

**Meeting:** IAASB Consultative Advisory Group (CAG)  
**Meeting Location:** New York, USA  
**Meeting Date:** March 6–7, 2018

## Agenda Item **B**

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

#### **Objectives of Agenda Item**

1. The objectives of this agenda item are to:
  - (a) Inform Representatives on the ISA 540 Task Force’s (the Task Force) activities since the September 2017 CAG meeting;
  - (b) Obtain Representatives’ views on the issues paper regarding the draft proposed ISA 540 (Revised); and
  - (c) Provide a report back on comments of the CAG Representatives on this project as discussed at the September 2017 CAG meeting.

#### **Project Status and Timeline**

2. The Task Force and the IAASB are working towards a June 2018 approval of the standard.
3. The Appendix to this paper provides a history of previous discussions with the CAG and IAASB on this topic, including links to the relevant CAG documentation.

#### *IAASB Interaction with the IAASB CAG with Respect to Draft ISA 540 (Revised)*

4. The substantive issues being raised for the purposes of the March 2018 IAASB meeting are included in this paper and **Agenda Items B.1–B.4**. Accordingly, this serves as the final discussion of ISA 540 (Revised) prior to its anticipated approval by the IAASB in June 2018. Representatives and Observers may wish to take this opportunity to comment on the IAASB’s interaction with the CAG during the development and finalization of ISA 540 (Revised). As noted above, the Appendix to this paper provides a project history, including links to the relevant CAG documentation.

#### **September 2017 CAG Discussion**

5. Extracts from the draft minutes of the September 2017 CAG meeting, as well as an indication of how the Task Force or IAASB has responded to the Representatives’ comments are included in the table below.

Representatives' Comments	Task Force/IAASB Response
GENERAL COMMENTS	
Mr. van der Ende noted support for the direction taken in the Exposure Draft (ED) and suggested to include the flow chart in the final standard given that it is helpful to understand the flow of the standard. Ms. McGeachy agreed.	Support noted.
Mr. Milholland questioned who is responsible for making the standard practical – the IAASB or regional institutes or firms.	As part of the development of the ISA, and informed by comments received on exposure, the IAASB is responsible for considering the practicality, understandability, and clarity of its proposals.
Mr. Fortin questioned whether the risk factors will be maintained as there does not seem to be much support for them.  Mr. Baumann agreed with Mr. Sharko.	Mr. Sharko explained that respondents generally supported the use of the risk factors in identifying and assessing the risk of material misstatement but that some respondents questioned whether the factors should be used in the response to the assessed risk of material misstatement given their interrelationships. In the risk assessment these interdependencies do not matter as much as you can assess the factors at the same time. However, in the auditor's response to the risk of material misstatement, the objectives are based on each factor separately. Mr. Sharko also explained that that the United States Public Accounting Oversight Board (PCAOB) uses similar risk factors as part of their risk assessment procedures.
FIELD TESTING	
Mr. van der Ende highlighted the importance of field testing the requirements in ED- ISA 540 given the upcoming implementation of IFRS 9. <sup>1</sup> Ms. Weng questioned how many firms and what type of firms have performed field testing procedures. She noted that such information is important to better interpret the results of the field testing. Mr. Gaylen	The Task Force's leadership will have a call with the Global Public Policy Committee on March 9 about the current draft of proposed ISA 540 (Revised). Given the time of the year (busy season) and the limited time available it was decided that input on the standard would be more useful than performing field testing.

<sup>1</sup> International Financial Reporting Standard (IFRS) 9, *Financial Instruments*

Representatives' Comments	Task Force/IAASB Response
questioned if the field testing was performed at actual audits.	
Ms. McGeachy noted that field testing was performed in Canada and that respondents did not have difficulty in determining whether the risk of material misstatement came from complexity or estimation uncertainty. She therefore questioned at what level the restructuring of ISA 540 would take place.	Mr. Sharko explained that the restructuring of ED ISA 540 has not been discussed yet by the Board or the Task Force given that Staff is analyzing the comments received. He noted that a possible way forward is to move away from the risk factors in the work effort as this will help to alleviate the complexity and interrelationship issues. Mr. Sharko noted that another way to make the standard easier to apply, is to bring out more clearly that the auditor can obtain audit evidence about events occurring up to the date of the auditor's report for all accounting estimates.
STANDARDS ISSUED BY OTHER STANDARD SETTERS	
Mr. Fortin highlighted the importance of aligning the IAASB's and the PCAOB's proposals on auditing accounting estimates. Mr. Dalkin agreed.  Mr. Baumann noted that the PCAOB is currently analyzing the comments received on their accounting estimate standard and agreed that it is important to reconcile the different approaches for the response to the assessed risk of material misstatement. Mr. Baumann also offered to work together with the IAASB.	Point accepted.  Mr. Sharko noted that 15 letters asked the IAASB and the PCAOB to work together to bridge the gap between their respective proposal and that the IAASB is open to working with the PCAOB.  By changing the work effort paragraphs, the Task Force is of the view that the current draft of proposed ISA 540 (Revised) is more closely aligned with the PCAOB's proposals than ED-540. The Task Force also aligned the inherent risk factors with what the PCAOB has.
Mr. Milholland noted that there is a gap between the auditing standards and the actuarial standards and explained that the International Actuarial Association's (IAA) comment letter provides suggestions how that gap can be bridged.	Mr. Sharko noted that the gap between the actuarial standards and the IAASB's standards seems to be a broader issue and that the IAASB should consider it going forward.  Mr. Sharko had a call with the IAA to discuss how the IAASB and IAA could work together.
OTHER COMMENTS	
Mr. Koktvedgaard questioned how the Task Force obtains views from investors as only one investor responded to the ED. Mr. Yoshi added that the	Mr. Sharko noted that the Task Force's leadership has spoken to investors as part of its outreach

Representatives' Comments	Task Force/IAASB Response
<p>Corporate Reporting Users' Forum (CRUF) is classified under 'member bodies and other professional organizations' but should be classified as an investor. Mr. Yoshi added that CRUF supported paragraph 21(a) and related application material and supported paragraph A157 which discusses the dialogue between regulators and auditors.</p>	<p>activities subsequent to the ED and that Staff will look into reclassifying CRUF.</p> <p>Subsequently, Staff has classified CRUF as an investor.</p>
<p>Mr. van der Ende asked the Task Force to include more specific guidance with respect to expected credit losses and asked the Task Force to keep the hooks that are included in ED ISA 540.</p>	<p>The Task Force noted that some responses to ED-540 thought that there were too many references to banking and insurance matters. However, the Task Force has taken the opportunity to reference expected credit loss issues in different places throughout the ISA. For example, paragraph A30 contains guidance on expected credit losses and controls relating to complexity.</p>
<p>Mr. Milholland noted that a simple model does not necessarily mean that the inherent risk is low. He explained that for some accounting estimates little information is available and that the model used is therefore simple. However, the accounting estimate may have high estimation uncertainty which should be reflected in the disclosures.</p>	<p>Point accepted. The threshold of low/not low inherent risk has been removed, however the reasons for the assessed risk of material misstatement (for example, high estimation uncertainty needing to be reflected in the disclosures) has been maintained (<b>see paragraph 15 of Agenda Item B-1</b>)</p>
<p>Mr. Hansen noted concern about the enforceability of the standard given the comments around the complexity of the standard.</p>	<p>Point accepted. The Task Force has redrafted and simplified the material in key places (such as the work effort requirements – see <b>paragraphs 15-18D of Agenda Item B-1</b>) to better align with extant ISA 540<sup>2</sup> and the PCAOB proposed standard.</p>
TIMING	
<p>Mr. van der Ende noted support for approving proposed ISA 540 (Revised) in March 2018 but questioned, in that case, when the CAG will be informed about the progress of the project. If the plan is to approve the standard in March 2018, he suggested having a call to update the CAG around the December Board meeting. Mr. Dalkin agreed</p>	<p>Subsequent to the CAG meeting, the IAASB decided to defer approval of proposed ISA 540 (Revised). Approval of a final standard is now anticipated to be in June 2018.</p>

<sup>2</sup> Extant ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Representatives' Comments	Task Force/IAASB Response
and noted that a call will be scheduled to update the CAG on this important project. Mr. Baumann questioned whether a March 2018 approval will be achievable given the extent of the comments (including the comments from field testing), and particularly given the concerns around the operability and clarity of the standard.	
Mr. Thompson suggested to align the timing of this project with the project to revise ISA 315 (Revised), <sup>3</sup> especially in case of re-exposure, given the interrelationship between the standards and the risk that changes have to be made to ISA 540 (Revised) as the result of revising ISA 315 (Revised).	Mr. Sharko explained that aligning with the timeline of the ISA 315 Task Force would result in a 1-1.5 year delay for the project to revise ISA 540. He added that the Task Force's leadership regularly meets with the ISA 315 Task Force to align the standards.
Mr. Baumann questioned whether the IAASB could avoid re-exposure given the number and the extent of the comments received. Mr. James agreed.	Mr. Sharko acknowledged there is a chance for re-exposure but that it is too early to answer that question as the Task Force is in the process of analyzing the responses to the ED. Prof. Schilder added that the Board first needs to reach agreement on the standard before the question is asked whether re-exposure is needed.
PIOB REMARKS	
Mr. Holm noted that many areas in ED ISA 540 were enhanced such as the risk assessment, communications with regulators and those charged with governance and the auditor's judgment, but that the documentation section could be further enhanced. He highlighted that it is important to document the procedures and the auditor's judgements, including whether the accounting estimate is reasonable in the financial reporting spectrum. He furthermore noted that more guidance on expected credit losses and insurance contracts is needed given that was the issue the IAASB was addressing when the project started.	Mr. Sharko explained that the Basel Committee and International Association of Insurance Supervisors suggested to have an International Auditing Practice Note on auditing expected credit losses and insurance contracts. The advantage of this approach is that it would make the application material shorter and therefore less complex.

<sup>3</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

## Matters for CAG Consideration

6. The Representatives are asked to comment on the matters raised in the Issues Paper (**Agenda Item B.1.**)

## Material Presented – IAASB CAG Papers

Agenda Item B.1	ISA 540 – Issues Paper
Agenda Item B.2	Draft ISA 540 (Revised) – Clean
Agenda Item B.3	Comparison of Current Draft ISA 540 (Revised) with ED 540 – Requirements
Agenda Item B.4	Draft Proposed Conforming and Consequential Amendment – Clean

## Material Presented – IAASB CAG REFERENCE Papers

Draft ISA 540 (Revised) – Marked from December 2017 IAASB Meeting;	<a href="http://www.iaasb.org/system/files/meetings/files/20180312-IAASB_Agenda_Item_2-B-ISA-540-Revised-Marked-Final.pdf">www.iaasb.org/system/files/meetings/files/20180312-IAASB_Agenda_Item_2-B-ISA-540-Revised-Marked-Final.pdf</a>
Draft Conforming and Consequential Amendments – Marked from January 2018 IAASB Teleconference	<a href="http://www.iaasb.org/system/files/meetings/files/20180312-IAASB_Agenda_Item_2-E-Conforming_and_Consequential_Amendments-Marked-final_0.pdf">www.iaasb.org/system/files/meetings/files/20180312-IAASB_Agenda_Item_2-E-Conforming_and_Consequential_Amendments-Marked-final_0.pdf</a>
Appendix 4 of Draft ISA 540 (Revised)	<a href="http://www.iaasb.org/system/files/meetings/files/20180312-IAASB_Agenda_Item_2-D-Appendix_4-Final_0.pdf">www.iaasb.org/system/files/meetings/files/20180312-IAASB_Agenda_Item_2-D-Appendix_4-Final_0.pdf</a>

## Appendix

### 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
Discussion on audit issues relevant to ISA 540	March 2016 September 2016	March 2016 June 2016 July 2016 September 2016 December 2016
Exposure Draft	March 2017	March 2017
Discussion of Feedback from Exposure Draft and Development of Final ISAs	September 2017	September 2017 October 2017 December 2017 January 2018

##### **CAG Discussions: Detailed References**

Preliminary Discussions	<p><u>September 2015</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item D).  <a href="http://www.iaasb.org/cag/meetings/new-york-usa-0">www.iaasb.org/cag/meetings/new-york-usa-0</a></p>
Project Proposal	<p><u>December 2015</u></p>

ISA 540 – Cover and Report Back  
IAASB CAG Public Session (March 2018)

	See IAASB CAG meeting material and CAG meeting minutes (Agenda Item A). <a href="http://www.iaasb.org/cag/meetings/iaasb-cag-conference-call-december-2-2015">www.iaasb.org/cag/meetings/iaasb-cag-conference-call-december-2-2015</a>
Issues	<u>March 2016</u> See IAASB CAG meeting material and CAG meeting minutes (Agenda Item I) <a href="http://www.iaasb.org/cag/meetings/paris-france">www.iaasb.org/cag/meetings/paris-france</a> <u>September 2016</u> See IAASB CAG meeting material (Agenda Item E). <a href="http://www.iaasb.org/cag/meetings/new-york-usa">www.iaasb.org/cag/meetings/new-york-usa</a>
Exposure Draft	<u>March 2017</u> See IAASB CAG meeting material (Agenda Item D). <a href="http://www.iaasb.org/cag/meetings/iaasb-cag-meeting">www.iaasb.org/cag/meetings/iaasb-cag-meeting</a>
Discussion of Feedback from Exposure Draft and Development of Final ISAs	<u>September 2017</u> See IAASB CAG meeting material (Agenda Item B) <a href="http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain">http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</a>