

IAASB Exposure Draft

Proposed International Standard on Auditing 540 (Revised)
Auditing Accounting Estimates and Related Disclosures

response to exposure draft

1 August 2017

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As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

Our ref: Responses/ 170217 SC0236

International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York
10017 USA
Submitted electronically
August 2017

Dear IAASB secretariat

**IAASB Proposed International Standard on Auditing 540 (Revised)
*Auditing Accounting Estimates and Related Disclosures***

CIPFA is pleased to present its response to this ED, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

CIPFA welcomes this proposed revision, which further improves the extant ISA 540, both in respect of matters which arise from developments in financial reporting, and issues noted on the use of the standard by practitioners and regulators.

Comments On The Drafting Level And Specificity

In April 2007 CIPFA responded to an IAASB exposure draft which combined the previously separate standards ISA 540 (on accounting estimates) with ISA 545 (on fair value). CIPFA was strongly supportive of the withdrawal of ISA 545, and we noted our view that having a separate ISA relating to a specific accounting measurement approach was in retrospect anomalous. CIPFA was glad to see requirements which focused on more general requirements to obtain assurance on the correct application of financial reporting guidance, and in respect of the reliability of estimate data and calculations. Even so, we noted some respects in which the proposed revisions still engaged with the specifics of the IFRS framework rather than matters of fully general application.

Against this background, it does not surprise us that, when reviewing issues arising in connection with the audit of financial institutions, the Board found that most if not all of these would be equally relevant when auditing other complex accounting estimates. We are glad to see that the proposed revision has removed from the main body of the standard a number of details relating to fair value (including e.g. references to marketplace participants). We are also glad to see that these were not simply replaced by references to e.g. expected credit loss models. Material on both fair value and the specifics of ECL has been incorporated in the Application and Other Explanatory Material, framed as important examples, and we consider that this approach has been well executed. We also consider that the reframed 'Measurement Bases' appendix is an improvement on 'Fair Value Measurements and Disclosures under Different Reporting Frameworks'.

CIPFA's response to the IAASB Request for Comments

CIPFA's comments on the questions in the Request for Comments are attached in an Annex.

Generally we support the approach taken in the ED.

Redrawing the boundary between basic procedures and enhanced audit effort based on 'low inherent risk' (rather than a holistic view of significant risk of material misstatement) is a novel approach, but does appear workable. We also note and agree that in those cases where reliance on controls forms part of the basis for auditor assurance, the ED is clear that controls must be tested.

I hope this is a helpful contribution to the development of a revised ISA 540.

If you have any questions about this response, please contact Steven Cain
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Yours sincerely

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CIPFA RESPONSES TO QUESTIONS IN THE REQUEST FOR COMMENTS

Overall Questions
<p>1) Has ED-540 been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates?</p>
<p>CIPFA considers that ED-540 has been appropriately updated to reflect the changing financial reporting environment, including IFRS developments and specific issues arising from implementation of changed IFRS requirements to the financial services and insurance sectors. This will also probably be helpful in connection with any issues arising from related changes to other standards frameworks, whether these are local implementation which have regard to IFRS, and changes to International Public Sector Accounting Standards (IPSASs), which are developed having regard to related IFRS treatments insofar as these are relevant to public sector financial reporting.</p> <p>We would note our view that, in making these changes, ED-540 seems to us to achieve a better balance than the extant ISA 540, both in making the body of the ISA requirements independent of the financial reporting framework, and in including material which is helpful for auditors of a variety of reporting entities, without providing too much detail on specific sector issues.</p> <p>Having regard to the representations made to the IAASB on its workplan, we believe that there may be an appetite for additional material on matters relating to e.g. the audit of entities in the financial services sector. However, if the Board were to provide further more detailed guidance or educational material, this would be better placed in a practice statement or other document separate from the main ISA standards.</p>
<p>2) Do the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates?</p>
<p>CIPFA considers that the material in ED-540 appropriately reinforces the application of professional skepticism, mainly by promoting rigorous planning, testing and evaluation, while in some places simply highlighting the need to apply professional skepticism.</p> <p>Both approaches are necessary, given that professional skepticism is characterised both by a mindset which reflects an appropriate degree of challenge in the circumstances of the audit, and a technical understanding of the adequacy of audit evidence having particular regard to issues arising from information obtained from sources related to the audited entity, or other interested parties.</p>

Focus on Risk Assessment and Responses

3) Is ED-540 sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk?

CIPFA was generally content with the approach to scalability in the extant ISA 540. However, we accept stakeholder suggestions that there may be difficulties in operationalising this effectively, and regulator representations which suggest that extant ISA 540 is not being applied correctly, resulting in both under and over audit.

Against this background, we support the revised approach based on considering whether an accounting estimate is subject to low, or other than low, inherent risk.

4) When inherent risk is not low (see paragraphs 13, 15 and 17–20):

a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?

b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?

c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?

a) CIPFA considers that the revised requirements may avoid certain cases where, due to a misunderstanding of the requirements of extant ISA 540 or for other reasons, auditors might mistakenly assess accounting estimates as not being subject to significant risk.

b) CIPFA considers that the 3 factor approach will capture the main elements of risk to accounting estimates.

c) CIPFA considers that the guidance is useful and, taken together with a proper understanding of the requirements of audit evidence, will help them to achieve the objectives of the audit.

5) Does the requirement in paragraph 20 (and related application material in paragraphs A128–A134) appropriately establish how the auditor’s range should be developed? Will this approach be more effective than the approach of “narrowing the range”, as in extant ISA 540, in evaluating whether management’s point estimate is reasonable or misstated?

CIPFA considers that the ED-540 material is easier to understand and provides better support for evaluating whether management’s point estimate is reasonable or misstated.

6) Will the requirement in paragraph 23 and related application material (see paragraphs A2–A3 and A142–A146) result in more consistent determination of a misstatement, including when the auditor uses an auditor’s range to evaluate management’s point estimate?

CIPFA considers that the ED-540 material is easier to understand and provides better support for evaluating whether management’s point estimate is reasonable or misstated.

Conforming and Consequential Amendments

7) With respect to the proposed conforming and consequential amendments to ISA 500 regarding external information sources, will the revision to the requirement in paragraph 7 and the related new additional application material result in more appropriate and consistent evaluations of the relevance and reliability of information from external information sources?

The proposed conforming and consequential amendments are helpful. The definition and guidance on external information sources address directly address a need which will be relevant to many audits.

Request for General Comments

8) In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:

(a) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-540.

(b) Effective Date—Recognizing that ED-540 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods ending approximately 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

CIPFA has no comments to make on the matters above.