

Proposed ISA 540 (Revised) – Selected Paragraphs – Clean**Introduction****Scope of this ISA**

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to accounting estimates and related disclosures in an audit of financial statements. Specifically, it includes requirements and guidance that refer to, or expand on, how ISA 315 (Revised),¹ ISA 330,² ISA 450,³ ISA 500⁴ and other relevant ISAs are to be applied in relation to accounting estimates. It also includes requirements and guidance on the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias.

Nature of Accounting Estimates

2. Many monetary amounts for financial statement items are susceptible to an inherent lack of precision in their measurement, which is referred to as estimation uncertainty. In the ISAs, such monetary amounts are referred to as accounting estimates. (Ref: Para. A1)
- 2A. Accounting estimates vary widely in nature and are required when the monetary amounts cannot be directly observed. The measurement process is subject to estimation uncertainty that reflects inherent limitations in available knowledge or data. These limitations lead to the need for judgment in selecting and applying the method used and give rise to the need to make assumptions. The need to make assumptions results in inherent variations in the outcome of the measurement process. Other variations in the measurement process, which are not due to estimation uncertainty and could result in a misstatement of the accounting estimate, also may arise when the process is affected by subjectivity, complexity and other inherent risk factors. (Ref: Para. A1A–A1H, Appendix 1)

Key Concepts of This ISA

- 3A. This ISA requires a separate assessment of inherent risk for purposes of assessing the risks of material misstatement at the assertion level for accounting estimates. Depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be affected by estimation uncertainty, complexity, subjectivity or other inherent risk factors, and the interrelationship among them. As explained in ISA 200,⁵ inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. Accordingly, the level of inherent risk depends on the degree to which the inherent risk factors affect the likelihood or magnitude of misstatement, and varies on a scale from lower to higher. For purposes of this ISA, this scale is referred to as the spectrum of inherent risk. The auditor's separate

¹ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

² ISA 330, *The Auditor's Responses to Assessed Risks*

³ ISA 450, *Evaluation of Misstatements Identified during the Audit*

⁴ ISA 500, *Audit Evidence*

⁵ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph A40

assessment of inherent risk depends on where the level of inherent risk falls on the spectrum. (Ref: Para. A70-A71B, Appendix 1)

4. This ISA also requires a separate assessment of control risk for accounting estimates. It refers to relevant requirements in ISA 315⁶ and ISA 330,⁷ and provides related guidance, to emphasize the importance of the auditor's decisions about controls relating to accounting estimates, including decisions about whether:
 - There are controls relevant to the audit and, accordingly, whether to evaluate their design and determine whether they have been implemented.
 - To test the operating effectiveness of relevant controls. (Ref: Para. A1R-A1S)
- 4A. This ISA emphasizes that the auditor's further audit procedures (including, where appropriate, tests of controls) need to be responsive to the assessed risks of material misstatement at the assertion level, considering the reasons for the assessment given to such risks. Those reasons may relate to the effect of one or more inherent risk factors on the auditor's assessment of inherent risk, or to the auditor's assessment of control risk.
5. The exercise of professional skepticism by the auditor is important to the auditor's work relating to accounting estimates because of susceptibility to management bias or to misstatement due to fraud in making accounting estimates due to their subjective, potentially complex and uncertain nature.
6. This ISA requires the auditor to evaluate, based on the audit procedures performed and the audit evidence obtained, whether the accounting estimates and related disclosures are reasonable⁸ in the context of the applicable financial reporting framework or are misstated. For purposes of this ISA, reasonable, in the context of the applicable financial reporting framework, means that the relevant requirements of the applicable financial reporting framework have been applied appropriately, including those that address:
 - The making of the accounting estimate, including the selection of the method, assumptions and data from available alternatives in view of the nature of the accounting estimate and the facts and circumstances of the entity;
 - The selection of an appropriate management's point estimate; and (Ref: Para: A41A-A41B)
 - The disclosures about the accounting estimate, including disclosures about how the accounting estimate was developed and that explain the nature, extent, and sources of estimation uncertainty. (Ref: Para. A1Q–A3, A41C-A41D)

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Requirements

Risk Assessment Procedures and Related Activities

10. When obtaining an understanding of the entity and its environment, including the entity's internal control, as required by ISA 315 (Revised),⁹ the auditor shall obtain an understanding of the following

⁶ ISA 315 (Revised)

⁷ ISA 330, *The Auditor's Responses to Assessed Risks*

⁸ See also ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 13(c).

⁹ ISA 315 (Revised), paragraphs 3, 5–6, 9, 11–12, 15–17, and 20–21

matters related to the entity's accounting estimates to the extent necessary to provide an appropriate basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. (Ref: Para. A8A–A10, A59)

The Entity and Its Environment

- (a) The entity's transactions and other events and conditions that may give rise to the need for, or changes in, accounting estimates to be recognized or disclosed in the financial statements. (Ref: Para. A10B)
- (b) The requirements of the applicable financial reporting framework, including the recognition criteria, measurement bases, and the related presentation and disclosure requirements. (Ref: Para. A11–A11A)
- (c) Regulatory factors relevant to the entity's accounting estimates. (Ref: Para. A14)
- (d) The nature of the accounting estimates and related disclosures that the auditor would expect to be included in the entity's financial statements, based on the auditor's understanding of the matters in 10(a)–(c) above. (Ref: Para. A16)

The Entity's Internal Control Relevant to the Audit

- (e) The nature and extent of oversight and governance that the entity has in place over management's process for making accounting estimates. (Ref: Para. A17A–A17C).
- (f) How management identifies the need for, and applies, specialized skills or knowledge related to accounting estimates, including with respect to the use of a management's expert. (Ref: Para. A17D)
- (h) How the entity's risk assessment process identifies and addresses risks relating to accounting estimates, including with respect to estimation uncertainty, complexity, subjectivity, and susceptibility to management bias or to misstatement due to fraud. (Ref: Para. A17E–A17G)
- (i) With respect to the entity's information system: (Ref: Para. A25–A25A)
 - (i) How management identifies classes of transactions, or other events and conditions, that are significant to the financial statements and that give rise to the need for, or changes in, accounting estimates and related disclosures; (Ref: Para. A25Aa)
 - (ii) For the accounting estimates in paragraph 10(i)(i), how management:
 - a. Identifies the relevant methods, assumptions or sources of data, and the need for changes in them, that are appropriate in the context of the applicable financial reporting framework, including how management: (Ref: Para. A25B–A25D)
 - (i) Selects or designs, and applies, the methods used, including the use of models; (Ref: Para. A26–A30)
 - (ii) Selects the assumptions to be used, including consideration of alternatives, and identifies significant assumptions; (Ref: Para. A33–A38); and
 - (iii) Selects the data to be used; (Ref: Para. A35, A41)
 - b. Understands the degree of estimation uncertainty, including through considering the range of possible measurement outcomes; and (Ref: Para. A41AA)

- c. Selects a point estimate and related disclosures for inclusion in the financial statements. (Ref: Para.A41A–A42D)
- (ia) Control activities relevant to the audit over management's process for making accounting estimates (see paragraph 10(i)). (Ref: Para. A58–A58D)
- (j) How management reviews the outcome(s) of previous accounting estimates and responds to the results of that review.

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Identifying and Assessing the Risks of Material Misstatement

13. In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the assertion level, as required by ISA 315 (Revised),¹⁰ the auditor shall separately assess inherent risk and control risk, taking the following into account in making the assessment of inherent risk: (Ref: Para. A70–A75A)
 - (a) The degree to which the accounting estimate is subject to estimation uncertainty; and (Ref: Para. A75B–A75E)
 - (b) The degree to which the following are affected by complexity, subjectivity, or other inherent risk factors:
 - (i) The selection and application of the methods, assumptions and data in making the accounting estimate; or
 - (ii) The selection of management's point estimate and related disclosures for inclusion in the financial statements. (Ref: Para. A79–A92A)

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Responses to the Assessed Risks of Material Misstatement

15. As required by ISA 330,¹¹ the auditor's further audit procedures shall be responsive to the assessed risks of material misstatement¹² at the assertion level, considering the reasons for the assessment given to those risks. The auditor's further audit procedures shall include one or more of the following approaches:
 - (a) Determining whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate (see paragraph 17);
 - (b) Testing how management made the accounting estimate and related disclosures about estimation uncertainty (see paragraphs 17A-17F); or
 - (c) Developing an auditor's point estimate or range based on available audit evidence to evaluate management's point estimate and related disclosures about estimation uncertainty (see paragraphs 18-18C).

The auditor's further audit procedures shall take into account that the higher the assessed risk of

¹⁰ ISA 315 (Revised), paragraph 25 and 26

¹¹ ISA 330, *The Auditor's Responses to Assessed Risks*, paragraphs 6-15 and 18

¹² ISA 330, paragraphs 6-7 and 21

material misstatement, the more persuasive the audit evidence needs to be.¹³ The auditor shall design and perform further audit procedures in a manner that is not biased toward only obtaining audit evidence that is likely to be corroborative and that excludes evidence that may be contradictory in nature.. (Ref: Para. A92D–A94)

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Developing an Auditor's Point Estimate or Range Based on Available Audit Evidence to Evaluate Management's Point Estimate and Related Disclosures about Estimation Uncertainty

18. When the auditor's further audit procedures include developing a point estimate or range to evaluate management's point estimate and related disclosures about estimation uncertainty: (Ref: Para. A126C–A132)
 - (a) If the auditor's point estimate or range is developed using some or all of the auditor's own methods, assumptions or data, the auditor shall obtain sufficient appropriate audit evidence to enable the auditor to evaluate whether the methods, assumptions or data used are appropriate in the context of the applicable financial reporting framework, including with respect to the matters in paragraphs 17B-17D, as applicable.
 - (b) When the auditor uses management's methods, assumptions or data, the auditor shall obtain sufficient appropriate audit evidence in accordance with paragraphs 17B-17D to evaluate whether management's methods, assumptions or data are appropriate.
- 18C. If the auditor develops an auditor's range, the auditor shall:
 - (a) Determine that the range includes only amounts that are supported by sufficient appropriate audit evidence, and have been evaluated by the auditor to be reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework; and (Ref: Para. A133-A134)
 - (b) Obtain sufficient appropriate audit evidence about whether management's point estimate and the disclosures in the financial statements that describe the estimation uncertainty are reasonable in the context of the applicable financial reporting framework.

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Documentation

27. The audit documentation relating to accounting estimates shall include: (Ref: Para. A158–A158B)
 - (a) Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control, as required by paragraph 10; and
 - (b) The basis for significant professional judgments made,¹⁴ including:
 - (i) For risks of material misstatement relating to accounting estimates for which inherent risk is assessed as higher on the spectrum of inherent risk, including significant risks, how the auditor's further audit procedures are responsive to the assessed risks of material misstatement at the assertion level, considering the reasons for the assessment

¹³ ISA 330, paragraph 7(b)

¹⁴ ISA 230, *Audit Documentation*, paragraphs 8, A6, A7 and A10

given to those risks, as required by paragraph 15;

- (ii) The auditor's response when management has not taken appropriate steps to understand and address estimation uncertainty as required by paragraph 17F;
- (iii) The auditor's evaluation of the implications for the audit when indicators of possible management bias are identified, as required by paragraph 21A; and
- (iv) The auditor's evaluation of the reasonableness of the accounting estimates and related disclosures in the context of the applicable financial reporting framework, as required by paragraph 23.

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Application and Other Explanatory Material

Nature of Accounting Estimates

Examples of Accounting Estimates (Ref: Para. 2)

A1. Examples of accounting estimates related to classes of transactions, account balances and disclosures include:

- Inventory obsolescence.
- Depreciation of property and equipment.
- Valuation of infrastructure assets.
- Valuation of financial instruments.
- Outcome of pending litigation.
- Provision for expected credit losses.
- Valuation of insurance contract liabilities.
- Warranty obligations.
- Employee retirement benefits liabilities.
- Share-based payments.
- Fair value of assets or liabilities acquired in a business combination, including the determination of goodwill and intangible assets.
- Impairment of long-lived assets or property or equipment held for disposal.
- Non-monetary exchanges of assets or liabilities between independent parties.
- Revenue recognized for long-term contracts.

Nature of Accounting Estimates (Ref: Para. 2-2A)

A1a. The nature, condition and circumstances of financial statement items vary widely and give rise to quantitative and qualitative attributes of those items. These attributes (referred to in this ISA as valuation attributes) influence an item's cost or price, and therefore the monetary amount of the item, on the relevant measurement basis.

A1b. The nature of a financial statement item may give rise to valuation attributes relating to the rights, obligations or other claims relating to resources, or changes therein, which the item embodies. The circumstances and condition of a financial statement item also may give rise to valuation attributes. Valuation attributes also may affect how the item contributes to the timing and amounts of cash flows, and related risks and uncertainties, and may reflect other risks and uncertainties inherent in the item.

Methods (Ref: Para. 2A)

A1A. A method is a measurement technique used by management to make an accounting estimate in accordance with the required measurement basis. For example, one recognized method used to make accounting estimates relating to share-based payment transactions is to determine a theoretical option call price using the Black Scholes option pricing formula. A method is applied using a computational tool or process. A model is a computational tool used to make an accounting estimate by applying assumptions and data, and a set of relationships between them, as specified by the method.

Assumptions and Data (Ref: Para. 2A, Appendix 1)

A1D. Assumptions involve judgments based on the best available information about matters such as the choice of an interest rate, a discount rate, or judgments about future conditions or events. An assumption may be selected by management from a range of possible alternatives. Assumptions that may be made or identified by a management's expert become management's assumptions when used by management in making an accounting estimate.

A1E. For purposes of this ISA, data is information that can be obtained through direct observation or from a party external to the entity. Information obtained by applying analytical or interpretive techniques to data is referred to as derived data when such techniques have a well-established theoretical basis and do not involve management judgment. Otherwise, such information is an assumption.

A1F. Examples of data include:

- Prices agreed in market transactions;
- Operating times or quantities of output from a production machine;
- Historical prices or other terms included in contracts, such as a contracted interest rate, a payment schedule, and term included in a loan agreement;
- Forward-looking information such as economic or earnings forecasts obtained from an external information source, or
- A future interest rate determined using interpolation techniques from forward interest rates (derived data).

A1G. Data can come from a wide range of sources. For example, data can be:

- Generated within the organization or externally;
- Obtained from a system that is either within or outside the general or subsidiary ledgers;
- Observable in contracts; or
- Observable in legislative or regulatory pronouncements.

Key Concepts of This ISA

Inherent Risk Factors (Ref: Para. 3A)

A1P. [Sentence moved from par 1 of Appendix 1 and modified slightly] Inherent risk factors are characteristics of conditions and events that may affect the susceptibility of an assertion to misstatement, before consideration of controls. This ISA focuses on the inherent risk factors of estimation uncertainty, subjectivity and complexity, but recognizes that other inherent risk factors also may exist. Appendix 1 further explains the nature of these inherent risk factors, and their inter-relationships, in the context of making accounting estimates and their presentation in the financial statements.

A1Q. Other inherent risk factors that the auditor may consider in identifying and assessing the risks of material misstatement may include the extent to which the accounting estimate is subject to, or affected by:

- Change in the nature or circumstances of the relevant financial statement items, or requirements of the applicable financial reporting framework which may give rise to the need for changes in the method, assumptions or data used to make the accounting estimate; and
- Susceptibility to management bias or to misstatement due to fraud in making the accounting estimate.

Control Risk (Ref: Para. 4)

A1R. [Moved from A74A and modified] In making a separate assessment of control risk at the assertion level, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not perform tests of controls, the auditor's assessment of the risk of material misstatement at the assertion level cannot be reduced for the effective operation of internal controls with respect to the particular assertion.¹⁵

A1S. [Moved from A75A] An important consideration for the auditor in the assessment of control risk at the assertion level is the effectiveness of the design of the control activities that the auditor intends to rely on by testing their operating effectiveness. The extent to which the design of these control activities addresses the assessed inherent risks will likely affect the nature, timing or extent of substantive procedures to be performed.

Concept of "Reasonable" (Ref: Para. 6)

A2. Other considerations that may be relevant to the auditor's consideration of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework include whether:

- The data and assumptions used in making the accounting estimate are consistent with each other and with those used in other accounting estimates or areas of the entity's business activities; and
- The accounting estimate takes into account appropriate information as required by the applicable financial reporting framework.

¹⁵ ISA 530, *Audit Sampling*, Appendix 3

- A3. The term “applied appropriately” as used in paragraph 6 means in a manner that not only complies with the requirements of the applicable financial reporting framework but, in doing so, reflects judgments that are consistent with the objective of the measurement basis in that framework.

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Risk Assessment Procedures and Related Activities

Obtaining an Understanding of the Entity and Its Environment (Ref: Para. 10)

Scalability

A8AA. Paragraphs 11–24 of ISA 315 (Revised) require the auditor to obtain an understanding of certain matters about the entity and its environment, including the entity’s internal control. The requirements in paragraph 10 of this ISA relate more specifically to accounting estimates and build on the broader requirements in ISA 315 (Revised).

A8A. The extent of the risk assessment procedures related to the entity’s accounting estimates may depend, to a greater or lesser degree, on whether the individual matter(s) apply in the circumstances, and the extent to which such an understanding is important given the nature of the entity. For example, the entity may have few transactions or other events and considerations that give rise to the need for accounting estimates, the applicable financial reporting requirements may be simple to apply, and there may be no relevant regulatory factors. Further, the accounting estimates may not require significant judgments, and the processes for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be less subject to estimation uncertainty, be affected to a lesser degree by subjectivity, complexity, or other inherent risk factors, and there may be fewer controls relevant to the audit. If so, the auditor’s risk assessment procedures to understand the matters in paragraphs 10(e)–(i) are likely to be less extensive.

A8B. By contrast, the accounting estimates may require significant judgments by management, and the processes for making the accounting estimates may be complex and involve the use of complex models. In addition, the entity may have a more sophisticated information system, and more extensive controls over accounting estimates. In these circumstances, the accounting estimates may be more subject to estimation uncertainty, and be affected to a greater degree by subjectivity, complexity or other inherent risk factors. If so, the auditor’s risk assessment procedures to understand the matters in paragraphs 10(e)–(i) are likely to be more extensive.

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The Entity’s Information System Relating to Accounting Estimates (Ref: Para. 10(ii))

A25. The auditor’s understanding of the entity’s information system relating to accounting estimates in paragraph 10(i) relates to the requirements in paragraphs 18(a) and (d) of ISA 315 (Revised). In obtaining that understanding, the auditor may consider:

- Whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions.
- How management addresses the completeness of accounting estimates, in particular for estimates related to liabilities.

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Selection of a point estimate and related disclosures for inclusion in the financial statements (Ref: Para. 10(i)(c))

A41A. The requirements of the applicable financial reporting framework may specify the approach to selecting management's point estimate from the reasonably possible measurement outcomes. Financial reporting frameworks may recognize that the appropriate amount is one that is representative of the range of reasonably possible measurement outcomes and, in some cases, may indicate that the most relevant amount may be in the central part of that range.

A41B. For example, with respect to fair value estimates, IFRS¹⁶ indicates that, if multiple valuation techniques are used to measure fair value, the results (i.e., respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances. In other cases, the applicable financial reporting framework may specify the use of a probability-weighted average of the reasonably possible measurement outcomes, or of the measurement amount that is most likely or that is more likely than not.

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Identifying and Assessing the Risks of Material Misstatement (Ref: Para. 13)

A70. Paragraph A42 of ISA 200 states that the ISAs do not ordinarily refer to inherent risk and control risk separately. However, this ISA requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement, including significant risks, at the assertion level for accounting estimates in accordance with ISA 330.¹⁷

A71. In making the separate assessment of inherent risk, the auditor is required to take into account the degree to which the accounting estimate is subject to, or affected by estimation uncertainty, complexity, subjectivity, and other inherent risk factors. The auditor's consideration of the inherent risk factors may also provide information to be used in determining:

- Where the level of inherent risk falls on the spectrum of inherent risk;
- The reasons for the assessment given to the risks of material misstatement at the assertion level; and
- The auditor's further audit procedures in accordance with paragraph 15 are responsive to those reasons.

The interrelationships between the inherent risk factors are further explained in Appendix 1.

A74. The reasons for the auditor's assessment of the risks of material misstatement may result from one or more of the inherent risk factors of estimation uncertainty, complexity, subjectivity or other inherent risk factors. For example:

- (a) Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments

¹⁶ IFRS 13, Fair Value Measurement, paragraph 63

¹⁷ ISA 330, paragraph 7(b)

in a variety of entity specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to be subject to high estimation uncertainty and significant subjectivity in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities.

- (b) An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes, but may involve little subjectivity and the degree of estimation uncertainty may be low, depending on the nature of the inventory.
- (c) Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgment, for example, an accounting estimate that requires a single critical judgment about a liability, the amount of which is contingent on the outcome of the litigation.

A74A. The relevance and significance of inherent risk factors may vary from one estimate to another. Accordingly, the inherent risk factors may, either individually or in combination, affect simple accounting estimates to a lesser degree. For example, for simple accounting estimates, the auditor may identify fewer risks or assess the inherent risks at the lower end of the spectrum of inherent risk.

A74B. Conversely, the inherent risk factors may, either individually or in combination, affect complex accounting estimates to a greater degree, and may lead the auditor to assess inherent risk at the higher end of the spectrum of inherent risk. For these accounting estimates, the auditor's consideration of the effects of the inherent risk factors is likely to directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately the persuasiveness of the audit evidence needed in responding to the assessed risks.

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Responses to the Assessed Risks of Material Misstatement (Ref: Para. 15)

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Obtaining Relevant Audit Evidence Whether Corroborative or Contradictory

A92E. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.¹⁸ ISA 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of the risk of material misstatement. Therefore, the consideration of the nature or quantity of the audit evidence may be more important when inherent risk relating to an accounting estimate is higher.

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Developing an Auditor's Point Estimate or Using an Auditor's Range (Ref: Para. 18–18C)

A133. The requirement in paragraph 18C(a) for the auditor to determine that the range includes only amounts that are supported by sufficient appropriate audit evidence does not mean that the auditor is expected to obtain audit evidence to support each possible outcome in the range individually. Rather, the auditor is likely to obtain evidence to determine that the points at both ends of the range

¹⁸ ISA 500, *Audit Evidence*, paragraph A1

are reasonable in the circumstances, thereby supporting that amounts falling between those two points also are reasonable.

A134. In certain circumstances, the size of the auditor's range may be multiples of materiality for the financial statements as a whole, particularly when materiality is based on operating results (for example, pre-tax income) and this measure is relatively small in relation to assets or other balance sheet measures. This may arise when the estimation uncertainty associated with the accounting estimate is itself multiples of materiality, which may be the case in certain business sectors, such as insurance where a high degree of estimation uncertainty is more typical and there may be specific requirements in the applicable financial reporting framework in that regard. Based on the procedures performed and audit evidence obtained in accordance with the requirements of this ISA, the auditor may conclude that a range that is multiples of materiality is, in the auditor's judgment, appropriate in the circumstances. When this is the case, the auditor's evaluation of the reasonableness of the disclosures about estimation uncertainty becomes increasingly important, particularly whether such disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes. Paragraph A143A also includes considerations that may be relevant in these circumstances.

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Documentation (Ref: Para. 27)

A158. In applying ISA 230¹⁹ in the context of auditing accounting estimates, the auditor is required to prepare audit documentation about key elements of the auditor's understanding of the entity and its environment and the basis for significant professional judgments made. In addition, the auditor's judgments about the assessed risks of material misstatement related to accounting estimates, and the auditor's responses, may likely be further supported by documentation of communications with those charged with governance and management.

A158A. The auditor also may consider documenting:

- When management's application of the method involves complex modeling, whether management's judgments have been applied consistently and, when applicable, that the design of the model meets the measurement objective of the applicable financial reporting framework.
- When the selection and application of methods, data or significant assumptions is affected by complexity to a higher degree, the auditor's judgments in determining whether specialized skills or knowledge are required to perform the risk assessment procedures, to design and perform procedures responsive to those risks, or to evaluate the audit evidence obtained. In these circumstances, the documentation also may include how the required skills or knowledge were applied.

A158B. The exercise of professional skepticism in relation to accounting estimates is important when the accounting estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity or other inherent risk factors. Paragraph A7 of ISA 230 notes that, although there may be no single way in which the auditor's exercise of professional skepticism is documented, the audit documentation may nevertheless provide evidence of the

¹⁹ ISA 230, paragraph 8(c)

auditor's exercise of professional skepticism. For example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgments made in forming a conclusion as to the sufficiency and appropriateness of the audit evidence obtained. Examples of other requirements in this ISA for which documentation may provide evidence of the exercise of professional skepticism by the auditor include:

- Paragraph 10(d), regarding how the auditor has applied an understanding in developing its own expectation of the accounting estimates and related disclosures to be included in the financial statements and how that expectation compares with the financial statements prepared by management;
- Paragraph 15, which requires further audit procedures to be designed and performed to obtain evidence that is not biased toward only audit evidence that is likely to be corroborative and that excludes audit evidence that may be contradictory in nature;
- Paragraphs 17C(a)(ii), 17D(a)(ii) and 21A, which address indicators of possible management bias; and
- Paragraph 22A, which addresses the auditor's consideration of audit evidence, whether corroborative or contradictory.