

ISA 315 (Revised)¹—Proposed Conforming and Consequential Amendments to ISA 540 (Revised)²

Objective of the IAASB Discussion

To approve the proposed conforming and consequential amendments to ISA 540 (Revised) and ISA 200, paragraph A42, set out in **Agenda Item 1-A**, arising from the proposed revisions to ISA 315 (Revised), for public exposure.

Introduction

1. As agreed by the IAASB on the May 22, 2018 IAASB teleconference, proposed conforming and consequential changes to ISA 540 (Revised) would be presented for approval after the June 2018 Board meeting once ISA 540 (Revised) had been finalized.
2. This paper sets out the ISA 315 Task Force's views about the proposed conforming and consequential changes that will be needed to ISA 540 (Revised) as set out in **Agenda Item 1-A** on the basis of the proposed revisions to ISA 315 (Revised) approved by the IAASB in June 2018.
3. **Agenda Item 1-B** sets out the Exposure Draft of ISA 315 (Revised) (ED-315), with no mark-ups and renumbered. References in ISA 540 (Revised) in Agenda Item 1-A have been changed to correspond to this version of ISA 315 (Revised).

Background

4. Because the auditor's risk assessment procedures, and the identification and assessment of the risks of material misstatement, in relation to accounting estimates, are an extension of those required by ISA 315 (Revised), it has been recognized that close coordination was needed between the ISA 315 Task Force and the ISA 540 Task Force.
5. The ISA 315 Task Force has continued to coordinate with the ISA 540 Task Force as changes to ISA 540 (Revised) have been progressed and finalized. In particular, at the June 2018 Board meeting where the final ISA 540 (Revised) and the ED-315 (Revised) were approved, the Task Forces worked closely to identify and make changes that could be made prior to finalization of the standards, thereby reducing as much as possible the number of conforming changes that would be needed to ISA 540 (Revised) as a result of ED-315.
6. The following sets out a brief explanation of the conforming and consequential changes that have been proposed to ISA 540 (Revised), as set out in **Agenda Item 1-A** (the full text of the revised ISA 540 has been provided in Agenda Item 1-A). The nature of these changes is the same as the conforming and consequential changes that were proposed, and approved, at the June 2018 Board meeting, to the other ISAs arising from the proposed revisions to ISA 315 (Revised).

¹ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

² ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

Proposed Conforming and Consequential Changes to ISA 540 (Revised)

7. Changes have been proposed, as relevant, to update ISA 540 (Revised) for revisions in ED-315:
- To the name of the standard (i.e., the name of ISA 315 has been revised to “Identifying and Assessing Risks of Material Misstatement”).
 - For references made to specific aspects in ISA 315 (Revised), which now includes elevated focus on the applicable financial reporting framework and the system of internal control. For example, where it was referenced that an understanding was needed for the entity and its environment, including the entity’s internal control, this has been changed to an understanding of the ‘entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control.’
 - To the names of the components of the entity’s system of internal control. Where the term ‘internal control’ is used in reference to ISA 315 (Revised), this has been changed to the ‘entity’s system of internal control’ (which is consistent with the approach taken in relation to conforming amendments in the other ISAs).
 - To change paragraph numbers where the paragraphs are referenced in ISA 540 (Revised).
 - For consistency of terms used, for example, ‘control activities’ is only used in ED-315 to refer to that specific component of the system of internal control. In ISA 540 (Revised), where the terms have been used in a different context to how the term has been used in ED-315, changes have been made as appropriate, such as the change from ‘control activities’ to ‘controls.’
 - To remove the specific requirement for a separate assessment of inherent and control risk as this will be required by the revised requirements in ED-315, and add a reference to the requirement in ED-315. Conforming changes to paragraph A42 of ISA 200³ have also been proposed.
8. Significant changes have made in ED-315 to enhance the requirements and application material in relation to the auditor’s considerations relating to information technology (IT). Consistent with the approach to making conforming and consequential changes to ISA 330⁴ in relation to the new IT material, enhancements are have also been made in ISA 540 (Revised) to be more specific about matters relating to IT (such as being more specific that it is the IT applications and IT environment that are relevant – see paragraphs A44, A52 and A101 of ISA 540 (Revised)).

Revising Extant Requirements and Application Material for New Concepts Introduced in ED-315

9. Although ISA 540 (Revised) introduced new requirements and application material related to inherent risk factors, the inherent risk factors explained in ISA 540 (Revised) are specific to accounting estimates. ED-315 introduces the concept of inherent risk factors more broadly, which will then allow ISA 540 (Revised) to explain the inherent risk factors in the context of accounting estimates. Accordingly, changes have been made to reflect that ISA 315 (Revised) introduces the concept, and ISA 540 (Revised) explains how to apply these in the context of accounting estimates.
10. ISA 540 (Revised) also introduced the concept of the ‘spectrum of inherent risk.’ However, ED-315 has further explained this concept, in particular how to determine ‘significant risks’ in relation to the spectrum

³ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

⁴ ISA 330, *The Auditor’s Responses to Assessed Risks*

of inherent risk (i.e., those inherent risks that are *close to the upper end of the spectrum of inherent risk*). In considering conforming changes for this in ISA 540 (Revised), which in various places references the ‘higher end of the spectrum of risk,’ but is not referring to significant risks, the ISA 315 Task Force agreed that no further changes be proposed so as to not confuse those risks that were assessed as ‘higher’ risk with those risks that should be determined to be significant risks. However, where the term ‘lower’ has been used in ISA 540 (Revised), the ISA 315 Task Force agreed that this should be changed to ‘close to the lower end’ of the spectrum of risk to be consistent with how the risk assessments are being described in ED-315.

11. ED-315 has introduced new concepts for ‘significant’ classes of transactions, account balances and disclosures, and their ‘relevant’ assertions (defined in paragraphs 4(h) and 4(j) of ED-315). As appropriate, changes have been proposed where these concepts would be applicable, for example when referring to ‘assertions’ where there is a reasonable possibility of a material misstatement, these have been changed to ‘relevant’ assertions.

Clarifications Relating to Controls, and Controls Relevant to the Audit

12. The ISA 315 Task Force spent significant time making revisions in relation to the auditor’s understanding of the system of internal control, including the consistency of the use of terms to describe the same concepts and matters, as well as explaining which controls are relevant to the audit, and what was required in relation to controls relevant to the audit. ED-315 has also clarified when the evaluation of the design of controls, and the determination as to whether the controls have been implemented, is needed, and how control risk is assessed (i.e., control is assessed at the maximum level if the auditor does not intend to rely on the operating effectiveness of controls).
13. As many of the concepts and matters relating to the auditor’s understanding of the entity’s system of internal control, and assessment of control risk, is explained in the context of accounting estimates in ISA 540 (Revised), it has been necessary to make similar clarifications as conforming changes to ISA 540 (Revised).

Way Forward

14. Once approved, a short Explanatory Memorandum explaining the nature of the proposed revisions (in the same way that the Conforming and Consequential Amendments to the other ISAs have been explained in the Explanatory Memorandum to ED-315 have been presented), together with the final approved proposed changes to ISA 540 (Revised), will be developed. Being mindful that ED-315 will already have been published, and to reduce the timing of release of these final changes relating to ED-315, it is proposed that this Explanatory Memorandum, and exposure draft, are finalized with the ISA 315 Task Force, the IAASB’s leadership and the leadership of the ISA 540 Task Force.

Matters for IAASB Consideration

1. The Board is asked for its views on the proposed changes to ISA 540 (Revised) and ISA 200, paragraph A42, as set out in **Agenda Item 1-A**, and to approve these proposed changes for public exposure as a supplement to the Exposure Draft of ISA 315 (Revised).
2. The Board is asked whether it agrees with the approach to finalizing and publishing the explanatory memorandum and exposure of the proposed changes to ISA 540 (Revised) as set out in paragraph 14.