ISA 540 (Revised) Post-Implementation Survey

Response ID:424 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) : IFAC (International Federation of Accountants)
Name(s) of contact(s) for this submission : Laura Takamizawa; Harpal Singh
Job title or role : Advocacy, Regulatory, & Policy Implementation Lead; Head of Advocacy, Regulatory & Policy
E-mail address(es) of contact(s) : LauraTakamizawa@ifac.org; HarpalSingh@ifac.org

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

Other

Please specify:

International organization for the accountancy profession

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?

Yes

4A. Please provide further information about your outreach activities, including:

The manner in which the outreach was undertaken. : IFAC's response is informed by targeted outreach across the accountancy profession through IFAC's International Standards Community of Practice, with a virtual discussion structured around the IAASB's post-implementation review survey questions. The discussion was supplemented by review of written submissions received from professional accountancy organizations (PAOs) and consideration of practical implementation issues raised through IFAC's advisory and community networks.
The nature and number (or estimate thereof) of stakeholders with whom you engaged. : Approximately 30 stakeholders participated in the virtual discussion. IFAC's International Standards Community of Practice includes representatives across multiple jurisdictions from PAOs, IFAC's Small- and Medium-sized Practices Advisory Group, and IFAC's Professional Accountants in Business Advisory Group.

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).

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.

Overall, IFAC considers ISA 540 (Revised) to be a helpful improvement over the previous standard and to have strengthened the audit approach to accounting estimates and related disclosures. In IFAC's view, the revised standard has improved the auditor's focus on the nature of accounting estimates, including estimation uncertainty, complexity, subjectivity and other inherent risk factors, and has reinforced a more risk-based approach to audit work.

The main implementation challenges relate to consistent and proportionate application of requirements. This is particularly relevant for SMPs and SME audits, where estimates may be relatively simple, management processes informal, and controls limited or not designed to support a controls-based audit approach. In such cases, auditors may perform or document work that is disproportionate to the risk profile of a simple estimate, including detailed work to understand management's process even when the more appropriate response is to develop the auditor's own estimate or perform substantive procedures.

IFAC therefore encourages the IAASB to focus any further action on a narrow scope amendment to reduce the scope of application of the standard, targeted clarification, simplification, and practical implementation support rather than expanding any requirements. Priority areas include scalability for less complex estimates, proportionate documentation, avoiding duplication in the interaction between ISA 540 (Revised) and ISA 315 (Revised 2019), and auditing technology-enabled or AI-supported estimation models, including "black box" models that may make it harder to apply professional judgment and skepticism.

Given the close interrelationship with ISA 315 (Revised 2019), we recommend that the results of this PIR be evaluated in conjunction with the findings of the planned PIR of ISA 315 (Revised 2019).

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: IFAC considers the IAASB's non-authoritative guidance and support tools useful, particularly where practitioners are aware of them and use them. Outreach indicated that flowcharts, examples, and other implementation materials help explain the requirements and support implementation. However, those materials could be made more visible, accessible, and clearly organized so practitioners can readily find and use them when applying ISA 540 (Revised). There is also scope for additional practical examples and clearer scalability messaging, particularly for less complex estimates and SME audit contexts. IFAC encourages the IAASB to continue using non-authoritative materials as the primary means of supporting implementation, rather than defaulting to additional requirements. These materials would be most useful if they clearly illustrate proportionate application, including what may be sufficient for simple estimates, how documentation can be scaled, and how auditors can avoid unnecessary duplication when applying ISA 540 (Revised) alongside ISA 315 (Revised 2019).

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:

IFAC considers that ISA 540 (Revised) has delivered additional benefits by clarifying the requirements compared with the previous standard and supporting a more structured audit approach to accounting estimates. It also provides a useful foundation for addressing newer challenges, including the use of technology and artificial intelligence in developing estimates, although further implementation support may be needed in this area.

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.

IFAC is aware of some significant challenges in applying ISA 540 (Revised) in a consistently scalable and proportionate way. This is an area where simplification could create real benefits.

The most significant proportionality challenges arise for relatively simple estimates with low estimation uncertainty. A key practical concern is that, for very simple estimates, the auditor may in some cases appear to perform more work than management in developing the estimate. The standard may lead to application in a way that drives extensive work effort in understanding and documentation of management's process, even where estimates have low uncertainty or where the auditor's response is to develop their own estimate rather than test management's process.

These challenges are particularly relevant for SMPs and SME audits, where management processes may be informal and controls less formalized. However, IFAC views this as a broader scalability issue, not solely an SMP issue. The challenge is to apply the standard in a way that responds to the assessed risks and the nature of the estimate while avoiding unnecessary work for lower-risk estimates.

IFAC also notes that documentation can be a scalability challenge. Even where the audit procedures themselves are appropriately scaled, auditors may feel compelled to document more extensively than is proportionate to demonstrate compliance with the standard. Further clarity on what proportionate documentation looks like for simple or lower-risk estimates would therefore be helpful.

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?

Yes

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)?

We outline two specific challenges above, the first relating to application of the standard for simple estimates, and the second relating to documentation.

A narrow scope amendment to modify the scope of application of the standard would be a way to address the first challenge. Application could be limited to only those estimates with significant estimation uncertainty. In other words, estimates where there is a risk of material misstatement that has not been assessed as being at an acceptably low level or at the lower end of the spectrum of inherent risk.

Additional requirements should certainly be avoided as these could risk increasing work effort without addressing the main practical challenge, which is how the existing requirements are applied across estimates with very different levels of complexity and estimation uncertainty.

The scope reduction discussed above would also partially resolve the documentation issue as simple estimates would no longer give rise to redundant work effort under the standard. This amendment could be supplemented by practical guidance demonstrating proportionate application where the auditor is not seeking to test management's process. This could illustrate what sufficient, yet proportionate documentation looks like in such cases to help ensure auditors demonstrate compliance without excessive documentation that does not add commensurate value.

IFAC also recommends clarifying the interaction between ISA 540 (Revised) and ISA 315 (Revised 2019), particularly to help auditors avoid duplication in risk assessment and in understanding the entity's processes and controls. As mentioned above in our response to Q6, given the close interrelationship with ISA 315 (Revised 2019), we recommend that the results of this PIR be evaluated in conjunction with the findings of the planned PIR of ISA 315 (Revised 2019).

Finally, IFAC encourages the IAASB to consider additional implementation support on technology-enabled or AI-supported estimation models, particularly where management uses models that may be difficult for auditors to understand, challenge or explain because of their "black box" nature.

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.

IFAC considers that ISA 540 (Revised) has helped reinforce the exercise of professional skepticism in the audit of accounting estimates. This includes supporting greater challenge of management's judgments and focusing auditors on the methods, assumptions and data used in developing estimates.

While issues in practice may exist in terms of challenging management's judgements, professional skepticism is influenced by factors beyond the wording of the standard, including auditor experience, supervision, firm methodology and the audit environment. As such, the standard remains appropriate. Care should be taken when interpreting inspection findings in this area, as the cause of findings typically does not indicate deficiencies in standards, but rather deficient application.

A key emerging challenge relates to complex or technology-enabled estimates, including AI-supported models. The use of such models may make it harder for auditors to understand and challenge management's methods, assumptions, data and outputs, particularly where the model has a "black box" nature. IFAC therefore believes further non-authoritative implementation support would be helpful on how auditors can apply professional skepticism when auditing complex, model-driven or AI-supported estimates, including when specialized skills or knowledge may be needed.

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)?

IFAC does not believe that revised or additional requirements are needed in this area. Further non-authoritative implementation support would be helpful, particularly in relation to complex or technology-enabled estimates.

In particular, IFAC encourages the IAASB to consider practical guidance on how auditors apply professional skepticism where management uses AI-supported or other model-driven approaches that may be difficult to understand or challenge because of their "black box" nature.

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.

IFAC is aware of practical challenges in understanding how ISA 540 (Revised) interacts with ISA 315 (Revised 2019) in relation to risk assessment procedures for accounting estimates. The issue is not necessarily that the two standards are inconsistent, but that auditors may find it difficult to determine how the ISA 540 requirements build on, rather than duplicate, the broader risk assessment work performed under ISA 315.
This can create a perception of duplicated work effort, particularly when obtaining an understanding of management's process and related controls for accounting estimates. The concern is more pronounced for less complex estimates and audits of SMEs, where management processes may be informal and controls may be limited. In those circumstances, further clarity would help auditors apply both standards in a way that is proportionate to the nature and risk profile of the estimate.

We also refer back to the issue already raised in our response to question 13. We do not consider applying ISA 540 (revised) to all accounting estimates to be a reasonable or proportionate outcome regardless of existing guidance on scalability and, indeed, this is not the approach that generally happens in practice considering the extent of transactions and balances that are subject to estimates. We consequently believe the scope of ISA 540 (Revised) should be adapted so that it is focused on estimates involving estimation uncertainty that gives rise to risks of material misstatement that have not been assessed as acceptably low or as being at the lower end of the spectrum of inherent risk. This would result in a significant reduction in complexity, particularly when auditing the financial statements of less complex entities.

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.*

1 – Strongly Agree

	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.

IFAC has observed that the main challenge in relation to risk assessment procedures does not necessarily arise with complex estimates, where the need for more extensive work is generally clearer. A more difficult issue can arise in SME or less complex audits, where accounting estimates may be simple and not among the areas of greatest audit risk.

In these circumstances, there is a risk that applying ISA 540 (Revised) may direct disproportionate attention to accounting estimates, including understanding and documenting management's process, when audit effort may be better focused elsewhere.

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)?

As noted in earlier responses, and our response to question 13, narrowing the scope of application of ISA 540 (Revised) to remove simple estimates would both help to reduce issues in this area and support effective consideration of risk by auditors. Non-authoritative guidance to help auditors minimise unnecessary duplication of work when navigating the interaction between ISA 540 (Revised) and ISA 315 (Revised 2019) may also be helpful.

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			

22A. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *testing how management made the 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) Testing management's selection of the method, significant assumptions, and data used, including whether management's judgments give rise to indicators of possible management bias.		X			
(b) Understanding management's application of the method involving complex modelling and testing complex models, including the integrity and completeness of the data used.		X			
(c) Whether management has taken appropriate steps to understand and address estimation uncertainty, including the selection of an appropriate point estimate and developing related disclosures about estimation uncertainty.		X			

22B. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *developing a point estimate or range*.

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
(a) Determining when it may be appropriate to develop an auditor's point estimate or range.		X			
(b) Determining that the auditor's range includes only amounts that are supported by sufficient appropriate audit evidence and have been evaluated to be reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework.		X			
(c) Maintaining objectivity and independence, for example, when material adjustments are made to management's point estimate based on the auditor's point estimate developed using a model or assumptions that were different from management's models and assumptions.			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.

IFAC is aware of some practical challenges in responding to assessed risks of material misstatement for accounting estimates. However, the extent of challenge varies depending on the response approach and the nature of the estimate. These are inherently greater for estimates with a high degree of estimation uncertainty. In our view, these challenges mostly relate to the application of well-understood requirements and not the standards themselves.

Using evidence from events occurring up to the date of the auditor's report may be relatively straightforward in many cases, while testing how management made the estimate or developing the auditor's own estimate or range can be more challenging, particularly where management's process is informal or where the estimate involves significant judgment, complex modelling, or difficult assumptions and data.

A greater practical challenge arises in SME or less complex audits, where management's process for developing an estimate may be informal, poorly documented, or not clearly remembered. In such cases, auditors may find it difficult to determine whether to test management's process in depth or instead develop their own estimate or range as the more effective response.

For more complex estimates, challenges may arise in testing management's methods, assumptions and data, understanding complex models, addressing estimation uncertainty, and evaluating identified misstatements where the audit evidence supports a point estimate or range that differs from management's estimate. The challenges therefore do not relate only to highly complex estimates or only to simple ones. The key issue is helping auditors select and apply a response that is proportionate to the assessed risk and capable of providing sufficient appropriate audit evidence without unnecessary work.

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)?

Already covered in previous questions

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.

IFAC has not identified significant concerns in relation to communications about accounting estimates. The more relevant practical issues relate to documentation and, in some cases, specialized skills or knowledge.

Documentation appears to be the main challenge. Scalability in documentation can be as challenging as scalability in audit procedures, particularly for simple or lower-risk estimates where auditors may feel pressure to document more extensively than necessary to demonstrate compliance. Further practical examples of proportionate documentation would be helpful.

Specialized skills or knowledge are most relevant where estimates involve complex valuation techniques, specialist models or technology-enabled approaches. However, we note a potential unintended consequence that ISA 540 (Revised) may be interpreted as encouraging specialist involvement in more circumstances than is necessary. Further practical guidance could help auditors determine when specialist input is needed and proportionate.

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?

Difficult to Determine

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)?

As discussed in our earlier responses, narrowing the scope of ISA 540 (Revised) so that it only applies estimates with significant estimation uncertainty would be helpful in reducing the documentation burden.

IFAC also encourages the IAASB to provide practical support on documentation and use of specialized skills in complex or technology-enabled estimate environments. This would be particularly helpful where management uses complex models or AI-supported tools that may be inherently difficult for auditors to understand or challenge.