ISA 540 (Revised) Post-Implementation Survey

Response ID:413 Data

3. Section II: About the Respondent

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

Organization (or leave blank if you are completing the survey in your personal capacity) : Grant Thornton International Ltd.
Name(s) of contact(s) for this submission : Katherine Schamerhorn
Job title or role : Global Leader – Service Line Capabilities and Quality
E-mail address(es) of contact(s) : katherine.schamerhorn@gti.gt.com

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

Accounting Firm

Specify the type of accounting firm you represent:

Global accounting firm

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

Global

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).

We believe ISA 540 (Revised) has achieved its intended purpose of establishing more robust requirements and detailed guidance to foster audit quality by driving auditors to perform appropriate procedures in relation to accounting estimates and related disclosures with an emphasis on appropriately exercising professional skepticism. Based on our experience, we believe both the public interest and the profession have benefited from the implementation of this standard. As such, we firmly believe that no standard-setting activities related to ISA 540 (Revised) are necessary at this time. We support the IAASB developing non-authoritative guidance supporting practical application of the standard or facilitating or supporting actions by others to develop such guidance, in response to targeted matters, including those we describe below.

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.

We believe ISA 540 (Revised) has achieved its intended purpose of establishing more robust requirements and detailed guidance to foster audit quality by driving auditors to perform appropriate procedures in relation to accounting estimates and related disclosures with an emphasis on appropriately exercising professional skepticism.
Specifically, we believe the introduction of inherent risk factors and enhanced risk assessment procedures have had a positive impact on the quality of work performed. As a result of shifting work from the execution phase of the audit to planning and risk assessment, we believe engagement teams obtain a better understanding of the estimates that are in scope for the audit and assess related risks more consistently and more appropriately. We believe this is an improvement over the previous version of ISA 540 which lacked clarity around the concept of "significant estimates" and frequently resulted in inconsistent application. In contrast, under ISA 540 (Revised), enhanced risk assessment is driving better responses to accounting estimates associated with a risk of material misstatement because engagement teams are tailoring responses to the identified risk, rather than employing a standardized response.

Similarly, we believe the enhanced stand-back requirements have also had a positive impact on the quality of work performed. We heard in outreach amongst our network firms that this requirement has been appropriately used by engagement teams to challenge management's assumptions and evaluate the consistency of evidence obtained.
Finally, we believe the guidance in Appendix 2 related to communications with those charged with governance has facilitated meaningful conversations; as a result, we heard in outreach amongst our network that those charged with governance have been more attentive to matters related to management's estimates.

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?

1 – Strongly Disagree
Comments: The non-authoritative guidance and other tools were not widely used as part of implementation efforts across our network. The examples provided in the non-authoritative guidance were too simplistic and did not address areas where engagement teams commonly struggle. As a result, we developed our own guidance, both globally and locally, to illustrate areas that might have either lower risk or higher risk depending on the facts and circumstances. We also leveraged guidance from jurisdictional standard setters, such as CPA Canada. As the IAASB considers non-authoritative guidance to support future standards, we encourage such guidance to focus on practical examples where judgments about complexity, uncertainty, and risk assessment impact the planned response. We also believe additional guidance about scalability would have been helpful. The example provided in ISA 540 (Revised) appears circular because it requires the auditor to perform a substantial amount of risk assessment work related to understanding the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control in assessing risks of material misstatement and assessing inherent risk and control risk for accounting estimates. We heard in outreach amongst our member firms that auditors continually default to obtaining a detailed understanding under paragraph 13 of ISA 540 (Revised), rather than scaling their risk assessment work effort for estimates that are clearly not associated with a risk of material misstatement. In addition, we also heard that the non-authoritative guidance was not considered in certain jurisdictions because it was not translated to other languages.

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?

Yes

Please specify:

Related to Question 8(b), we responded "0" to indicate a neutral response. We did not see changes related to consideration of the skills and competency of the engagement team, including the need to involve specialists or experts as a result of implementing ISA 540 (Revised). We also want to bring to the IAASB's attention that in many jurisdictions, regulators are asking more questions about the need to involve specialists or experts. In certain jurisdictions, regulators are interpreting ISA 540 (Revised) differently and setting an expectation that the use of an expert is always required, even when the engagement team has appropriate skills and competencies.
Related to question 8(e), we responded "0" because we believe the increased focus on understanding controls related to accounting estimates was driven by ISA 315 (Revised 2019). In our outreach amongst network firms, we also heard that auditors are less focused on testing controls related to accounting estimates because ISA 540 (Revised) paragraph 18 requires the auditor to perform specific further audit procedures.

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 experienced or are aware of any issues or challenges related to scalability and proportionality.

3 – Moderate Issues or Challenges

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

As noted in our response to Question 6, we believe the introduction of inherent risk factors and enhanced risk assessment procedures have had a positive impact on the quality of work performed. However, we continue to see challenges in execution, as described in our response to Question 7A. Furthermore, we continue to hear that teams are designing responses for all accounting estimates, regardless of risk assessment, in accordance with paragraph ISA 540 (Revised) paragraph .18 because

they are more focused on the amount of the estimate and not the underlying risk (or lack thereof).
As noted in our response to Question 7A, we developed our own guidance to provide examples about how to address areas where we commonly receive questions. One such area is related to smaller entities with estimates that have one or more estimate that involves the use of methods, models, assumptions, or data that have an element of complexity in a given year (for example, there is estimation uncertainty but it's not high uncertainty). Because the ISA for LCE standard scopes out entities with complex estimates, auditors are required to apply ISA 540 (Revised). We found that, for these entities, ISA 540 (Revised) requires audit procedures that may go beyond what the entity does and there is not sufficient application material to guide the team in how to scale their response similar to that found in other ISAs.

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)?

Non-authoritative guidance related to the matters identified in our response to Q11 may help to promote consistent application of the standard.

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

14. Indicate the extent to which you have experienced or are aware of the following issues or challenges in applying 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 encountered related to exercising professional skepticism.

Upon adopting ISA 540 (Revised), we observed that the enhanced stand-back requirement resulted in some challenges and inconsistency in application. In subsequent audit cycles, we have observed that the challenges and inconsistency have resolved, and we believe the explicit considerations required by the enhanced stand-back have improved audit quality related to accounting estimates. See also our response to Q6.

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?

No

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)?

None needed, see response to Question 15.

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

18. Indicate the extent to which you have experienced 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.

As described in our response to Q7A, the work effort associated with risk assessment is circular in nature, and thus it can be difficult for auditors to differentiate the work effort related to obtaining an understanding of accounting estimates for which it is clear there is no risk of material misstatement compared with estimates that have estimation uncertainty, complexity, or subjectivity.

19. Briefly describe these or any other issues or challenges you encountered 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.

Related to Question 18(d), we responded "2" as it relates to scalability for less complex entities that are scoped out of applying the ISA for LCE. ISA 540 (Revised) does not include explicit scalability considerations for smaller entities with limited resources which may not have robust methods related to accounting estimates. We heard in outreach amongst our network firms that auditors have questions about the expected work effort in such scenarios. Specifically, the standard does not address how to evaluate the impact of these scenarios on the audit, including whether such matters are considered a pervasive finding, an identified deficiency to evaluate further under ISA 450, or whether such matter is required to be communicated.

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?

Yes

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)?

Non-authoritative guidance related to the matters identified in our response to Q19 may help to promote consistent application of the standard.

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

22. Indicate the extent to which you have experienced 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 level from among the testing approaches in paragraph 18 of ISA 540 (Revised).				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 encountered 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.

Related to Question 22(g), we support the language in ISA 540 (Revised) which permits the auditor to have a wide range, in

certain cases, when developing a point estimate or range; however, we continue to see auditors struggle with evaluating identified misstatements related to accounting estimates. While we believe auditors struggle less with this evaluation under ISA 540 (Revised) than the previous standard, we do not think the issue is resolved. This challenge is not limited to estimates that have a high degree of estimation uncertainty or complexity. Furthermore, we are concerned these challenges may be exacerbated by proposed changes to ISA 520, which would require the auditor to "determine an amount, not exceeding performance materiality, as a basis for evaluating any difference between the expectation developed to the auditor and the recorded amount… that is acceptable without further investigation." Given the similarity between the design of a substantive analytic and the process for developing a point estimate or range in ISA 540 (Revised), we suggest the IAASB proceed with caution related to the proposed changes to ISA 520 as these standards may appear to be in conflict if the proposed changes are made.
Additionally, in certain jurisdictions, regulators have questioned auditors who chose not to test operating effectiveness of controls relevant to accounting estimates, even though such tests are not required by ISA 540 (Revised).

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?

No

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)?

We suggest that non-authoritative guidance including practical examples that follow the auditor's evaluation of an accounting estimate through ISA 540 (Revised) from start to finish (that is, obtaining an understanding of the accounting estimate, designing and performing a response, completing the overall evaluation, and considering what to communicate) would assist auditors in evaluating misstatements. It would be helpful if such examples covered an accounting estimate that is typically not significant (for example, depreciation) in addition to accounting estimates commonly associated with risks on the higher end of the spectrum of inherent risk, including significant risks. A flowchart may also be a helpful way to illustrate the evaluation.

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

26. Indicate the extent to which you have experienced 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.

As described in our response to Q9, one challenge related to ISA 540 (Revised) relates a presumption by regulators in certain jurisdictions that the use of an auditor's expert is expected even though the standard does not include any such implicit or explicit requirements.

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?

No

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)?

No suggested actions at this time.