



ISA 540 – Accounting Estimates

Rich Sharko, Task Force Chair

Marc Pickeur, Task Force Co-Chair

IAASB Meeting, New York

December 5, 2016



Objectives of the Session

- Update the Board on the Task Force's activities
 - Obtain the Board's views on the Draft of ISA 540 (Revised) (Agenda Item 2-B)
-

What is the Revision of ISA 540 Trying to Achieve?

- Enhance the ISA for an evolving and complex business environment
 - Is it “fit for purpose”?
 - Does it deal adequately with issues raised for financial institutions?
- Fostering an appropriately independent and challenging mindset in the auditor
 - Does it identify the right risks and drive the right responses?
 - Appropriate application of professional skepticism
- Enhancing communication, transparency with respect to audit implications of accounting estimates

Task Force Activities

- Approval of Exposure Draft (ED) now scheduled for March 2017 IAASB Meeting
 - Time needed to deliberate different approaches and develop drafting
 - Ideas need to evolve and be evaluated
 - E.g., approach of emphasizing the risk factors and developing a more granular, risk-responsive work effort
 - Time to ensure Board is informed about the issues

Updated Timeline Based on March 2017 ED Approval

- March 2017: Approval of ED
- Mid-April 2017: Issuance of ED
- Mid-August 2017: Close comment period ED
- September 2017: High level feedback to IAASB
- October, December 2017 IAASB meetings: Board deliberations
- March 2018: Anticipated approval of ISA 540 (Revised)

Why is March 2017 Approval Important?

- Effective date IFRS 9
- Auditors need time to implement changes in methodologies
 - Clear steer on direction
- Expectations from regulators

Considerations for December 2016 IAASB Meeting

- Implications for the timeline: Approval in March 2017 is essential
 - Consideration of critical matters vs ancillary matters
- Clarity, understandability and practicality of implementation
- Responsiveness to issues identified to date
 - IFRS 9
 - Balance between ISA 540 and other projects
- Balance between prescription and principles

Question 1

Highlights from each member of areas that they particularly wish to discuss in Agenda Item 2-B

Introduction, Definitions, Risk Assessment

- Introduction

- Need to include how the factors of complexity, judgment and estimation uncertainty impact estimates to provide the context for their use in the standard
- Explain in application material what is meant by the term “reasonable” (based on suggestions November 2016 Board Teleconference)
- Reordering of application material

- Risk Assessment

- Changes to improve clarity, understandability and conciseness
- Understanding of components of internal control included in paragraph 8

Question 3

Comments on paragraph 1-10

Responding to the Assessed Risks of Material Misstatement

- It is critical that the Task Force gets a clear direction from the Board on the work effort
 - Clarity
 - Understandability
 - Responsiveness to what we have heard
 - Practical to implement
 - Balance between prescription and principles
- Paragraph 11A-13E

Responding to the Assessed Risks of Material Misstatement

- Order of paragraphs amended
- Overarching work effort requirement redrafted (Paragraph 13)
 - Explicit threshold included – threshold based on low inherent risk (low RoMM without regard to relevant controls)
 - When RoMM is not low, or is low based on an expectation that relevant controls are operating effectively: perform procedures in paragraph 13A-13C to address complexity, judgment and estimation uncertainty

Question 2(a)

- The IAASB is asked whether paragraph 13 is sufficiently clear on when the auditor is required to comply with paragraphs 13A–13C, including:
 - Whether the IAASB is satisfied with the Task Force’s approach to the threshold in paragraph 13
 - Whether the IAASB supports the view that the approach to inherent risk in the threshold in paragraph 13 does not contradict the application material of ISA 200 that allows the auditor to do a combined assessment of inherent risk and control risk

Responding to the Assessed Risks of Material Misstatement

- Work effort requirement for accounting estimates over threshold (Paragraph 13A-C): objective based
 - Auditor determines procedures to be performed based on nature of risks
 - No need for alternative procedure “exemption” requirement
 - Avoid perception that only substantive procedures need to be performed
- Disclosures requirement similar as presented in November 2016 teleconference

Questions 2(b) and (c)

- (b) Does the IAASB support the ‘objectives-based’ approach to the work effort in paragraphs 13A–13C, and what views does the IAASB have on the level of detail in these paragraphs?
- (c) Are paragraphs 13A–13C written in such a way to ensure that the auditor is designing and performing appropriate procedures that take into consideration the reasons for the assessment of the risk of material misstatement at the assertion level (i.e., the factors from paragraph 10 of Agenda Item 2-B)?

Responding to the Assessed Risks of Material Misstatement

- Stand back requirement enhanced
 - Evaluate that sufficient and appropriate audit evidence is obtained for accounting estimates that meet the threshold
 - Streamlined requirements from extant ISA 540 - included in stand back:
 - Recognition, presentation and disclosure (Extant paragraph 17 and 19)
 - Application of financial reporting framework (Extant paragraph 12)
 - Whether accounting estimates are misstated (Extant paragraph 18)
- No specific procedures for accounting estimates that give rise to significant risk

Question 2(d)

Should the stand back provision address the accounting estimates collectively, each accounting estimate individually, or only those accounting estimates for which procedures are triggered under paragraphs 13A–13C?

Other Changes to ISA 540

- Indicators of possible management bias
 - Importance of holistic view emphasized
 - Reference to fraud and linkage to ISA 240
- Written representations
 - Broadened to address “methods” and “data” in addition to assumptions
- Communication with Those Charged with Governance
 - Linked to factors: complexity, judgment and estimation uncertainty
 - Application material with respect to communications with regulators retained

Other Changes to ISA 540

- Documentation
 - Reverted back to extant 540
 - Requirement to document management bias expanded to include the auditor's evaluation thereof

Question 3

Comments on paragraph 21-23

Other Matters

- Professional skepticism
 - Continuous focus on Professional skepticism in task force meetings
 - Some matters addressed (e.g. stand back provision), others to be considered in Q1 2017
- Testing operating effectiveness of controls
 - Banking and insurance regulators signaled that a specific requirement is needed to test operating effectiveness of controls. Two options:
 - Option 1: add similar requirement from ISA 330 in ISA 540
 - Option 2: amendments to application material in ISA 330

Question 4

What views does the IAASB have the on the Task Force's exploration of addressing the operating effectiveness of controls, including the two options? Which option (if any) is preferred?

Consequential and Conforming Amendments

- External information sources (EIS) (ISA 500)
 - Amendments made to include EIS in ISA 500
 - No changes made in requirements or AM related to management's expert
 - Added definition of EIS
 - Information from an individual or organization that is publicly available
 - With respect to the same information, either an EIS or a management's expert but not both
 - Added application material to paragraph 9 for audit evidence implications
 - Relevance and reliability of information, possible approaches for obtaining audit evidence (including when there are difficulties)

Consequential and Conforming Amendments

- Who should address external information sources? Future ISA 500 TF (?) or ISA 540 TF?
 - Task Force of view that ISA 540 Task Force should make changes
 - More timely
 - Responsive to calls from stakeholders (banking and insurance regulators)
 - Acknowledged in the project proposal
- Conforming amendments to ISA 260 (Revised) and ISA 580
 - Proposals for changes will be made at March 2017 meeting

Question

Comments on consequential and conforming amendments

Next Steps

- Further work needed:
 - The application material supporting the work effort
 - An explanation in the introductory paragraphs of the ISA of the purpose and intended operation of ISA 540
 - Whether and how to incorporate material addressing illiquid or inactive markets, based on relevant material from IAPN 1000
 - Some recommendations of the PSWG

Chairs' Considerations

- Implications for the timeline: Approval in March 2017 is essential
 - Consideration of critical matters vs ancillary matters
- Clarity, understandability of proposals
- Responsiveness to issues identified to date
 - IFRS 9
 - Balance between ISA 540 and other projects
- Balance between prescription and principles

IAASB

**International Auditing
and Assurance
Standards Board®**

www.iaasb.org

IAPN.

ISA.

ISAE.

ISQC.

ISRE.

ISRS.

For copyright, trademark, and permissions information, please go to [permissions](#) or contact permissions@ifac.org.
