



International Federation of Accountants

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Agenda Item

3

Committee: IAASB

Meeting Location: Montreal

Meeting Date: September 18–22, 2006

Accounting Estimates and Fair Values

Objectives of Agenda Item

1. To approve the proposed ISA 540 (Revised), “Auditing Accounting Estimates and Related Disclosures (Other Than Those Involving Fair Value Measurements and Disclosures),” as the ‘close-off’ ISA under the IAASB’s previous drafting conventions.
2. To review as a first read the proposed combined ISA 540-545, “Auditing Accounting Estimates, Including Those Measured at Fair Value, and Related Disclosures.”

Task Force Members

3. The members of the Task Force are:

Philip Ashton (Chair)	IAASB Technical Advisor
Jon Grant	IAASB Technical Advisor
Edmund R. Noonan	External Member
David Thomas	External Member
Gérard Trémolière	IAASB Member

The Task Force has been supported by Professor William R. Kinney Jr., of the University of Texas at Austin, and currently by Mr Chris Taylor, Partner in PwC’s London Financial Services Practice, in relation to issues pertaining to fair values.

Activities Since Last IAASB Discussions

4. The Task Force has met twice since the March 2006 IAASB meeting to consider the redrafting of ISA 540 (Revised) and the issue of how to address ISA 545, “Auditing Fair Value Measurements and Disclosures” simultaneously with the future exposure of the redrafted ISA 540.
5. At its September meeting, the IAASB CAG will be discussing issues relating to this project, in particular the question of whether the proposal to combine ISAs 540 and 545 makes sense in light of current financial reporting standards and the future direction that they might take. Input received from the IAASB CAG will be reported to the IAASB in September.

Matters for IAASB Consideration

CLOSE-OFF OF ISA 540 (REVISED)

6. At its March meeting, the IAASB discussed and agreed in principle the proposed revised ISA 540. It did not, however, formally approve the draft as the document as the ‘closed-off’ version under the IAASB’s previous drafting conventions because of the interrelationship of ISA 540 with aspects of the project on Materiality (which was scheduled for discussion at a subsequent meeting).
7. The Task Force has reviewed the relevant paragraphs of the related Materiality documents approved at the May IAASB meeting and made the necessary conforming changes. In addition, the Task Force undertook a full and final review of the proposed revised ISA 540. It identified a number of additional editorial suggestions to ISA 540 that it believes necessary. These are shown in mark-up in Agenda Item 3-A.
8. The proposed wording changes include amendment to certain of the bold-type paragraphs, in particular paragraphs 86 and 98. The original wording of paragraph 86 implied the need to obtain sufficient appropriate audit evidence to ‘support’ a conclusion by management which could potentially introduce an unintended confirmation-bias by the auditor. The requirement has therefore been amended to make it neutral. Paragraph 98 has been extended to clarify the intended purpose of the requirement. The other editorial changes are self explanatory.
9. The IAASB is asked to note that a minority of the Task Force has concern with the requirement in paragraph 101 relating to management representations. The requirement is seen to exacerbate the issue of the extent of written representations asked from management, and as ambiguous in terms of the boundaries that circumscribe the extent of representations to be obtained for significant assumptions. The Task Force has concluded, however, that the requirement should remain as presented until the IAASB concludes its deliberations on the revision of ISA 580, “Management Representation,” at which time the Task Force recommends a review of the representation requirements in each of the ISAs as to their continuing relevance.
10. As noted in the March IAASB agenda material, the Task Force is of the opinion that re-exposure of the ISA is not required. The analysis¹ provided to the IAASB demonstrated that no new concepts or significant principles have been introduced, and that the requirements are largely consistent with those proposed in the Exposure Draft.

CLARIFICATION OF ISA 540 (REVISED), AND COMBINATION OF ISAS 540 AND 545

11. In March, the IAASB asked the Task Force to identify an optimal solution to the issue of the interrelationship between ISA 540 (Revised) and ISA 545 such that standards and guidance on auditing fair values are dealt with simultaneously with the future exposure of ISA 540 redrafted in accordance with the clarity drafting conventions.
12. The Task Force’s proposals for the redrafting of ISA 540 and its revision to incorporate relevant elements of ISA 545 are explained in the Issues Paper in Agenda Item 3-B.

¹ See Agenda Item 3 and 3-C of the March 2006 IAASB meeting.

13. Although the Task Force undertook separately the redrafting of ISA 540 (Revised) and the revision thereof to deal with the issue of auditing fair values in a coherent and integrated manner, it found the presentation of one document, combining both the redrafting and revision elements, to be the most effective way to demonstrate the changes proposed. Accordingly, Agenda Item 3-C presents the proposed Combined ISA 540-545, showing changes from the proposed ‘close-off’ ISA 540 (Agenda Item 3-A) in mark-up.
14. For review purposes, the IAASB is asked to note the following:
- Changes arising from the redrafting of ISA 540 are shown in mark-up.
 - Changes necessary to produce an ISA that deals both with the audit of estimates and fair values (i.e., to incorporate relevant material from ISA 545) are shown in mark-up and highlight.

Material Presented (Note: Agenda Items 3-A, 3-B, 3-C and 3-E will be used for purposes of the discussions at the meeting.)

Agenda Item 3-A (Pages 1959 – 1982)	ISA 540 (Revised) – For Close Off (Mark-up from March IAASB Meeting)
Agenda Item 3-B (Pages 1983 – 1988)	Issues Paper – Redrafting of ISA 540, and Combination of ISAs 540 & 545
Agenda Item 3-C (Pages 1989 – 2022)	Proposed Combined ISA 540-545 (Mark-up from Agenda Item 3-A)
Agenda Item 3-D (Pages 2023 – 2054)	Proposed Combined ISA 540-545 (Clean) (For reference purposes only)
Agenda Item 3-E (Pages 2055 – 2062)	Summary and Disposition of the Present Tense in ISA 540
Agenda Item 3-F (Pages 2063 – 2102)	Analysis of ISA 545 (For reference purposes only)

Action Requested

15. The IAASB is asked to:
- Approve the proposed ISA 540 (Revised) in Agenda Item 3-A as the ‘close-off’ ISA under the IAASB’s previous drafting conventions.
 - Review as a first read the proposed Combined ISA 540-545 in Agenda Item 3-C.

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