

Proposed Disposition of the Present Tense and Other Statements in the Draft Revised ISA 540

I. Those That Have Been Elevated to a Requirement

§ Agenda Item 3-A	Statements	New § Agenda Item (3-C)	Comment
17	...The auditor inquires of management about changes in circumstances such as, for example, whether:	6(b)	Applicable in all cases, and considered to be a necessary risk assessment procedure in relation to the completeness assertion.
33	In assessing the risks of material misstatement, the auditor considers the degree of estimation uncertainty and susceptibility to bias....	8(a)	Applicable in all cases, and considered to be an essential amplification to the general requirement to assess risks in relation to estimates.
56	In testing how management has made an accounting estimate, the auditor evaluates whether the assumptions, individually and collectively, are reasonable for the purposes of making the accounting estimate.	10(b)	Applicable in all cases, considered to be an essential component of the work expected when testing how management made an estimate.
72	<p>When the auditor develops a range with which to evaluate the reasonableness of management's point estimate (the 'auditor's range'), the range cannot be one that comprises all possible outcomes if it is to be useful. Such a range would be too wide to be effective for purposes of the audit. The auditor's range is useful and effective when it is sufficiently narrow to enable the auditor to identify a material misstatement. This is achieved by:</p> <ul style="list-style-type: none"> eliminating from the range those outcomes at the extremities of the range judged by the auditor to be unlikely to occur, and continuing to narrow the range, based on audit evidence available, until the auditor is unable to distinguish a best estimate based upon the relative likelihood of occurrence of the remaining outcomes, and accordingly all outcomes within the range are considered reasonable. 	10(d)	Considered to be essential to the overall aim of the revised ISA in enhancing the rigor applied when the auditor chooses to develop a range for audit purposes.

II. Those That Have Been Treated as Application Guidance and Redrafted

§ Agenda Item (3-A)	Statements	New § Agenda Item (3-C)	Comment
10	... The auditor obtains this understanding by performing risk assessment procedures, which involve gathering, updating and analyzing information throughout the audit.	-	Deleted. Considered redundant with ISA 315.
16	... The auditor obtains an understanding of the methods and practices followed by management for periodically reviewing the circumstances that give rise to the accounting estimates and re-estimating the accounting estimates as necessary.	A17	Guidance on how to obtain the necessary understanding. Also, may not be applicable in all cases as some entities may not have specific methods and practices.
19	During the audit the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. If so, the auditor considers why the entity's risk assessment process failed to identify them and whether the process is appropriate for the circumstances. ISA 315 provides guidance...	A20	Second sentence deleted; considered redundant with ISA 315.
21	In obtaining an understanding of how management made the accounting estimates, the auditor ordinarily considers matters such as: <ul style="list-style-type: none"> • The types of accounts or transactions to which the accounting estimates relate (for example, whether the estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions). • Whether, and if so how, management has used recognized measurement techniques for making particular accounting estimates. 	A23	Application guidance in nature. Treatment consistent with that of similar guidance in ISA 315.
22	In obtaining an understanding of relevant internal controls, the auditor ordinarily considers matters such as: <ul style="list-style-type: none"> • The experience and competence of those who make the accounting estimates. • How management determines the completeness, relevance and accuracy of the data used to develop accounting estimates. • The controls over the review and approval of accounting estimates by appropriate levels of management and, where appropriate, those charged with governance. • Other internal controls relevant to the accounting estimation process. 	A24	Clearly application guidance in nature.

§ Agenda Item (3-A)	Statements	New § Agenda Item (3-C)	Comment
25	<p>In obtaining an understanding of the assumptions underlying the accounting estimates, the auditor considers matters such as:</p> <ul style="list-style-type: none"> • The nature of the assumptions, including which of the assumptions are likely to be significant assumptions, and how management assesses whether the assumptions are complete (i.e., that relevant variables have been taken into account). • How management determines that the assumptions are internally consistent. • Whether the assumptions relate to matters within the control of management... and how they conform to the entity's business plans and the external environment, or to matters that are outside its control.... 	A28	Clearly application guidance in nature.
27	<p>In obtaining an understanding of whether, and if so how, management has assessed the effect of estimation uncertainty, the auditor considers matters such as:</p> <ul style="list-style-type: none"> • Whether, and if so how, management has considered alternative assumptions or outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the assumptions on an accounting estimate. • How management determines the accounting estimate when analysis indicates a number of outcome scenarios. • Whether management monitors the outcome of accounting estimates made in the prior period, and whether management has appropriately responded to the outcome of that monitoring procedure. 	A31	Clearly application guidance in nature, as the need to consider such matters will vary in the circumstances.
29	<p>The review of the outcome or re-estimation of prior period accounting estimates may assist the auditor in identifying circumstances or conditions that increase the susceptibility of an accounting estimate to, or indicate the presence of, possible management bias. The auditor's attitude of professional skepticism is an important factor in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.</p>	A33	Emphasizes a matter already covered by ISA 200.
37	<p>In determining which accounting estimates have high estimation uncertainty, the auditor disregards the materiality of the amount currently recognized or disclosed in the financial statements....</p>	A40	Clearly application guidance in nature.

§ Agenda Item (3-A)	Statements	New § Agenda Item (3-C)	Comment
44	The auditor considers whether and why management has changed an accounting estimate or the method for making the accounting estimate from the prior period...	A49	Paraphrases an existing requirement.
48	...For example, sale of inventory of a superseded product shortly after the period end may provide audit evidence relating to the estimate of the net realizable value of that inventory. In order for such events to remove the need to perform additional audit procedures on the estimate, the auditor obtains sufficient appropriate evidence about the events.	A54	Paraphrases a general requirement of the auditor.
50	When events contradict the accounting estimate made, the auditor considers whether this may be indicative of management having ineffective processes for the making of accounting estimates.	A56	A general consideration covered already in principle by ISAs 315, 330 and 450.
54	<p>Testing how management made the accounting estimate ordinarily involves:</p> <ul style="list-style-type: none"> • Testing the extent to which data on which the accounting estimate is based is accurate, complete and relevant, and whether the estimate has been properly determined using such data and management assumptions; • Considering the source, relevance and reliability of external data; • Recalculating the accounting estimate, and reviewing information about an accounting estimate for internal consistency; • [Evaluating whether the assumptions made by management, individually and collectively, are reasonable;] • Considering management's review and approval processes; and • Considering whether there are any indicators of possible management bias in the making of the accounting estimate. 	A61	Clearly application guidance in nature, except for fourth bullet (assumptions) which is elaborated on in extent paragraph 56 and which has been elevated as a requirement.
58	The auditor considers the assumptions made by management both individually and collectively because assumptions are frequently interdependent, and therefore need to be internally consistent.	A67	Explanation of the basis of the related requirement, as proposed.
60	<p>....Although the extent of audit evidence to be obtained about management's intent is a matter of professional judgment, the auditor's procedures ordinarily include the following:</p> <ul style="list-style-type: none"> • Considering management's history of carrying out its stated intentions. • Reviewing written plans and other documentation, including, 	A71	Clearly application guidance in nature.

§ Agenda Item (3-A)	Statements	New § Agenda Item (3-C)	Comment
	<p>where applicable, formally approved budgets, authorizations, minutes, etc.</p> <ul style="list-style-type: none"> Considering management's stated reasons for a particular course of action. Considering management's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its existing commitments. 		
69	<p>When the auditor makes a point estimate or a range, the auditor may use assumptions different from those used by management. In such circumstances, to the extent not already done, the auditor obtains an understanding of management's assumptions in order to establish that the auditor's model takes into account relevant variables, and to be able to understand and evaluate any significant differences from management's point estimate. The auditor also establishes that the underlying data used in making the point or range estimate is relevant and reliable...</p>	A81	The need to perform the identified procedures is not applicable in all cases, depending on the nature of the estimate, and assumptions and data used.
70	<p>When using the work of an expert, the auditor obtains sufficient appropriate audit evidence that such work is adequate for the purposes of the audit, and complies with the requirements of ISA 620, "Using the Work of an Expert."</p>	A83	Already required by ISA 620.
73	<p>It may indicate, however, that the estimation uncertainty associated with the estimate is such that it gives rise to a significant risk. Further, in such cases, the auditor considers whether recognition criteria and disclosure requirements of the financial reporting framework have been met</p>	A87	References to an existing requirement.
74	<p>In some rare cases, the auditor may be able to narrow the range to a point where audit evidence indicates a point estimate that differs from management's. In such cases, that point estimate is used as the auditor's point estimate.</p>	A88	Clearly application guidance in nature.
75	<p>In auditing accounting estimates, the auditor's further substantive procedures are primarily directed towards the evaluation of:</p> <ul style="list-style-type: none"> How management has assessed the effect of estimation uncertainty on the accounting estimate, and the effect such uncertainty may have on the appropriateness of the recognition of the estimate in the financial statements; and The adequacy of related disclosures. 	A89	Paraphrases matters covered by existing requirements.
79	<p>Where management has not considered alternative assumptions or outcomes, the auditor requests management to support how it has addressed the effects of estimation uncertainty on the accounting</p>	A92	Clearly application guidance in nature.

§ Agenda Item (3-A)	Statements	New § Agenda Item (3-C)	Comment
	estimate.		
81	...Smaller entities may use less formal means and simpler procedures to assess the estimation uncertainty. In these circumstances, in addition to the auditor's review of available documentation, the auditor generally obtains audit evidence of management consideration of alternative assumptions or outcomes by inquiry of management.	A93	Clearly application guidance in nature.
87	Where management has recognized an accounting estimate in the financial statements, the auditor evaluates whether the recognition criteria of the applicable financial reporting framework have been met. Where the auditor judges that it is the estimation uncertainty associated with an accounting estimate that gives rise to a significant risk, this evaluation focuses on whether the measurement of the accounting estimate is sufficiently reliable to meet the recognition criteria of the applicable financial reporting framework.	A97	Paraphrases an existing requirement. Guidance on the application of an existing requirement to specific circumstances.
88	With respect to accounting estimates that have not been recognized, the auditor evaluates whether the recognition criteria of the applicable financial reporting framework have, in fact, been met. Where an accounting estimate has not been recognized and the auditor concludes that this treatment is appropriate, the auditor considers the adequacy of the disclosures in the notes to the financial statements and also whether to draw the reader's attention to a significant uncertainty by adding an emphasis of matter paragraph to the auditor's report. [Proposed] ISA 706, "Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report," establishes standards and provides guidance concerning such paragraphs.	A98	Paraphrases an existing requirement. Covered by ISA 706.
90	The auditor's evaluation of the adequacy of disclosure of estimation uncertainty is particularly important when management's point estimate falls within the auditor's range that is greater than the amount lower than materiality determined for purposes of assessing risks and designing further audit procedures.	A100	Guidance on the application of an existing requirement to a specific circumstance.
91	The auditor also considers any additional requirements of the applicable financial reporting framework for disclosures regarding uncertainties.	A101	Covered by the existing related requirement.
92	Where the applicable financial reporting framework does not prescribe disclosure of estimation uncertainty, the auditor nevertheless encourages management to describe, in the notes to the financial statements, the circumstances relating to the estimation uncertainty...	A102	Not applicable in all cases, and clearly application guidance as to the process that the auditor might undertake.

§ Agenda Item (3-A)	Statements	New § Agenda Item (3-C)	Comment
94	Based on the audit evidence obtained, the auditor may conclude that the evidence points to an estimate that differs from management's point estimate. In such cases, where the auditor has developed a range, a misstatement exists when management's point estimate lies outside the auditor's range. The misstatement is measured as the difference between management's point estimate and the nearest point of the auditor's range. Where the audit evidence supports a point estimate, the difference between the auditor's point estimate and management's point estimate constitutes a financial statement misstatement.	A103	<p>Arguably, the second and third sentences define how to treat the disposition of audit findings when the auditor chooses to develop a range, and therefore should be elevated. However, doing so would not recognize that the development of a range may lead to, or be used in combination, with other audit procedures identified in extant para 46. On balance, the Task Force does not consider it appropriate to elevate as a requirement.</p> <p>The fourth sentence applies generally to any area of the audit, and is not considered to represent a requirement necessary to the objective of ISA 540.</p>
99	The auditor considers the judgments and decisions made by management in determining whether there are indicators of possible management bias. Such indicators do not themselves constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates	A108	Clearly application guidance to the related requirement.

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