

# CEAOB

## Committee of European Auditing Oversight Bodies

International Auditing and  
Standards Assurance Board  
IAASB  
529 Fifth Avenue  
New York  
NY 10017  
USA

28 July 2017

### **Comment letter relating to the IAASB's Exposure Draft – ISA 540**

Dear Madam, dear Sir,

1. The CEOB appreciates the opportunity to comment on the IAASB's ("Board") exposure draft on proposed International Standard on Auditing (ISA) 540 Revised – Auditing Accounting Estimates and Related Disclosures, issued in April 2017.
2. As a body of European audit regulators, the CEOB considers it is important to pursue continuing improvement of standard setting for the audit profession.
3. The content of this letter has been discussed and agreed upon by its members. The comments in this letter reflect matters of consensus within the CEOB. Nevertheless, the comments hereafter are not intended to include all comments that might be provided by the individual regulators that are members and their respective jurisdictions.

#### *General support for revising ISA 540*

4. We support the project to revise ISA 540 to foster better audit quality in respect of accounting estimates. The database maintained by the audit regulator members of the CEOB includes a high number of inspection findings on this topic. We support revisions to the ISAs which have the potential to drive better audit quality and consistency in its application by auditors.
5. The main areas of findings in relation to ISA 540 highlighted in a survey conducted by European audit regulators based on data collected in the European database were (i) insufficient challenge of management assumptions (ii) insufficient audit procedures performed by the auditor and (iii) weaknesses in testing internal control related to preparing accounting estimates.

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*Support for the balance achieved in the revised standard*

6. We support the efforts of the Board to improve the standard in order to meet the challenges of auditing increasingly complex estimates. We support and encourage the Board's efforts to avoid adding unnecessary requirements and application material to the standard.

*Enhancement in the standard through the proposed revisions*

7. We, in general, believe that several proposals in this exposure draft are steps in the right direction, and can help achieve better quality in the audit of accounting estimates. We support the:
  - a. proposal to adapt the level of work effort required to the level of risk and to the factors inherent to the risk,
  - b. inclusion of a provision (in par. 16 of the proposal) which highlights a requirement stemming from ISA 330, to perform tests of controls to ensure their operating effectiveness before relying on them or when substantive procedures alone are not sufficient,
  - c. inclusion of the "stand back" requirements in par. 22 and 23, which encourage the auditors to take into account all information gathered and to investigate contradictory evidence obtained.
8. We nevertheless recommend to the Board to consider various additional enhancements as mentioned hereafter:

*Link to be clarified between different levels of risks*

9. The revised standard is built on the concepts of estimates with a "low inherent risk" and estimates where "inherent risk is not low", which, we believe will be helpful in allowing responses to be adapted to those situations. Some questions could be raised on the linkage of those risks, if any, with the "significant risk" concept. We believe further explanation of the interrelationship between the different risk concepts would be beneficial.
10. We believe par. A95 creates an ambiguity regarding the separate assessment of inherent and control risk, which should be avoided. We recommend further alignment of this paragraph with the provisions of par. 15.

*Increased focus on disclosures related to estimates*

11. We support the IAASB's effort to enhance the focus of the auditor on the quality of disclosures provided by the audited entity and agree that disclosures are a key aspect in the audit of accounting estimates. Regarding the proposal to move the objective to check the fact that disclosures are "reasonable" rather than "adequate", we encourage the Board to provide further explanations regarding the notion of "reasonable" compared to the former terminology "adequate" in order to achieve consistency in application.

12. In addition, we believe that the revised ISA should more clearly require the auditor to understand the risks (and internal controls) relating to the preparation of disclosures by management, in addition to the provisions in par. 10(a) and 10(e).

*Meaning of the notion of outcome of an estimate*

13. We encourage the Board to check the consistent use all over the standard of the notion of "outcome of an accounting estimate" which has been defined in the standard (par. 9 f). Further clarity around the meaning of "outcome" in different situations would be useful to drive further consistency in application.

*Alternative evaluations by management*

14. In par. 19(b), we suggest changing the proposed requirement, by integrating an additional step, so that the auditor asks the entity's management to provide alternative evaluations before requesting the auditor to develop its own estimate. This would mean elevating the application material described in par. A126 into the requirements.

*Procedures for low vs. non low risk*

15. Some concerns have been raised regarding par 15, which is not consistently understood. We believe that the Board should consider adding more guidance or redrafting par.15 to state clearly whether the procedures foreseen in par. 15a) are applicable or not in cases when the inherent risk is not low.

*Level of work effort when an estimation is complex, due to the difficulty in obtaining reliable data and maintaining the integrity of the data*

16. The standard (par. 15b) describes that the auditor shall perform further audit procedures when the inherent risk of the estimate is not low. For the cases where the estimates are "complex" the matters to be supported by audit evidence are described in par. 17. This paragraph only applies when a complex method is used by management or when the method otherwise involves specialized skills or knowledge; no further indication is given regarding further procedures required in case of complexity due to the difficulty or unavailability of data. In this second situation of complexity, the standard should also make sure that the auditors appropriately address the following matters:
  - a. analysis of the relevance of the changes in method used (if any) since the last period,
  - b. analysis, of the relevance in the changes operated in data sources (if any),
  - c. analysis of the appropriateness of adjustments incorporated, if any, (for instance analysis of the discount/premium applied to the most comparable data obtained when exact comparable data is not available).

The Board should clarify that the provision of par. 18c (ii) and (iii) which is applicable to "judgements" is also applicable to this situation of "complexity".

17. In par. 20 we believe the extent to which the amounts used to develop the auditor's range should be "supported by the audit evidence" should be further clarified, taking into account that all the data cannot always be checked against external data. The meaning of this paragraph needs to be developed through further references to other standards applicable or further guidance.

#### *Use of experts*

18. In addition to the requirements of par. 12, we believe that it is important to further highlight in the guidance that an involvement of specialized skills might be necessary to inform or confirm the evaluation, by the auditor, of level of estimation uncertainty in cases where only a specialist has the necessary level of understanding of the potential impact of the accounting estimate. Such involvement could either lead to the specialist performing audit procedures but could also end with his involvement in the risk assessment.

#### *Impairment indicators*

19. Par. A22 indicates that the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify, in relation with ISA 315. We believe that missing indicators of impairment, that management failed to identify, should also be referred to in this paragraph, so that the auditor remains alert to any impairment indicators.

#### *Weakness in internal control design or operation*

20. In addition, we believe that further clarity about the actions to be taken by the auditor when internal control is not appropriately designed or is not operating well, in the context of an accounting estimate, would be welcome. A reference to ISA 330 could be added in this regard.

#### *Consideration of other valuations techniques, data and assumptions*

21. We believe the consideration of whether there are other available valuation techniques, assumptions or data that could have been more appropriate is a way to exercise the auditors' professional scepticism. Thus, we believe the content of application material A101 should be applicable for all kind of factors addressed in par.17 to 20, since it is a way to reduce auditor's bias when assessing the risk of material misstatements in the accounting estimates.

#### *Conforming ISA 500 amendments*

22. We support the aim to develop further professional scepticism by the auditor on the use of data from external sources as audit evidence. The notion of "publicly available information" should be clarified further in ISA 500, since it could be understood as open and free data, which is not necessarily the case. Pricing services data are indeed often available if the user pays for the data.

23. In case of use of information from the external source, the auditor should at least check that the data has been accurately incorporated (no mathematical/accuracy errors) and assess that the information is relevant and reliable or verify management's assessment thereof.

*Post implementation*

24. We also would like to encourage the Board to perform a post implementation review after implementation of the revisions to evaluate whether the revisions have led to the positive changes expected.

I hope that you found these comments helpful. Please do not hesitate to contact me if you have any questions.

Yours faithfully,



Ralf Bose  
Chairman