



ISA 540

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IAASB

**International Auditing
and Assurance
Standards Board**

PRESENTATION OVERVIEW

- Overview of project timeline
- Timeline context – other key IAASB work plan projects
- Risks to timeline
- Development of the Exposure Draft:
 - Scope of the ISA
 - Risk assessment
 - Work effort
 - Other issues
 - Professional skepticism
- Next steps
- Questions

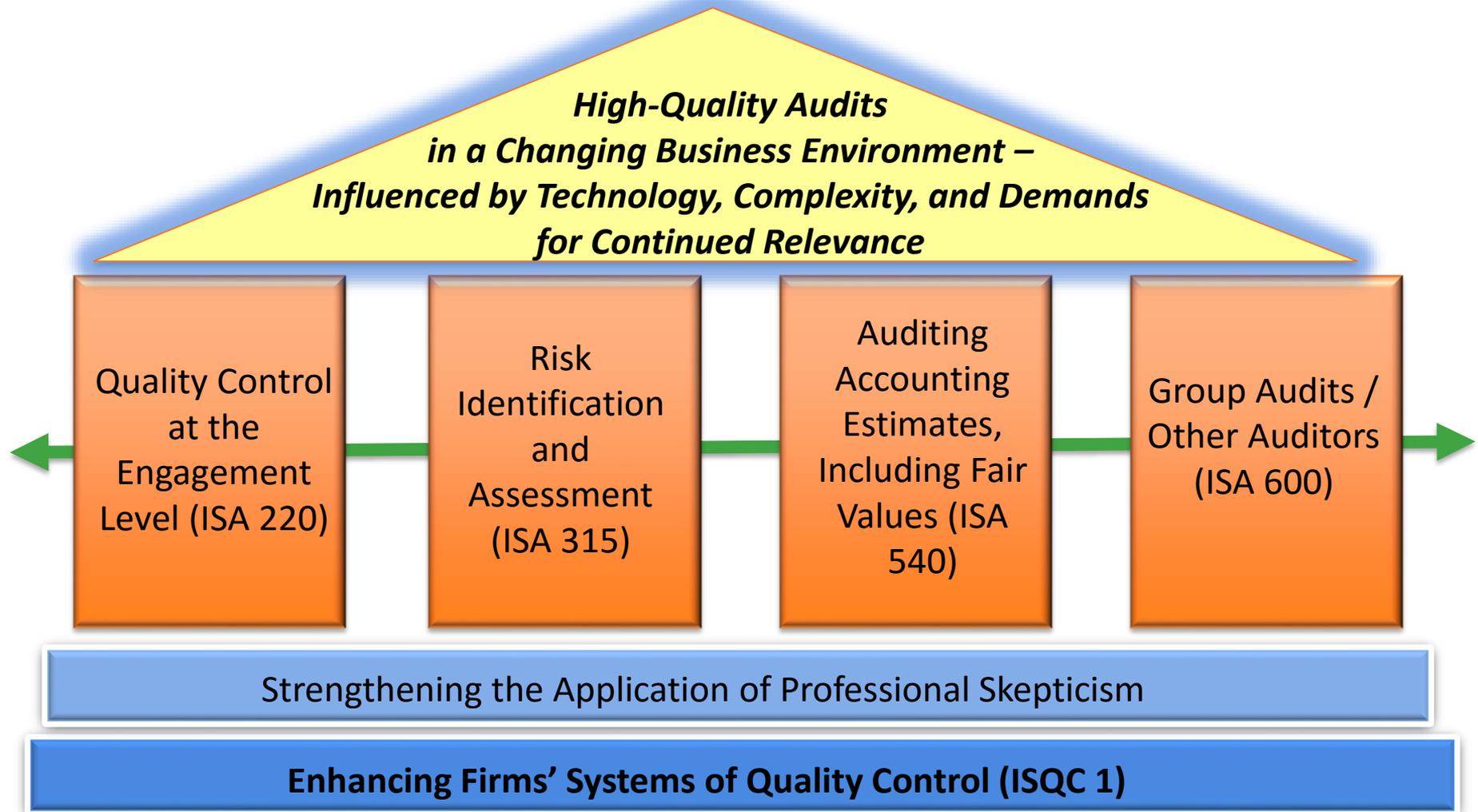
OVERVIEW OF PROJECT TIMELINE

Activity	Target Date (*IAASB Board meeting)
First read of Exposure Draft	September 2016*
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*
Approval of final standard	December 2017*

OTHER KEY IAASB WORK PLAN PROJECTS

- **ISA 540** - one of many key projects in progress in response to public interest issues.
- **Enhancing Audit Quality:** Revision of ISQC1 (Firm level quality control), ISA 220 and other enhancements to ISAs (Engagement level QC)
 - Addressing various matters identified in the December 2015 Invitation To Comment
 - Consideration of how to incorporate a Quality Management Approach
- **Risk Assessment:** Revision of ISA 315 – Understanding the Entity/Risk Assessment (RA)
 - Understanding internal control – clarification of necessary extent (scalability) and how this informs RA
 - Revision of concept of significant risks to enhance understanding and consistent application
- **Group Audits:** Revision of ISA 600
- **Use of technology in the audit** – exploring key concepts related to audit evidence
 - Potential revision of ISA 500 (Audit Evidence)

TIMELINE CONTEXT – OTHER KEY IAASB WORK PLAN PROJECTS



RISKS TO TIMELINE

- Project timeline is ambitious due to IFRS 9 effective date
- Potential risks to timeline need to be managed to achieve expectations:
 - **Volume of changes** to be addressed in the short timeframe with limited staff and Board time
 - **Scope creep** – e.g., addressing issues more related to ISA 500 or ISA 620
 - **Scalability** – balancing SME considerations with demands for more industry specific requirements
 - Reaching consensus on level of **prescription of work effort** and expected **mandatory requirements** in all engagements while retaining flexibility to address the wide range of accounting estimates and engagement circumstances
 - Aligning (and predicting) **changes arising from other concurrent projects**, in particular ISA 315 revision

ISA 540 REVISED ED: SCOPE

- Standard applies to all accounting estimates – from the most simple to the very complex
- Definition of an Accounting Estimate:
“A monetary amount prepared in accordance with the requirements of the applicable financial reporting framework, the measurement of which cannot be made with certainty”
- Building scalability throughout the ISA for smaller entities:
 - Enhanced introductory material explaining that the standard is intended to be scalable of requirements and guidance
 - Accounting estimates with “lower” risk should be addressed by ISA 330 i.e., no specific work effort response required by ISA 540
 - This approach allows the ISA to be better targeted on more complex estimates with “higher” risk

ISA 540 REVISED ED: RISK ASSESSMENT

- Enhanced understanding requirement to inform RA:
 - Independent consideration of expected estimates and disclosures
 - Use, and sources, of data – including from third parties/external sources
 - Additional consideration of internal control, governance, and oversight
- Critical “factors” in identifying and assessing risks:
 - Estimation Uncertainty – and sensitivity to particular data and assumptions
 - Complexity
 - Use of judgement, incl. selection of methods, assumptions and data sources
- Based on factors – identify significant risks and those considered “lower” risks
 - This approach requires auditors to address all risks with a greater focus on higher risks
 - Avoids the perception that auditors designate a small number of significant risks, and do not perform adequate procedures regarding the rest of the risks.

ISA 540 REVISED ED: WORK EFFORT

- Key change – procedures directly responsive to risks (based on enhanced RA requirements) vs an unfocussed audit of the estimate as a whole
- Simple “lower” risks – addressed in ISA 330 – no further specific procedures to test the estimate in ISA 540 (scalability)
- 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)
 - 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

ISA 540 REVISED 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 (*in addition to those above that are retained with added clarification as to when responsive*):
 - 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
 - Determine whether management's disclosures adequately convey the estimation uncertainty associated with the accounting estimate in view of the applicable financial reporting framework

ISA 540 REVISED ED: WORK EFFORT DETAIL

- Use of models is an important focus area and additional expanded procedures developed:
 - Testing the model including, for complex models, management's or management's expert's competence and 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 under what circumstances
- Overall stand-back requirement to assess sufficiency of audit evidence

ISA 540 REVISED ED: OTHER ISSUES

- Auditor Reporting:
 - ISA 701, when developed, directly acknowledge accounting estimates in the consideration of matters requiring significant auditor attention (those identified as having high estimation uncertainty) and also provides examples of how a key audit matter could be described, and how it was addressed by the auditor, related to accounting estimates
 - 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
- Management Bias:
 - New material addressing controls that may serve to mitigate management bias
 - Consistent with extant, required to consider indicators of management bias
 - Enhanced documentation requirement – how the auditor addressed any identified indicators

ISA 540 REVISED ED: OTHER ISSUES

- Documentation:

- The Task Force continues to deliberate the appropriate amendments to make to the requirement and further changes are likely. The current draft is:

“The auditor shall include in the audit documentation:

- (a) The rationale for the auditor’s judgment to use, or not to use, an auditor’s expert when dealing with accounting estimates with high estimation uncertainty or high complexity;*
- (b) Indicators of possible management bias, if any; and how the auditor addressed them;*
- (c) The basis for how the auditor demonstrated professional skepticism in auditing the accounting estimates. This shall include the auditor’s overall conclusions about the reasonableness of the accounting estimates, and their disclosure, and the significant professional judgments made by the auditor regarding accounting estimates with high estimation uncertainty or high complexity.*
- (d) When the auditor has performed other procedures that are more responsive to the risk of material misstatement, a description of the other procedures and the auditor’s rationale for why they are more responsive to the identified risk.”*

ISA 540 REVISED ED: 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:
 - In understanding the entity – developing independent preliminary view of expected estimates and disclosures;
 - More rigorous risk assessment, driven by consideration of specific risk factors;
 - Determination of procedures to respond to risk more directly linked to risk factors – promoting better consideration of responsiveness
 - Stand-back requirement
 - Increased documentation requirement, including justification when designing and performing alternative procedures deemed more responsive to the identified RoMM



NEXT STEPS

- Discussion of proposed text of exposure draft at September 2016 IAASB meeting and IAASB CAG meeting
- 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 October and November
- 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
- Further outreach to be considered as necessary

QUESTIONS

- What are your views on the enhanced risk assessment procedures?
- Recognising the ISA applies to all entities and all accounting estimates, and the broad range of accounting estimates that exist in financial statements, what are your views on:
 - The proposed treatment of “lower” assessed risks of material misstatement (RoMM) (to be addressed in accordance with ISA 330)?
 - The proposed approach of the work effort procedures being more directly responsive to the identified and assessed RoMM?
 - How best to address scalability and applicability with respect to mandating procedures?
- Are there any other steps that could be taken to enhance application of professional scepticism beyond the enhancements proposed?



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