

**Meeting:** IAASB Consultative Advisory Group  
**Meeting Location:** Paris, France  
**Meeting Date:** March 8–9, 2016

## Agenda Item



### ISA 540 – Report Back and Issues

#### Objectives of Agenda Item

1. The objectives of this agenda item are to:
  - a) Inform Representatives and Observers on the ISA 540 Task Force's activities since the December 2015 CAG teleconference;
  - b) Obtain Representatives' and Observers' views on the issues paper regarding the revision of International Standard on Auditing (ISA) 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*; and
  - c) Provide a report back on comments of the CAG Representatives and Observers on this project as discussed at the December 2015 CAG Teleconference.

#### Project Status and Timeline

2. In its December 2015 meeting, the IAASB approved the project proposal to revise ISA 540 – as discussed in the December 2015 CAG Teleconference. The IAASB also discussed a draft project publication that explains the IAASB's project on ISA 540 and also highlights key areas of focus for auditors of entities adopting Expected Credit Loss models that are required by some financial reporting frameworks. The IAASB also discussed this publication at its January 25<sup>th</sup> teleconference, and plans to issue it in early March 2016.
3. Since the December 2015 CAG meeting, the Task Force met six times by teleconference and once physically. The Task Force and IAASB leadership also engaged in several outreach activities; an overview from the outreach activities since the September 2015 CAG meeting is included in Appendix A.
4. In its meeting and teleconferences the Task Force discussed whether the issues identified earlier in the project as being relevant for audits of financial institutions are also applicable for audits of other entities. It also discussed if there were any issues for non-financial institutions that were not identified originally but should be included in the holistic revision of ISA 540. The results of the Task Force deliberations are included in the issues paper (**Agenda Item I.1**).
5. Appendix B to this paper provides a history of previous discussions with the CAG and IAASB on this topic, including links to the relevant CAG documentation.

## December 2015 CAG Discussion

6. Extracts from the draft minutes of the December 2015 CAG teleconference, as well as an indication of how the Task Force or IAASB has responded to the Representatives' and Observers' comments are included in the table below.

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>Messrs. Baumann, Dalkin, Hansen, Inuma, James, Rockwell, Stewart, Thompson, and Yurdakul, as well as Mmes. Elliott, Molyneux, McGeachy, and Singh supported the project to revise ISA 540. Mr. Baumann noted that almost every important number in the financial statements is an accounting estimate, accounting estimates are often complex to calculate and to audit, and many inspection findings relate to auditing accounting estimates.</p>	<p>Support noted</p>
<p>Messrs. Dalkin, Michel, Rockwell, and Kazuhiro noted support for the IAASB's and Working Group's change in direction to focus on a more holistic revision of ISA 540. Messrs. Stewart and van der Ende and Ms. Molyneux agreed, but continued to be of the view that there are specific issues related to auditing accounting estimates for financial institutions, particularly for larger financial institutions, that should also be addressed by the Working Group in this project. Ms. Molyneux therefore supported the Working Group's plan to address issues related to accounting estimates in financial institutions by issuing International Auditing Practice Notes (IAPNs) or other non-authoritative material specifically for financial institutions. Mr. Thompson agreed, noting that the ISAs should be applicable for all audits and that industry-specific matters can be addressed in IAPNs or other non-authoritative material. On the other hand, Mr. Rockwell noted his preference to address the issues identified within the ISAs as much as possible, in light of the due process attached to the ISAs, while recognizing the balance between principles and detailed guidance. Mr. Koltvedgaard noted that the Working Group needs to strike the right balance in addressing certain</p>	<p>Point noted.</p> <p>The Task Force is of the view that, given the deadlines and the resource constraints, it should first focus on the ISA 540 exposure draft. However, the Task Force will consider whether new guidance could be included within ISA 540 (Revised) in relation to certain issues particularly relevant to financial institutions, without unduly burdening the standard. Doing so could provide useful hooks for any additional guidance that could be developed in the future. As noted in the project proposal, the Task Force will consider and advise the IAASB as to the need for, and potential timing of, development of non-authoritative guidance, including IAPNs. Such non-authoritative guidance may, for example, address specific audit considerations related to financial institutions and the relationship between the financial institution's regulatory supervisor and the external auditor.</p>

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>issues holistically and others for financial institutions only.</p>	
<p>Mr. van der Ende was of the view that, while the project proposal presented a complete list of issues, the project proposal could give more prominence to the role of those charged with governance; identification of, and work effort on, significant risks; having the right expertise given the complex business environment; challenging management's assumptions; systems and governance; and the dialogue with the financial institution's regulatory supervisor.</p>	<p>Point taken into account.</p> <p>The Task Force was of the view that the issues noted were all included in the project proposal and were presented appropriately.</p>
<p>Messrs. Iinuma, Michel, Rockwell, and Stewart, as well as Mmes. McGeachy and Robert, noted that there should be a strong link in the project proposal between the project to revise ISA 540 and the project on professional skepticism, as many inspection findings with respect to accounting estimates related to professional skepticism.</p>	<p>Point accepted.</p> <p>Mr. Sharko agreed. The project proposal includes a separate section on professional skepticism and the Task Force added that the Task Force will work together with the Professional Skepticism Working Group to consider how the concept of professional skepticism could be reinforced in ISA 540.</p>
<p>Mr. Koktvedgaard expressed the view that too much detail in the ISA may contradict the IAASB's principles-based approach to standard-setting. Ms. Robert and Messrs. Michel and Kazuhiro agreed. Messrs. Michel and Kazuhiro added that too much focus on details could lead to less professional judgment. Mr. Baumann disagreed and was of the view that a principles-based standard on accounting estimates will lead to more inspection findings.</p>	<p>Point noted.</p> <p>The Task Force was of the view that the right balance should be struck between having sufficient detail to guide auditors and having too many requirements.</p>

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>Mr. James highlighted the importance of experts in auditing accounting estimates, particularly for financial institutions, because of the judgments involved in, and the size of, the collective provision. He noted that the IAASB may need to undertake a separate project on the use of auditor's experts.</p> <p>Mr. Baumann agreed with the importance of experts in auditing accounting estimates and noted that, because of the close relationship between accounting estimates and experts, the United States Public Company Accounting Oversight Board (PCAOB) was advised to coordinate changes between the standards. Mr. Thompson noted it would be useful if the IAASB's project to revise ISA 540 and the PCAOB's project on auditing accounting estimates and fair value measurements can be aligned. Mr. Baumann agreed, noting that the IAASB and PCAOB have already had a constructive dialogue on this topic, and the PCAOB is hoping to work closely with the IAASB on this project in 2016.</p>	<p>Point noted.</p> <p>The IAASB acknowledged the importance of the involvement of auditor's experts in auditing certain complex accounting estimates, and will therefore consider whether ISA 540 addresses the use of auditor's experts appropriately and whether amendments to ISA 620<sup>1</sup> are necessary to more clearly address the need for the auditor to consider whether and when an auditor's expert should be involved.</p> <p>The Task Force will continue its dialogue with the PCAOB and will follow the PCAOB's projects on auditing estimates and fair value measurements<sup>2</sup> and the use of the work of specialists.<sup>3</sup> A representative of the PCAOB is an observer of the ISA 540 Task Force.</p>
<p>Mr. van der Ende emphasized the importance of continued outreach, specifically with the Global Public Policy Committee and the Basel Committee on Banking Supervision (BCBS), given the complexity of the matters.</p>	<p>Point accepted.</p> <p>Mr. Sharko confirmed that the Working Group will continue its outreach effort during the revision of ISA 540, including with the organizations highlighted by the CAG representatives and observers.</p>
<p>With respect to the effects on small and medium practices, Mr. Stewart noted that the complexity of auditing accounting estimates is not driven by the</p>	<p>Point accepted.</p> <p>The Task Force agrees that the complexity of auditing accounting estimates is based on the circumstances.</p>

<sup>1</sup> ISA 620, *Using the Work of an Auditor's Expert*

<sup>2</sup> On August 19, 2015, the PCAOB issued for public comment a staff consultation paper that seeks input on certain issues related to auditing accounting estimates and fair value measurements.

<sup>3</sup> On May 28, 2015, the PCAOB issued for public comment a staff consultation paper that seeks input on potential changes to the PCAOB's standards for the auditor's use of the work of specialists, specifically the objectivity and oversight of specialists and the use of their work in audits. The IAASB response to the PCAOB's staff consultation paper is available at: <http://www.ifac.org/news-events/2015-08/iaasb-comments-pcaob-staff-consultation-paper-auditor-s-use-work-specialists>.

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>size of the entity, but is based on the circumstance of the audit.</p> <p>Mr. Kazuhiro noted that the revisions to ISA 540 should allow auditors to have sufficient time and flexibility to use their professional judgment in determining which risks are significant to the audit.</p>	<p>The Task Force noted the importance of auditors exercising professional judgment in determining which risks are significant to each audit engagement as ISA 540, as all other ISAs, will be principle based.</p>
<p>Mr. Baumann noted that the project proposal only addresses third-party pricing services used by management and suggested reference should be made to auditors' use of third-party pricing services. He also explained his view that third-party pricing services are different from experts in many respects. For example, experts provide customized work while third-party pricing services provide a standardized product.</p>	<p>Point accepted.</p> <p>The use of third-party pricing services by auditors was included in the project proposal.</p>
<p>Mr. Hansen noted that, given its importance, the relationship between the financial institution's regulatory supervisor and the external auditor should be included more explicitly in the project proposal. With respect to this relationship, Mr. Stewart noted that some could see the enhanced communications between the financial institution's supervisor and the external auditor as the auditor abrogating audit responsibilities to the regulator.</p>	<p>Point taken into account.</p> <p>The Task Force agreed that the relationship between the financial institution's regulatory supervisor and the external auditor is important to address in this project and that this is reflected in the project proposal.</p>
<p>Mr. James noted that the project proposal was written at a high level and highlighted that further emphasis could be given within the project on what a complex and a non-complex estimate is, guidance on documenting the cause of audit differences, guidance on how to extrapolate identified differences, and highlighting that there are also other financial reporting standards (besides IFRS 9)<sup>4</sup> that require the development of complex accounting estimates, such as IAS 36.<sup>5</sup> Mr. James also suggested ISA 540 could include</p>	<p>Point noted.</p> <p>The Task Force will consider, based on outreach to be performed and deliberations in the Task Force, whether guidance is needed on the matters noted.</p>

<sup>4</sup> International Financial Reporting Standard (IFRS) 9, *Financial Instruments*

<sup>5</sup> International Accounting Standard (IAS) 36, *Impairment of Assets*

Representatives' and Observers' Comments	Task Force/IAASB Response
additional guidance on how the auditor can identify management bias.	
Ms. Elliott questioned why the governance over complex models is not included in the section that addresses the need for ISA 540 to remain fit for purpose in light of today's evolving and complex business environment.	Point accepted.  The second bullet in paragraph 19 of the project proposal notes that the public interest is also served by improving ISA 540 by including specific material addressing governance over complex models used to generate accounting estimates.
Mr. Michel noted that top-down analytical procedures in the planning and completion phases of the audit can assist auditors in forming an overall conclusion as to whether the accounting estimates in the financial statements are consistent with the auditor's understanding of the entity.	Point noted.  The Task Force will consider this point when revising ISA 540.
Mr. Yurdakul noted his preference to enhance audit documentation requirements when revising ISA 540, as inspection findings highlight that not all audit work related to accounting estimates is documented in the audit file.	Point noted.  The Task Force will consider whether the documentation requirements should be strengthened.
Ms. Singh supported the diverse backgrounds of the members of the Working Group. Mr. Koktvedgaard added that it is important to have members with a non-financial institution background in the Working Group as well.	Support noted.  The Task Force includes several members with a non-financial institution background.
Mr. Hansen, as well as Mmes. McGeachy, Robert and Singh, was supportive of the proposed timeline and had no additional comments. Ms. Molyneux was also supportive of the timeline, but emphasized the importance of the IAASB meeting its key milestones as included in the timeline, in light of the effective date of IFRS 9.	Support noted.  Ms. Healy noted that the timeline is aggressive but that the outreach already conducted by the Working Group and future outreach might be helpful in addressing the right issues on a timely basis.
Mr. van der Ende noted the planned approval of ISA 540 (Revised) in Q4 2017, but also noted that the process of implementation of IFRS 9 in financial institutions will be a critical challenge during 2016 and 2017. He noted that the Basel Committee has been aware of this project and	Point noted.  Mr. Sharko and Ms. Healy noted that the project publication, which will be released in Q1 2016, might alleviate some of the timing concerns, as it will highlight relevant audit issues in relation to

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>believes that completing this project in the proposed timeline will be challenging. Mr. van der Ende questioned which safeguards are in place to mitigate the risk of delays in the project and suggested that the project proposal include a more detailed timetable.</p>	<p>IFRS 9 for financial institutions and will signal the IAASB's plans with respect to the issues that are likely to be addressed in a revision of ISA 540.</p>
<p>Mr. Iinuma noted the importance of having sufficient resources available for this project. Ms. Molyneux and Mr. van der Ende agreed.</p>	<p>Point noted.                      Mr. Sharko and Ms. Healy noted that staffing of this project will be discussed in the IAASB's Steering Committee.</p>
<p>Mr. Stewart and Ms. Molyneux recommended developing the proposed non-authoritative guidance simultaneously with the revision of ISA 540 given the demands from stakeholders. Mr. Kazuhiro agreed and noted that it would be useful to include the development of the non-authoritative guidance in the timetable.</p>	<p>Point noted.                      Ms. Healy noted that the revised version of ISA 540 will be used as the base for the non-authoritative guidance and, therefore, the non-authoritative guidance cannot not be efficiently developed simultaneously.</p>
<p>Mr. van der Ende expressed a preference to have regular conference calls and meetings between the Working Group and the CAG to keep the CAG informed about the progress and to give the CAG the opportunity to provide timely comments. Mr. Koktvedgaard noted the teleconference calls do not provide the opportunity to have robust discussions.</p>	<p>Point accepted.                      Ms. Healy added that the March and September 2016 CAG meetings will be critical. The Task Force is in favor of having regular conference calls and meetings with the CAG.</p>

**Matters for CAG Consideration**

- The Representatives and Observers are asked for their views on the matters for CAG consideration included in **Agenda Item I.1**.

## Outreach Activities since September 2015 CAG Meeting

The Task Force and IAASB leadership participated in, or presented, at the following events:

- Meeting with representatives of the Bank of Japan (Schilder, Sharko, Gunn, James)
- Meeting with representatives of the Japanese Financial Services Agency (Schilder, Sharko, Gunn, James)
- Meeting with Japanese bank auditors (Sharko, James)
- Presentation to International Forum of Independent Audit Regulators' Standards Coordination Working Group (Schilder, Sharko, Gunn, James)
- Meeting with representatives of the U.S. Securities and Exchange Commission (Sharko, Pickeur, James)
- Meeting with representatives of the International Monetary Fund (Sharko, Pickeur, James)
- Meeting with representatives of the PCAOB (Sharko, Pickeur, Healy, James)
- Meeting with representatives of the Financial Accounting Standards Board (Sharko, Pickeur, Healy, James)
- Meeting with representatives of the Federal Reserve, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency (Sharko, Pickeur, James)
- Participation in the Institute of International Finance's three way dialogue meeting between standard setters, regulators and banks, and partly attended by representatives of the large international accounting networks (Pickeur, van den Hout)
- Meeting with the European Banking Authority's Audit Subgroup (Pickeur)
- Meeting with a IFRS 15<sup>6</sup> Specialist (Sharko, Pickeur, Shannon, James, van den Hout)
- Meeting with representatives of the International Accounting Standards Board (Sharko, Pickeur, Shannon, James, van den Hout)
- Teleconference with International Organization of Securities Commissions Committee 1, Auditing Subcommittee (Sharko, Pickeur, James, van den Hout)
- Teleconference with International Association of Insurance Supervisors Accounting and Auditing Working Group (Köhler, Sharko, Pickeur, van den Hout, Williams)

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<sup>6</sup> IFRS 15, *Revenue from Contracts with Customers*

## Project History

Project: ISA 540

### Summary

	CAG Meeting	IAASB Meeting
Preliminary discussions on audit issues relevant to financial institutions and ISA 540.	September 2015	March 2015 June 2015 September 2015
Discussion on project proposal to revise ISA 540.	December 2015 Teleconference	December 2015
Discussion on project publication		January 2016

### CAG Discussions: Detailed References

Preliminary Discussions	<p><u>September 2015</u>                      See IAASB CAG meeting material included in Agenda Items D, D.1, D.2, and D.3.  <a href="http://www.iaasb.org/cag/meetings/new-york-usa-0">http://www.iaasb.org/cag/meetings/new-york-usa-0</a></p>
Project Proposal	<p><u>December 2015</u>                      See IAASB CAG meeting material included in Agenda Items A, and A.1.  <a href="http://www.iaasb.org/cag/meetings/iaasb-cag-conference-call-december-2-2015">http://www.iaasb.org/cag/meetings/iaasb-cag-conference-call-december-2-2015</a></p>