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The Chair
Auditing and Assurance Standards Board
PO Box 204
Collins Street West
Melbourne Victoria 8007

Our ref ED comment submission ASA
540
Contact Juliet Low (+61 2 9295 3881)

15 October 2018

Dear Sir,

Comment submission on AUASB Exposure Draft (ED) ASA 540 *Auditing Accounting Estimates and Related Disclosures*

We are pleased to have the opportunity to respond to ASA 540 *Auditing Accounting Estimates and Related Disclosures* ED issued by the Australian Auditing and Assurance Standards Board (AUASB). This letter represents the views of KPMG Australia.

Overall, KPMG Australia is supportive of the adoption of the proposed Auditing Standard.

Please refer to Appendix 1 to this letter for our views and responses to the specific questions raised by the AUASB for comment.

Should you wish to clarify any aspect of KPMG Australia's submission, I would be pleased to discuss. My contact details are julietlow@kpmg.com.au or (02) 9295 3881.

Yours faithfully,

A handwritten signature in blue ink that reads 'Juliet Low'.

Juliet Low
Partner

Appendix 1 – KPMG Australia’s views on specific matters highlighted by AUASB in the Exposure Draft (ED) ASA 540 Auditing Accounting Estimates and Related Disclosures

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?

We believe the applicable laws and regulations have been appropriately addressed and no references to relevant laws or regulations have been omitted.

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?

A blurring of the lines between the auditor’s and management’s responsibilities could occur where the auditor is required by paragraph 27(b) to develop a point estimate or range. This may conflict with legal requirements for the auditor to be independent in fact and appearance. Paragraph A116 refers to this possibility. However, the standard currently leads to a modified opinion if the auditor cannot develop a point estimate or range without compromising independence. A more proportionate outcome could be obtained if paragraph 27(b) was amended – refer to point 6 below.

Other than this, we do not believe any applicable laws and regulations may impact or conflict with the proposed standard.

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?

We are not aware of any relevant principles and practices that may impact the application of the proposed standard.

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?***

We expect to incur costs associated with training and coaching auditors to apply the changes in requirements. In light of the expectation that ASA 540 will increase the estimates subject to audit, the sufficiency and / or appropriateness of audit evidence to be obtained, and the documentation of the auditor's considerations, we expect costs on audits to increase. It is difficult to estimate the extent of costs or the proportion of audit fee, as each audit will be impacted in a different manner depending on the associated risks. We consider that the increase in costs will generally benefit audit quality, consistent with the intention of the AUASB and IAASB.

However, we note that unnecessary incremental costs may be incurred where the auditor is required to comply with paragraphs 27(a) and 27(b). Firstly, the auditor may perform procedures in accordance with paragraph 27(a), and still be required to develop a point estimate or range; secondly, the only response contemplated by paragraph 27(b) is the development of a point estimate or range, which can be a more costly procedure than the alternatives in paragraph 18.

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).

In our view it would be beneficial for the AUASB to consider issuing guidance similar to that included in PCAOB Release No. 2017-002 issued 1 June 2017 in relation to:

- Examples of Use of Pricing Information from Third Parties and Audit Evidence; and
- Audit Evidence Regarding Valuation of Investments Based on Investee Financial Condition or Operating Results.

The proposed inclusions in AS 2501 *Auditing Accounting Estimates, Including Fair Value Measurements* and AS 1105 *Audit Evidence* respectively, provide guidance on two aspects of estimation complexity that Australian auditors would find relevant and useful in interpreting and applying ASA 540.

6. Specific stakeholder feedback requested:

Paragraph 27: Management's Selection of a Point Estimate and Related Disclosures about Estimation Uncertainty

As set out below, we have significant concerns with paragraph 27(b), which prescribes one specific response to circumstances outside the auditor's control, over and above additional procedures required by paragraph 27(a).

In relation to sub paragraph 27 (a):

While subparagraph 27 (a) emphasises the importance of management's responsibility to perform the necessary procedures to understand and address estimation uncertainty, we have the following concerns:

- We have reservations about the effectiveness of this requirement because management, as the preparers of financial statements including estimates, are not

obliged to comply with auditing standards but with accounting standards. The requirement for management to understand and address estimation uncertainty does not currently reside within the accounting standards. Thus the requirement on the auditor to request “management to perform additional procedures to understand estimation uncertainty or to address it” is not backed by a similar obligation on the preparer. We recommend the AUASB engage in discussions with the AASB to insert a similar requirement to the same effect within the accounting standards.

- Without an equivalent requirement on management, paragraph 27(a) is essentially redundant and requires an additional work effort from the auditor which could be avoided by defaulting to paragraph 27(b).

In relation to sub paragraph 27(b):

- We believe the auditor’s objective is to independently challenge the reasonableness of management’s work to address estimation uncertainty, as opposed to developing the estimate in cases where management’s response is insufficient.
- One challenge that may arise is a blurring of the lines between the auditor’s and management’s responsibilities with management’s acceptance of the auditors’ estimate over their own. A suggestion that the auditor’s independence in fact or appearance may be compromised appears to be an unacceptable outcome of this requirement.
- Paragraph A116 recognises this potential conflict but A117 makes it clear that a modified opinion would be the outcome if the auditor cannot develop a point estimate or range. This appears to be an overly strict outcome.
- In our view paragraph 27(b) should acknowledge there are other ways to gather the level of audit evidence required for an area of high estimation uncertainty, as set out under paragraph 18.
- Also, it is unclear in this context what would constitute a misstatement of the estimate, and guidance would be useful. For example, it would be beneficial to clarify whether there is a presumption the auditor’s estimate could be sufficiently informed such that a misstatement could be identified, posed to management and requested to be corrected.
- We seek clarification about the meaning of “to the extent practicable” and suggest the inclusion of examples of instances when it is impracticable. This could be similar to the guidance in ASA 501 *Audit Evidence—Specific Considerations for Inventory and Segment Information*. In the absence of a clear requirement capable of consistent application, we are concerned that variability of practice will occur, with some auditors determining that independence considerations allow the development of a point estimate, and others proceeding to qualify the audit opinion.
- Additionally, we seek clarification about the meaning of “sufficiently address”, and the intended level of auditor’s discretion when applying the requirements of this



paragraph. For example, where management's estimate is deemed to be materially fairly stated, but the auditor judges that management's process for developing the estimate did not sufficiently address estimation uncertainty, it would appear to be unnecessary to require the auditor to request management to perform additional procedures, to evaluate these, and then to develop an auditor's point estimate or range.

We have no comments in relation to sub paragraph 27 (c).

Paragraph 30: Other Considerations Relating to Audit Evidence

We are concerned that paragraph 30 together with A130 and A131 require the auditor to request a management expert to comply with paragraph 27, and could be difficult to enforce in practice. As above, without an equivalent requirement on the management expert, in our view paragraph 27(a) is essentially redundant and the likely outcome is that the auditor will default to paragraph 27(b).

Paragraph 33: Overall Evaluation Based on Audit Procedures Performed

We are supportive of the requirements in paragraph 33 and have no further comments.

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

No, there are no other significant public interest matters we wish to raise.