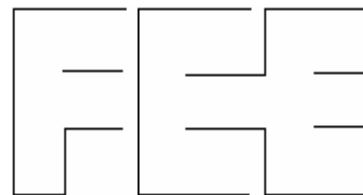


Date  
18 April 2007

Le Président

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Mr. J. Sylph  
Executive Director Professional Standards  
International Auditing and Assurance Standards Board (IAASB)  
545 Fifth Avenue, 14<sup>th</sup> Floor  
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USA

[Edcomments@ifac.org](mailto:Edcomments@ifac.org)

Dear Mr. Sylph,

**Re: Exposure Draft – Proposed International Standards on Auditing 540 (Revised and Redrafted) – Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures**

As the representative organisation of the European accountancy profession, FEE is pleased to comment on the Exposure Draft – Proposed International Standard on Auditing (ISA) 540 (Redrafted) on Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures (Proposed ISA 540).

FEE supports Proposed Revised and Redrafted ISA 540 and, specifically, the combination of previous ISAs 540 and 545. Our detailed comments on how the standard would in our view be further enhanced are set out below. This letter also includes our responses to the questions raised.

## **1. Detailed Comments**

### **1.1. Comments on Requirements**

#### *Paragraph 9*

The final part of the second sentence of paragraph 9 beginning with the words 'and whether' is unnecessary in the requirements section as it is covered by paragraph 8(c) and the first part of paragraph 9 as amplified by paragraphs A31 and A35. Accordingly, in our view, it should either be deleted or included in the Application and Other Explanatory Material.

#### *Paragraph 10*

We note that paragraph 10(a) tends to duplicate paragraph 10(b), in particular when taken together with paragraph 19. To remove unnecessary duplication, we recommend that paragraphs 10(a) and 10(b) could be combined as follows: "Determine which accounting estimates, whether recognized or disclosed in the financial statements, have high estimation uncertainty or are susceptible to bias and may, therefore, give rise to significant risks".

### *Paragraph 12*

We interpret paragraph 12 “The auditor shall determine the need to use the work of an auditor’s expert to...” to mean that, in every audit of accounting estimates, the auditor will be required positively to determine if an expert needs to be involved. Whilst it is feasible that the auditor may want to consider using an expert for a fair value of real estate or a complex derivative or some other unusual item with high estimation uncertainty, it is highly unlikely that such a need exists when determining if an allowance for, say, doubtful accounts is reasonable. Hence, we believe this requirement does not meet the specified criteria because it will not be applicable in virtually all engagements to which Proposed ISA 540 is relevant. Accordingly, in our view, this sentence should more properly be included in the Application Material.

Alternatively, if it is felt that a requirement is justified, FEE recommends that more flexible wording is used, in line with paragraph A51 (and also closer to the approach in paragraph 46 of the close-off document), as follows: “The auditor shall consider if he has the necessary skill and knowledge to obtain sufficient appropriate audit evidence regarding accounting estimates that give rise to risks of material misstatement, or determine that it is necessary to use the work of an auditor’s expert”.

### *Paragraph 21*

Inclusion of certain specific documentation requirements in individual ISAs can help an auditor's interpretation of how to apply the ISA 230 documentation principles. Where such explicit requirements take the ambiguity out of how ISA 230 should be applied to an individual ISA, we will support such clarification.

However, in our view, paragraph 21(a) duplicates the scope of the latest draft version of ISA 230 through its focus on documenting professional judgements on significant matters. Further, paragraph 21(b) in our view puts undue emphasis on the relevance of management bias to this ISA and this point is already covered not only by ISA 230 but also by ISA 240. Paragraph 21, as well as the related Application Material given in paragraph A111, should therefore in our view be deleted from Proposed ISA 540 as duplicative and unnecessary.

## **1.2. Comments on Application and Other Explanatory Material**

### *Paragraph A26*

Paragraph A26 states that “In some cases, however, an expert is needed...” This implies that the need to use an expert in smaller entities is not uncommon, however we believe that in practice the need to use an expert in a smaller entity environment could be rare. Therefore, we suggest the introductory words in the second sentence of paragraph A26 should be changed from ‘In some cases’ to ‘In a few cases’.

### *Paragraphs A32 and A66*

The last sentence of paragraph A32 and the second sentence of paragraph A66 contain text that serves to limit or further specify the extent of an auditor’s responsibilities, which may apply in some, although not virtually all, engagement circumstances, but which, when they apply, are fundamental to compliance with the requirements of Proposed ISA 540.

Inclusion of such text in the Application and Other Explanatory Material is a significant issue in the light of the uncertainty in relation to the adoption (or not) and authority of the Application and Other Explanatory Material as part of the expected adoption of the ISAs by the European Commission. We therefore recommend these sentences be placed in the requirements sections, either within, or subsequent to, the requirements of paragraphs 9 and 13 respectively, to which they relate.

*Paragraph A86*

Paragraph A 86 - The first three sentences of paragraph A86 are unnecessary as they merely repeat other requirements and guidance at length. This is inconsistent with other application paragraphs which do not refer to other requirements. The first three sentences of A86 should be deleted and paragraph 10 (b) should be referenced to A86.

*Paragraph A90 (linked to paragraph 14(a))*

Paragraph 14(a) and the related paragraph A90 do not provide sufficient practical guidance in a smaller entity context on how the auditor is to evaluate whether the effects of estimation uncertainty on the accounting estimate have been adequately addressed. Stating in the last sentence of A90 effectively that the auditor should educate management on their responsibilities is not necessarily going to resolve the issue. There needs to be some other audit procedure which the auditor can apply. FEE recommends that IAASB liaises further with the IFAC Small and Medium Practices Committee to develop a practical solution to such situations. If this is not possible, it calls into question the validity of requirements in paragraph 14.

*General comment*

Reference should also be made to our comments on Application and Other Explanatory Material in Sections 2.3 and 2.4 below.

## **2. Responses to IAASB's Questions**

### **2.1. Is the objective to be achieved by the auditor, stated in the proposed revised and redrafted ISA, appropriate?**

Yes. The objective is oriented to the outcome of the financial statements being free of material misstatement and requires the use of judgement by auditors.

### **2.2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?**

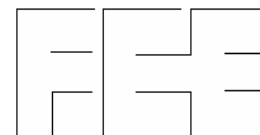
Not in all cases. We refer to our comments on requirements in relation to paragraphs 9, 10, 12, 14 and 21.

### **2.3. Comments on the proposed combination of ISAs 540 and 545, its effect on the content of the ISA, and the proposed withdrawal of ISA 545.**

FEE supports in principle the proposed combination of ISAs 540 and 545 and the proposed withdrawal of ISA 545. The requirements are appropriate for both the audit of estimates and the audit of fair values, and the combination of the two ISAs will enhance the auditor's understanding of auditing issues associated with accounting estimates and fair value accounting estimates.

The combination of the two documents has, however, resulted in extensive Application Material and we believe that there would be significant value in performing a further exercise to eliminate duplication and overlap. We suggest that the level of internal cross-referencing in the Application Material is evidence that further thought might be given to the rationalisation of this material. For example:

- Paragraphs A15 and A21 (particularly the first part thereof and the first bullet) cover the same area and could be merged or otherwise rationalised;



- Paragraph A72 is covered by a combination of paragraph A27 bullet 1 and paragraph A86;
- Paragraph A74 is a mere repetition of ISA 330 material;
- Paragraph A86's first three sentences are unnecessary as they merely repeat other requirements and guidance;
- Paragraph A92 is not really necessary; and
- Paragraph A107 could be merged with paragraph A9 and paragraph 19 referred back to the merged paragraph.

FEE is aware that some commentators may question whether the Proposed ISA 540 adequately addresses the auditing needs of specific industries, particularly banking and insurance, and, therefore, may call for further application guidance relating to those industries. However, in the context of a standard on accounting estimates and fair value accounting estimates which is to be applicable globally in virtually all engagements and in line with our comments above about the volume of the Application Material already included in Proposed ISA 540, we do not believe it should be a priority for the IAASB to develop additional application guidance at this point in time to cover specific industry needs.

#### **2.4. Comments on whether the special considerations in the audit of small entities and public sector entities in relation to fair value accounting estimates have been dealt with appropriately in the Proposed revised and redrafted ISA 540.**

*Comments on small entities:*

FEE believes that the application guidance on considerations specific to smaller entities is not always helpful in explaining what the auditor should do in these circumstances. In this respect, we refer to our specific comments on paragraphs 26 and 90 of the Application Material. We also draw attention to our comments on Section 2.3 above. We believe it will be a particular burden for auditors of smaller entities to work with Application Material that is longer than it needs to be.

#### **2.5. Views on the inclusion of the specific proposed documentation requirement in ISA 540 (Revised and Redrafted), having regard to proposed ISA 230 (Redrafted).**

We are of the view that there is no need for specific documentation requirements in ISA 540. We refer to our comments on paragraph 21.

### **3. Translation and wording issues**

The terms 'Management's point estimate' and 'Auditor's point estimate' included in the definitions in paragraph 7 (b) and (e) may be difficult to translate in a number of languages. The IAASB should consider using the terms 'Management's best estimate' and 'Auditor's best estimate' instead.

If you have any further questions about our views on these matters, please do not hesitate to contact us.

Yours sincerely,

Jacques Potdevin  
President