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31 July 2017

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

Submitted electronically at www.iaasb.org, and to MattWaldron@iaasb.org

Dear Matt

SAICA COMMENT LETTER ON THE PROPOSED ISA 540 (REVISED) AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

The South African Institute of Chartered Accountants (SAICA) is the home of chartered accountants in South Africa – we currently have over 42,000 members from various constituencies, including members in public practice ($\pm 30\%$), members in business ($\pm 50\%$), in the public sector ($\pm 5\%$), education ($\pm 2\%$) and other members ($\pm 13\%$). In meeting our objectives, our long-term professional interests are always in line with the public interest and responsible leadership. SAICA is currently the only professional accountancy organisation that has been accredited by the Audit Regulator in South Africa, the Independent Regulatory Board for Auditors (IRBA).

We welcome the opportunity to comment on the proposed ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures* (ED).

Overall we are supportive of the modernisation of ISA 540 for evolving financial reporting frameworks and the enhancement of the identification and assessment of risks of material misstatement and risk response with respect to accounting estimates and related disclosures. Please find included the comments prepared by SAICA (accompanying this cover letter).

We wish to express our appreciation for the work of the IAASB task group in addressing this challenging, but extremely important aspect of an audit of financial statements. Please do not hesitate to contact us should you wish to discuss any of our comments. You are welcome to contact Willie Botha (willieb@saica.co.za) or Thinus Peyper (thinusp@saica.co.za).

Yours sincerely

Signed electronically

Willie Botha
Senior Executive – Assurance and Practice

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Annexure 1: Summary of responses from field testing

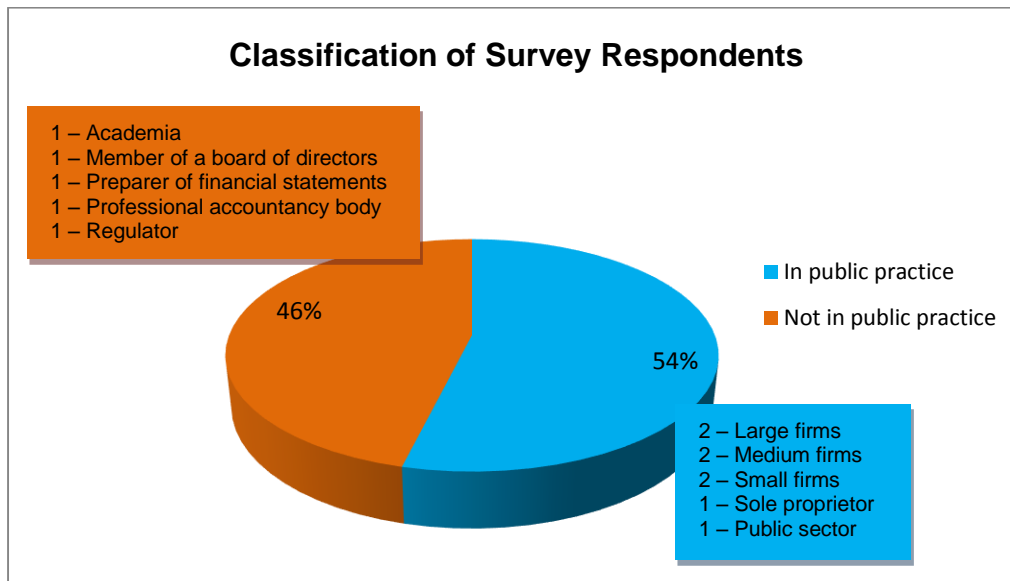
A. SAICA'S APPROACH TO RESPOND

1. SAICA's approach to informing our members of the proposed amendments, and to gather information to inform our comment letter can be summarised as follows:
 - A SAICA internal working group studied and debated the ED and prepared initial thoughts and input pertaining to the questions that have been posed (questions 1 to 8), as well as identifying other matters of importance on which comments may be required. The internal working group proceeded to prepare a template of specific questions to be answered by field testing participants, as well as a survey questionnaire to be completed by other members wishing to participate (an online survey).
 - SAICA issued a communication requesting its members to respond to the questions asked in the explanatory memorandum by means of an online SAICA survey. The survey link was sent to all members.
 - SAICA further issued a communication requesting its members to participate in field testing the amended requirements and guidance on a live audit and to provide us with feedback based on specific questions around implementation. A questionnaire was sent to members who were willing to participate. Most of the feedback received were based on completed audits rather than live audits due to the timing of the audits, as well as the due date for providing feedback.
 - SAICA established a comment letter task group consisting of members of the SAICA Assurance Guidance Committee (AGC) to discuss the ED, review the draft comment letter and provide any additional inputs they may have.

B. OVERVIEW OF SURVEY RESPONDENTS AND FIELD TESTING RESPONDENTS

Survey responses

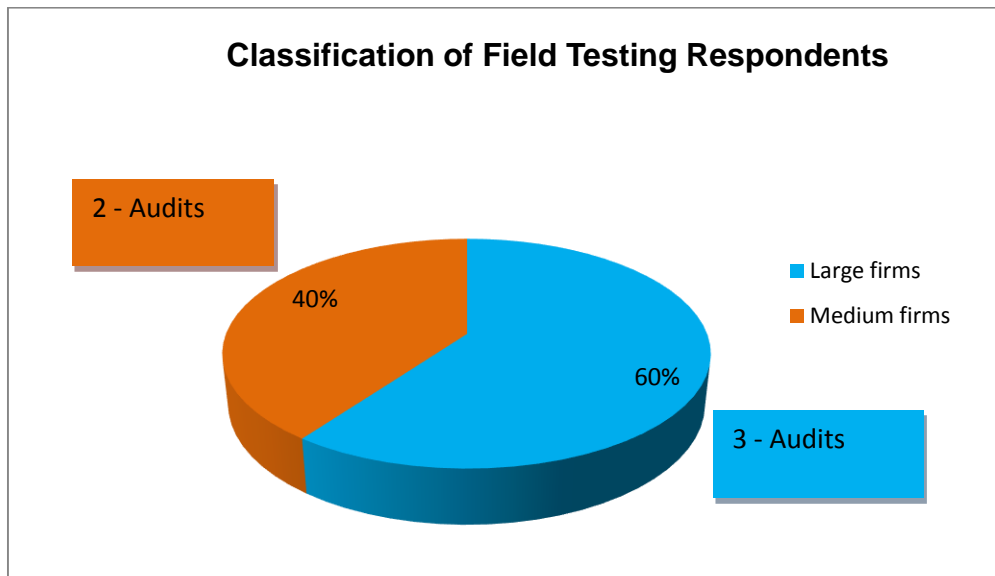
2. The SAICA survey was completed by 13 respondents. All the respondents are members of SAICA, while 9 are also registered with the IRBA. The graphic below provides an overview of the classification of respondents:



3. In the analysis above, the following meaning is attributable to the relevant terms:
- Large firms are firms with more than 10 partners
 - Medium firms are firms with 5 – 10 partners
 - Small firms are firms with 2 – 5 partners
4. In applying the survey approach as part of previous comment letters submitted to the IAASB, SAICA has been able to achieve a higher response rate. We believe that the lower response rate this time is in part owing to the highly technical nature of the proposed standard and the fact that we did not have sufficient time to present to our members an information session (via webcast), before requesting the completion of the survey. However, we are satisfied that the respondents that replied provided appropriate input for the SAICA comment letter task group to consider and discuss.
5. Throughout this comment letter we present the results from the survey by referring to “**survey respondents**”. The survey results have not been analysed statistically and cannot be extrapolated. The results are presented as perceptions and views that have been observed, and although not representative of a general or common view, provide insights into, and some additional perspectives regarding the matters on which the IAASB are seeking comments, as well as in relation to additional matters that were included in the survey that the IAASB may find helpful.

Field testing responses

6. Respondents from 5 audit firms agreed to participate in field testing and to complete SAICA’s questionnaire designed for field testing respondents. The graphic below provides an overview of the classification of respondents.



7. Throughout this comment letter we present the results from the field testing by referring to “**field testing respondents**”. As stated in paragraph 1, above, most of the feedback received were based on completed audits rather than live audits due to the timing of the audits, as well as the due date for providing feedback. However, the results still provide valuable additional insights into the application of the requirements of the ED. A summary of the responses from field testing is included as **Annexure 1** to this submission.

C. DETAILED COMMENTS TO QUESTIONS

8. Our detailed comments are presented in terms of the questions posed in the Explanatory Memorandum (questions 1 to 8) including additional questions posed by SAICA as part of the SAICA survey and field testing questionnaire in order to cover and form a view on all aspects of the ED that were deemed important.

Question 1

Has the ED been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates (including enhanced emphasis on obtaining an understanding of the requirements of the financial reporting framework)?

9. All the survey respondents agreed that the ED has been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates, including enhanced emphasis on obtaining an understanding of the requirements of the financial reporting framework.
10. The following comments to the SAICA survey refer to the additional requirements introduced in paragraph 10 of the ED and illustrate support for the additional focus in the ED to draw the auditor’s attention on obtaining an understanding of accounting estimates:
- 10(b): Regulatory factors, if any, relevant to accounting estimates. This requirement also re-enforces the auditor’s existing responsibilities in this regard in terms of ISA 250.
 - 10(c): The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity’s financial statements. It is further SAICA’s view that it is appropriate to add the context of “expects to be included”; i.e. anticipating what

would be relevant and required in the circumstances of the entity, and thereby enhancing the auditor's application of professional scepticism.

- 10(e)(iii): The process used by management to select data, including the source(s) of that data and how management identifies significant data. The application material further recognises that there could be large volumes of data from complex IT systems.
- 10(e)(v): How management identifies and addresses the risk of management bias, together with the application material in paragraph A45 provide much needed emphasis on this important element of accounting estimates.
- 10(f): Although extant ISA 540 required the auditor to obtain an understanding of the relevant controls related to how management makes accounting estimates, this paragraph specifies that the auditor must obtain an understanding of each of the components of internal control. This will ensure that the auditor obtains a more thorough understanding of management's process of making accounting estimates, leading to a more robust risk assessment and identification of risks of material misstatement (RoMM).

11. SAICA agrees that the ED has been appropriately updated. In addition to the points referred to above, paragraph 10(a) clarifies the auditor's responsibility of understanding the applicable financial reporting framework in respect of accounting estimates in its full context, i.e. the recognition criteria, measurement bases and presentation and disclosure requirements.
12. We appreciate the fact that the International Standards on Auditing (ISAs) are written in the context of being framework neutral. The expansion of the application material throughout, in particular in relation to complexity, the use of judgement by management and estimation uncertainty enhances the standard's ability to remain principles based in dealing with evolving financial reporting frameworks. Appendix 1 and Appendix 2 provide helpful guidance in the context of relevant requirements of financial reporting frameworks, and the application material in paragraphs A135 to A138 focuses appropriately on disclosures in terms of the requirements of the applicable financial reporting framework.
13. We do however suggest that the IAASB consider expanding the guidance relating to mainly future orientated accounting estimates where the amounts may not be directly observable, including those estimates that utilise significant data and assumptions outside of the traditional general ledger and financial reporting system (e.g. include as a 3rd appendix) to further assist auditors with evolving financial reporting frameworks which include models such as the Expected Credit Loss model.

SAICA also considered the following **additional question**: Do you agree that the requirements in paragraphs 10 and 11 will result in a more detailed understanding of the accounting estimates at the entity and do you believe it will improve your ability to identify RoMM?

14. All the survey respondents agreed that these requirements will result in a more detailed understanding of the accounting estimates at the entity and do believe that it will improve their ability to identify RoMM.
15. The field testing respondents also agreed with these requirements but did indicate that the requirements may be too onerous for less complex accounting estimates. From a practical application point of view, guidance/ clarity is required on whether professional judgement can be applied in determining the extent of understanding required (e.g. are all of the elements identified in paragraph 10 always relevant; or are they all relevant in principle, but the depth of understanding may vary depending on the circumstances around the nature and extent of

an entity's accounting estimates in the context of the understanding that the auditor is required to obtain in terms of ISA 315 (Revised)). Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (d)).

16. The counter argument could be that the auditor needs to cover all of these aspects as part of the understanding phase of the audit to be more confident in the eventual result of the risk assessment, including distinguishing between when inherent risk is low and when inherent risk is not low.
17. SAICA agrees that the proposed revised requirements will result in a more detailed understanding. Our comments to question 3 should however be referred to in respect of the scalability of risk assessment procedures and related activities for an entity with less complex accounting estimates.

Question 2

Do the requirements and application material of the ED appropriately reinforce the application of professional scepticism when auditing accounting estimates?

18. Most of the survey respondents agreed. The upfront emphasis of its importance underlines the frame of mind with which the auditor should approach all audit work related to accounting estimates.
19. SAICA agrees that the ED appropriately reinforces the application of professional scepticism. At an overall level professional scepticism has been reinforced by enhancing the risk assessment requirements which will provide the auditor with a more in-depth basis for identifying and assessing RoMM. There is further a requirement for the auditor to "stand back" and re-evaluate the audit evidence obtained. The following specific requirements will also require the auditor to apply professional scepticism:
 - 10(c): That requires an understanding of the nature of accounting estimates and related disclosures that the auditor expects to be included, in addition to what has been included in the entity's financial statements.
 - 24: That requires the auditor to consider management bias by evaluating the judgements and decisions made by management for individual accounting estimates and in aggregate.
20. The IAASB could consider linking the professional scepticism "catch all" in paragraph 5 to ISA 200, paragraph 15 (and its related application material) for additional clarity and support of the concept.
21. The application of professional scepticism could be further enhanced if the following guidance is provided:
 - How the auditor should deal with contradictory evidence as described in ED-ISA 540 (Revised).23.
 - How the auditor should evaluate qualitative disclosures as mentioned in ED-ISA 540 (Revised).A57 and A137.

Question 3

Is the ED sufficiently scalable with respect to auditing accounting estimates, including when there is a low inherent risk?

22. Although the majority of the survey respondents agreed that the ED is sufficiently scalable with respect to auditing accounting estimates when inherent risks are assessed as “low”, one survey respondent expressed a strong view that this is not the case in respect of the risk assessment procedures and related activities – these requirements are detailed and extensive, which is appropriate for complex, highly judgemental accounting estimates that are subject to higher estimation uncertainty.
23. The above-mentioned view was confirmed by the views of the field testing respondents. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing questions (a), (b), (d) and (f)).
24. SAICA suggests that the IAASB consider that the requirements and application material of the ED could be further scaled in respect of the risk assessment procedures and related activities. For example, it may not be necessary for the auditor to obtain the same level of understanding, including for each of the components of internal control, for less complex accounting estimates than for more complex accounting estimates.

ISA 315 (Revised) paragraph A3 states that the auditor applies professional judgement to determine the extent of the understanding required and that the primary consideration is whether the understanding obtained is sufficient to meet the objective of the ISA. The auditor should therefore be able to apply more judgement in respect of the extent of understanding required for purposes of performing the risk assessment, which provides the basis for the auditor's further audit procedures depending on the nature and extent of the entity's accounting estimates.

25. The IAASB should further be mindful that although a clear distinction is made between “When inherent risk is low” and “when inherent risk is not low”, there is, apart from paragraph A96, no application material (or no clear application material) relating to the work effort linked to “When inherent risk is low”. The approaches in ED-ISA 540 (Revised).15(a) have been retained from extant ISA 540.13, which include related application material. The IAASB should consider whether some of that application material could be retained in the revised standard, adapted as required to the context of low inherent risk.

SAICA also considered the following **additional question**: Is the ED sufficiently scalable with respect to auditing accounting estimates when inherent risk is assessed as ‘not low’ (i.e. in terms of providing a sufficient “step-up” in terms of the further audit procedures that would be required to obtain sufficient appropriate audit evidence in the circumstances)?

26. All of the survey respondents agreed that the ED is sufficiently scalable with respect to auditing accounting estimates when inherent risk is assessed as ‘not low’.
27. SAICA agrees with the objective-based requirements that the auditor has to achieve based on the applicability of one or more of the three factors. It is suggested that the terms ‘low’ and ‘not low’ should be defined or described as these terms may not be specifically used in a firm's methodology.
28. The field testing respondents also stated that their work effort for risks assessed as ‘not low’ were similar to the previous year but required more documentation. Annexure 1 to this

comment letter provides a summary of responses from field testing (refer to field testing questions (e), (f) and (g)).

29. Overall, SAICA appreciates the proposed change in approach that is being introduced in this ED as a mechanism to make the requirements of the standard scalable (i.e. the distinction between “when inherent risk is low” and “when inherent risk is not low”). The IAASB should seek to apply this approach, as may be relevant and applicable, or adapted as necessary, to other standard-setting projects.

Question 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 RoMM (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?**
30. All of the survey respondents agreed that the requirements in paragraph 13, together with the requirements of ISA 315 (Revised), support a more effective identification and assessment of RoMM.
31. The application material in paragraphs A71 to A78 provides important guidance in relation to the assessment of RoMM in the context of accounting estimates; and specifically draws attention to low inherent risk and not-low inherent risk. It is helpful that specific focus is placed on significant risks (paragraphs A76 to A77), and on other relevant factors in addition to the three “main” factors (paragraph A78).
32. The IAASB should consider including in paragraph 13 a reference to Appendix 2.
33. SAICA’s comments relating to questions 3 and 4(b) should however be taken into account. I.e. guidance on the scalability of risk assessment procedures and related activities, and the interrelationship of the three factors for an entity where risks relating to accounting estimates have been assessed as ‘low’.
34. Most of the survey respondents and SAICA agree that when inherent risk is assessed as ‘not low’, the requirements in paragraphs 15(b) and 17 – 20, together with the relevant requirements of ISA 330, support more effective responses to RoMM.
35. The field testing respondents commented that the requirements resulted in a more detailed and specific response to RoMM and ensured that appropriate procedures are designed and performed. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing questions (f) and (g)).
- (b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which an accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgement by management and the potential for management bias, and estimation uncertainty?**
36. Most of the survey respondents supported the requirement and believe that the above-mentioned three factors influence the risk of material misstatement of an accounting estimate.

37. The majority of the field testing respondents also supported the requirement and believe that the three factors influence risk of material misstatement. Two respondents indicated that their risk assessment and response were consistent with the previous year. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (e)).
38. One survey respondent and a field testing respondent commented that there is not enough emphasis on the interrelationship between the three factors and the impact of the interrelationship on the auditor's identification and assessment of risks of material misstatement as well as the auditor's responses to those assessed risks.
39. SAICA notes that the ED recognises under the 'Key concepts of this ISA' that the three factors are interrelated. In paragraph 13, the auditor is required to take into account the extent to which one or more of the factors affect RoMM. Paragraph 15(b) requires the auditor to perform procedures to obtain evidence about complexity, judgement and estimation uncertainty (as indicated in paragraphs 17 – 19), when applicable. These sections indicate that there could be a scenario where only one or a combination of the factors are applicable.
40. However, we are aware of suggestions that the ED does not provide sufficient further guidance on the interrelationship of the factors and how the auditor's response to the risks are affected when more than one factor is applicable, including that the procedures relating to the objective-based requirements for each factor might overlap. The IAASB may have to consider this matter further (it would be interesting to see whether this is identified as an issue in the context of all of the comments that the IAASB receives).

(c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 – 19?

41. Most of the survey respondents and SAICA agree that there is sufficient guidance in relation to the proposed objectives-based requirements in ED-ISA 540.17 – 19, including the related application material.
42. The field testing respondents commented that more applicable guidance has been provided in the proposed revised standard. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (g)).
43. SAICA wishes to also note that the proposed objectives-based approach calls for considerable professional judgement to be exercised by the auditor, whilst at the same time allowing the auditor to scale and custom-design procedures relevant to the entity's accounting estimates that are responsive to the assessed risks of material misstatement. The IAASB could consider to also include professional judgement as part of the "Key concepts" section at the beginning of the standard (i.e. part of the "catch all" paragraphs upfront).
44. There is the risk that should an auditor get this wrong it will significantly impact the sufficiency and appropriateness of audit evidence in the circumstances. The IAASB may receive comments from respondents that focus on this aspect and who call for more specificity in relation to the procedures that are required to be performed. It is SAICA's view that the proposed approach is appropriately principles based and allows for the standard to be applied in the numerous different circumstances that are likely to be encountered in practice.

SAICA also considered the following **additional question**: Do you agree with the requirement in paragraph 16 to test the operating effectiveness of internal controls, if the auditor intends to rely on controls relating to accounting estimates, or if substantive procedures alone cannot provide sufficient appropriate audit evidence?

45. All of the survey respondents agreed with the requirements in paragraph 16.

One survey respondent supported the emphasis placed on a controls based approach in auditing accounting estimates as accounting estimates in some instances relate to more complex environments that require the selection of models, methods, assumptions and data in making those accounting estimates; and because accounting estimates are increasingly derived from complex information technology systems and generated from large volumes of data. Both these factors lend themselves to being more efficiently and effectively audited by means of a controls based approach.

46. The field testing respondents further commented that the applicability of the requirement would depend on the nature and size of the entity, the processes around estimates and whether internal controls are in place that can be relied upon. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (h)).

47. SAICA agrees with the requirement in paragraph 16 to test the operating effectiveness of internal controls, if the auditor intends to rely on controls relating to accounting estimates, or if substantive procedures alone cannot provide sufficient appropriate audit evidence. The application material in paragraphs A98 to A100 provides appropriate additional guidance. Greater emphasis on performing tests of controls will however require clarity in ISA 315 (Revised) and ISA 330 on the understanding required and how this affects the nature, timing and extent of substantive procedures and the combination of tests of controls and substantive procedures.

48. SAICA wishes to draw the IAASB's attention to a possible consistency / interpretation risk that we have encountered in South Africa around the design and performance of tests of controls in response to RoMM at the assertion level which may also have implications for the application of ED-ISA 540.16 and A98 – A100. The difference in interpretation relates to whether ISA 330.A4(a) provides for a scenario where the auditor is able to perform only tests of controls to obtain sufficient appropriate audit evidence in response to RoMM at the assertion level (for individual assertions) without also performing substantive procedures on the assertions concerned.

Question 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 described in extant ISA 540, in evaluating whether management's point estimate is reasonable or misstated?

49. Most of the survey respondents agreed that the requirements in paragraph 20 and related application material in paragraphs A128 – A134 appropriately establish how the auditor's range should be developed.

50. One survey respondent found it more difficult to determine a range that is specifically applicable to the estimate being audited and suggested that guidance and examples should be provided in this regard.

51. This was supported by another survey respondent who suggested that the guidance should be expanded to include examples of possible plausible relationships between data that may typically be used to develop a point estimate or an auditor's range for the more common accounting estimates, such as the examples given in paragraph A1.
52. SAICA agrees that additional guidance may be required. The application material clarifies that developing a point estimate or range is a substantive analytical procedure in terms of ISA 520. The requirements and guidance of the ED should therefore be aligned to the auditor's considerations in ISA 520 (in particular in relation to the amount of difference of recorded amounts from expected values that is acceptable without further investigation). ISA 520.A16 includes guidance in determining whether the difference in the recorded amount and the auditor's expected amount is acceptable, i.e. the difference that can be accepted is influenced by materiality and the desired level of assurance (risk).
53. The field testing respondents also indicated that the determination of an auditor's range is one of the difficult areas to implement. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing questions (b) and (i)(2)).
54. All of the survey respondents agreed that the revised approach relating to determining and using an auditor's range in evaluating whether management's point estimate is reasonable or misstated, will be more effective.
55. When one considers the end result of the proposed approach to developing an auditor's range, compared to the "narrowing the range" approach in the extant standard, SAICA's conclusion is that you in essence achieve the same result, without being 'limited' by the application material in the extant standard (paragraphs A93 to A95) around specific steps to "narrow the range". Paragraph 20 read together with paragraphs A143 to A145 are interpreted to mean that all of the amounts included in the auditor's range should be considered as being reasonable. Conversely, if management's point estimate equals any of the amounts in the auditor's range, the auditor's conclusion will be that the accounting estimate concerned is reasonable (and not misstated). This is also the reason why the evaluation proposed in paragraph A145 would lead to an acceptable audit outcome. SAICA suggests that the IAASB considers how these important concepts may be clarified further, including using examples to illustrate.
56. Furthermore, we suggest that paragraph 20 include references, or otherwise be linked to the application material in paragraphs A128 to A134, as well as A143 to A145.

Question 6

Will the requirements 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?

57. Also refer to our comments in relation to question 5, above.
58. Most of the survey respondents and SAICA agree that the requirements in paragraph 23 and related application material will result in a more consistent determination of whether an accounting estimate is reasonable or misstated, including when the auditor uses an auditor's range to evaluate management's point estimate.

59. One survey respondent commented that paragraph A144 uses the term “significant” which is open to interpretation and may not be applied consistently. It was suggested that additional guidance and examples should be provided of when a variation would be considered significant. The guidance and examples should also relate the concept of a ‘significant variance’ to that of materiality.

Question 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?

60. All the survey respondents agreed that the revision to the requirements in ISA 500 and the related new additional application material, will result in more appropriate and consistent evaluations of the relevance and reliability of information from external information sources.
61. One survey respondent commented that the additional guidance on when an external organisation is acting as an external information source vs. as a management’s expert is particularly useful.
62. SAICA agrees with the above-mentioned views expressed.

Question 8

(a) Translations

63. The IAASB’s pronouncements are not translated in South Africa.

(b) Do you agree that the effective date should be 18 months after the approval of the final ISA, with early adoption being permitted and encouraged?

64. Most of the survey respondents agreed that the effective date should be 18 months after the approval of the final ISA, with early adoption being permitted and encouraged.
65. One survey respondent suggested that the effective date should be aligned to the effective date of IFRS 9 as this was one of the main reasons for the revision of the ISA.
66. Another survey respondent suggested a 24 month period stating that the ED proposes a substantive revision to the audit approach. 18 months is too short for the significant development work to amend an audit methodology and working papers as well as training of audit staff to appropriately apply the revised requirements.
67. SAICA supports an 18 month or longer period before the revised ISA is made effective. The option to early adopt the revised ISA will address the concern raised regarding the effective date of IFRS 9.

Additional questions

68. SAICA also considered the following additional questions:

Do you agree that the stand back provision in paragraph 22 will improve the auditor's focus on whether sufficient appropriate audit evidence has been obtained?

69. Most of the survey respondents agreed that the stand back provision in paragraph 22 will improve the auditor's focus on whether sufficient appropriate audit evidence has been obtained. It also enhances the auditor's exercise of professional scepticism.
70. One survey respondent commented that when auditing an accounting estimate, particularly one that is subject to more complexity, judgement and estimation uncertainty, the extent of audit work that the auditor is required to perform can easily lead the auditor to lose sight of the overall evaluation with respect to obtaining sufficient appropriate audit evidence whether the financial statements are materially misstated.

Requiring the auditor to take a step back after having performed the relevant audit procedures and re-evaluate the outcome of the audit procedures will assist the auditor in making an overall/ holistic assessment of whether sufficient appropriate audit evidence has been obtained and to reach an appropriate conclusion on whether an accounting estimate is free from material misstatement. It was however suggested that paragraphs A139 – A141 be clarified by specifically stating that the auditor should 'stand back' and evaluate the audit evidence obtained regarding the accounting estimate.

Do you agree with the decision of the IAASB to place more emphasis on communication with those charged with governance regarding accounting estimates in paragraph 26?

71. All of the survey respondents agreed with the decision of the IAASB to place more emphasis on communication with those charged with governance regarding accounting estimates.
72. One survey respondent commented that this will also enhance the communication of key audit matters which often relate to matters of significant complexity, judgement and estimation uncertainty.
73. The majority of the field testing respondents also agreed with the requirement and stated that it did not affect their audit where the risk was assessed as 'not low' because significant risks were already communicated to those charged with governance (and flagged as possible key audit matters). Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (i)(6)).
74. SAICA agrees with the above-mentioned views expressed.

Do you agree that the requirement in paragraph 27 and the related application material (see paragraphs A158–A159) will result in consistent documentation of the basis for the auditor's evaluation of the reasonableness of accounting estimates?

75. Most of the survey respondents agreed that the requirement in paragraph 27 and the related application material will result in consistent documentation of the basis for the auditor's evaluation of the reasonableness of accounting estimates.
76. One survey respondent and one field testing respondent suggested that a specific documentation requirement should be included in respect of the considerations and conclusions of the "stand back" provision.

77. The majority of the field testing respondents indicated that the amended requirements did not affect their audits as the risks were previously assessed as significant and therefore required similar documentation. It was however noted that documentation would increase for risks assessed as 'low'.

Furthermore, it was indicated that the link between documentation requirements and work effort requirements relating to the auditor's consideration of management bias is not clear. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (i)(7)).

78. SAICA generally agrees with the respondents' views and have further comments and suggestions in the paragraphs that follow to contribute to the clarity and consistent application of the documentation requirements.

79. The ED does not contain specific documentation requirements regarding the following sections of the ISA:

- Risk assessment procedures and related activities
- Identifying and assessing the RoMM
- Responses to the assessed RoMM
- Disclosures related to accounting estimates

We have deduced that the reason for this is that the ED describes in the scope section that the ISA expands on how ISA 315 (Revised), ISA 330, ISA 500 and other relevant ISAs are to be applied in relation to accounting estimates and therefore the documentation requirements in those ISAs should be applied in addition to the ED.

80. ISA 240 however, also contains requirements relating to risk assessment, identifying and assessing RoMM and responses to assessed RoMM. The documentation requirements in ISA 240 differ from the proposed requirements in ED-ISA 540 as it makes reference to ISA 315 (Revised) and ISA 330 and also includes the specific documentation requirements relating to these ISAs. It is therefore recommended that the documentation requirements in the ED should be worded similarly to the requirements in ISA 240 (i.e. applying a similar approach). SAICA believes it is important that the standard is written in such a way that auditors do not underestimate the implications for audit documentation.

81. With respect to the documentation requirements pertaining to the auditor's evaluation of management bias, paragraph A159 is narrow in referring only to the examples in paragraph A147. We believe that the reference should be more holistically to the requirement in paragraph 24, which will be aligned to the approach adopted in paragraph A158 that refers to paragraphs 17 – 21 and 22 – 23.

One of the key components of the proposed revised standard is the expansion of the application material (i.e. the A-paragraphs). Do you believe that the application material is sufficient in extent and content to provide meaningful guidance in enhancing the auditor's understanding of the requirements regarding the auditing of accounting estimates and how to carry these requirements out?

82. Most of the survey respondents agreed that the application material is sufficient in extent and content to provide meaningful guidance in enhancing the auditor's understanding of the requirements and how to carry these requirements out.
83. One survey respondent suggested that it may be useful to expand the application material further to include more practical examples that will illustrate the practical application of the requirements.
84. The field testing respondents also agreed and believed that the application material is vital in understanding the ED. Annexure 1 to this comment letter provides a summary of responses from field testing (refer to field testing question (c)).
85. SAICA agrees that the application material is comprehensive and most helpful. We have included a few suggestions in terms of the possible expansion of application material in certain areas as part of our responses to the other questions in this comment letter.
86. There was a particular comment from the survey respondents that more guidance should be considered for the **audits of smaller entities** where accounting estimates may be less complex.

SAICA compared the ED to the extant standard in relation to "Considerations specific to smaller entities". We found that the relevant A-paragraphs in the ED (A23, A44, A60, A100, A107 and A110) have retained the guidance included in the extant standard, with some amendments, additions and clarification in certain cases. There are two instances where the guidance in the extant standard has not been 'transferred' to the ED:

- Extant ISA 540.A67: We believe that the matter relating to a longer period between the balance sheet date and the date of the auditor's report is a characteristic that is specific to smaller entities and relevant in considering the audit evidence for certain accounting estimates. We request that the IAASB consider retaining this guidance.
- Extant ISA 540.A106: This paragraph includes, among other, the following guidance that has not been retained in the ED, "... the auditor may explain to management the process or the different methods available for doing so, and the documentation thereof. This would not, however, change the responsibilities of management for the preparation of the financial statements." The circumstance described here is a reality of practice in dealing with many smaller entities. We are not sure why the IAASB has decided not to retain this as part of the guidance; we had considered that the decision may relate to a possible conflict with independence requirements in the Code of Professional Conduct.

D. EDITORIAL AND OTHER COMMENTS ON SPECIFIC PARAGRAPHS

87. Paragraph 13 makes reference to ISA 315 (Revised) without a specific paragraph reference in a footnote for the auditor to cross-reference to. Paragraphs A48 and A76 makes reference to specific paragraphs in ISA 315 (Revised) instead of using a footnote. Paragraph A50 makes no reference to ISA 315 but includes a footnote.

Paragraphs 15, A94, A95 and A96 make reference to ISA 330 without a specific paragraph reference in a footnote for the auditor to cross-reference to.

Paragraph A151 refers to ISA 700 (Revised) without a specific paragraph reference in a footnote for the auditor to cross-reference to.

We suggest that referencing in the ED to other ISAs should be aligned to the referencing in all other ISAs.

88. We suggest that the words 'also is' in paragraphs 5, A113 and A116 should be changed to 'is also', similarly the words 'also may' in paragraphs A11, A99, A120, A122, A132, A133, A144 and the conforming amendment to ISA 260.A20 should be changed to 'may also'.
89. Paragraph A135 states that paragraph 21 applies regardless of whether the auditor is required to perform procedures under paragraph 19. It is not clear why paragraph 19 is referred to. It is suggested that either the correctness of the reference is considered or the paragraph should be deleted.
90. Paragraph 25 requires the auditor to obtain written representations regarding 'significant' data and 'significant' assumptions. We believe that 'significant' should be deleted to require the auditor to obtain written representation from management and those charged with governance for selected data and selected assumptions used in making the accounting estimate (this will be consistent with the wording used in paragraph 10(e)).

APPENDIX: SUMMARY OF RESPONSES FROM FIELD TESTING

Introduction

- 91. As indicated under section B of this comment letter, 5 audit firms agreed to participate in field testing the requirements and guidance of ED-ISA 540 (Revised) and to complete SAICA's questionnaire designed for field testing respondents.
- 92. In the paragraphs that follow, field testing respondents described their understanding and their experience in implementing the requirements and guidance. The comments are each from individual respondents, unless indicated otherwise.
- 93. This feedback is provided as additional information for the IAASB to consider with respect to the perceptions that have been expressed from field testing; in certain instances SAICA has added comments.

Field test question (a)

What difficulties did you experience in understanding the new requirements?

- 94. The standard appears to have been developed with complex estimates in mind but will likely result in significant incremental effort for lower risk estimates, as the standard is not very clear how to practically differentiate between the work effort that is required for estimates that is 'not low' risk compared to those that are 'low' risk.
- 95. In implementing responses to the risks of material misstatement that is 'not low', the practitioner is required to implement procedures in accordance with paragraphs 17 – 20. It is unclear how these procedures interact with the procedures articulated in paragraphs 15(a)(i) to (iii). These procedures have always been applied to estimates and are presumably still relevant to address risks relating to estimates. It is assumed that paragraphs 17 – 20 are in addition to the procedures in paragraph 15(a).

SAICA comment: The application material in paragraph A97 is intended to address this concern.

- 96. It is unclear what the extent of documentation should be to demonstrate the execution of the requirements in paragraphs 22 and 23.

Field test question (b)

What difficulties did you experience in implementing/ applying the new requirements during the audit?

- 97. The field testing respondents described difficulties in implementing the requirements in the paragraphs that follow.
- 98. How to determine the most appropriate point estimate or range.
- 99. In understanding the models used by management, the most complex part is evaluating the extent of management bias and the impact on the point estimate.

100. The approach of identifying all accounting estimates and then assessing the risks of material misstatement as 'low' or 'not low' resulted in more detailed documentation and a shift in the flow of the audit file to ensure these requirements are met.

SAICA comment: This may also be linked to a firm's audit methodology. The revised standard will require the necessary update of methodologies in terms of ensuring compliance with the standard, as well as the most efficient way in which this may be accomplished.

101. The entity's documentation was not always formalised and in sufficient detail for the auditor to perform the risk assessment procedures.
102. The articulation of risks of material misstatement relating to disclosures and execution of procedures to address the risks.

Field test question (c)

The purpose of application and other explanatory material of an ISA is for the auditor to understand the objectives of the ISA, the meaning of the requirements and how to carry them out. Did you find that the application material assisted you during the audit? (Also taking into account that a key component of the revised standard is the expansion of the application material)

103. The field testing respondents agreed that the application material is detailed and does assist in guiding the assessment; they also commented that the application guidance is vital for an understanding of the requirements of the ED.

Field test question (d)

Did the requirements in paragraphs 10 and 11 result in a more detailed understanding of the accounting estimates at the entity and did it improve your ability to identify risks of material misstatement? Please provide reasons for either "Yes" or "No" responses.

104. The field testing respondents agreed and provided the following comments
- The detailed breakdown in paragraph 10 is useful in identifying factors that should be considered.
 - The requirements prompt auditors to ask more probing and specific questions in obtaining an understanding.
 - The extent of understanding required is more detailed and drives a more granular risk assessment. The focus on risk assessment will inform the auditor's judgement regarding risk and an appropriate response thereto.
 - These requirements assist the team in ensuring that all factors are documented in one place.
 - It also assisted in increasing the documentation around the extent of management skills and knowledge used.
 - Paragraph 11 notes, "The review is not intended to call into question judgements about previous period accounting estimates that were appropriate based on the information available at the time they were made." This is a useful reminder to evaluate relevant factors each year, separately from the year before. A change in assumptions is based

on what is available at the time and does not necessarily equate to management bias pertaining to achieving a specific outcome.

105. One respondent did however comment that these requirements may be too onerous for obvious low risk estimates, where this level of understanding would not be required.

SAICA comment: Refer to our detailed comments to question 1.

Field test question (e)

How did these requirements affect your assessment of risks of material misstatement (RoMM) at assertion level; also linked to the three factors (complexity, judgement and estimation uncertainty) that are most likely to influence the RoMM?

106. The majority of the field testing respondents described that the requirements improved their assessment in that it was documented in more detailed, resulted in a better understanding and a more effective response to the assessed risks (the right work in the right areas). It highlighted more clearly the risk factors and considerations.
107. Two field testing respondents indicated that the assessment of RoMM was consistent with the previous year.
108. Another field testing respondent commented that previously complexity and judgement were sources of estimation uncertainty, and has always been considered. It is not clear whether estimation uncertainty is no longer impacted by these factors and whether it should be a factor on its own.

SAICA comment: This talks to the interrelationship between the three risk factors identified in the standard. Also refer to our detailed comments to question 4(b).

Field test question (f)

How did the inherent risk you assessed as “low” and/ or “not low” affect your work effort? (in terms of nature, timing and extent)

109. All of the field testing respondents commented that at an overall level, the nature, timing and extent of further audit procedures performed did not significantly differ from the previous year for inherent risks assessed as ‘not low’. Paragraphs 17 – 20 required a more detailed and specific response to RoMM.
110. One field testing respondent commented that the requirements streamlined the process in terms of once it was identified whether the risk is ‘low’ or ‘not low’ to then determine the extent of work that is required.

SAICA comment: This observation confirms that the objective of the IAASB in terms of achieving scalability of the requirements and their application could be achieved.

111. Two field testing respondents commented that there was an increase in the documentation of how management made the estimate for risks assessed as ‘low’ and that this documentation is not necessary to reach a conclusion that the risk is ‘low’.

Field test question (g)

What are your views on the effectiveness and efficiency of the objective based requirements (paragraphs 17 – 19) in guiding the design and performance of further audit procedures?

112. Most of the field testing respondents commented that the objective based requirements ensure that appropriate procedures are performed. It provides for a more detailed and direct response to the specific estimate. More applicable guidance has been provided, especially considering the new accounting standards that are soon to be implemented.
113. One respondent commented that once the RoMM is assessed as 'not low' the procedures required to obtain audit evidence regarding Complexity, Judgement and Estimation Uncertainty were consistent with the previous year.
114. Another respondent commented that in practice the procedures related to complexity and judgement might overlap.

Field test question (h)

What are your views on the internal controls requirement in paragraph 16? (The extant ISA 540 did not include a specific requirement, but a controls based approach has become more important due to the nature of accounting estimates, the complexity and judgement involved in selecting methods, making assumptions and the use of data.)

115. Most of the field testing respondents agreed with the requirement and commented that the applicability of the requirement (whether internal controls will be tested), will depend on the nature and size of the entity (e.g. large data intensive companies such as banks, insurers, and telecommunication entities), the processes around estimates and whether internal controls are in place that can be relied upon.

Field test question (i)

What are your views on how the following matters impacted the performance of your audit? (Did you experience difficulties in applying the matters and did the matters contribute to you achieving the objective of obtaining sufficient appropriate audit evidence in an efficient manner?)

Question (i)(1)

The change in focus relating to significant risks, in that the ED no longer include specific requirements for significant risks.

116. One of the field testing respondents commented that the team's focus shifted to correctly and thoroughly assessing the criteria set out, instead of distinguishing between significant/not-significant risks.

SAICA comment: Although the ED does not include requirements specific to significant risks as is the case in extant ISA 540, the manner in which significant risks are referred to in paragraphs 13 and 15, and the related application material in paragraphs A76 – A77 and A94 – A95, are adequate.

117. Two of the field testing respondents commented that this change did not have an impact on their audit.

Question (i)(2)

The changes in paragraph 20 and the related application material (paragraphs A128 – A134) when developing a point estimate/ range.

118. Most of the field testing respondents indicated that it is difficult to determine a point estimate or range. The factors to be considered in identifying the range required is not clear and guidance and examples are required. Previously paragraph A94 of the extant ISA was used that permitted a range equal/less than performance materiality.

SAICA comment: Refer to our detailed comments to question 5.

119. One field testing respondent commented that it provides more reliable conclusions on whether the RoMM for that specific estimate was addressed and whether misstatements actually exist.
120. Another field testing respondent agreed with the changes with respect to the calculation of a range and setting the parameters of the range and commented that it recognises the complexity of some of the estimates being evaluated.

Question (i)(3)

Enhanced requirements in paragraph 21 and related application material on disclosures.

121. Most of the field testing respondents agreed with the requirements around disclosures. The requirements in paragraph 21 and the application guidance reinforce the IAASB's emphasis on risks related to disclosures; that the auditor should identify disclosures upfront and address the risks of material misstatement related to disclosures during the audit process instead of towards the end of the audit.
122. One field testing respondent however, commented that disclosures are typically only available for audit at the end of the audit and results in more work to be performed towards the end of the audit.
123. Another field testing respondent suggested that the detailed application guidance relating to the disclosures should be included in the main standard to clarify the auditor's objectives related to disclosures. It is suggested that the following matters relating to risks of material misstatement of disclosures be clearly articulated:
- understanding of the process to calculate disclosures,
 - identification of risks of material misstatement related to disclosures, and
 - the work effort related to disclosure risks.

Question (i)(4)

The stand-back provision in paragraph 22 when inherent risk is not low.

124. All of the field testing respondents agreed with the requirement and it was indicated that this already forms part of the approach of one of the firms.

- 125. One field testing respondent commented that the paragraph is useful in understanding the 'big picture'. It assists in defining what the outcome should be and confirming that the process makes sense and the outcome is reasonable.
- 126. Two respondents commented that guidance should be provided on how to perform and document the stand-back provision.

Question (i)(5)

Evaluating whether the accounting estimate is reasonable or misstated in paragraph 23 (Including the sufficiency of guidance regarding the evaluation of misstatements).

- 127. Most of the field testing respondents agreed with the requirement.
- 128. One field testing respondent commented that the requirement ensures that the auditor takes into account all available information and then makes a decision on whether the result is reasonable or misstated. This assisted the audit team during discussions with management as all relevant and supporting evidence was available.
- 129. One field testing respondent however commented that the determination of reasonable vs. not-reasonable (i.e. misstated) could be clearer, especially where assumptions are highly sensitive.

Question (i)(6)

Enhanced communication with those charged with governance in paragraph 26.

- 130. The majority of the field testing respondents agreed with the requirement and indicated that it would not have an impact on audits where significant risks were previously communicated to those charged with governance or if the entity is a listed entity, the information around estimates would likely have been communicated and raised as possible key audit matters.
- 131. Two field testing respondents commented that it might be a more difficult process in an audit of a private company where there are less formal processes in place to communicate all these types of matters to TCWG. The list of possible matters to communicate in paragraph A155 however provides good guidance on what to report.
- 132. One field testing respondent commented that there is a need to clarify at which level these detailed communications should take place.

Question (i)(7)

The requirements in paragraph 27 and related application material in paragraph A158 regarding documentation.

- 133. The majority of the respondents agreed with the requirement and stated that it did not have an impact on the documentation for their accounting estimates assessed as significant. It was noted that the ED no longer focusses on documentation around risks relating to accounting estimates assessed as significant risks.

SAICA comment: The explicit link to the documentation requirements in ISA 230 should address the matter relating to significant risks. Also refer to our other comments with respect to the proposed documentation requirements under additional questions on pages 13 – 14.

134. One field testing respondent commented that documenting the indicators of possible management bias required more detailed consideration.
135. Another field testing respondent commented that the documentation requirements do not clearly link back to the objective. The link between the work effort requirements and the documentation requirements relating to indicators of management bias, is further not clear. A suggestion was made to include some of the detail in paragraph A158 in the requirements section of the standard.