



# ISA 540 (Revised)

**Rich Sharko, IAASB Member and Chair of the ISA 540 Task Force**

**Marek Grabowski, IAASB Member and Co-Chair of the ISA 540 Task Force**

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## Consultative Advisory Group – Themes from Discussion

- Many noted that it was more understandable and readable than ED-540
  - Importance of linkages to other ISAs, Appendix 1 seen as useful, flowchart supported
- Support for the treatment of professional skepticism
  - Paragraph 15 could be interpreted as requiring a search for contradictory evidence
- Some support for requirements of ISA 540
  - Terminology aligns with that used by valuation experts
  - Importance of documentation and the co-ordination with IFIAR
  - Challenges: length of sentences affects translation, whether para 10 is incremental to ISA 315, volume of accounting guidance in Appendix
- Scalability – spectrum of IR should be in the requirements, mixed views on Appendix 4 (examples)
- Mixed views on need for re-exposure

## Outreach - GPPC

- Significant improvement from ED with respect to readability and clarity
- Concerns raised around:
  - Consistency between paragraph 10 and ISA 315 (Revised)
  - More guidance needed on assessing control risk
  - Significant data – term is not well understood
  - Management's expert – more guidance needed on what auditor should do
  - Management bias – focus on bias that results in a material misstatement (not all bias)
  - Documentation – limited support for paragraph 27(b) and (c)
  - Inclusion of Appendix 4 in the standard – more time needed to develop examples
  - Effective date – implementation period too short
- Questioned whether re-exposure is needed given the changes

## Outreach - SMPC

- Scalability
  - Supported including example(s) in the standard
    - Supported additional example (AR)
    - Examples in middle of risk spectrum would be useful (not at extreme ends of spectrum)
  - Introductory wording in paragraph 10 – too cryptic
- Clarity and understandability improved significantly
  - Concerns around
    - Paragraph 15, last sentence: seek audit evidence from relevant sources, regardless of whether evaluated as corroborative or contradictory
    - Paragraph 18A(a), regarding scope of work effort when auditor's point estimate or range is developed using own methods, assumptions or data

## Approach to IAASB Discussion

- Summary of significant changes to ISA 540 requirements and application material
- Walk through of ISA 540
  - Agenda Item 2-B (marked) for requirements and Agenda Item 2-C (clean) for application material
  - Matter for IAASB Consideration #3 in connection with discussion of paragraph 15
  - Matters for IAASB Consideration #1 and 4 after requirements and application material have been discussed
  - Appendices 1 and 2 (Matter for IAASB Consideration #5)
- Walk through of other proposed conforming and consequential amendments, including ISA 500

## Approach to IAASB Discussion (cont'd)

- Proposed Appendix 4
  - Matter for IAASB Consideration #2
- Other Matters
  - Effective date
  - Any other matters to be discussed (Matter for IAASB Consideration #6)



# Summary of Significant Changes to ISA 540 (Revised)



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## Introduction, Objective and Definitions

- Introduction

- Further aligned with work of ISA 315 Task Force
- Updated based on December 2017 Board discussion
- Reallocation of application material from paragraph 10

- Objective

- No longer refers to accounting estimates “including those required to be recognized or disclosed in the financial statements” (addressed in paragraph A4)
- Streamlined

- Definitions

- Minor changes to definitions of accounting estimate and estimation uncertainty

## Risk Assessment and Related Activities

- Paragraph 10

- Changed lead-in wording to emphasize scalability (“to the degree relevant in the circumstances”)
  - Emphasis is on “degree” as many or most of the matters are relevant for all types of estimates and smaller entities, unless the matter does not apply in the circumstances (e.g., regulatory factors)
  - Additional emphasis on scalability in the application material (see paragraphs A8A-A10)
- Improved and simplified the structure by rewording or combining some subparagraphs
- Added a requirement (paragraph 10(ia)) for the auditor to obtain an understanding of the controls relating to management's process for making accounting estimates
  - Added due to the importance of understanding relevant control activities in assessing risks of material misstatement and designing appropriate responses

## Identifying and Assessing the RoMM

- Made it explicit in the requirement in paragraph 13 for the auditor to assess inherent and control risk separately for accounting estimates
  - In previous discussions, the Board was supportive of explicitly requiring separate assessments in ISA 540 (Revised), consistent with the changes proposed to ISA 315 (Revised)
- Changes to application material
  - Recasted the wording of several paragraphs (A75B, A79, A82, A83) to focus on matters that may be important for the auditor to consider in assessing RoMM
  - Improved the structure and flow by merging paragraphs

## Responses to the Assessed RoMM

- Paragraph 15
  - Revised the last sentence of paragraph 15 and added application material (paragraph A92E) in response to the Board discussion in December 2017 (to be discussed during walkthrough of ISA 540)
  - Added paragraph A94 to emphasize that responses are scalable based on the assessed RoMM and the reasons for the assessed risks
- Control testing (paragraph 16)
  - Included paragraph A97B (based on IAPN 1000) to describe factors that the auditor may take into account in determining the nature, timing and extent of testing of controls

## Responses to the Assessed RoMM (cont'd)

- Paragraph 17F
  - Changed the order of the sub-requirements (first evaluate whether a deficiency exists)
  - When management has considered alternative assumptions, performed a sensitivity analysis, or provided additional disclosures, reference is made back to paragraph 17E
- Paragraphs 18-18C (auditor's point estimate or range)
  - 18A(a) - when the auditor's point estimate or range is developed using the auditor's own methods, assumptions or data, the auditor obtains evidence about the matters in paragraphs 17B-D, as applicable
  - 18C – added requirement, consistent with paragraph 17E(b), for the auditor to evaluate management's point estimate and disclosures (i.e., required regardless of testing approach)

## Other Requirements

- Stand-back: added introductory wording that links paragraph 23 to paragraph 22 to help clarify that the requirement applies to each accounting estimate
- Included Appendix 3 on matters to communicate with TCWG
- Paragraph 27 expanded to include more specific documentation requirements about significant professional judgments for accounting estimates (responds to comments):
  - Key elements of understanding of the entity and its environment (based on ISA 315, 32(b))
  - The reasons given to the separate assessments of inherent risk and control risk
  - For accounting estimates subject to a greater degree of estimation uncertainty, or affected to a greater degree by subjectivity, complexity, or other inherent risk factors, the auditor's rationale for selecting one or more of the approaches to testing the accounting estimate
  - The auditor's response when management has not appropriately understood and addressed estimation uncertainty

## Application Material and Appendices

- The Task Force analyzed and reviewed the application material, with a view to streamlining and restructuring it to:
  - Delete or re-purpose material considered to be educational in style or repetitive
  - Reorganize paragraphs to better align with the restructured requirements
  - Make it more concise and understandable
  - Add guidance, including examples, to address specific comments received
- Appendix 1 updated to provide clarifications and strengthen the integration with Appendix 2; several paragraphs included from application material
- Appendix 2 updated to provide clarifications and address comments received on ED-540, e.g., explained the interrelationship among the inherent risk factors

## Scalability

- In addition to the scalability points mentioned on slides 9 and 11, the Task Force continues to further consider ways to demonstrate scalability
  - Developed an example (proposed Appendix 4) to illustrate the scalability in the requirements in paragraphs 10 through 18D for a straightforward cash bonus accrual and a more complex share-based bonus arrangement
- The Task Force continues to coordinate with the ISA 315 Task with respect to the spectrum of risk concepts and other alignment as appropriate
- Task Force welcomes views on scalability at any time, but proposed Appendix 4 will be covered separately later in the discussion

# Walk Through of ISA 540 (Revised) Requirements and Application Material

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## Spectrum of Risk Concepts

The IAASB is asked for its views on:

- Whether the Board agrees that the spectrum of risk exists for both inherent risk and the risk of material misstatement.
- The description of the spectrum of risk concepts in paragraphs A1I-A1O of **Agenda Item 2C**, and whether such descriptions will be useful in ranking risks (whether inherent risks or RoMM) in terms of significance.
- Whether all, or a subset, of the final agreed wording should be included in ISA 540 (Revised).

## Professional Skepticism

- Task Force continues to discuss ways to emphasize the importance of the effective exercise of professional skepticism in the evaluation of management's judgments relating to accounting estimates
- Revised the last sentence of paragraph 15 and added application material (paragraph A92E) in response to the Board discussion in December 2017
- A92E emphasizes that auditor is not expected to conduct an exhaustive search for evidence from all relevant sources, but is intended to drive an approach that is not biased in favor of seeking corroborative evidence
- New proposed conforming amendment to paragraph A7 of ISA 230 (see pages 3-4 of Agenda Item 2-E) and related application material paragraph A158B in Agenda Item 2-C

## Matter for IAASB Consideration

3. The IAASB is asked for its views on:
  - The revised wording in paragraph 15 and related application material paragraph A92E.
  - The proposed conforming amendment to paragraph A7 of ISA 230 (**see Agenda Item 2-E**) and the related application material paragraph A158B in ISA 540 (Revised).

## Matters for IAASB Consideration

The IAASB is asked for its views on:

1. The way that scalability is introduced and demonstrated in the requirements and application material.
4. Whether the restructured and redrafted application material is clear and understandable, and appropriately supports the application of the related requirements.

# ISA 540 (Revised) Appendices 1 and 2

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## Matter for IAASB Consideration

5. The IAASB is asked for its views on whether the changes to the appendices are helpful, and whether the cross-references between the appendices and the requirements and application material help to support integration of the appendices and the standard.



# Proposed Conforming and Consequential Amendments



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## Other Matters – Conforming and Consequential Amendments

- ISA 200, paragraph A42: “Ordinarily, therefore” removed and sentences reordered to enhance flow and clarity
- ISA 230, paragraph A7: Emphasizes the importance of documenting the exercise of professional skepticism when accounting estimates are subject to a greater degree of estimation uncertainty, or other inherent risk factors
- ISA 260, paragraph A20: Redrafted to more closely mirror the language and intent of the requirement (paragraph 16)
- ISA 500:
  - Definition:
    - Split into two sentences and restructured to aid clarity, but consequently lengthened
    - Management’s expert’s use of an EIS addressed through paragraph A48
    - Application material streamlined, redrafted and terminology aligned

## Other Matters – Conforming and Consequential Amendments

- ISA 500 (cont.):
  - Paragraph 7: No change to requirement. Task Force continues to acknowledge overlap with definition of audit evidence but supports emphasis on external information sources (as previously supported by the Board)
  - Paragraph A33F:
    - Introductory language clarified - procedures may be “deemed appropriate in the circumstances” (rather than “relevant”) to indicate they are “possible” procedures, not required
    - Procedures reordered – performing procedures at the EIS moved to last to de-emphasize i.e., not first/preferred approach
  - Paragraph A33H: Elevated to follow A33F to improve linkage of paragraphs
  - Paragraph A48: Addition to address management’s expert’s use of an EIS

# Proposed Appendix 4

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## Matter for IAASB Consideration

2. The IAASB is asked for its views on the detailed example of scalability in proposed Appendix 4 (see **Agenda Item 2-D**).

# Other Matters

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## Other Matters – Effective Date

- The Task Force is proposing that the effective date of final ISA 540 (Revised) be for audits of financial statements for periods ending on or after December 15, 2019
  - Early adoption permitted
  - Same as communicated in the ED

## Next Steps

- Outreach
  - Regulators
  - Practitioners
- Plan for final approval in June 2018

## Matters for IAASB Consideration

6. The Board is asked for its views on whether there are any other matters relating to proposed ISA 540 (Revised) that need to be discussed before the standard is finalized as expected in June 2018.



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