



INSTITUTE OF
**PUBLIC
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IPA Submission

**Exposure Draft ED03/18 *ASA 540 Auditing Accounting
Estimates and Related Disclosures***

16 October 2018

15 October 2018

Mr Roger Simmett
The Chair and CEO
Australian Auditing and Assurance Board
PO Box 204 Collins Street West
Melbourne VIC 8007

Dear Roger

Re: Exposure Draft ED03/18 ASA 540 Auditing Accounting Estimates and Related Disclosures

On behalf of the Institute of Public Accountants (IPA), I submit our review of Exposure Draft ED 3/18 *ASA 540 Auditing Accounting Estimates and Related Disclosures*.

The IPA broadly supports the revisions to ASA 540. However, the IPA is of the view that the revised ASA 540 should have better addressed the following issues:

1. Overall Assessment of Estimate – the standard is focused on the components that constitute an accounting estimate but does not place enough emphasis on the overall outcome of the estimation process. The standard needs to provide better guidance in relation to the review of the outcomes in the context of macro-economic, industry and client constraints when auditing the appropriateness of accounting estimates.
2. Inherent Bias – the standard manifests an inherent bias towards consistency in assumptions and basis of estimates. It is the IPA's contention that audit failure is often a result of accepting the estimate based on consistency with prior years when in fact the assumptions should change regularly. Risk-free rates, WACC, growth rates among other assumptions should change yearly with changes in the macro-economic conditions, industry and client specific factors.
3. Management Bias – The IPA does not believe management bias is properly dealt with. The focus is on evidence of management bias in the determination of accounting estimates in particular the selection of assumptions. The IPA is of the view the standard should acknowledge that inherent risk related to a motive to misstate by management arising from factors such as remuneration arrangements. The IPA believes such inherent risk should affect the nature, extent and timing of audit procedures carried out in relation to accounting estimates and the current structure of ASA 540 does not adequately address such considerations.
4. Disclosures – currently the quality of disclosures in relation to estimation uncertainty and management judgements are variable and some of the responsibility lays with auditors not sufficiently understanding their obligations in regard to such disclosures. ASA 540 while it does acknowledge these obligations, it does not provide much guidance in this area. The IPA believes ASA 540 should include more comprehensive guidance in relation to the audit of disclosures relating to estimation uncertainty and management judgements including the application of materiality to such disclosures.

5. Quality of Application Guidance – The IPA is disappointed that the application guidance included in ASA 540 is mainly in the nature of explanatory material and does not provide much in the way of practical guidance. In addition, the guidance is often not definitive and in essence requires the exercise of auditor judgement.

Our comments and responses to the questions in the Exposure Draft are set out in the Appendix to this letter.

If you would like to discuss our comments, please contact me or our technical advisers Mr Stephen LaGreca (stephenlagreca@aol.com) or Mr Colin Parker (colin@gaap.com.au) (a former member of the AASB), GAAP Consulting.

Yours sincerely

Vicki Stylianou
Executive General Manager, Advocacy & Technical
Institute of Public Accountants

About the IPA

The IPA is a professional organisation for accountants recognised for their practical, hands-on skills and a broad understanding of the total business environment. Representing more than 35,000 members in Australia and in over 65 countries, the IPA represents members and students working in industry, commerce, government, academia and private practice. Through representation on special interest groups, the IPA ensures the views of its members are voiced with government and key industry sectors and makes representations to Government including the Australian Tax Office (ATO), Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) on issues affecting our members, the profession and the public interest. The IPA recently merged with the Institute of Financial Accountants of the UK, making the new IPA Group the largest accounting body in the SMP/SME sector in the world.

Appendix

Question 1

Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?

IPA response

The IPA is not aware of any reference to law or regulation that has been omitted from the proposed revised standard.

Question 2

Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?

IPA response

The IPA is unaware of any law or regulation that would impede the application of the proposed standard.

Question 3

Are there any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or does, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?

IPA response

The IPA is unaware of any principle or practice that may impede or conflict with the proposed standard.

Question 4

What, if any are the additional significant costs to /benefits for auditors and the business community arising from compliance with the main changes to the requirements of the proposed standard? If significant costs are expected, the AUASB would like to understand:

- (a) Where those costs are likely to occur;*
- (b) The estimated extent of costs, in percentage terms (relative to audit fee);*
and
- (c) Whether expected costs outweigh the benefits to the users of audit services?*

IPA response

The IPA expects that the more comprehensive documentation requirements of the revised standard could potentially be the source of additional audit costs, however the IPA does not consider the documentation requirements unreasonable and arguably are consistent with the type of documentation that should have always been prepared.

Question 5

What, if any implementation guidance auditors, preparers and other stakeholders would like the AUASB to issue in conjunction with the release of ASA 540 (specific questions/examples would be helpful).

IPA response

The IPA anticipates auditor will have issues with the new expected loss model in AASB 9 *Financial Instruments* and as such believes it would be useful for implementation guidance in relation to the audit of expected credit losses including the use of the provision matrix approach under the simplified approach.

The other area the IPA believes implementation guidance would be useful is in relation to impairment testing particularly when fair values less cost of disposal is used.

Question 6

Over the course of the development of the IAASB's ISA 540, the AUASB discussed a number of issues that were raised by Australian stakeholders at various feedback sessions. The AUASB provided feedback on these matters directly to the IAASB. The IAASB has sought to address these issues in the development of the final ISA 540 that the AUASB now exposes as ED 03/18. Accordingly, the AUASB now seeks specific stakeholder feedback on the following requirements and related application material to the proposed standard:

- (d) Paragraph 27: Management's Selection of a Point Estimate and Related Disclosures about Estimation Uncertainty*
- (e) Paragraph 30: Other Considerations Relating to Audit Evidence*
- (f) Paragraph 33: Overall Evaluation Based on Audit Procedures Performed*

IPA response

(d) The IPA does not find the guidance in relation to ASA 540.27 (ASA 540.A115-A117) particularly useful. The guidance is vague and does not provide a clear course of action for the auditor. Furthermore, the guidance barely deals with disclosure issues.

(e) The IPA has no comment on ASA 540.30 and related guidance (ASA 540.A126-A132).

(f) The IPA does not believe ASA 540.33 and related guidance ASA 540.A137-A138, ASA 540.34-36 and ASA 540.A139-A144 adequately address the issue of an overall evaluation of an accounting estimate in terms of the macro-economic environment, the industry and the client's capabilities.

Question 7

Are there any other significant public interest matters that stakeholders wish to raise?

IPA Response

The IPA has no other public interest matters it wishes to raise other than the matters included in the covering letter.