



ISA 540

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IAASB Meeting - Lima, Peru

Agenda Item 2

March 13, 2017

IAASB

International Auditing
and Assurance
Standards Board

Timeline

Monday

- 9:15 – 9:45 – Opening Remarks
- 9:45 – 10:30 – Introduction and Appendices*
- 10:30 – 11:45 – Objective, Definitions, Risk Assessment*
- 11:45 – 15:15 – Work Effort*
- 15:15 – 16:00 – Management Bias, Communication, Documentation*

Tuesday

- 9:00 – 10:30 – Conforming Amendments*

* *Requirements and Application Material will be discussed together*

Timeline

Wednesday

- 9:00 – 10:30 – Reserved for key issue(s)

Thursday

- 14:00 – 17:00 – Approval of ISA 540

Friday

- 9:00 – 11:30 – Approval of Conforming Amendments, Exposure Period, Discussion of Explanatory Memorandum, Effective Date

Input Received on Draft Proposed ISA 540 (Revised)

- CAG
- FSB, BCBS, IAIS
- IOSCO SC1 AuSC
- IFIAR SCWG
- GPPC Banking Liaison Group
- IFAC SMPC
- Offline comments received from some members

Input from CAG

- CAG supportive of issuance of the ED
- Introduction and Appendices
 - Mixed views on length of the document
 - Support for highlighting importance of professional skepticism and disclosures
 - Input received from IASB on Appendix 1
 - Suggestion to publish appendices as Staff Publications
- Risk assessment
 - Questioned why retrospective review is conditional → seen as a lower bar than extant

Input from CAG

- Work effort
 - Is the approach clear enough? Flow chart would be useful to navigate through the standard
 - More guidance on ranges
- Conforming amendments
 - One observer preferred a focus on pricing services
- **PIOB Comments at CAG Meeting**
 - Importance of a clear and concise standard
 - Expand documentation requirement

Input from FSB, BCBS, and IAIS

- FSB
 - Supportive of the amount of guidance
 - Regulators see ECL as a paradigm shift and expect enhanced judgment to be applied by auditors
- BCBS
 - Supportive of ED and happy with progress made
 - Discussed if standard is specific enough for ECL models. Sufficiently focused on forward looking information?
- IAIS
 - Questions around models, including back testing
 - Insurance contracts standard should be anticipated

Input from IOSCO SC1 Auditing Subcommittee

- Supportive of material on professional skepticism, would prefer that it not be linked to reasonable (implies a corroborative mindset)
- Are “reasonable” and “appropriate” being used consistently?
- Para 13: highlight inherent risk v control risk, interaction between/distinction of the factors
 - Do substantive procedures need to address all assertions (cf PCAOB standard)?
- Para 13C: is it always practical for the auditor to develop a point estimate or range
- Concept of “residual estimation uncertainty” unclear

Input from IFIAR Standard Co-Ord Working Group

- Support for the project, quality proposals are the most important
- Should not weaken paragraph 9
- Application material too long
- Be careful about overuse of “shall consider” due to difficulty in inspecting against

Input from GPPC Banking Working Group IAASB Liaison

- Para 3: phrasing this in the negative implies that management doing these things is sufficient
- Para 8(aA): “regulatory factors” are too broad
 - Could tie more closely to ISA 250
- Factors are interrelated, may be common for some estimates to have all three
- Para 13: OK but could be clearer
- Modelling: should have a focus on controls
- Para 13C(b): need to explain “to the extent possible”- accounting estimates in banks will often have very wide ranges. Para A60M is critical and more guidance would help.

Input from IFAC SMPC

- Scalability is important – important to support the use of the ISAs for SMPs
- Para 8 very detailed for SMPs
- Will the approach imply that a checklist is needed?
- Is there more that could be said for SMP audits? Examples (depreciation, inventory obsolescence) are too obvious
 - Suggested adding a question in the ED
- Implementation guidance needed to apply how it should be applied to SMPs

Input from IFAC SMPC

- Work effort:
 - Plainer English preferred
 - Often able to conclude that controls will likely be ineffective without testing
 - Repetition of ISA 330 requirements not helpful
 - Further explanation of “reasonable” would be useful
- Supported proposed effective date
- Explain inherent limitations of an audit of accounting estimates more clearly

Matter for IAASB Consideration

1. Are the requirements clear, understandable, and capable of practical application?

Introduction (Paragraphs 1-5, App 1 & 2)

- Introduction redrafted to highlight factors and key concepts
 - Some concerns expressed about para 3 being phrased in terms of what management did not do
 - Is it clearer to talk in terms of inherent risk factors?
 - Para 4, last sentence – the word “beyond” is confusing
- Appendices
 - Appendix 1 – Measurement Bases of Acc Estimates
 - Comments received from IASB
 - Appendix 2 – Factors: Estimation Uncertainty, Complexity, Judgment
 - “Residual” estimation uncertainty
 - A suggestion from CAG that these could be issued as Staff documents

Introduction (Paragraphs 1-5, App 1 & 2)

Matter for IAASB Consideration

2(a) The IAASB is asked for its views on the introduction section, including the new appendices

Objective, Definitions, Risk Assessment (Para 6-10)

- Objective now refers to disclosures as “reasonable” rather than “adequate”
 - Comment that ISA 700.13(e) uses adequate
- Definitions: only minor changes
- Risk Assessment:
 - Obtain an understanding of the regulatory factors (Para 8(cA))
 - How management identifies and addresses the risk of management bias (paragraph 8(c)(iiiA))
 - Significant data and assumptions (paragraphs 8(c)(ii-iiA))

Objective, Definitions, Risk Assessment (Para 6-10)

Matters for IAASB Consideration

- 2(b) The IAASB is asked for its views on the changes to the objective**

- 3. The IAASB is asked for its views on the revisions to the risk assessment section of proposed ISA 540 (Revised) (paragraphs 8-10 of Agenda Item 2-C)**

Work Effort (Para 11A-13F)

- Para 13 (threshold) welcomed by SMPs
- Can para 13 be simplified?
 - Would a direct reference to inherent risk be an acceptable way to simplify the drafting?
- Complexity/Judgement/Estimation Uncertainty
 - Redrafted/reorganized 13A/B/C to improve logical flow and readability
 - Questions about what to do when more than one factor applies

Work Effort (Para 11A-13F)

- 13C – Estimation Uncertainty
 - Clarifies that the auditor’s response depends on whether management took appropriate steps to understand and address estimation uncertainty
 - Changed focus from “narrowing the range” to only including in the auditor’s range amounts that are supported by evidence and that the auditor has evaluated to be reasonable in the context of the applicable financial reporting framework
 - The application material on ranges was challenging
 - More guidance on how to deal with very large ranges?
 - Others see challenges with what it means for management not to appropriately address the effect of estimation uncertainty
 - Developing a range - Is this a matter for the EM?

Work Effort (Para 11A-13F)

- Disclosures (Para 13D)
 - No significant changes to 13D or the application material
 - Comments from CAG:
 - Pleased to see reference to disclosures beyond those specifically required by the framework
 - Suggested that paragraph 13D(b) should also apply to fair presentation frameworks

Work Effort (Para 11A-13F)

- Stand back provision (Paras 13E/F)
 - Discussed at the January teleconference
 - Improved linkage/alignment with ISA 330
 - Clarified that it applies to accounting estimates for which procedures were performed in paragraphs 13A-13C
 - Why not all estimates? Diverts attention away from the ROMMs
 - Paragraph 13F
 - Took on IAASB comments from January teleconference
 - Task Force discussed how to determine the misstatement if management's estimate is outside the auditor's range.
 - Would like to provide further guidance but difficult to determine what that guidance could cover
 - Suggest a question be included in the EM on misstatements for ranges

Work Effort (Para 11A-13F)

Matter for IAASB Consideration

4. The IAASB is asked for its views on the paragraphs 13–13F of Agenda Item 2-C

Other Requirements (Para 21-23)

- Management bias (paragraph 21)
- Written representations (paragraph 22)
- Communication with Those Charged With Governance or management (paragraph 22A)
- Documentation (paragraph 23)
 - PIOB comment at CAG:
 - Expand the documentation required given the complexity and the professional judgments needed;
 - Require the auditor to document which judgements were made, how the auditor evidenced a professionally skeptical mindset, and how the auditor's assessed the factors that drive the risks

Effective Date

- Balancing speed with allowing time for implementation
- Task Force recommends normal 18–24 month implementation period
- Periods ending or periods beginning?
- Early adoption would be permitted

Matters for IAASB Consideration

5. What views does the IAASB have on the proposed effective date of ISA 540 (Revised)?

Conforming and Consequential Amendments

- Limited conforming amendments to ISA 260, ISA 580
- Proposed changes to ISA 500 were flagged in the project proposal, straw poll at December 2016 meeting
 - Amendment proposed to para 7 instead of para 9 as paragraph 9 was more specific, and to limit the changes to ISA 500
 - Broadened application material to better cover non-pricing related external information sources
 - CAG comment that this would be better focused on pricing sources alone

Matter for IAASB Consideration

6. The IAASB is asked for its views on the consequential and conforming amendments made to ISA 260 (Revised), ISA 500, and ISA 580

Explanatory Memorandum

- Appendix 1 to Agenda Item 2-A contains some initial thinking from the Task Force on matters that could be covered in the Explanatory Memorandum to the ED

Matters for IAASB Consideration

7. The IAASB is asked whether there are other matters that should be addressed in the Explanatory Memorandum

IAASB

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