

Consequential and Conforming Amendments to Other ISAs

Introduction

1. As part of the revision of ISA 540¹ the Task Force also considered whether consequential and conforming amendments to other ISAs were necessary. The Task Force has identified a need for conforming amendments to:
 - ISA 260 (Revised), *Communication with Those Charged with Governance*;
 - ISA 500, *Audit Evidence*; and
 - ISA 580, *Written Representations*.

Consequential Amendments to ISA 500

Background

2. In the Project Proposal the IAASB acknowledged that amendments to ISA 500 may be needed to clarify the distinction between a third-party pricing source and a management's expert, as defined in ISA 500. In addition, the IAASB noted that there may be merit in clarifying the related auditing considerations in light of the relevant material contained in IAPN 1000.
3. The IAASB discussed the Task Force's preliminary views on external data sources in its July 2016 teleconference and the Task Force considered the Board's responses in the Task Force's November 2016 teleconference.

External Information Sources

4. In its July 2016 teleconference the Board agreed with the Task Force's view that many entities use external parties for data other than prices and that it would be better to refer to these parties as 'external data sources'. In its deliberations the Task Force noted that ISA 500 generally uses the term 'information' in relation to audit evidence. Accordingly, the Task Force concluded that using the term 'external information sources' would be more appropriate. This is especially important as information is broader than data and ISA 500 is dealing with more than just data as is contemplated in ISA 540 and.

The Difference between an External Information Source and a Management's Expert

5. In the July 2016 teleconference, the Board was generally of the view that whether the data is specifically generated for the entity or is widely available to the public was the key criterion for determining whether an external information source is a management's expert. The Board also asked the Task Force to consider whether a definition of "external data source" should be added.
6. Based on the discussion in the July 2016 teleconference, the Task Force is of the view that consequential amendments to ISA 500, including a definition of an external information source with related application material that provides additional guidance that explains how an external information source differs from a management expert, would be helpful.
7. In crafting a definition of an external information source the Task Force noted that in certain circumstances an individual or organization can be a management's expert or an external information source depending on the facts and circumstance. The Task Force was of the view

¹ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

that, with respect to the same information, the individual or organization can be either an external information source or a management expert's but not both. The Task Force recognized that this may be an area of confusion for practitioners and therefore added 'and is not a management's expert' in the definition of an external information source to make this clear.

8. The application material provides guidance about how an external information source can be distinguished from a management's expert by highlighting that:
- The information is not specifically generated for the entity; and
 - The information is generally available to the public.

The application material also includes examples of external information sources and highlights that, depending on the facts and circumstances, an individual or organization may be an external information source or a management's expert.

9. See paragraph 5(cA) and A1A–A1C in the Appendix.

Audit Evidence Implications of Data from External Information Sources

Nature and Extent of Procedures to Be Performed Over Data from External Information Sources

10. With respect to data from internal and external sources, the Task Force points out extant ISA 500 describes in paragraph 8 how to address information prepared using the work of a management's expert and describes in paragraph 9 how to address information prepared by the entity. See below paragraph 8 and 9 of extant ISA 500.

8. If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (Ref: Para. A34–A36)
- (a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37–A43)
 - (b) Obtain an understanding of the work of that expert; and (Ref: Para. A44–A47)
 - (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A48)
9. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including, as necessary in the circumstances:
- (a) Obtaining audit evidence about the accuracy and completeness of the information; and (Ref: Para. A49–A50)
 - (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A51)"

11. The Task Force was of the view that the nature and extent of procedures to test management's use of external information sources depends on the observability of inputs and the complexity of methods used to generate the data. It was also noted that the nature and extent of the procedures performed by the auditor depends in part on the availability of information from the source – that is, alternative procedures may need to be performed if sufficient information is not available from the external information source to enable particular procedures to be performed.

12. With respect to the influence of management bias on data obtained from an external information source, the Task Force noted that bias may be less than for internally generated data. However, the Task Force was also of the view that the auditor should still have a skeptical mindset and cannot assume that the data from an external information source is reliable and free from bias. For example, in some instances management may be able to influence the data provided by the external information source, management may be biased in selecting a particular external information source, the external information source might have its own biases, and the information received from the external information source may be incomplete or wrong.
13. The Task Force was therefore of the view that the auditor should evaluate whether the data obtained from the external information source is reliable as required by paragraph 9 of ISA 500 and included a reference to external information sources in the first sentence of requirement 9 (see the appendix for the revisions made to paragraph 9). The application material highlights:
- That the auditor may obtain an understanding of why management uses an external information source, as well as how management ensured that the information is sufficiently reliable for preparing its financial statements (Paragraph A48A);
 - Factors that the auditor could consider to assess the reliability of information from an external information source (Paragraph A48B);
 - Factors that the auditor could consider to assess the reliability of prices from an external information source (Paragraph A48C);
 - That the availability of information to understand the methods and assumptions used by the external information source may influence the nature, timing and extent of the auditor's procedures (Paragraph A48D);
 - That the observability of inputs and complexity of methods used to generate the information from the external information source may influence the nature and extent of procedures that the auditor needs to perform to test the reliability of information from an external information source (Paragraph A48E).
 - Possible approaches to gather evidence concerning the reliability of information from external information sources (Paragraph A48F).
 - Additional considerations for evaluating the evidence provided by the external information source related to fair value measurements (Paragraph A48G). The Task Force will liaise with the International Accounting Standards Board to align the wording in this paragraph with IFRS 13.²

Challenges in Obtaining Sufficient and Appropriate Audit Evidence from External Information Sources

14. The Task Force identified the following challenges that may be encountered in obtaining sufficient appropriate audit evidence from an external information source:
- Non-disclosure of information by the external information source about the data and the process used to generate the data because of confidentiality or proprietary reasons;
 - When ISAE 3402³-style reports are used, the controls tested over valuation do not provide direct audit evidence of the actual valuation..

² International Financial Reporting Standard 13 (IFRS), *Fair Value Measurement*

³ International Standards On Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*

- For pricing services, the information needed to determine whether fair values are based on transactions of comparable assets or liabilities is generally only available at an aggregated level, and at a security level via a 'deep dive,' for which external information sources may limit the number that their customers, including companies and auditors, may request.
15. The Task Force included application material that describes alternative procedures that may be performed when the practitioner is having difficulty in obtaining sufficient and appropriate audit evidence. The application material also includes guidance on the situation when the auditor faces a scope limitation and modifies the audit opinion due to an inability to obtain an understanding of how the external information source generates the data (Paragraph A48K). This guidance is similar to the wording used in ISA 501, paragraph A14.

Management and the Auditor Using the Same External Information Source

16. In its discussions, the Task Force was of the view that the facts and circumstances of the situation would need to be considered to determine whether it is appropriate for the auditor to use the same external information source as management. For example, when the data obtained from the external information source is used to make an accounting estimate, and the auditor assesses the risk of material misstatement related to the estimate as low, it may be appropriate for the auditor to rely on that data as audit evidence (assuming the auditor has determined that the data is reliable).
17. However, when the data obtained from the external information source is used to make an accounting estimate that has a high assessed risk of material misstatement, it may be necessary for the auditor to have a more intensive response, including on the extent of the procedures to evaluate the relevance and reliability of that information. Additional procedures may focus on whether the data is complete and free of material error. When another external information source is available, this may include the auditor accessing a different external information source from that used by management.
18. The Task Force also noted that in less developed markets there might be only one external information source for certain data. In these circumstances the auditor may consider alternative procedures, such as analytical procedures, to assess the reliability of the data.
19. Based on the above the Task Force drafted application material that deals with the situation where the auditor and management use the same external information source (see paragraph A48H and A48I in the Appendix)

Process for Making the Amendments to ISA 500

20. In the development of the IAASB's Work Plan for 2017–2018 (the Work Plan) it was noted that, besides the ISA 540 project, the data analytics and professional skepticism projects also discussed possible amendments to ISA 500. The IAASB therefore decided to include a question in its Work Plan whether the IAASB should explore the issues related to audited evidence more holistically through a potential revision to ISA 500.
21. The responses to the Work Plan indicated that most respondents (79 of 91 respondents) were of the view that it is moderately to very important for the IAASB to consider a project related to audit evidence. Many of these respondents pointed to three emerging trends that will necessitate some reconsideration of the topic:
- The impact of the ISA 540 project on ISA 500;
 - The impact of the data analytics project on ISA 500; and

- The impact of the professional skepticism project on ISA 500.
22. Given the broad support for a project to revise ISA 500, **Agenda Item 4-B** states that a project on ISA 500 is to commence in March 2017. This raises the question about whether the amendments to ISA 500 proposed in Section I-B above should be exposed with proposed ISA 540 (Revised), or whether they should be held over and considered more holistically with the other potential amendments to ISA 500.
 23. The Task Force noted that a major advantage of addressing the issue by the ISA 540 Task Force is the timeliness of the response. The IAASB has not yet formed a working group to revise ISA 500 and any changes to the standard would most likely be several years away. Accordingly, the ISA 540 Exposure Draft can therefore address the topic sooner.
 24. Addressing external information sources as part of ISA 540 would be responsive to stakeholders, especially banking and insurance regulators, who have been urging the IAASB to address this issue since the development of Internal Auditing Practice Note (IAPN) 1000⁴ in 2011. Some key stakeholders indicated that they would be opposed to a further delay in addressing this topic.
 25. In addition the Task Force noted that the ISA 540 Project Proposal acknowledges that amendments to ISA 500 may be needed to clarify the distinction between a third-party pricing source and a management's expert. The Task Force was also of the view that the consequential amendments to ISA 500 with respect to external information source can be made without a major changes to ISA 500.
 26. On the other hand, the advantage of including external information sources in a revision of ISA 500 is that ISA 500 would only be opened up once and that the issues with external information sources can be considered in conjunction with the issues identified by the Data Analytics and Professional Skepticism projects.
 27. On balance, the Task Force is of the view that the ISA 540 Task Force should address external information sources as part of its project and propose consequential amendments to ISA 500 as proposed in Section I-B. The changes that the ISA 540 Task Force would make are strictly limited to external information sources and no other changes will be made to ISA 500, such as changing the definition and requirements related to management's experts.
 28. This approach leaves open the possibility that, if stakeholders were opposed to amending ISA 500 for external information sources, the ISA 500 project working group would be fully informed on respondents views and would therefore be better placed to respond in due course.

Matter for IAASB Consideration

1. The IAASB is asked for its views on the proposed amendments to ISA 500 as shown in the Appendix. The IAASB is also asked whether the proposed amendments to ISA 500 for external information sources should be addressed as part of the ISA 540 Exposure Draft.

Conforming Amendments to ISA 260 (Revised) and ISA 580

29. The Task Force has also discussed the possible merit in making conforming amendments to ISA 260 (Revised) and ISA 580 to emphasize key points arising from the revision of ISA 540. At the present time, the Task Force has not sought to draft the conforming amendments but would ask the IAASB to note that proposals will be made at the March 2017 IAASB meeting.

⁴ IAPN 1000, *Special Considerations in Auditing Financial Instruments*

30. With respect to the conforming amendments to ISA 260 (Revised), the Task Force intends to propose changes to the application material in ISA 260 (Revised) to highlight matters that the auditor may communicate with those charged with governance related to accounting estimates. Of particular importance is the relationship between paragraph 16(a) of ISA 260 (Revised) and the Task Force's proposed paragraph 22A of ISA 540.
31. In regard to written representations, the Task Force will propose changes to the Illustrative Representation Letter shown in the Appendix to ISA 580.

ISA 500, Audit Evidence Marked from Extant ISA 500

Definitions

5. For purposes of the ISA, the following terms have the meanings attributed below:

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(cA) External information source – An individual or organization, other than a management's expert, that provides publicly available information and that is used by the entity in preparing the financial statements. (Ref: Para. A1A-A1C)

(d) Management's expert – An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

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7. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence. (Ref: Para. A26–A33)

8. If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (Ref: Para. A34–A36)

(a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37–A43)

(b) Obtain an understanding of the work of that expert; and (Ref: Para. A44–A47)

(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A48)

9. When using information produced by the entity or an external information source, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including, as necessary in the circumstances: (Ref: Para. A48A–A48K)

(a) Obtaining audit evidence about the accuracy and completeness of the information; and (Ref: Para. A49–A50)

(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A51)

External Information Source (Ref: Para 5(cA))

A1A. In preparing the financial statements management may make use of information obtained from an external information source. Indicators that information is from an external information source rather than a management's expert include:

- The information is not specifically generated for the entity;
- The information is generally available to the public.

Whether or not management pays a fee for the information does not affect the determination

as to whether information is considered to be from an external information source or from a management's expert.

A1B. External information sources may include pricing services, governmental organizations, central banks or recognized stock exchanges. Examples of information from external information sources may include:

- Prices and pricing related data;
- Macro-economic data such as historical and forecast unemployment rates and economic growth rates, or census data;
- Credit history data;
- Industry specific data such as an index of reclamation costs for certain extractive industries or viewership ratings used to determine advertising revenue in the entertainment industry; and
- Mortality tables used to determine liabilities in the life insurance and pension sectors.

A1C. Depending on the facts and circumstances an individual or organization may be an external information source or a management's expert. Professional judgment may be needed to determine whether a specific organization is acting as an external information source or a management's expert. For example:

- An organization may be acting as an external information source by providing data of real estate prices for a particular region to the public. The same organization may also be a management's expert by providing an entity with a valuation for its real estate portfolio.
- Some actuarial organizations publish mortality tables which, when used by an entity, is information from an external information source, while the same actuarial organization may be a management's expert when helping management with calculating the pension liability for several of its complex pension plans.
- An individual or organization may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the individual or organization applies that expertise in making an estimate specifically for the entity and which the entity uses in preparing its financial statements, the individual or organization is a management's expert. If, on the other hand, that individual or organization merely provides price data to the public regarding private transactions to the public, and the entity uses that information in its own estimation methods, the individual or organization is an external information source.

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~~A35. When information to be used as audit evidence has been prepared using the work of a management's expert, the requirement in paragraph 8 of this ISA applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the individual or organization applies that expertise in making an estimate which the entity uses in preparing its financial statements, the individual or organization is a management's expert and paragraph 8 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to paragraph 7 of this ISA, but is not the use of a management's expert by the entity.~~

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External Information Sources

A48A. The auditor may obtain an understanding of why management uses an external information source, as well as how management ensured that the information is sufficiently reliable for use in preparing its financial statements. Through the understanding obtained, the auditor may be able to better understand what procedures may need to be performed to consider the reliability of the data obtained from the external information source.

A48B. The following factors are important considerations about the reliability of information from an external information source:

- The reputation of the external information source in the jurisdiction. For example, a central bank or government statistics office with a legislative mandate is likely to be an authority for certain types of information;
- The ability of management to influence the information received from the external information sources;
- The competence and capability of the external information source with respect to that particular type of information;
- Past experience of the auditor with the external information source and its reliability;
- When available, information about the methods used in preparing the information, how the methods are being applied including, where applicable, how models have been used in such application, and the controls over the methods;
- The entity's controls over the information obtained from external information sources;
- Whether the external information source prices are considered to be consistent in relation to prices from other known reliable external information sources; and
- When available, information to evaluate the appropriateness of valuation techniques, assumptions and inputs for either the specific security or asset class.

A48C. The availability of information to understand the methods and assumptions used by the external information source may influence the nature, timing and extent of procedures to test management's use of the sources. For example, pricing services often provide information about their methods and assumptions by asset class rather than individual securities. Brokers often provide only limited information about their inputs and assumptions when providing broker indicative quotes for individual securities. The ability of the auditor to assess the reliability of the information from the external information source may vary significantly depending on the type of asset or liability and the information source.

A48D. The observability of inputs and complexity of methods used to generate the information from the external information source may also influence the nature and extent of procedures that the auditor needs to perform to test the reliability of information from that source. For example, when testing the reliability of pricing data from a pricing service, the nature of the procedures needed to test the reliability of pricing data for a corporate bond may be different than for asset backed securities issued with the backing of a governmental agency.

A48E. Possible approaches to gathering evidence concerning the reliability of information from external information sources include the following or some combination of the following:

- Obtaining a service auditor's report that covers the controls over the information provided

and determining, whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls.⁵

- Obtaining and evaluating information provided by external information sources about the controls and processes, valuation techniques, and assumptions.
- Performing procedures at the external information source to understand the controls and processes, valuation techniques, and assumption used.
- Independently developing a point estimate or a range for prices provided by the external information source and comparing whether the results were within a reasonable range of each other.
- Testing the controls management has in place to assess the reliability of the information from external information sources.

A48F. For fair value measurement the auditor may evaluate whether the evidence provided by the external information source is relevant. This may include determining the following:

- (a) Whether fair values are based on trades of the same instrument or active market quotations;
- (b) When the fair values are based on transactions of comparable assets or liabilities, how those transactions are identified and considered comparable;
- (c) When there are no transactions either for the asset or liability or comparable assets or liabilities, how the information was developed including whether the inputs developed represent the assumptions that market participants would use when pricing the asset or liability, if applicable;
- (d) Whether management has considered alternative prices; or
- (e) When the fair value measurement is based on a broker quote, whether the broker quote:
 - (i) Is from a market maker who transacts in the same type of financial instrument; and
 - (ii) Is binding or nonbinding, with more weight placed on quotes based on binding offers.

A48G. In some situations management and the auditor may use the same external information source because there is, for example, only one provider of certain information. In such cases, the auditor may consider the facts and circumstances in determining whether it is appropriate for the auditor to use the same external information source as management. For example, when the information obtained from the external information source is used to make an accounting estimate, the auditor may need to obtain more persuasive audit evidence the higher the assessed risk of material misstatement.

A48H. Additional procedures may focus on whether the information is accurate and complete. When another external information source is available, this may include the auditor accessing a different external information source from that used by management to compare with the external information source used by management.

A48I. When the auditor is having difficulty in gathering evidence concerning the reliability of information from external information sources using the approaches in paragraph A48F,

⁵ ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

alternative audit procedures may provide evidence about the reliability of information obtained from the external information source. The procedures the auditor may perform depend on the specific facts and circumstances. For example, when the information received from the external information source relates to security prices, the auditor may be able to obtain an independent price from another external pricing source or performing substantive analytical procedures.⁶

A48J. In some cases, it may not be possible to obtain sufficient appropriate audit evidence. In such cases, ISA 705 (Revised) requires the auditor to modify the opinion in the auditor's report as a result of a scope limitation.⁷

⁶ Substantive analytical procedures are analytical procedures used as a substantive procedure (ISA 520, *Analytical Procedures*, paragraph 1). A substantive procedure is defined in the ISAs as: 'An audit procedure designed to detect material misstatements at the assertion level.' An example of a substantive analytical procedure would be multiplying a debt by the contractual interest rate, and comparing the result with the recorded interest expense.

⁷ ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, paragraph 13