revised) Post-Implementation Survey

Response ID:284 Data

3. Section II: About the Respondent

1. Please provide the following information about your organization (if applicable) and other contact information:

Name(s) of contact(s) for this submission : Cristian Emmanuel Munarriz
E-mail address(es) of contact(s) : cristian_munarriz@yahoo.com.ar

2. Please select from the following options the stakeholder group to which you or your organization belongs:

Other

Please specify:

Individual (employee at accounting firm)

3. Please select from the following options the geographical region that best matches you or your organization:

South America

4. Did you undertake outreach activities with other stakeholders outside your organization to inform your responses to this survey?

No

5. You are welcome to provide any additional information you believe may be relevant to clarify the context in which you are completing the survey, or the circumstances or experiences that have informed your views or perspectives (or you can choose to leave this question blank).

I work in audit and financial reporting advisory at a global accounting firm and I am involved in accounting and auditing technical committees in my PAO, but I am completing this survey as an individual. The views on this survey are my own, and they do not necessarily represent the views of any organization I am involved with

4. Section III: Overall Questions

6. Please provide overall views about whether ISA 540 (Revised) has achieved its intended purpose and the objectives of the IAASB in developing the revised standard.

Generally speaking, I think the ISA 540 (Revised) has achieved its intended purpose and objectives.

7. Are you aware of the non-authoritative guidance and support tools developed to support the implementation of ISA 540 (Revised)?

Yes

7A. Do you agree that the non-authoritative guidance and support tools developed to support the implementation of ISA 540 (Revised) are useful?

3 – Agree

Comments: I think the flowcharts and diagrams are useful, but I am not sure the illustrative examples for simple estimates are entirely useful, as I think it is not practical to have documentation at the same level of detail of that illustrative example in every single "simple" estimate in the financial statements, as estimates exist in most financial statement elements other than cash, especially for audits of SMEs

5. Section IV: Perceived Benefits from ISA 540 (Revised)

8. For each perceived benefit, indicate the extent to which you agree that ISA 540 (Revised) has led to benefits or improvements.

	4 – Strongly Agree	3 – Agree	2 – Disagree	1 – Strongly Disagree	0 – No Response
(a) Enhanced exercise of professional skepticism when auditing accounting estimates.		X			
(b) Greater consideration of the skills and competencies of the engagement team, including the need to involve specialists or experts.	X				
(c) Greater attention to understanding management's process for making estimates, including the selection of methods, assumptions and data (and the consistency of selection between periods).	X				
(d) Better or more focused assessments of the risks of material misstatements for accounting estimates.	X				
(e) More focus on understanding and testing controls related to accounting estimates.			X		
(f) Increased auditor attention to disclosures related to accounting estimates, including disclosures about estimation uncertainty.		X			
(g) Enhanced interactions and communications between the auditor and management and those charged with governance related to the audit of accounting estimates.		X			
(h) Enhanced quality of financial reporting related to accounting estimates.		X			

9. Are there any additional benefits or positive outcomes arising from the implementation of ISA 540 (Revised) that you would like to highlight?

No

6. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised)

10. ISA 540 (Revised) was designed to be capable of being applied to all accounting estimates, and for the nature, timing and extent of the risk assessment and further audit procedures to be varied in relation to the estimation uncertainty and the assessment of the risks of material misstatement. Indicate the extent to which you have observed or are aware of any issues or challenges related to scalability and proportionality.

4 – Significant Issues or Challenges

11. Briefly describe these or any other issues or challenges you observed related to scalability and proportionality.

Issue 1:
I think the risk assessment procedures related to the understanding of internal control are excessive, especially for simple accounting estimates. In contrast to transactions (i.e. sales, purchases, collections, payments, etc) and management of assets (i.e. cash, inventory management, etc), where the deficiencies in internal controls are very relevant because they may provide an opportunity for fraud, for estimates the risks are more related to inherent risk factors than to internal control deficiencies. While robust understanding of the methods, assumptions, source of data and estimation uncertainty is very important to appropriate assessment of the inherent risk factors, in my view, the specific control activities (paragraph 13.i) do not always have the same importance.
There are some routinary but complex estimates (e.g. expected credit losses in financial institutions, or asset retirement obligations in extractive industries) where control activities may be more relevant as the model used may be highly dependent on specific controls related to business operations (e.g. regarding credit risk assessment, specific financial projections and forecasts, etc). But the vast majority of accounting estimates (especially in SMEs) are based on simple methodologies and less

subjective assumptions, especially routinary estimates (like depreciation of PP&E, incurred credit losses models for trade receivables, usual contingencies for which use of external lawyers is used, NRV of inventories, FV of quoted equity instruments, etc), for which the control activities are less relevant due to the limited opportunity for fraud related to internal control deficiencies and because a controls reliance approach is rarely used for these estimates.

There are also other estimates with complex methodologies and subjective assumptions but that are performed only in certain situations (e.g. IAS 36 impairment testing triggered by indicators of impairment, FV of equity settled share based payments, etc), or that are performed on a routine basis but only for financial reporting purposes (e.g. FV of unquoted equity instruments). These estimates may be more reliant on management review controls (instead of routine control activities), which are very difficult to assess and document, and are generally not relevant for audit purposes, except if the auditor is required to issue a separate opinion on internal control, because the deficiencies in such controls do not increase opportunity for fraud (as they are already interrelated with inherent risk factors, like subjectivity and management bias) and they are generally inefficient to test in a controls reliance approach.

Therefore, I think only relevant control activities should be identified under paragraph 13.i) in line with paragraph 26.a) of ISA 315. The identification of relevant control activities for the estimates to which is considered relevant should depend on auditor's judgment.

Issue 2:

I think the stand-back requirements in paragraph 33-35 are overkill for every single accounting estimate. I think this requirement should be limited to estimates with higher inherent risk. For other estimates, I think only paragraph 33.a) may be relevant to assess if the risk assessment conclusion for these estimates is still consistent with audit evidence obtained in other areas (i.e. to double check that these estimates are still low/medium inherent risk). For these other estimates, I think it is unlikely that application of paragraph 33.b) and c) will have a different outcome than before.

Issue 3

I think that there may be application issues regarding audit documentation in the paragraph 39.b). Despite the comment in paragraph A150 that auditors are not required to document how every inherent risk factor was taken into account in the risk assessment in relation to each accounting estimate, I think that, in practice, this is usually the case, resulting in excessive documentation

12. In your view, are the issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

Difficult to Determine

13. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

I think a combination of standard-setting and non-authoritative guidance would be the best approach for issues 1 and 2, and non-authoritative guidance for issue 3 (maybe moving the clarification in p.A150 to the requirements)

7. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

14. Indicate the extent to which you have observed or are aware of the following issues or challenges relating to ISA 540 (Revised) with respect the auditor exercising professional skepticism when auditing accounting estimates and related disclosures.

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
(a) Appropriately challenging management's judgments used in making accounting estimates, particularly when they involve complex or subjective inputs.			X		
(b) Identifying and appropriately responding to potential indicators of management bias in the development of accounting estimates.		X			
(c) Appropriately considering all relevant audit evidence obtained, whether corroborative or contradictory.			X		

15. Briefly describe these or any other issues or challenges you observed related to exercising professional skepticism.

Management bias
As explained in paragraph A133, analysis of management bias is supposed to be performed at an aggregate level rather than at the individual accounting estimate level. As the detailed work for each accounting estimate is generally performed by different individuals (especially in large engagements), I think there is a lack of clarity about the need of coordination of this analysis at engagement team level. This issue may be even more prevalent in group audits where some accounting estimates (e.g. goodwill impairment testing) are audited directly by the group auditor and other estimates are audited by component auditors.
I think further guidance about this requirement may be useful. Potentially adding a specific requirement for engagement partners and group engagement partners to take responsibility for this assessment to be specifically discussed in engagement team discussion and wrap-up meetings may be useful because they generally have the overall knowledge of the audited entity.

Stand-back
I think the stand-back requirements in paragraph 33-35 are overkill for every single accounting estimate. I think this requirement should be limited to estimates with higher inherent risk. For other estimates, I think only paragraph 33.a) may be relevant to assess if the risk assessment conclusion for these estimates is still consistent with audit evidence obtained in other areas (i.e. to double check that these estimates are still low/medium inherent risk). For these other estimates, I think it is unlikely that application of paragraph 33.b) and c) will have a different outcome than before

16. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

Difficult to Determine

17. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

For management bias, I think non-authoritative guidance and some limited standard-setting may be effective.
For stand-back, I think standard-setting may be useful

8. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

18. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *risk assessment procedures and identifying and assessing the risks of material misstatement related to accounting estimates*.

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
(a) The consideration of inherent risk factors and the interrelationship between them in identifying and assessing risks of material misstatement related to accounting estimates.			X		
(b) How the understanding of the entity and its environment, and the entity's internal control for accounting estimates, relates to the understanding required by ISA 315 (Revised 2019) (i.e., whether it is clear that the requirements in paragraph 13 of ISA 540 (Revised) relate specifically to accounting estimates and build on the broader requirements in ISA 315 (Revised 2019)).	X				
(c) Reviewing the outcome of previous accounting estimates or, where applicable, their subsequent re-estimation (i.e., the retrospective review of accounting estimates).	X				
(d) Understanding management's process for making accounting estimates, including how management identifies and selects relevant methods, assumptions and data, and how management understands and addresses estimation uncertainty.			X		
(e) The separate assessments of inherent and control risk relating to an accounting estimate.			X		
(f) Whether any of the assessed risks of material misstatement are significant risks.			X		

18A. Provide additional input, if any, about any issues or challenges regarding the interaction of ISA 540 (Revised) with ISA 315 (Revised 2019) in relation to risk assessment procedures and the identification and assessment of risks of material misstatement for accounting estimates.

Control activities
I think the risk assessment procedures related to the understanding of internal control are excessive, especially for simple accounting estimates. In contrast to transactions (i.e. sales, purchases, collections, payments, etc) and management of assets (i.e. cash, inventory management, etc), where the deficiencies in internal controls are very relevant because they may provide an opportunity for fraud, for estimates the risks are more related to inherent risk factors than to internal control deficiencies. While robust understanding of the methods, assumptions, source of data and estimation uncertainty is very important to appropriate assessment of the inherent risk factors, in my view, the specific control activities (paragraph 13.i) do not always have the same importance.
There are some routinary but complex estimates (e.g. expected credit losses in financial institutions, or asset retirement obligations in extractive industries) where control activities may be more relevant as the model used may be highly dependent on specific controls related to business operations (e.g. regarding credit risk assessment, specific financial projections and forecasts, etc). But the vast majority of accounting estimates (especially in SMEs) are based on simple methodologies and less subjective assumptions, especially routinary estimates (like depreciation of PP&E, incurred credit losses models for trade receivables, usual contingencies for which use of external lawyers is used, NRV of inventories, FV of quoted equity instruments, etc), for which the control activities are less relevant due to the limited opportunity for fraud related to internal control deficiencies and because a controls reliance approach is rarely used for these estimates.
There are also other estimates with complex methodologies and subjective assumptions but that are performed only in certain situations (e.g. IAS 36 impairment testing triggered by indicators of impairment, FV of equity settled share based payments, etc), or that are performed on a routine basis but only for financial reporting purposes (e.g. FV of unquoted equity instruments). These estimates may be more reliant on management review controls (instead of routine control activities), which are very difficult to assess and document, and are generally not relevant for audit purposes, except if the auditor is required to issue a separate opinion on internal control, because the deficiencies in such controls do not increase opportunity for fraud (as they are

already interrelated with inherent risk factors, like subjectivity and management bias) and they are generally inefficient to test in a controls reliance approach.
Therefore, I think only relevant control activities should be identified under paragraph 13.i) in line with paragraph 26.a) of ISA 315. The identification of relevant control activities for the estimates to which is considered relevant should depend on auditor's judgment

18B. Indicate the extent to which you agree with the following statements with respect to *reviewing the outcome of previous accounting estimates or, where applicable, their subsequent re-estimation.*

	4 – Strongly Agree	3 – Agree	2 – Disagree	1 – Strongly Disagree	0 – No Response
(a) The retrospective review process is difficult due to changes in economic conditions or assumptions that make prior-period estimates less comparable.	X				
(b) The time and effort required to perform a retrospective review outweigh the perceived benefits for audit risk assessment.			X		

19. Briefly describe these or any other issues or challenges you observed related to risk assessment procedures and whether such issues or challenges relate primarily to estimates that have a high degree of estimation uncertainty or complexity.

Retrospective review
While application of this requirement is clear for routine estimates (e.g. impairment of trade receivables and inventory, sales with right of return, etc) and some estimates based on broader financial projections and forecasts (e.g. impairment of goodwill and PP&E, FV of unquoted equity instruments if discounted cash flows are used, where you can see how the financial forecasts used in the estimate in prior year were met in current year), it is less clear how to perform this review for specific estimates. For example:
1) One-off estimates where the estimate is generally performed once for financial reporting purposes and there is little available subsequent information to contrast with the estimate (e.g. FV of acquired assets and liabilities in a business combination, FV of equity settled share based payments, etc). In this case, there is neither re-estimation nor outcome.
For example, in the case of FV of acquired assets and liabilities in a business combination is not clear if the auditor should compare FV of specific assets that were sold (e.g. inventory) with their subsequent sale, if applicable, or do nothing at all.
In the case of FV of equity settled share based payments, it is not clear if the auditor should consider new equity settled share based payments issued (i.e. compare FV of a prior year equity settled share based payment with a current year equity settled share based payment, if similar), or do nothing at all.
2) Estimates based on financial projections but where the cash outflows are expected to occur many years into the future, so there is lack of subsequent information to contrast against the estimate (e.g. asset retirement obligations, where the actual cash flows can only be observed many years into the future). In this case, you only have re-estimation but not outcome.
For example, it is not clear if the auditor should compare the asset retirement obligation with the outcome of similar asset retirement obligations, or only with the subsequent re-estimation if the asset retirement obligation's outcome will occur in the future.
3) Routine accounting estimates performed for financial reporting purposes where the outcome of the estimate cannot be usually verified with subsequent objective information unless certain conditions occur (e.g. FV of PP&E items and unquoted equity instruments where the market or cost approach are used that are not routinely bought or sold). In this case, you only have re-estimation but usually not outcome.
For example, it is not clear if the estimate should only be compared with the outcome when it actually occurs (i.e. comparing only with subsequent re-estimation in the other periods), or it should be compared with the outcome of the sale of similar assets (i.e. sale of a similar item of PP&E) or similar transactions made by other entities (purchase or sale of the same equity instrument by another entity).
4) Estimates that were calculated on a different basis or using different methods (e.g. impairment testing of non-financial assets using value in use in one year and fair value less cost of disposal in the other, or FV of an asset using market approach in one year and cost or income approach in the other). In this case, there is generally no outcome and the re-estimation may not be entirely comparable.

For example, it is not clear if the auditor should compare comparable assumptions (considering that differences may exist due to the different accounting requirements for both basis), if any. As the underlying causes of the differences between prior year and current year estimate may not be identifiable, the retrospective review may not be useful.
5) Also, it should be clarified how the retrospective review should be performed when comparing fair value and subsequent sale of the asset, as the underlying causes of the differences between both values may not be identifiable, making the retrospective review not very useful for risk assessment purposes in such cases.
6) For estimates made in highly unstable scenarios or for which the economic environment changed significantly and the estimate is significantly affected by economic environment (e.g. IAS 36 impairment testing), it may not be possible for the auditor to identify the specific underlying causes of the differences between the estimate and the subsequent re-estimation or outcome due to the significant change in many economic variables, making the retrospective review not very useful for risk assessment purposes in such cases. This is the case for some estimates significantly affected by economic environment in many emerging economies, and also applicable to the current global geopolitical and economic environment (i.e. conflicts in Ukraine and Iran, US tariffs, etc).
For cases 1) to 3), maybe further application guidance is useful.
While I think that the retrospective review is very important for risk assessment of accounting estimates, especially those with higher inherent risk and most susceptible to management bias, I am not sure if the requirement is useful for cases 4 to 6) (at least from a cost-benefit perspective). Therefore, for cases 4) to 6), I think the IAASB should consider adding an exemption for the requirement, where the auditor is required to document the reasons this exemption was applied for each estimate and the impact in risk assessment, if any (for example, if the exemption is related to case 6 there may be an impact in the assessment of the level of estimation uncertainty).

20. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

Difficult to Determine

21. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

I think the IAASB should think if the requirement is useful for these specific cases I mentioned above and make limited amendments accordingly. If so, further clarity in the form of application guidance and/or non-authoritative guidance may be useful (application guidance in the standard may be preferrable)

9. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

22. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *responding to the assessed risks of material misstatement*

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
Responses to the Assessed Risks of Material Misstatement (a) Determining the most appropriate response(s) to the assessed risks of material misstatement at the assertion			X		
(b) Determining whether to test the operating effectiveness of controls related to an accounting estimate.			X		
(c) Appropriately applying the testing approach of obtaining audit evidence about events occurring up to the date of the auditor's report, either alone or with another testing approach(es).			X		
(d) Testing how management made the accounting estimate.			X		
(e) Developing an auditor's point estimate or range.			X		
Overall Evaluation (f) Determining whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.			X		
(g) Evaluating identified misstatements related to accounting estimates, including when the audit evidence supports a point estimate that differs from management's point estimate or a range that does not include management's point estimate, or when the auditor's range is wide (in some cases, multiples of materiality for the financial statements as a whole).		X			

23. Briefly describe these or any other issues or challenges you observed related to responding to risks of material misstatement and whether such issues or challenges relate primarily to estimates that have a high degree of estimation uncertainty or complexity.

Auditor's range is wide for estimates with very high estimation uncertainty

It is not clear how to address the fact (e.g. in the audit report and in the evaluation of uncorrected misstatements) when the auditor's range for an accounting estimate is wider than materiality.

24. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

Yes

25. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

I suggest further clarity in the form of application guidance

10. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

26. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *communication, specialized skills or knowledge, including using the work of an auditor's expert, and documentation*.

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
Communication (a) Determining the matters, if any, to communicate related to accounting estimates, (including about significant qualitative aspects of the entity's accounting practices and significant deficiencies in internal control).			X		
Specialized Skills or Knowledge, Including Using the Work of an Auditor's Expert (b) Determining when it is appropriate to involve an auditor's expert(s) (an internal or external expert) and using the work of an auditor's expert(s) in auditing an accounting estimate(s).			X		
Documentation (c) Preparing appropriate audit documentation in accordance with the requirements in paragraph 39 of ISA 540 (Revised).		X			

27. Briefly describe these or any other issues or challenges you encountered or observed related to communications, specialized skills or knowledge (including using the work of an auditor's expert) and documentation.

Documentation
I think that there may be application issues regarding audit documentation in the paragraph 39.b). Despite the comment in paragraph A150 that auditors are not required to document how every inherent risk factor was considered in the risk assessment in relation to each accounting estimate, I think that, in practice, this is usually the case, resulting in excessive documentation

28. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

Yes

29. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

I think non-authoritative guidance and maybe moving the clarification in p.A150 to the requirements