Response ID:422 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) : KPMG International Limited
Name(s) of contact(s) for this submission : Sheri Anderson
Job title or role : Partner
E-mail address(es) of contact(s) : sranderson@KPMG.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).

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.

In general, we believe that ISA 540 (Revised) has achieved its intended purpose and the objectives of the IAASB in developing the revised standard. We consider that the revisions have been appropriately responsive to the environment, have driven improvements in audit quality, and have enhanced interoperability of the auditing standards with financial reporting frameworks.

In particular, we believe that the enhancements to risk assessment have improved audit quality. We consider that these changes support a more focused and effective risk assessment based on the auditor developing a more robust understanding of the specific drivers of risks of material misstatements in respect of estimates. Accordingly, this facilitates the performance of more targeted further audit procedures to respond to the assessed risks of material misstatement, improving the quality of audit evidence obtained and the robustness of audit conclusions reached. We highlight that this is the case especially in respect of complex estimates that are subject to greater estimation uncertainty.

We also believe that the revisions to the standard drive greater exercise of professional skepticism by auditors in relation to auditing estimates, in particular when evaluating management's judgements and assumptions due to the increased granularity of the risk assessment, which drive the auditor to question and challenge management's judgments with greater specificity, as well as due to the enhancements to the stand-back requirements.

We welcome the increased emphasis on the consideration of matters relating to accounting estimates, in particular, those that are complex and subject to greater estimation uncertainty, when communicating with those charged with governance. We consider that this helps to foster more robust discussions between auditors and those charged with governance, and drive audit quality. We also believe that the enhancements to the standard, in driving a more rigorous risk assessment that is focused on the underlying specific drivers of risks, and more targeted audit procedures to respond to the assessed risks, assists auditors in providing improved transparency in the auditor's report when describing Key Audit Matters in respect of 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?

3 – Agree
Comments: We consider the non-authoritative guidance and related tools to be very helpful in supporting implementation of the revised standard, in particular, the Simple and Complex Illustrative Examples, which compare and contrast in detail the auditor's understanding and approach and how this may be scaled in a way that is proportionate to the complexity of the particular estimate, and the Expected Credit Losses Illustrative Examples, which provide helpful guidance in auditing such complex estimates. We recommend, in our response to Question 13, that a further example in respect of a less complex estimate be developed, to better support auditors in scaling the requirements of the standard in a proportionate manner.

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:

In general, we believe that the revisions to ISA 540 have achieved the IAASB's objectives to modernize the standard, in the public interest, to make it more responsive to evolving audit risks in an increasingly complex business environment. We highlight the following benefits that we have observed, in particular:

Risk Assessment - We consider that the enhancements to the standard in the area of risk assessment, especially the requirement to separately assess inherent risk and control risk for accounting estimates; the recognition that inherent risk lies along a spectrum; the introduction of the concept of inherent risk factors, and the disaggregation of the elements of estimates into methods, significant assumptions and data have enhanced audit quality. We believe that these changes support the performance of more rigorous and effective risk assessment procedures based on the auditor developing a more robust understanding of the specific drivers of risks of material misstatements in respect of estimates, particularly for complex estimates that are subject to greater estimation uncertainty. We also believe that the enhanced risk assessment also assists the auditor in identifying control deficiencies, including in relation to the inappropriate selection or application of methods, assumptions or data.

Responses to Assessed Risks – We believe that the enhancements to risk assessment facilitate the performance of more targeted further audit procedures to respond to the assessed risks of material misstatement, focused on where the risk specifically resides, rather than a more generalized response to an aggregate and undifferentiated risk. We welcome the introduction of clear, objective-based requirements, in particular, those directed to the estimate elements of methods, assumptions and data, which drive a more focused and consistent approach, improving audit quality and consistency.

Consideration of the Skills and Competencies of the Engagement Team, Including the Need to Involve Specialists/Experts – We believe that the more granular and targeted approach resulting from the changes to the standard as described above has enhanced the auditor's considerations in respect of whether the engagement team collectively has the appropriate competence and capabilities to perform the audit procedures required in respect of estimates. This includes considerations as to whether there is a need to involve specialists and experts, including valuation experts, IT/technology experts, including data analysts and those with expertise in emerging technologies, including the use of AI. As a result, the revised standard not only helps to ensure that such specialists/experts are involved as part of a multidisciplinary engagement team when necessary, but also enables engagement teams to involve appropriate specialists/experts in a more focused way to address specific risks, and to assist in exercising professional skepticism, improving the quality of audit work in complex areas.

Professional Skepticism - We consider that the revisions to the standard drive greater exercise of professional skepticism by auditors in relation to auditing estimates. In particular, we believe the revisions drive auditors to exercise professional skepticism in respect of estimates throughout the audit e.g., when understanding the basis for management's selections, judgements and assumptions, when challenging management e.g., with respect to changes (or the need for changes), alternatives and considering whether there are indicators of management bias, as well as due to the enhancements to the stand-back requirements, which we consider have improved the identification of management bias and enhanced the robustness of audit conclusions.

Communication/Transparency - We also welcome the increased emphasis on the consideration of matters relating to accounting estimates, in particular those in relation to which there is higher inherent risks, e.g. because they are more complex and/or have high estimation uncertainty, when communicating with those charged with governance. We believe these help to foster more robust discussions between auditors and those charged with governance, and drive audit quality.

In addition, we believe the enhancements to the standard drive auditors to place greater emphasis on audit procedures in respect of disclosures related to estimates, and support more meaningful communication of auditor considerations in respect of estimate-related matters, including estimation uncertainty, when describing Key Audit Matters. This enables users of financial statements to better understand audit judgements and risks in respect of estimates.

Documentation requirements – We welcome the enhancements to documentation requirements, which we consider align with the more robust and structured approach that underpins the changes made to the standard. We consider that these changes support engagement teams to document their audit work in respect of estimates more clearly. This includes a more structured description of the key aspects of their risk assessments, clearer linkage between identified risks and responses designed to address these, as well as demonstrating how the auditor exercised professional skepticism.

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.

4 – Significant Issues or Challenges

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

We believe that the most significant challenges in applying the revised standard relate to scalability and proportionality matters. While we acknowledge that the revised standard drives a more rigorous and targeted approach to auditing estimates, in particular, for complex estimates that are subject to a higher degree of estimation uncertainty, we believe that it is overly calibrated to such complex estimates. As a result, there are significant challenges in scaling the requirements, in particular, the risk assessment requirements, when auditing less complex estimates with low estimation uncertainty.

We believe that the revised standard is intended to be scalable to all types of estimates, noting that paragraph 3 states "The nature, timing and extent of the risk assessment and further audit procedures required by this ISA will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement. For certain accounting estimates, estimation uncertainty may be very low, based on their nature, and the complexity and subjectivity involved in making them may also be very low. For such accounting estimates, the risk assessment procedures and further audit procedures required by this ISA would not be expected to be extensive."

The application material provides further guidance regarding scalability, e.g. at paragraph A20, the standard acknowledges that "the accounting estimates may not require significant judgements, and the process for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be subject to, or affected by, estimation uncertainty, complexity, subjectivity or other inherent risk factors to a lesser degree and there may be fewer identified controls in the control activities component. If so, the auditor's risk identification and assessment procedures are likely to be less extensive and may be obtained primarily through inquiries of management with appropriate responsibilities for the financial statements, such as simple walk-throughs of management's process…". Furthermore, we acknowledge that the Illustrative Examples guidance, in describing the auditor's approach and understanding for a less complex estimate, demonstrates ways in which the auditor's procedures may be less extensive, both in terms of risk assessment and further audit procedures.

However, this guidance within the standard itself is overall limited, high level and conceptual, with the result that it is unclear to auditors as to the extent to which they may scale certain of the risk assessment procedures. The detailed example of a less complex estimate within the supplementary material still contains elements of complexity and does not sufficiently illustrate how certain aspects of the standard may be scaled, in particular, in relation to documenting auditor decisions and judgements.

Risk Assessment Procedures – Obtaining an Understanding

Of particular concern is the fact that the standard and related supplementary guidance together indicate that the auditor is required to address each of the aspects of obtaining an understanding as set out at paragraph 13 of the revised standard, in order to identify and assess the risks of material misstatement in respect of each estimate, irrespective of the characteristics of that estimate, i.e., including when this is a less complex estimate. We consider that this may result in an audit work effort that is unnecessarily onerous and "over-engineered" in respect of less complex estimates as the standard requires the auditor to obtain an overly detailed understanding that is disproportionate to the objective of the procedures, being identification and assessment of risks of material misstatement. We do not consider that this is aligned with the fundamental principle that an audit is risk-based, and instead, the requirements appear overly prescriptive. This presents pervasive challenges to auditors as many financial statement line items are, or include, such estimates.

Concerns arise, in particular, in relation to risk assessment procedures at paragraph 13(h)(ii) regarding the understanding that is required in respect of how management identifies, selects, designs and applies, as relevant, the methods, assumptions and sources of data used to make the estimate, including consideration of the need for changes, alternatives, uncertainties, possible measurement outcomes, and how management addresses these, including selecting a point estimate. These considerations may not always be proportionate to the audit of less complex estimates, and, furthermore, the related documentation requirements, in particular, the requirement to document key elements of such understanding, may drive an unduly burdensome documentation process that does not enhance audit quality. Furthermore, the requirements may drive a compliance mindset for the auditor, and may even detract from audit procedures that would better address the estimate in question.

In connection with the above, the requirements in respect of exercising professional skepticism, such as in challenging management regarding their selection and application of methods, assumptions and data, and consideration of alternatives, create challenges in respect of less complex estimates. Refer to Question 15 for further information.

The below examples help to illustrate how the standard does not enable the auditor to appropriately scale the risk assessment procedures in line with the inherent risk, and the degree to which the estimate is affected by inherent risk factors, when performing audit procedures in respect of a less complex estimate:

• When auditing a "simple" depreciation estimate that uses the 'straight line' method, complexity and estimation uncertainty are likely to be low, with estimation uncertainty primarily driven by subjectivity relating to the determination of useful economic lives and residual values. Despite an experienced auditor being able to make this judgment relatively quickly, and to have clear upfront expectations as to the methods and data used to make the estimate, the revised standard drives the auditor to focus significant work effort on performing risk assessment procedures to obtain a detailed understanding of the estimate, as described by paragraph 13, including matters such as how management identifies the relevant methods, assumptions or sources for data, understands the degree of estimation uncertainty, including considering the range of possible measurement outcomes, and how management addresses estimation uncertainty.

• When auditing financial instruments that are "level 1" in the fair value hierarchy, the auditor is similarly directed to understand the method, assumptions and data in respect of the valuation estimate of the financial instruments. While this may be appropriate when these financial instruments are highly material relative to other assets held by the reporting entity (in which case, even low levels of estimation uncertainty may have a material impact), when that is not the case, the work effort required to perform risk assessment is disproportionate, and is driven by the fact that the financial instruments are an estimate, rather than because there is a real possibility of risks of material misstatement relating to estimation uncertainty.

Risk Assessment Procedures – Retrospective Review

We also highlight that there are scalability and proportionality challenges in relation to performing a retrospective review as required by paragraph 14 of the revised standard. For further information regarding our concerns, and our recommendations to address these, refer to our response to Questions 18B and 21.

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)?

To address the scalability challenges we describe above, we recommend that the IAASB explore amendments to the standard and/or supporting materials that would continue to drive appropriate rigor in risk assessment for complex estimates with high estimation uncertainty, while enabling a more proportionate and streamlined approach to be taken for less complex estimates, that would improve audit efficiency and effectiveness while not compromising audit quality. We believe that such an approach should enable an auditor to use their professional judgement to direct audit procedures performed as part of obtaining an understanding to those specific aspects of the estimate which the auditor considers would drive estimation uncertainty. While most, if not all, estimates have a method, assumptions and data, the risks of material misstatement related to estimation uncertainty for less complex estimates are often isolated to the significant assumptions.

We also suggest that the IAASB develop an additional example of a "simple" estimate, such as a simple depreciation estimate as described above, to illustrate both the nature and extent of application of the required procedures to such an estimate, and the related documentation of the auditor's decisions and judgements.

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.

As noted in our response to Question 9, we believe that the revisions to the standard have strengthened the auditor's application of professional skepticism in relation to accounting estimates.

However, we highlight that challenges may arise in practice relating to the application of professional skepticism when performing audit procedures in respect of estimates as a result of the scalability matters described above, because the standard appears to drive the auditor to question and challenge management regarding its estimation process, in respect of each of the elements of the process, i.e., the methods, assumptions and data selected/applied. However, as the risks of material misstatement related to estimation uncertainty for less complex estimates are often isolated to the significant assumptions, it may not be necessary or appropriate, when performing audit procedures in respect of an less complex estimate, for auditors to question and challenge management in respect of their selection and application of the method and data, and consideration of alternatives (e.g,, where management has used the "straight line" method in respect of depreciation, and the data is sourced from the fixed assets register).

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?

Yes

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)?

We consider that the challenges in practice in respect of exercising professional skepticism result from the standard being insufficiently scalable in respect of enabling auditors, when auditing a less complex estimate that is subject to low estimation uncertainty, to direct audit procedures more specifically to elements of management's estimation process where risk resides. While most, if not all, estimates have a method, assumptions and data, the risks of material misstatement related to estimation uncertainty for such less complex estimates are often isolated to the significant assumptions. Accordingly, as we recommend elsewhere, we believe that the standard should provide the auditor with more flexibility to exercise professional judgment when determining the work effort required to obtain sufficient understanding of the method(s) and data (as required at paragraph 13(h)) to identify and assess the risks of material misstatement, or when performing the further audit procedures, with related exercise of professional skepticism, to address risks of material misstatement relating to the method or data (as required at paragraphs 22-25 of the revised standard) for these less complex estimates.

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.

Actual grading for 18(b) - 2

We have not graded our response to Question 18(b) specifically as a 4 or 3, however, we highlight the importance of close coordination by the IAASB regarding any future revisions to ISA 540 with revisions to ISA 315, and also, in particular, ISA 330, to ensure such revisions are coherent and mutually reinforcing. We note, in particular, the need for careful consideration of the consequences of proposed changes to ISA 330.18.

Furthermore, we highlight that paragraph 13(i) of ISA 540 requires the auditor to understand controls over management's process for making estimates. Taken in conjunction with paragraph 13(h)(ii), we believe that, when performing audit procedures in respect of complex estimates such as in relation to expected credit losses, for which management may use complex modelling techniques, the revised standard would currently direct the auditor to understand the detailed internal architecture and decision-making logic of such models, and to identify inherent risks and control risks based on such understanding, in order to address risks of material misstatement (RMMs) at the assertion level. Over the next few years, entities are expected to significantly expand their use of AI modelling, e.g., within the banking industry entities are expected to utilize machine learning to enhance predictive accuracy of expected credit losses. As such models become increasingly sophisticated, using advanced techniques and complex algorithms that enable them to operate with greater processing volumes, it is likely to become significantly more challenging to develop such an understanding, including in respect of related controls.

Accordingly, we recommend that the IAASB explore inclusion, within the application material to this paragraph, of content that would guide auditors, when performing audit procedures in respect of such complex models, to direct their audit procedures to focus on understanding the strength of governance controls over such models, including in relation to their selection, customization and development, and review controls regarding the evaluation of the results that they produce.

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 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.

We have observed a number of challenges in respect of the risk assessment procedures required by the revised standard, which are reflected in the gradings we have assigned in respect of each of the detailed questions above, in particular, 18(d). We note that the challenges relate, in particular, to our concerns regarding the scalability and proportionality of the standard in respect of less complex estimates that are subject to low estimation uncertainty, or estimates where estimation uncertainty may be confined to one element of the estimate. For further information regarding these concerns refer to Question 11.

Retrospective review

We support the principle of performing a retrospective review regarding the outcome of previous accounting estimates or, where applicable, their subsequent re-estimation, as required at paragraph 14 of the revised standard. We believe that this procedure can provide useful information, including regarding the effectiveness of management's estimation process, about the complexity or estimation uncertainty related to a particular estimate, as well as to assist the auditor in identifying management bias.

However, we consider that the inclusion of this requirement in an unconditional form creates challenges in terms of scalability and proportionality of audit work. These challenges arise, in particular, in relation to estimates with low complexity and estimation uncertainty. Although the requirement includes scalability in enabling the auditor to determine the nature and extent of the review based on the characteristics of the accounting estimate, there is very limited further guidance in relation to practical scalability adaptations. As a result, auditors may direct a disproportionate work effort towards compliance with this requirement, the audit evidence obtained from this review may be duplicative of other audit evidence obtained, for example, from inquiry of management and process walkthroughs when this is accompanied by sufficient detailed questioning and challenge, as well as substantive audit procedures, and as a result may not provide incremental audit evidence regarding the estimation process.

The standard contains only limited discussion regarding the relationship between the review and the type of estimate, e.g., when the estimate is a value-in-use estimate, the retrospective review may provide helpful insights regarding management's forecasting process as a key aspect of their estimation process, however, when the estimate is a fair value estimate based on observable market values, a retrospective review is less likely to provide meaningful insights to inform risk assessment.

The standard also makes reference to performing the review over several periods when the outcome of an accounting estimate is resolved over a longer period, however, it does not address the circumstances in which the outcome of the estimate is resolved in each period (e.g., such as the collection of short-term trade receivables) but it is the pattern of resolution over multiple periods, e.g., where management's assumptions may have been overly optimistic in each period, that may provide meaningful insights for the auditor to support risk identification and assessment.

The above scenarios may result in the auditor performing unnecessary audit work without obtaining useful information, as a result of which auditors may approach this review requirement as a mechanical compliance procedure and conclude that an estimate is reasonable without obtaining meaningful insight into the quality of the estimate or whether there are indicators of bias. Furthermore, the audit procedures performed may not be appropriately designed to address specific risks to obtain sufficient approach audit evidence.

In addition to the above, the standard does not adequately discuss the impact on the audit of variances, including:

• Whether a higher variance indicates that there is a higher inherent risk, or is an indicator of management bias, and the factors the auditor may consider in making this determination, which may lead to inconsistency in practice;

• Although the standard notes that "The review is not intended to call into question judgements about previous accounting estimates that were appropriate based on the information available at the time they were made", with the related application material also stating that "A difference between the outcome of an accounting estimate and the amount recognized in the previous period's financial statements does not necessarily represent a misstatement of the previous period's financial statements", it is possible that a retrospective review may identify a misstatement in the previous period's financial statements, and the standard does not explicitly acknowledge this or note that, in these circumstances, the auditor considers the implications for the prior year auditor's report.

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)?

Refer to Question 13 for further information regarding recommendations to address issues or challenges in relation to scalability.

Suggestions re retrospective review

We recommend that the standard include conditionality in the requirement to perform a retrospective review, e.g., that the auditor be required to "consider performing" such a review, with related application material setting out factors that the auditor may consider in making this determination, that are directed to understanding the specific risks associated with the estimate. We believe that this would better align with the fundamental premise that an audit is risk-based, and that requirements are principles-based rather than prescriptive. Factors to consider may include the applicability of inherent risk factors, including whether the estimate is complex versus less complex, the degree of estimation uncertainty, and the nature of the estimate, e.g., whether the estimate is a value-in-use estimate or a fair value estimate based on observable market values.

In addition, we suggest that the application material further discuss the performance of the retrospective review for different types of estimates, in terms of the information that the review may provide regarding management's estimation process. This may include consideration of inherent risk factors, building on the material included at A58 and A59. We recommend that the standard include examples to better illustrate how the review may be designed in order to provide meaningful information to inform risk identification and assessment.

Furthermore, we recommend that the standard provide additional guidance as to the steps the auditor may take, including to comply with the IESBA Code of Ethics, and with applicable legal and regulatory requirements, in the event that the retrospective review identifies differences that may be indicative of a material misstatement of the prior period financial statements.

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			

22A. Indicate the extent to which you have experienced 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 experienced 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 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.

In general, we consider that the revised standard sets out clearer, more structured, objective-based requirements in respect of responses to the assessed risks of material misstatement. Taken together with the revisions to the standard to drive a more rigorous risk assessment process, enabling the auditor to design more targeted further audit procedures to respond to the assessed risks of material misstatement, focused on where the risk specifically resides, we believe the revised standard drives significant improvements to audit quality, in particular, in respect of more complex estimates with greater estimation uncertainty.

However, we highlight that there are a number of challenges in applying the requirements of the standard in respect of responses to the assessed risks of material misstatement, as follows:

• In requiring the auditor to perform "one or more" of the approaches described at paragraph 18 of the standard, there may be differing interpretations as to how auditors make the determination as to which further audit procedures to perform. In particular, different interpretations of these requirements may blur the lines between the requirement at paragraph 18(b) to test how management made the accounting estimate, in particular, how management addressed estimation uncertainty, and the requirement at paragraph 18(c) to develop an auditor's point estimate or range, for which the auditor may use management's methods, assumptions and data, or the auditor's own.

• Furthermore, when management's application of the method involves complex modelling, there may be challenges for the auditor in applying the requirements, in particular, of paragraph 23-26 of the standard, as these may be interpreted as requiring the auditor to reperform all aspects of the calculations of the model, which may not be necessary or practicable. This may be the case, in particular, when large volumes of data are processed by a highly complex model (which may run at huge scale, may be highly automated, and which often requires use of significant infrastructure e.g., supercomputers and data warehouses) and/or when the model itself is proprietary. In these circumstances, audit procedures may more appropriately be directed to testing management's governance and controls in respect of the model, including review controls.

As the use of emerging technology in this area continues to evolve at pace, these challenges are expected to increase significantly in the foreseeable future.

• While most, if not all, estimates have a method, assumptions and data, the risks of material misstatement related to estimation uncertainty for less complex estimates are often isolated to significant assumptions, and the further audit procedures to address risks of material misstatement relating to the method or data for these less complex estimates may be simple and not necessarily any different than if the class of transaction, account balance or disclosure did not contain an estimate (i.e., there may be little to no judgment involved in the selection or application of the methods or selection of the data and therefore they are not a source of estimation uncertainty).

However, when a class of transaction, account balance or disclosure is identified as containing an estimate, if the auditor decides to test how management made the accounting estimate, paragraphs 22-26 direct the auditor to obtain sufficient appropriate audit evidence regarding the risks of material misstatement relating to each of the selection and application of methods, significant assumptions and data used by management in making the estimate.

• We also highlight that management's point estimate may be based on inappropriate methods, assumptions or data, but, in the event that the auditor has developed an independent expectation in terms of a point estimate or range, using the auditor's own methods, assumptions and data, management's point estimate may fall within the auditor's range. The standard does not include content to guide the auditor as to appropriate next steps to take in this scenario, including relevant considerations when management discloses the inappropriate methods, assumptions or data in the notes to the financial statements.

• The standard does not address relevant considerations for grouping similar estimates for sampling, which may lead to inefficiency and excessive documentation when dealing with large numbers of similar items (such as tax provisions or financial instruments).

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)?

We set out the following recommendations for further enhancements to the standard to address the challenges described above:

• We recommend that the IAASB explore additional enhancements to the revised standard to provide further clarification as to when only one of the required responses described at paragraph 18 would be appropriate, or when more than one, or a hybrid approach, may need to be taken by the auditor. We recommend that the IAASB provide illustrative examples, to demonstrate how each approach would be aligned to the specific characteristics of the estimate.

• We suggest that the application material provide additional clarity to assist the auditor in determining the further audit procedures to perform to obtain sufficient appropriate audit evidence in respect of mathematical accuracy of calculations in models. Such procedures may be directed to evaluation and testing of governance in respect of complex models, including related controls, and including those directed to ensuring model integrity and completeness of data, rather than end-to-end re-performance of model calculations, which may be challenging, and, in the case of highly complex models processing high volumes of data, may be impracticable.

• We believe it would be helpful if the standard could clarify that when an auditor has determined that risks of material misstatement related to estimation uncertainty for less complex estimates are isolated to significant assumptions, and that if risks of material misstatement related to methods or data do not relate to judgments regarding their selection or application and therefore affect estimation uncertainty, then, while there may still be risks of material misstatement associated with these elements that need to be addressed in the audit, the required responses in paragraphs 23 and 25 may not be applicable. We believe such clarification would be commensurate with the intention of the standard to drive more targeted responses by auditors, when performing further audit procedures, that are focused on the underlying specific drivers of risks of material misstatement that have been identified by auditors as a result of performing a more rigorous risk assessment, including developing a more granular understanding of elements of management's estimation process. Paragraph 18 makes reference to further audit procedures "being responsive to the assessed risks of material misstatement… considering the reasons for the assessment given to those risks". We recommend that further clarification be included within this paragraph, and also at paragraph 22, in respect of the applicability of the subsequent paragraphs at 23-25.

• We also recommend that the application material address the scenario in which management's point estimate may be based on inappropriate methods, assumptions or data, but, in the event that the auditor has developed an independent expectation in terms of a point estimate or range, using the auditor's methods, assumptions and data, management's point estimate may fall within the auditor's range. In these circumstances, while there may not be a material misstatement of the financial statements, there are likely to be control deficiencies in respect of management's estimation process, and we recommend that the application material explicitly guide the auditor to communicate such matters to those charged with governance. Furthermore, if the reporting entity discloses the inappropriate methods, significant assumptions or data used by management in the notes to the financial statements, this may be misleading to users and may constitute a material misstatement of the financial statements. Accordingly, we recommend that the standard highlight this and guide the auditor regarding the implications for the auditor's report, and the audit more broadly.

• In respect of estimates relating to financial instruments, we recommend that the IAASB explore clearer linkage between this standard and the concepts and requirements proposed in revised ISA 500, in particular, in relation to the evaluation of the relevance and reliability of audit evidence, and consideration of the applicability of significant attributes of reliability. We note that this would provide greater clarity in respect of pricing information from recognized pricing services that is used as audit evidence in respect of valuation of financial instruments. We recommend that the IAASB consider including guidance material issued by the PCAOB and AICPA in this regard, which may be codified into the standard in a manner that retains principles-based requirements in the ISAs, or included in supplementary materials.

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.

N/A

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 Response

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)?

N/A