

Accounting Estimates

Rich Sharko, Task Force Chair

Marc Pickeur, Task Force Co-Chair

IAASB Meeting

Hong Kong

September 19, 2016

CAG Feedback

- Commentary and questions about the anticipated timeline
- Some support for approach to scalability
- Aspects of application material may need to be added back to the definitions (or deleted)
- Retrospective review – first two sentences need to be looked at
- Support for approach to work effort (para. 13)
 - Some concerns that it may be too prescriptive
 - Linkage with risk assessment
- Extant language is inconsistent with financial reporting framework in places (esp. the appendix)
- Public sector paragraphs need revision

Setting the Scene

- Task Force has not yet finalized all aspects of the draft ED.
- Areas still being worked on include:
 - Some recommendations from PS group
 - Conforming amendments to ISA 500 for external data sources (discussed with IAASB in July)
 - Application material on many of the work effort requirements
 - Continuing discussion on what elements of the work effort procedures should be mandatory
 - Alignment of language through the ISA

Outline

- Timeline
- Issues:
 - Definitions
 - Risk Assessment
 - Work Effort, including scalability
 - Other Issues
- Next Steps

Project Timeline

Activity	Target Date (*IAASB Board meeting)
Draft Exposure Draft Discussion	September 2016
Intended Approval of Exposure Draft (issued with 120 day comment period)	December 2016
Exposure comment period close	Late April 2017
Board discussion of respondents comments and Task Force proposed responses	June (preliminary feedback only), September & October 2017*
Intended Approval of final standard	December 2017*

ISA 540 ED: Definitions

- Definitions (paragraph 7)
 - Accounting Estimate
 - Auditor's Point Estimate or Range
 - Estimation Uncertainty
 - Management Bias
 - Management's Point Estimate
 - Outcome of an Accounting Estimate
- Previous definitions of “method,” “model,” “assumption,” and “data” have been relocated to application material and made less definitive

2. The IAASB is asked for its views on:
- a) The changes made to the existing definitions and the new application material related to these definitions; and
 - b) The decision to explain the “method,” “model,” “data,” and “assumptions” through application material to paragraph 8.

ISA 540 ED: Risk Assessment

- Enhanced understanding requirement to inform RA
- Independent consideration of expected estimates and disclosures (paragraph 8(aA))
- Use, and sources, of data – including from third parties/external sources (paragraph 8(c)(iA))
- Additional consideration of internal control, governance, and oversight (paragraph 8A)
- Sensitivity to particular data and assumptions (paragraph 8(c)(iv) and 10(a))

Matter For IAASB Consideration

3. The IAASB is asked for its views on:
- a) The additional requirements and application material in paragraph 8 and 8A.
 - b) Any other matter in these paragraphs, for example, the structure of paragraphs 8/8A.

ISA 540 ED: Risk Assessment

- Retrospective review (paragraph 9)
- Auditor's use of an expert (paragraph 9A)

4. The IAASB is asked for its views on:
- a) The changes made to the retrospective review
 - b) The new requirement to assess whether an auditor's expert needs to be engaged in order to perform risk assessment procedures and related activities

ISA 540 ED: Risk Assessment

- Identify and assess the risks of material misstatement, including that relating to the factors of estimation uncertainty, complexity, and judgment (paragraph 10)
- Determine which of the identified risks are assessed, in the auditor's judgment, as being of lower risk (paragraph 10A)

5. The IAASB is asked for its views on:
- a) The factors identified for identifying and assessing the risks of material misstatement, being estimation uncertainty, complexity, and judgment; and
 - b) New paragraph 10A that requires the auditor to assess whether or not the risk of material misstatement is lower risk.

ISA 540 ED: Work Effort

- Key change – procedures directly responsive to risks (based on new RA requirements) vs an unfocussed audit of the estimate as a whole
- “Lower” risks to be addressed in ISA 330: no further ISA 540 procedures
- Risks other than “lower” – require more persuasive audit evidence the higher the assessed risk:
 - More granular procedures designed to be responsive to identified risks
 - Auditor performs procedures from the list unless other procedures are more responsive (auditor will need to set out justification)

- Risks other than “lower” (continued)
 - Seeking to identify range of more specific responses – but challenge in identifying all possible approaches
 - Consideration being given to what is always expected in given circumstances
- Additional emphasis on need for specialised skills or expertise (paragraph 11A)

1. Does the IAASB agree with the Task Force's intended approach of dealing with scalability, and more specifically with addressing lower risks arising from accounting estimates differently from other risks? (see paragraph 12A of **Agenda Item 2-B**)

ISA 540 ED: Work Effort Detail

- Extant ISA 540 requires the auditor to select one or more procedures from a list of 4: Test subsequent evidence (post year-end), Test the method and assumptions, Test the operating effectiveness of controls, Develop independent point estimate
- Examples of proposed detailed procedures responsive to the identified and assessed risks:
 - Test whether key data sources are relevant and reliable
 - Determine whether data or assumptions obtained from external data sources are appropriate and reasonable in the context of the applicable financial reporting framework

ISA 540 ED: Work Effort Detail

- Use of models is an important focus area:
 - Testing the model including, for complex models, management's or management's expert's competence/expertise, and appropriateness of the model in light of the financial reporting framework
 - When testing the model is deemed a responsive procedure, whether the key assumptions are reasonable and data used accurate, complete and appropriate for the model
- Further consideration being given to what procedures, including testing effectiveness of controls, should be mandated, and the circumstances
- Stand-back req. to assess sufficiency of audit evidence

Matter For IAASB Consideration

6. What views does the IAASB have on the work effort requirements? (paragraphs 11A-16A)

- Lead-in to paragraph
- Focus on risks other than lower risks
- How much should the procedures be mandatory
- The link between para. 10 and para. 13
- The use of a table
- The stand back requirement

Significant Risks

- Open question on how to move forward
- Previous IAASB discussion:
 - Intensity of response
 - More qualified and experienced engagement team members to be involved?
 - Look more closely at contradictory (or inconsistent) evidence

ISA 540: Other Issues

- Professional Skepticism: Steps taken to enhance application of professional scepticism throughout the standard (ongoing process):
 - More than just adding the words “professional skepticism”
 - Trying to drive actions that promote skepticism:
 - Developing independent preliminary view of expected estimates and disclosures; More rigorous risk assessment, driven by specific risk factors;
 - Determination of procedures to respond to risk more directly linked to risk factors
 - Stand-back requirement
 - Increased documentation requirement, including justification when designing and performing alternative procedures deemed more responsive

ISA 540: Auditor Reporting

- ISA 540 Task Force of the view that ISA 701 is sufficient in this regard but will identify any conforming amendments necessary resulting from the proposed revised risk assessment approach

Matter for IAASB Consideration

7. Does the IAASB support the proposed changes to ISA 540 or ISA 701 described in Agenda Item 2-A (paragraphs 62-63)?

ISA 540: Communication with Those Charged With Governance

- New requirement added to reinforce importance of communicating with TCWG
- Also provides hook for application material on when reporting to regulators may be required (e.g. prudentially supervised entities)

Matter for IAASB Consideration

8. Does the IAASB support new paragraphs 22A and A127A–A127B??

ISA 540: Documentation

- Enhanced documentation requirements in light of outreach activities and inspection findings
- Covers use of an expert, responses to management bias, how the auditor demonstrated professional scepticism, when the auditor performed other procedures that are more responsive (see para 13)

Matter for IAASB Consideration

9. Does the IAASB support the proposed changes to paragraph 23 and A128?

ISA 540: Insurance Contracts

- Briefing from IASB representatives
- Areas of key judgments identified – parallels with other complex estimates

Matter for IAASB Consideration

10. Are there areas of the ISA where material related to insurance contracts should be added?

Next Steps

- Chairs of the ISA 540, ISA 315, & Professional Skepticism groups to continue dialogue and address overlapping issues
- Further Task Force meetings and teleconferences scheduled in Oct/Nov
- October IAASB teleconference used to address any key matters arising from September 2016 IAASB meeting requiring specific additional Board input ahead of December 2016
- December 2016 IAASB meeting – proposed approval of exposure draft

IAASB

www.iaasb.org
