

### Discussion of Significant Changes to Requirements and Application Material

This paper is intended to provide background information on the significant changes made by the ISA 540 Task Force (the Task Force), and the rationale for those changes, to the requirements and application material of proposed ISA 540 (Revised)<sup>1</sup> and the conforming and consequential amendments. The significant changes addressed are based on the drafts presented at the March 2018 IAASB Meeting, except changes to the selected paragraphs of proposed ISA 540 (Revised) presented to the Board for the April 24 teleconference, which are based on drafts presented for that call.

Reference	Significant Changes and the Rationale for Those Changes
<b>Key Concepts of This ISA</b>	
<b>Paragraph 2</b>	<ul style="list-style-type: none"> <li>- This paragraph has been revised in response to comments on the April 24, 2018 Board teleconference about the need for clarity and understandability (in particular, the reference to “other variations”), and to better explain the linkage between the inherent risk factors and the measurement of monetary amounts.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Former paragraphs A1a and A1b, which provided guidance on valuation attributes, have been deleted because there is no reference to that concept in paragraph 2. The Task Force believes that other references to valuation attributes in the draft standard and in Appendix 1 are understandable in the context in which such references are used. The Task Force also notes that very few comments were received on references to valuation attributes other than in former paragraphs A1a and A1b.</li> </ul>
<b>Paragraph 3</b>	<ul style="list-style-type: none"> <li>- Based on input from the ISA 315 Task Force, the wording has been revised to simplify the reference to the spectrum of inherent risk, and to delete the reference to the level of risk on a scale that varies from “lower to higher.”</li> </ul>

<sup>1</sup> Proposed ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

Reference	Significant Changes and the Rationale for Those Changes
<b>Paragraphs 4 and 5</b>	<ul style="list-style-type: none"> <li>- Paragraph 4 has been revised to focus only on the relevant requirements of ISA 315 (Revised)<sup>2</sup> and ISA 330<sup>3</sup> referred to in draft ISA 540 (Revised), and the auditor’s decisions about controls relating to accounting estimates. Paragraph 5 has been added in response to comments on the April 24, 2018 Board teleconference (including from the ISA 315 Task Force) that the wording in former paragraph A1R of the application material was better positioned in the Key Concepts section in the context of the separate assessment of control risk.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- As noted above, the wording in former paragraph A1R has been relocated to paragraph 5. Paragraph A9 (formerly A1S) has been revised to provide more explanation about the auditor’s considerations in assessing control risk at the assertion level.</li> </ul>
<b>Paragraph 7</b>	<ul style="list-style-type: none"> <li>- The wording has been revised based on the suggestion from the ISA 315 Task Force to align with the changes to ISA 315 (Revised). The same change has been made in other places in the draft of ISA 540 (Revised) where this wording is used.</li> </ul>
<b>Effective Date</b>	
<b>Paragraph 9</b>	<ul style="list-style-type: none"> <li>- See section 3 of <b>Agenda Item 2</b>.</li> </ul>
<b>Definitions</b>	
<b>Paragraph 11</b>	<ul style="list-style-type: none"> <li>- Minor change to the definition of accounting estimate and related application material to improve clarity.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Paragraph A13 – the reference to significant data was deleted to be consistent with the rest of ISA 540 (Revised).</li> </ul>
<b>Risk Assessment and Related Activities</b>	

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>3</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*

Reference	Significant Changes and the Rationale for Those Changes
<p><b>Paragraph 12</b></p>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The lead-in has been amended to drive scalability, shifting the emphasis from varying the extent of the understanding to varying the extent of the risk assessment procedures to obtain the understanding.</li> <li>- Subparagraph 12(g) now makes clear that the inherent risk factors are relevant to the auditor, but that the entity's risk assessment process may assist the auditor in understanding the effects of those risk factors.</li> <li>- Subparagraph 12(h) has been amended to improve clarity based on suggestions made at the April 2018 teleconference. This has resulted in changes to the lead-in and subparagraph 12(h)(ii), including the addition of “related disclosures” in (ii) to complete the path for disclosures through paragraph 12 (as it was previously only included in (i)). Subparagraph 12(h)(i) has been better aligned with paragraph 18(d) of ISA 315 (Revised).</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Paragraph A18 was amended to add back the material on the types of risk assessment procedures that may be useful when the effect of inherent risk factors is to a lesser degree, in accordance with comments at the April 2018 teleconference.</li> <li>- Paragraph A21 was relocated and enhanced to better explain the changes in circumstances that may give rise to the need for, or changes in, accounting estimates.</li> <li>- The reference to significant data in paragraph A41 was removed.</li> <li>- The heading above Paragraph A44 was changed to mirror language used in paragraph 25. Using the same language on how management takes steps to understand and address estimation uncertainty helps auditors draw the link between obtaining an understanding of how management understands estimation uncertainty, and the requirement in paragraph 25 for the auditor's further audit procedures to address whether management has taken appropriate steps to understand and address the estimation uncertainty.</li> <li>- The last bullet in A49 was redrafted to clarify the explanation about the variance in the effectiveness of different types of controls.</li> <li>- Paragraph A50 was amended to make clear that complexity may lead to the need for the application of specialized skills or knowledge.</li> </ul>

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<b>Paragraph 13</b>	<p data-bbox="527 337 764 367"><i>Application Material</i></p> <ul data-bbox="527 391 1898 532" style="list-style-type: none"> <li>- Paragraph A59 was amended to explain how a difference that arises from information that was available to management when the previous period's financial statements were finalized, or that could reasonably be expected to have been obtained and taken into account in the context of the applicable financial reporting framework, may call into question management's process.</li> </ul>
<b>Paragraph 14</b>	<p data-bbox="527 573 684 602"><i>Requirement</i></p> <ul data-bbox="527 626 1898 695" style="list-style-type: none"> <li>- Amended to clarify that the requirement relates to the auditor making a determination about whether the engagement team requires specialized skills or knowledge, not management.</li> </ul>
<b>Identifying and Assessing the Risks of Material Misstatement</b>	
<b>Paragraph 15</b>	<p data-bbox="527 800 764 829"><i>Application Material</i></p> <ul data-bbox="527 854 1898 1393" style="list-style-type: none"> <li>- Former paragraph A74A was deleted as revised paragraph 4 covers the point.</li> <li>- Paragraph A70 was added and explains how the auditor can assess control risk as well as the relationship between control risk and control reliance. The Task Force was of the view that this is useful guidance given that the rest of the application material related to paragraph 15 relates to inherent risk.</li> <li>- Former paragraph A75A was integrated into paragraph A9 (application material related to paragraph 4).</li> <li>- In the offline comments received, several Board members indicated that paragraphs A74, A75 and A76 were unclear as some of the matters included in these paragraphs appeared to relate to control risk while the paragraphs describe inherent risks. In response, the Task Force made several changes to clarify that these matters relate to inherent risk factors. The Task Force also streamlined the wording and incorporated the suggestions received from Board members.</li> <li>- Former paragraphs A85 and A92A were merged into paragraph A77 as both paragraphs discussed how the degree of estimation uncertainty associated with an accounting estimate influences the susceptibility of the accounting estimate to misstatement due to management bias. The Task Force further streamlined the</li> </ul>

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	application material and enhanced the example.
<p><b>Paragraph 16</b></p>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Two paragraphs were added based on offline suggestions from Board members:                             <ul style="list-style-type: none"> <li>• Paragraph A78 was added to clarify the link between the inherent risk factors and the determination of whether any of the risks of material misstatement are a significant risk.</li> <li>• Paragraph A79 was added to explain the reference to ‘obtain an understanding of the entity’s controls’ (as included in paragraph 16).</li> </ul> </li> </ul>
<p><b>Responses to the Assessed Risk of Material Misstatement</b></p>	
<p><b>Paragraph 17</b></p>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force shortened the wording of the bullets to clarify the descriptions of the testing approaches. This change also addressed the inconsistencies between the bullets that the Board noted in the April 24, 2018 Board teleconference, e.g. bullets (b) and (c) included references to disclosures but bullet (a) not. Conforming changes have been made throughout the standard.</li> <li>- Based on the comments made during the April 24, 2018 Board teleconference, the Task Force made changes to the last sentence of paragraph 17 and added new application material to explain the Task Force’s intention.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Based on concerns raised in the March 2018 Board meeting and April 24, 2018 Board teleconference, the Task Force explained in paragraph A82 that the last sentence of paragraph 17 is not meant to be an exhaustive search to identify all possible source of audit evidence.</li> </ul>
<p><b>Paragraph 18</b></p>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force made changes to align the requirement with ISA 330.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Former paragraph A97A was deleted as several Board members indicated in their offline comments that the</li> </ul>

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	<p>paragraph did not provide robust reasons for testing controls and that paragraph A88 includes such guidance already.</p> <ul style="list-style-type: none"> <li>- Paragraph A85 was added to signal the importance of testing the design, implementation and effectiveness of controls when the inherent risk is assessed as higher on the spectrum of inherent risk. The Task Force was of the view that such guidance would be welcomed by regulators who have been urging the IAASB to emphasize the importance of testing controls even when it is not required by the ISAs. The paragraph also explains that when the accounting estimate is affected by a high degree of subjectivity there are inherent limitations in testing the effectiveness of controls.</li> <li>- The Task Force made several changes to paragraph A88 to respond to comments made during the March 2018 Board meeting and offline comments received. Among other matters, the Task Force: <ul style="list-style-type: none"> <li>• Clarified its intention with respect to the first bullet in paragraph A88. Some Board members were of the view that the old guidance would have unintended consequences for small and medium sized practitioners.</li> <li>• Combined the bullet on the volume of transactions with the bullet on the electronic initiation, recording, processing and reporting of information, as these are closely linked with each other (i.e., a high volume of transactions often drives the need to use information technology).</li> </ul> </li> </ul>
<b>Paragraph 19</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force made changes to align the requirement with ISA 330 and to streamline it.</li> </ul>
<b><i>Determining Whether Events Occurring up to the Date of the Auditor's Report Provide Audit Evidence Regarding the Accounting Estimate</i></b>	
<b>Paragraph 20</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force aligned the first sentence of the requirement with the bullets of paragraph 17.</li> <li>- In the lead in sentence, the Task Force changed 'shall evaluate' to 'shall consider' as the evaluation of the accounting estimate is part of the stand-back in paragraph 32. The responses to the assessed risks of material misstatements (Paragraph 17-29) are about obtaining audit evidence, while the evaluations of the accounting</li> </ul>

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	<p>estimates and the determinations are part of the overall evaluation (paragraph 32-34).</p> <ul style="list-style-type: none"> <li>- The Task Force also changed ‘supports’ to ‘corroborates’ in the first bullet to be aligned with paragraph 17.</li> </ul>
<b><i>Testing How Management Made the Accounting Estimate</i></b>	
<b>Paragraph 21</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force aligned the introductory wording of the requirement to be consistent with paragraph 17 (i.e., to obtain sufficient appropriate audit evidence to address the risks of material misstatement).</li> <li>- When the auditor is testing how management made the accounting estimate, paragraph 21 is the umbrella requirement for the requirements in paragraphs 22-26. Because the introductory wording to paragraph 21 now references the requirement to obtain sufficient appropriate audit evidence to address the risks of material misstatement, the lead-in wording for paragraphs 22-26 has been simplified to indicate that the auditor’s further audit procedures shall address the matters in these paragraphs.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Former paragraph A100H was relocated to the application material related to paragraph 32(b) (paragraph A136) as the Task Force was of the view that it is applicable to all testing approaches and it relates to the auditor evaluating (instead of obtaining audit evidence) whether the recognition criteria of the applicable financial reporting framework have been met for accounting estimates that not have been recognized.</li> <li>- Paragraph A97 was added to enhance professional skepticism when: <ul style="list-style-type: none"> <li>• A change from prior periods in selecting a method, assumption or data is not based on new circumstances or new information;</li> <li>• Significant assumptions are inconsistent with each other and with those used in other accounting estimates, or with related assumptions used in other areas of the entity’s business activities.</li> </ul> </li> <li>- The Task Force clarified the example in paragraph A98 and moved it to the end of the paragraph.</li> </ul>
<b>Paragraph 22</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force changed the introductory sentence to be aligned with the structure of paragraph 21.</li> </ul>

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	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Paragraph A99 was moved here – formerly was paragraph A1B.</li> </ul>
<b>Paragraph 23</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force changed the introductory sentence to be aligned with the structure of paragraph 21.</li> <li>- In the updated version of ISA 540 (Revised), as presented to the Board in the March 2018 meeting, the Task Force added to paragraph 23(c) ‘to the extent such assumptions are known to the auditor’. Upon reflection, the Task Force was of the view that it is better to align the requirement with ISA 720 (Revised)<sup>4</sup> paragraph 14(b), which refers to ‘the auditor’s knowledge obtained’.</li> <li>- The Task Force deleted the second part of former paragraph 17C(d) as the application material sufficiently addresses the point.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Based on comments received in the March 2018 Board meeting, the Task Force added paragraph A105 to explain what is meant by ‘related assumptions used in other areas of the entity’s business activities’ in paragraph 23(c). The first sentence is based on paragraph A32 of ISA 720 (Revised). The Task Force also linked the application material to paragraph 8 of ISA 315 (Revised), which requires the engagement partner to consider whether information obtained is relevant to identify risks of material misstatement.</li> </ul>
<b>Paragraph 24</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force changed the introductory sentence to be aligned with the structure of paragraph 21.</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Paragraph A108 was added (based on suggestions received offline) and refers to ISA 500<sup>5</sup> for auditors to further understand what is meant by ‘relevant and reliable’ in paragraph 24(c).</li> </ul>

<sup>4</sup> ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information*

<sup>5</sup> ISA 500, *Audit Evidence*

Reference	Significant Changes and the Rationale for Those Changes
Paragraph 25	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Paragraph A114 was clarified as there were some concerns that this paragraph would go beyond what is required by the applicable financial reporting framework.</li> </ul>
<b><i>Developing an Auditor's Point Estimate or Range Based on Available Audit Evidence to Evaluate Management's Point Estimate and Related Disclosures About Estimation Uncertainty</i></b>	
Paragraphs 27-28	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- Based on comments during the April 24, 2018 Board teleconference and written comments received following the call, the Task Force has revised paragraph 27 into a single paragraph to clarify that the intent of the requirement is for the auditor to include further audit procedures to evaluate whether the methods, assumptions and data used in making the accounting estimates are appropriate in the context of the applicable financial accounting framework. In doing this, regardless of whether the auditor uses management's or the auditor's own methods, assumptions or data, these further audit procedures shall be designed and performed to address the matters in paragraphs 22-24. Paragraph 28(b) has been revised to be consistent with the wording in paragraphs 17 and 21 as described above (i.e., design and perform further audit procedures to obtain sufficient appropriate audit evidence to address the risks of material misstatement).</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- The Task Force revised paragraphs A118-A123 to improve the clarity of several of the bullet points in response to written comments from various Board members.</li> <li>- Paragraph A125 has been revised to clarify that a range that is multiples of materiality for the financial statements as a whole is more likely to arise in circumstances when the estimation uncertainty associated with the accounting estimate is itself multiples of materiality, which is more common in certain business sectors.</li> </ul>
<b><i>Other Considerations Relating to Audit Evidence</i></b>	
Paragraph 29	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- By including the reference to paragraphs 20-28, the Task Force clarified that this paragraph is applicable</li> </ul>

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	<p>regardless of the testing approach selected.</p> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Former paragraph A134A was deleted as the Task Force was of the view that the content of this paragraph is sufficiently covered by the changes to paragraph 29.</li> <li>- Former paragraphs A134D and A134E were merged into paragraph A128 as they both discuss the availability of information at an external information source. The Task Force further streamlined the paragraph and deleted some sentences given the overlap with guidance included in ISA 500.</li> <li>- Paragraph A129 was added to clarify the point made in paragraph A3 that assumptions, data and methods that were made or identified by a management's expert become management's assumptions when used by management.</li> </ul>
<b>Disclosures</b>	
<b>Paragraph 30</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- The Task Force changed the introductory sentence to be aligned with the structure of paragraph 21.</li> <li>- In the March 2018 IAASB meeting, the Board asked the Task Force to clarify how paragraphs 25 and 30 work together. In the updated draft of ISA 540 (Revised) at the March IAASB meeting, the Task Force added 'other than disclosures relating to estimation uncertainty' in paragraph 30. Generally, the Board didn't support this addition so the Task Force deleted it and instead added application material (paragraph A130) to explain the interactions between the paragraphs (and paragraph 34).</li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Former paragraphs A138 and A138A were moved to the application material related to paragraph 34 and are now paragraphs A142 and A143.</li> </ul>
<b>Management Bias</b>	
<b>Paragraph 31</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- The Task Force was of the view that one of the areas where professional skepticism is important is the evaluation</li> </ul>

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	of whether there are indicators of possible management bias. Therefore, the Task Force introduced language in paragraph A133 that is intended to enhance the exercise of professional skepticism.
<b>Overall Evaluation Based on Audit Procedures Performed</b>	
<b>Paragraph 32</b>	<p data-bbox="527 448 764 475"><i>Application Material</i></p> <ul data-bbox="527 500 1896 732" style="list-style-type: none"> <li>- In paragraph A135, the Task Force noted that there was opportunity to use the phrase “call into question” to draw the auditor’s attention to the need for professional skepticism when the auditor discovers, for example, that the accounting estimate is more complex than originally contemplated. This paragraph now also has been aligned with the references to the spectrum of inherent risk.</li> <li>- Former paragraphs A100H and A146 were relocated to become A136 and A137 as the Task Force believed that the messages in these paragraphs were better linked to the auditor’s overall evaluation.</li> </ul>
<b>Paragraph 34</b>	<p data-bbox="527 773 684 800"><i>Requirement</i></p> <ul data-bbox="527 824 1896 963" style="list-style-type: none"> <li>- The Task Force has sought to clarify the scope of paragraph 34 by referring to “each class of transactions, account balance, or disclosure that includes an accounting estimate.” The Task Force believes that this change, and the related application material, will help auditors understand that the determination is done at the assertion level, and that it does not need to be applied to every accounting estimate individually.</li> </ul> <p data-bbox="527 987 764 1015"><i>Application Material</i></p> <ul data-bbox="527 1039 1896 1398" style="list-style-type: none"> <li>- Paragraph A138 was added to make the point (discussed above) that the determination in paragraph 34 is done at the assertion level and that, accordingly, only those accounting estimates that give rise to one or more risks of material misstatement are within the scope of paragraph 34.</li> <li>- The guidance in paragraph A139 has been revised to better align the language within the paragraph referring to wide ranges. The Task Force has also sought to enhance the exercise of professional skepticism by noting that the auditor may need to challenge whether sufficient appropriate audit evidence has been obtained regarding the reasonableness of the amounts within the range when the range is wide.</li> <li>- Paragraphs A142–A143 (formerly A138–A138A) were relocated from being application material to paragraph 30 as they pertain to the paragraph 34(a) and (b).</li> </ul>

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<b>Documentation</b>	
<b>Paragraph 37</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>- Based on the comments made during the April 24, 2018 Board teleconference, the Task Force made the following changes to paragraph 37: <ul style="list-style-type: none"> <li>• The Board generally did not support having four sub-bullets under the bullet referencing ‘significant professional judgements made’. Accordingly, the Task Force simplified the construct of the requirement by specifying what needs to be included in the audit documentation for accounting estimates, in addition to what is already required by ISA 230.<sup>6</sup></li> <li>• The Task Force clarified the documentation requirement in paragraph 37(b) by aligning it more closely to paragraph 28(b) of ISA 330. The Task Force also added paragraphs A149 and A150 to provide further guidance about the documentation depending on the auditor’s decision to rely or not rely on relevant controls.</li> </ul> </li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Paragraph A152 was revised based on offline suggestions received. Among other changes, the Task Force aligned it to paragraph A7 of ISA 230 and made changes to enhance the construct.</li> </ul>
<b>Conforming and Consequential Amendments</b>	
<b>ISA 500, Audit Evidence</b>	
<b>Paragraphs 5(cA) and A1Ca</b>	<p><i>Definition of External Information Source and related Application Material</i></p> <ul style="list-style-type: none"> <li>- Minor editorial change to improve clarity and align terminology.</li> </ul>
<b>Paragraphs A33AA – A33Ga</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>- Paragraph A33A: Inclusion of reference to management’s expert’s potential use of an external information</li> </ul>

<sup>6</sup> ISA 230, Audit Documentation

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	<p>source in response to comments that a reference in A48 was too late and insufficiently prominent as the sole reference to the need to consider such a circumstance.</p> <ul style="list-style-type: none"> <li>- A33B: Redrafting of the lead-in to explain more clearly the applicability of the bullets. Minor editorials to certain bullets to improve clarity.</li> <li>- Paragraph A33F: Reordering of sentences to improve readability; inclusion of reference to ISA 315 (Revised) to reflect that the bullets are not solely about responding to risk and also include obtaining an understanding of the design and implementation of controls; addition of language referring to responding to risks of material misstatement to better acknowledge that ISA 330 and 540 address further audit procedures to respond to the identified risks and to emphasize that the procedures set out in the bullets are incremental to considering relevance and reliability; and redrafting the final bullet addressing performing procedures at the external information source</li> <li>- Paragraph A33H: Reordering of the two examples to address the more common example first and also to improve the flow into paragraph A33Ga.</li> <li>- Paragraph A33Ga: Minor editorials to improve clarity.</li> </ul>