



ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

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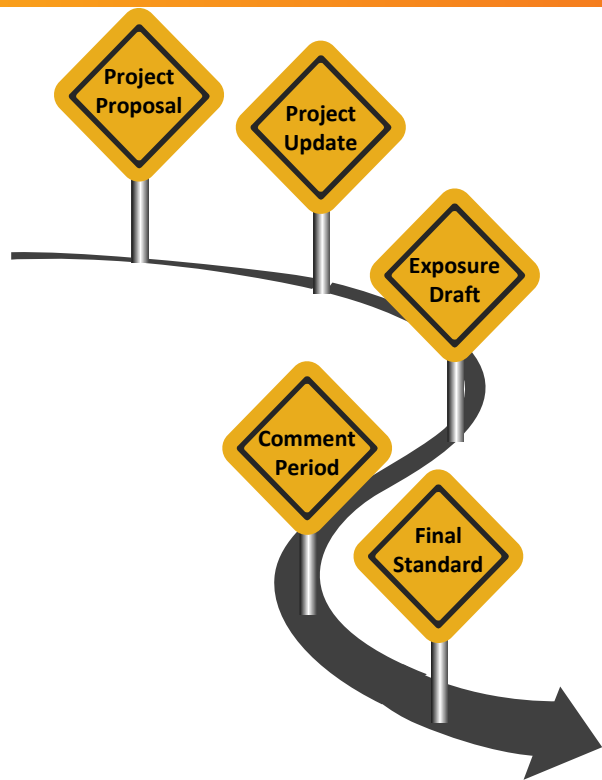
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ISA 540: Overview Project Timeline



- Standard-setting commenced January 2015
 - Based on work Plan for 2015–2016 which included a project to address issues relevant to the application of ISA 540 in audits of financial institutions, as well as more broadly
- Project update released March 2016
- Exposure Draft approved March 2017, published mid-April 2017
- ISA 540 (Revised) approved in June 2018
 - Issuance pending Public Interest Oversight Board’s confirmation that due process was followed
- Proposed effective date: periods ending on or after 15 December 2019

Public Interest Outcomes Identified in Relation to Auditing Accounting Estimates

- Need to address evolving audit risks relating to AEs, in more complex business environment
 - Such risks evolving and increasing due to:
 - FR frameworks evolving to require more complex AEs with high estimation uncertainty
 - Such AEs becoming more prevalent and a fundamental part of financial statements for some entities
 - Audit risks may arise because such AEs require:
 - Significant management judgment with potential for management bias and fraud
 - Use of more forward-looking information and more related disclosures of such information
 - More disclosures about measurement basis, estimation uncertainty, data and assumptions
 - Financial regulator concerns that complex processes in making such AEs give rise to risks due to:
 - Reliance on technology to make such AEs, when they require large volumes of system-generated data
 - Reliance on greater oversight by management and governance in using complex models
- Need to address audit quality and foster improved exercise of professional skepticism
 - Inspection findings raise significant concerns about audit quality and exercise of PS for AEs
- Potential to realize public interest benefits of audit by improved communication & transparency
 - TCWG, Supervisors and Regulators, or via KAMs → PI benefits to governance, reporting and regulation

ISA 540 (Revised) – Address Evolving Audit Risk

- Risk Assessment
 - Enhanced the risk assessment procedures relating to obtaining an understanding of the entity and its environment, including the entity’s internal control
 - Introduced separate assessment of inherent and control risk
 - In assessment of inherent risk, and determining whether a risk is a significant risk, included consideration of the effect of the inherent risk factors and their inter-relationships
 - Complexity
 - Subjectivity
 - Estimation uncertainty
 - Other (e.g. change or misstatement due to management bias or fraud)

ISA 540 (Revised) – Address Evolving Audit Risk

- Work Effort
 - Kept extant ISA 540's testing strategies
 - Introduced objectives-based requirements to respond to assessed risks of material misstatement. These are directed to
 - Methods (including when complex modelling is involved)
 - Assumptions
 - Data
 - Reference is made to relevant requirements in ISA 315 (Revised) and ISA 330 to emphasize the importance of testing controls
 - Strengthened requirement on when management has not appropriately understood estimation uncertainty
 - Enhanced the approach to the use of an auditor's point estimate or range
 - Clarified that the auditor also is required to comply with the relevant requirements in ISA 500

ISA 540 (Revised) – Address Evolving Audit Risk

- Disclosures
 - Changed the objective of the standard to obtain sufficient appropriate audit evidence about whether “accounting estimates and related disclosures” in the financial statements are “reasonable” (was ‘adequate’) in the context of the applicable financial reporting framework
 - Enhanced requirements to obtain audit evidence about whether the related disclosures are “reasonable”
 - Enhanced the overall evaluation requirement to determine whether the related disclosures are “reasonable” in the context of the applicable financial reporting framework, or are misstated
- Documentation requirement expanded
- Application material restructured and expanded

ISA 540 (Revised) – Address Evolving Audit Risk

- Conforming Amendments

- ISA 500 – external information source

- Definition

- Focused on the information being suitable for use by a broad range of users
 - Added service organization to avoid confusion with services for which ISA 402 applies

- Enhanced application material

- Examples of why and when different approaches to considering an EIS are likely needed
 - Included guidance with respect to the implications of restricted access to an EIS's information, or proprietary models

- Other Conforming Amendments to ISA 200, 230, 240, 260 (Revised), 580, 700 (Revised) and 701

ISA 540 (Revised) – Address Evolving Audit Risk

- Scalability

- Explicitly recognized concept of spectrum of inherent risk by
 - Building on existing concepts in ISA 200, ISA 315 (Revised), and ISA 330
 - Describing spectrum and emphasizing scalability in key concepts paragraphs
- Used wording in requirements to enhance scalability
- Provided application material, with examples where appropriate, to explain how certain requirements can be applied in a scalable manner

ISA 540 (Revised) – Professional Scepticism

- Several changes made to enhance the exercise of professional skepticism
 - Other inherent risk factor includes misstatement due to management bias or fraud
 - Requirement to design and perform further audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory
 - Focus on indicators of possible management bias in work effort
 - Requirements to “stand back” and evaluate the audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence
 - Use of stronger language (“challenge”, “question”, “reconsider”) in application material to reinforce the importance of exercising professional skepticism
 - ISA 230, paragraph A7 highlights importance of documenting the exercise of professional skepticism in relation to accounting estimates

ISA 540 (Revised) – Communication & Transparency

- Several changes made to enhance the communication and transparency
 - Included requirement to communicate with those charged with governance about significant qualitative aspects of the entity's accounting practices
 - Specifically noted that, in certain circumstances, the auditor is required by law or regulation to communicate about certain matters with other relevant parties, such as regulators and prudential supervisors
 - Noted in the application material that if the auditor's consideration of estimation uncertainty associated with an accounting estimate, and its related disclosures, is a matter that required significant auditor attention, then this may constitute a key audit matter

Questions?



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