

**Conforming and Consequential Amendments Arising from Draft Proposed ISA  
540 (Revised)**

**MARKED TO INCORPORATE ALL CHANGES AGREED DURING THE MARCH 2017  
IAASB DISCUSSIONS**

**ISA 260 (Revised), *Communication with Those Charged with Governance*****Matters to Be Communicated**

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*Significant Findings from the Audit*

16. The auditor shall communicate with those charged with governance: (Ref: Para. A17–A18)
- a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity; (Ref: Para. A19–A20)
  - b) Significant difficulties, if any, encountered during the audit; (Ref: Para. A21)
  - c) Unless all of those charged with governance are involved in managing the entity:
    - (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management; and (Ref: Para. A22)
    - (ii) Written representations the auditor is requesting;
  - d) Circumstances that affect the form and content of the auditor's report, if any; and (Ref: Para. A23–A25)
  - e) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process. (Ref: Para. A26–A28)

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*Significant Qualitative Aspects of Accounting Practices (Ref: Para. 16(a))*

- A19. Financial reporting frameworks ordinarily allow for the entity to make accounting estimates, and judgments about accounting policies and financial statement disclosures, for example, in relation to the use of assumptions in the development of accounting estimates. In addition, law, regulation or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective or complex judgments made by management in preparing the financial statements.
- A20. As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph A19, those charged with governance may be interested in the auditor's evaluation of

the ~~adequacy~~ reasonableness of disclosures of the estimation uncertainty and significant judgments relating to accounting estimates that are affected by, or subject to, estimation uncertainty, complexity, the need for the use of judgment by management, or other relevant factors. Open and constructive communication about significant qualitative aspects of the entity's accounting practices also may include comment on the acceptability of significant accounting practices and the quality of the disclosures. Appendix 2 identifies matters that may be included in this communication.

## **Specific Requirements in ISQC 1 and Other ISAs that Refer to Communications with Those Charged With Governance**

This appendix identifies paragraphs in ISQC 1<sup>1</sup> and other ISAs that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* – paragraph 30(a)
- ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraphs 21, 38(c)(i) and 40-42
- ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraphs 14, 19 and 22–24
- ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* – paragraph 9
- ISA 450, *Evaluation of Misstatements Identified during the Audit* – paragraphs 12-13
- ISA 505, *External Confirmations* – paragraph 9
- ISA 510, *Initial Audit Engagements—Opening Balances* – paragraph 7
- ISA 540, *Auditing Accounting Estimates and Related Disclosures* – paragraph 22A
- ISA 550, *Related Parties* – paragraph 27
- ISA 560, *Subsequent Events* – paragraphs 7(b)-(c), 10(a), 13(b), 14(a) and 17
- ISA 570 (Revised), *Going Concern* – paragraph 25
- ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* – paragraph 49
- ISA 610 (Revised), *Using the Work of Internal Auditors* – paragraph 18; ISA 610 (Revised 2013), *Using the Work of Internal Auditors* – paragraphs 20 and 31
- ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* – paragraph 46
- ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* – paragraph 17
- ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report* – paragraphs 12, 14, 23 and 30
- ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* – paragraph 12
- ISA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements* – paragraph 18
- ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – paragraph 17—19

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<sup>1</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

### **Qualitative Aspects of Accounting Practices**

The communication required by paragraph 16(a), and discussed in paragraphs A19–A20, may include such matters as:

#### **Accounting Policies**

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#### **Accounting Estimates**

- For items for which estimates are significant, issues discussed in ISA 540, including, for example:
  - How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements.
  - Changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates
  - Whether management's decisions relating to the recognition, measurement, presentation and disclosure of the accounting estimates in the financial statements are in accordance with the applicable financial reporting framework.
  - Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates and, if so, why, as well as the outcome of accounting estimates in prior periods.
  - Whether management's method for making the accounting estimates, including when management has used a model, is in accordance with the applicable financial reporting framework.
  - Whether the significant data and assumptions used by management in making the accounting estimate are reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework.
  - Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.
  - Risks of material misstatement.
  - Indicators of possible management bias.
  - How management has considered alternative assumptions or outcomes and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
  - The reasonableness of disclosure of estimation uncertainty in the financial statements.

Conforming Amendments  
IAASB Main Agenda (March 2017)  
**ISA 500, Audit Evidence,**

**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 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, including information obtained from an external information source. (Ref: Para. A26–A33J)

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)

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**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. An important consideration in determining whether an individual or organization is acting as an external information source is whether the individual or organization meets the definition of a management’s expert with respect to that information. Indicators that an external organization may be acting as an external information source rather than as a management’s expert include the following:

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

When such indicators are present, it is less likely that management will be able to influence the external information source. Whether or not management pays a fee to access information from

an external information source is not relevant in considering whether an individual or organization is acting as an external information source.

A1B. External information sources may include pricing services, governmental organizations, central banks or recognized stock exchanges. Examples of information that may be obtained from external information sources 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 information or 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, in respect of any particular set of information, be either an external information source or a management's expert but not both. Professional judgment may be needed to determine whether a specific organization is acting as an external information source or as a management's expert with respect to a particular set of information. For example:

- An external organization may be acting as an external information source with respect to data about real estate prices for a particular geographical region that it makes generally available to the public and that management uses in preparing the financial statements. The same external organization may at the same time be acting as a management's expert for the same entity in providing management with a valuation service with respect to the entity's real estate portfolio.
- Some actuarial organizations publish mortality tables for general use which, when used by an entity, may be information from an external information source, while the same actuarial organization may be a management's expert when helping management to calculate the pension liability for several of its 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 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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## Reliability

A31. The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources

external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

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#### External Information Sources

A33A. Obtaining an understanding of why management uses an external information source, and how management considered the relevance and reliability of the information for use in preparing its financial statements, helps to inform the auditor's consideration of the relevance and reliability of that information.

A33B. Depending on the circumstances, the following factors may be important considerations about the relevance and reliability of information obtained from an external information source:

- The nature and authority of the external information source used by the entity. For example, a central bank or government statistics office with a legislative mandate to provide industry information to the public is likely to be an authority for certain types of information;
- The ability of management to influence the information obtained from the external information sources;
- The competence and reputation of the external information source with respect to that particular type of information;
- Past experience of the auditor with the reliability of the information provided by the external information source;
- 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 information was developed taking into account the applicable financial

reporting framework;

- The nature and extent of disclaimers or other restrictive language relating to the information obtained; and
- Whether information is available regarding the appropriateness of techniques, assumptions and inputs applied by the external information sources in developing the information obtained.

A33C. The ~~ability of the auditor's to~~ consideration of the reliability of the information from the external information source, including its accuracy and completeness, may ~~vary significantly~~ depending on the nature of the external information source and the circumstances. In many circumstances, the auditor may not be able to consider the accuracy and completeness of the information received from an external information source as there may be no contractual relationship between the external information source and the entity that requiresing the provision of information, or the external information source may refuse to provide information seen as its considered to be intellectual property. For example, when an entity uses a central bank's inflation rate to make an accounting estimate, as part of considering the accuracy and completeness of the information, the auditor ~~is unlikely to be able to consider the bank's data and method other than what is made publicly available by the central bank~~. ~~In such circumstances, the auditor~~ may, depending on the significance of the information, consider the nature and authority of the source or, the auditor may obtain information from a different ~~external~~ information source, when available.

A33D. The availability of information to understand the methods and assumptions used by the external information source may influence the auditor's ~~ability to~~ consideration of 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.

A33E. The observability of inputs and complexity of methods used to generate the information from the external information source may also influence the auditor's ~~ability to~~ considerations related to the reliability of information from the external information source, including considerations related to the nature and extent of procedures ~~that the auditor needs~~ to perform to test the reliability of that information ~~from that source~~.

A33F. ~~Possible approaches for the auditor to~~ As part of the consideration of the relevance and reliability of information from external information sources, may include one or more of the following may be relevant:

- ~~Obtain a service auditor's report that covers the controls over the information provided and consider whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls.~~<sup>2</sup>
- Performing procedures at the external information source to understand and, where relevant, test the controls and processes, techniques, and assumption used, ~~including procedures to verify the completeness of the information after it is obtained from the external information source~~.
- Performing procedures, including when relevant, tests of the operating effectiveness of controls management has in place to assess the reliability of the information from external information sources.

<sup>2</sup>—ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

- Considering whether the information is intended to be used in the manner management is using it.
- When the information received from the external information source relates to security prices, ~~the auditor may be able to obtain~~ing an independent price from another ~~external information source or perform substantive analytical procedures.~~

A33G. For fair value measurement, additional considerations of the relevance and reliability of ~~the information obtained from external information sources used~~ may also include 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 and used represent the assumptions that market participants would use when pricing the asset or liability, if applicable. and
- (d) 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;
  - (ii) Is binding or nonbinding, with more weight placed on quotes based on binding offers; and
  - (iii) Reflects market conditions as of the date of the financial statements, when required by the applicable financial reporting framework.

A33H. In some situations, management and the auditor may use the same ~~external~~ information source, for example, because there is only one provider of certain information. When the information obtained from that ~~external~~ information source is used to make an accounting estimate, the auditor may consider whether using the same ~~external~~ information source as management is appropriate, or whether additional audit evidence is needed. In such cases, additional consideration may need to be given to whether the information ~~from the external information source~~ is accurate and complete (see also A33C for additional considerations related to the nature and authority of an external information source). ~~Additional consideration may be given whether the information from an external information source is accurate and complete. When another external information source is available, †~~This may include ~~the auditor~~ accessing a different ~~external~~ information source, when available, from that used by management to evaluate the external information source used by management.

## ISA 580, *Written Representations*

**Marked from Extant**

### Appendix 1

(Ref: Para. 2)

#### List of ISAs Containing Requirements for Written Representations

This appendix identifies paragraphs in other ISAs that require subject-matter specific written representations. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraph 39
- ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraph 16
- ISA 450, *Evaluation of Misstatements Identified during the Audit* – paragraph 14
- ISA 501, *Audit Evidence—Specific Considerations for Selected Items* – paragraph 12
- ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* – paragraph 22
- ISA 550, *Related Parties* – paragraph 26
- ISA 560, *Subsequent Events* – paragraph 9
- ISA 570 (Revised), *Going Concern* – paragraph 16(e)
- ISA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements* – paragraph 9
- ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – paragraph 13(c)

### **Illustrative Representation Letter**

The following illustrative letter includes written representations that are required by this and other ISAs in effect for audits of financial statements for periods beginning on or after December 15, 2009. It is assumed in this illustration that the applicable financial reporting framework is International Financial Reporting Standards; the requirement of ISA 570<sup>1</sup> to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor) (Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 20XX<sup>2</sup> for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or *give a true and fair view*) in accordance with International Financial Reporting Standards.

We confirm that (, *to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*):

#### *Financial Statements*

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation of the financial statements in accordance with International Financial Reporting Standards; in particular the financial statements are fairly presented (or *give a true and fair view*) in accordance therewith.
- The methods, ~~and~~ the significant data, and the significant assumptions used in making the accounting estimates and their related disclosures are appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of the applicable financial reporting framework. (ISA 540 (Revised))

Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards. (ISA 550)