



Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: New York, United States of America
Meeting Date: September 11–12, 2018

Agenda Item K

ISA 540 (Revised) – Report Back

Objective of Agenda Item

1. The objective of this agenda item is to provide a report back on comments of the CAG Representatives on this project as discussed at the March 2018 meeting.

Project Status – What Have We Done Since We Last Met?

2. Since the March 2018 IAASB CAG meeting, the IAASB approved ISA 540 (Revised) and conforming and consequential amendments to other International Standards at its June 2018 meeting. The revised ISA will be effective for audits of financial reporting periods beginning on or after December 15, 2019. Early adoption is permitted and encouraged. To facilitate early adoption, the IAASB has published the text of ISA 540 (Revised) pending Public Interest Oversight Board’s confirmation that due process was followed. Subject to receiving the PIOB’s confirmation, the final standard is anticipated in October 2018.
3. **Agenda Item K.1** includes the version of the standard that was submitted to the PIOB.
4. The **Appendix** to this paper provides a history of previous discussions with the IAASB CAG and IAASB on this topic, including links to the relevant IAASB CAG documentation.

Feedback - What Did We Hear Last Time We Met?

5. Extracts from the draft minutes of the March 2018 IAASB 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
READABILITY AND UNDERSTANDABILITY	
Messrs. Dalkin, van der Ende, Baumann, Martinez, Ruthman, Milholland and Mmes. Perera, McGeachy noted that the readability and understandability of the current draft of proposed	Support noted. Language structure has been reviewed and improved where possible.

Representatives' Comments	Task Force/IAASB Response
<p>ISA 540 (Revised)¹ was improved from previous drafts. Mr. N. James added that the standard, as presented, seems to be improved but that more time is needed to fully understand the changes made to the standard. Mr. Yurdakul agreed that the readability of the standard improved but noted that there are still many long sentences which will be difficult to translate.</p>	
SCALABILITY	
<p>Ms. Borgerth was of the view that proposed ISA 540 (Revised) is sufficiently scalable. Mr. Thompson noted that the notion of the spectrum of risk should be included in the requirements, including the response to the assessed risk of material misstatement, as it should be clear for auditors what is required for accounting estimates that are on the lower end of the spectrum of inherent risk. She added that it would be challenging for auditors to document where an accounting estimate sits on the spectrum of inherent risk.</p>	<p>Point noted.</p> <p>The spectrum of risk concept is now explained in the Introduction section and related application material. See paragraph 4 of ISA 540 (Revised) in Agenda Item K.1.</p> <p>The application material related to the risk assessment and the response to the assessed risk of material misstatement, explains how the standard is scalable. See paragraph A20–A22, A63, A67 and A84 of ISA 540 (Revised) in Agenda Item K.1.</p> <p>To further emphasize the scalability of the standard, paragraph 3 of ISA 540 (Revised) (see Agenda Item K.1) highlights that the nature, timing and extent of the risk assessment and further audit procedures required will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement.</p>
<p>Mr. Thompson noted that the work effort requirements in paragraphs 15–18C may be difficult to apply for simple accounting estimates.</p>	<p>Point noted.</p> <p>Paragraph 3 of ISA 540 (Revised) (see Agenda Item K.1) explains how accounting estimates vary, and that the nature, timing and extent of the risk assessment and further audit procedures required by ISA 540 (Revised) will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement. This is supplemented with application material in paragraph A7 that highlights the guidance in ISA</p>

¹ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

Representatives' Comments	Task Force/IAASB Response
	540 (Revised) on how the requirements can be scaled.
<p>M. McGeachy and Mr. Thompson supported having examples illustrating scalability. Ms. McGeachy noted that the examples could be better placed outside the standard, while Mr. Thompson noted that an example of how the standard can be applied for a simple accounting estimate could be included in the application material of paragraph 17. Mr. van der Ende and Ms. Elliott did not support the development of examples that illustrate scalability. Ms. Elliott was of the view that they were not necessary and Mr. van der Ende noted that the ISA 540 Task Force has limited time available and should focus on the ISA itself. Ms. Ovuka noted that it will be hard to write some of the examples and that the ISA 540 Task Force will need to get the right expertise.</p>	<p>Point noted.</p> <p>In its March 2018 meeting, the Board agreed not to include examples illustrating scalability in ISA 540 (Revised). It was agreed that the examples would be further considered in connection with the development of non-authoritative implementation guidance following the approval of the revised standard.</p> <p>Subsequently, the Steering Committee supported the formation of an ISA 540 (Revised) Implementation Working Group to support awareness, understanding and effective implementation of ISA 540 (Revised). This working group will consider developing examples illustrating scalability.</p>
WORK EFFORT	
<p>Messrs. van der Ende and Baumann noted that some stakeholders are of the view that proposed ISA 540 (Revised) should have an explicit requirement that goes beyond the current requirements in ISA 330 about testing the design, implementation, and operating effectiveness of controls. Mr. Thompson questioned whether some paragraphs of ISA 330 could be included in proposed ISA 540 (Revised).</p>	<p>Point noted.</p> <p>The IAASB agreed that it was important to align ISA 540 (Revised) with ISA 330 but was not appropriate/necessary to go beyond those requirements, and that ISA 540 (Revised) should highlight relevant requirements of ISA 330. Accordingly, to emphasize when testing the design, implementation, and operation effectiveness of controls is required and to highlight the importance testing the design, implementation, and operation effectiveness of controls when auditing accounting estimates, ISA 540 (Revised) includes two requirements (paragraph 19 and 20, see Agenda Item K.1) that emphasize the requirements of ISA 330.</p>
<p>Messrs. Iinuma, van der Ende and Rees supported the development of a flow chart that shows the structure of proposed ISA 540 (Revised). Mr. van der Ende added that the flow chart should show the linkages between proposed ISA 540 (Revised) and</p>	<p>Point noted.</p> <p>The Steering Committee supported the formation of an ISA 540 (Revised) Implementation Working Group to support awareness, understanding and effective implementation of ISA 540 (Revised). This working group will consider developing flowcharts.</p>

Representatives' Comments	Task Force/IAASB Response
other standards such as ISA 315 (Revised) and ISA 330.	
With respect to the risk assessment in paragraph 10, Messrs. Dalkin and Koktvedgaard noted that the ISA 540 Task Force should clarify whether the requirement is in addition to the requirements in ISA 315 (Revised), or is intended to replace the requirements of ISA 315 (Revised). Mr. Koktvedgaard also questioned if the risk assessment procedures that are in proposed ISA 540 (Revised) could be included in ISA 315 (Revised).	Point noted. Messrs. Sharko and Grabowski responded by noting that paragraph 10 of ISA 540 (Revised) (see Agenda Item K.1) explains how to apply ISA 315 (Revised) to accounting estimates and is, therefore, additional to ISA 315 (Revised).
Mr. Baumann noted that many accounting estimates are made by management's experts. As paragraph 18D links with paragraph 8 of ISA 500, ² he questioned whether proposed ISA 540 (Revised) would apply to such circumstances.	Point noted. Mr. Grabowski noted that the application material highlighted (see paragraph A130 of ISA 540 (Revised) in Agenda Item K.1) that if management uses an assumption made by a management's expert, it becomes management's assumption and is therefore within the scope of proposed ISA 540 (Revised). The IAASB agreed to include in paragraph 30 of ISA 540 (Revised) essential application material that highlights that the requirements in paragraphs 21–29 of this ISA may assist the auditor in evaluating the appropriateness of the expert's work as audit evidence for a relevant assertion in accordance with ISA 500, and that, in evaluating the work of the management's expert, the nature, timing and extent of the further audit procedures are affected by the auditor's evaluation of the expert's competence, capabilities and objectivity, the auditor's understanding of the nature of the work performed by the expert, and the auditor's familiarity with the expert's field of expertise (see Agenda Item K.1).
Mr. Iinuma supported the inclusion of Appendix 1, which explains the range of different types of	Point noted.

² ISA 500, *Audit Evidence*

Representatives' Comments	Task Force/IAASB Response
<p>measurement bases that may be relevant in making an accounting estimate and how the measurement basis is applied in making an accounting estimate and related disclosures.</p>	<p>In its March 2018 meeting, the Board agreed not to include Appendix 1 in ISA 540 (Revised) to reduce its length. It was agreed that the appendix 1 would be further considered in connection with the development of non-authoritative implementation guidance following the approval of the revised standard.</p> <p>Subsequently, the Steering Committee supported the formation of an ISA 540 (Revised) Implementation Working Group to support awareness, understanding and effective implementation of ISA 540 (Revised). This working group will consider developing examples illustrating scalability.</p>
PROFESSIONAL SKEPTICISM	
<p>Mr. van der Ende supported the ISA 540 Task Force's proposals. Ms. McGeachy supported the use of "challenge" when appropriate in the circumstances, but that it should be used judiciously.</p>	<p>Support noted.</p> <p>Mr. Grabowski agreed, noting that there is a spectrum of professional skepticism with tough questioning at the highest end.</p>
<p>Mr. Baumann noted that paragraph 15 could be read as requiring the auditor to seek contradictory evidence. He noted that this did not seem to be the ISA 540 Task Force's intention, but the wording needed to be clearer. Mr. Dalkin suggested that "consider" may better reflect the ISA 540 Task Force's intention rather than "seek." Mr. Rockwell suggested that the term "relevant" should be used in relation to the audit evidence as well as the sources of audit evidence as this would assist in clarifying the ISA 540 Task Force's intent. Mmes. Elliot and Singh agreed with Mr. Rockwell.</p>	<p>Point noted.</p> <p>Mr. Grabowski noted that the ISA 540 Task Force is not intending that the auditor be required to seek contradictory evidence as it is possible that none may exist. He added that the purpose of the requirement is for the auditor to not disregard contradictory evidence that is obtained. Mr. Grabowski explained that paragraph 15 is concerned with obtaining audit evidence and that the standard needed a trigger for the auditor to exercise greater professional skepticism.</p> <p>In finalizing ISA 540 (Revised), the Task Force made further changes to clarify the intent of paragraph 15 of ISA 540 (Revised) and included application material that highlights that the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence (see Agenda Item K.1).</p>

Representatives' Comments	Task Force/IAASB Response
OTHER COMMENTS ON PROPOSED ISA 540 (REVISED)	
Messrs. Bini and Yoshii supported the terminology used in the requirements as it was the same as that used by valuation experts, and that the alignment of terminology would aid co-operation between auditors and valuation experts. Mr. Yoshii noted the importance of the requirements on disclosures.	Support noted Prof. Schilder noted that collaboration with other international organizations is important and highlighted that he had spoken with Mr. Milholland about working closer together with the actuarial profession.
Mr. van der Ende noted that documentation was a key issue for proposed ISA 540 (Revised) as some professional skepticism matters are supported by documentation requirements. He noted that he intended to speak to International Forum of Independent Audit Regulators (IFIAR) to better understand their perspectives in this regard.	Point noted.
Mr. van der Ende questioned whether the material in paragraph A1O about the spectrum of inherent risk was understandable. He highlighted that the position of a point estimate within a range of possible values and how to measure a misstatement were both critical issues for the Basel Committee. He added that, while some further improvements could be made, the Basel Committee is satisfied with the standard as presented and believes it is important to approve the ISA in June 2018 as planned. He also explained that the Basel Committee is meeting with the Global Public Policy Committee (GPPC) ³ in April 2018.	Support noted. Mr. Grabowski noted that Appendix 1 of proposed ISA 540 (Revised) gave background on where a point estimate may be in the range of possible values as it was primarily an accounting matter. Subsequently, the Task Force deleted paragraph A1O and made various changes to enhance the explanation of the spectrum of inherent risk further. See paragraph 4, A68–A70 of ISA 540 (Revised) in Agenda Item K.1 .
Mr. Rees noted that he was surprised that there was so much accounting guidance in Appendix 1 and asked if many comments were received on it. He added that a lengthy appendix on accounting matters may be difficult to keep up to date as accounting requirements change.	Point noted. Mr. Grabowski highlighted that there was a relatively small number of comments on Appendix 1 supported it. He noted that the ISA 540 Task Force had been careful to articulate the relevant principles, but that the principles needed some explanation. In its March 2018 meeting, the Board agreed not to include Appendix 1 in ISA 540 (Revised). It was

³ The GPPC consist of the following accounting networks: BDO, Deloitte, EY Grant Thornton, KPMG and PWC.

Representatives' Comments	Task Force/IAASB Response
	<p>agreed that the appendix 1 would be further considered in connection with the development of non-authoritative implementation guidance, following the approval of the revised standard, which will make it easier to keep the guidance up to date.</p>
<p>COMMENTS ON THE IAASB'S CONSIDERATION OF RE-EXPOSURE OF ISA 540</p>	
<p>Mr. van der Ende noted the importance of finalizing the ISA in June 2018 and explained that he did not believe that the ISA required re-exposure based on the current changes, but that any further changes would need to be carefully examined in light of the potential risk of re-exposure. Mr. Yoshii also highlighted that re-exposure would be difficult given the importance of having ISA 540 (Revised) available for application to IFRS 9.⁴</p>	<p>Point noted.</p> <p>In June 2018 the Board approved ISA 540 (Revised) and conforming and consequential amendments to other International Standards and voted against re-exposure.</p> <p>For the Board's June 2018 meeting the Task Force prepared an analysis on whether re-exposure was needed in its view and expressed its view that it was not.⁵</p>
<p>Mr. Dalkin and Mr. van der Ende noted that Agenda Item B.3 showed that most of the requirements had not changed significantly compared to the version of ISA 540 that was exposed (ED-540), but that they had been extensively restructured to improve the readability and clarity of the ISA. Mr. Koktvedgaard noted that the key question for the IAASB should be whether the final ISA 540 (Revised) contains matters that could not be anticipated from the exposure draft (ED). He noted that a way of finalizing the standard would be to carefully consider whether the benefits from changes proposed are so important that it would be worth the delay caused by re-exposing ISA 540 (Revised). Mr. Baumann noted that the key question should be whether there are changes that have not been subject to auditor or regulator comment.</p>	<p>Point noted.</p> <p>Prof. Schilder noted that the IAASB must first approve the final text of the ISA, then decide on re-exposure. Mr. B. James noted that the IAASB issues several education documents with a final ISA, including a Basis for Conclusions and an "At a Glance" document, and those documents help auditors, regulators, and others understand both the ISA and the IAASB's rationale for changes made since ED-540.</p>
<p>Mr. N. James asked how the board objectively evaluates whether the changes amount to more than a reorganization of material from ED-540. He</p>	<p>Point noted.</p> <p>Mr. Sharko and Prof. Schilder noted that the IAASB would have an open discussion on the issue and</p>

⁴ International Financial Reporting Standard (IFRS) 9, *Financial Instruments*

⁵ http://www.iaasb.org/system/files/meetings/files/20180616-IAASB_Agenda_Item_2-F-Examination_of_Changes-final.pdf

Representatives' Comments	Task Force/IAASB Response
<p>noted that there was considerable pressure on the IAASB to not re-expose and that this may affect the IAASB's deliberations.</p>	<p>would likely bring a broad spectrum of views to the discussion. Mr. Grabowski added that the IAASB's decision to delay ISA 540 (Revised) by a quarter showed that the ISA 540 Task Force would not submit the ISA for approval until the ISA 540 Task Force believed that the ISA was ready to be approved. Mr. Waldron noted that he would consider the implications of other recent IAASB deliberations on re-exposure, and take an independent approach to considering his guidance to the IAASB on whether or not it should be re-exposed. Mr. Dalkin noted that he would evaluate the significance of any changes made in the coming months and would ask the IAASB CAG to meet with the ISA 540 Task Force by teleconference if there were substantial changes. Subsequently the Task Force prepared an analysis on whether re-exposure was needed in its view and concluded that it was not. This conclusion was subsequently agreed by the IAASB.⁶</p>
<p>Ms. Elliott noted that the IAASB may need to consider re-exposing to support the public's perception of a high-quality process and end-product. Ms. Singh agreed, noting that, while the CFA Institute supports the current draft of ISA 540 (Revised), the IAASB may need to re-expose the ISA to maintain the public's confidence.</p>	<p>Point noted. Mr. Dalkin and Prof. Schilder noted that certain regulators had encouraged the IAASB to improve the speed of standard-setting. Prof. Schilder added that it was important for the IAASB to carefully weigh the public interest and to explain the rationale for its decision on re-exposure.</p>
<p>Mr. Ruthman asked about the co-ordination of the projects on ISA 315 (Revised) and ISA 540 (Revised) given the time that will pass before ISA 315 (Revised) is released.</p>	<p>Point noted. Mr. Sharko noted that ISA 540 (Revised) must be operable with both the extant and revised ISA 315 (Revised), and that the ED for ISA 315 (Revised) will propose conforming amendments to ISA 540.</p>
<p>Mr. van der Ende noted that the IAASB needs to support the implementation of the ISA.</p>	<p>Point accepted. The IAASB formed an ISA 540 (Revised) Implementation Working Group to support awareness, understanding and effective implementation of ISA 540 (Revised).</p>

⁶ http://www.iaasb.org/system/files/meetings/files/20180616-IAASB_Agenda_Item_2-F-Examination_of_Changes-final.pdf

Representatives' Comments	Task Force/IAASB Response
PIOB REMARKS	
Ms. Pettersson supported having examples illustrating scalability and noted that the PIOB communicated the key public interest issues related to this project to the ISA 540 Task Force.	<p>Point noted.</p> <p>In its March 2018 meeting, the Board agreed not to include example illustrating scalability in ISA 540 (Revised). It was agreed that the examples would be further considered in connection with the development of non-authoritative implementation guidance following the approval of the revised standard.</p> <p>Subsequently, the Steering Committee supported the formation of an ISA 540 (Revised) Implementation Working Group to support awareness, understanding and effective implementation of ISA 540 (Revised). This working group will consider developing examples illustrating scalability.</p>
She also noted that the PIOB will look at the IAASB's evidence on its re-exposure decision.	<p>Point noted.</p> <p>For the Board's June 2018 meeting the Task Force prepared an analysis on whether re-exposure was needed in its view.⁷</p>
She also noted that the communication between the auditors of prudentially regulated institutions and the regulators was a matter of public interest and that she encouraged regular communication in this regard.	<p>Point accepted.</p> <p>The Task Force added to the standard that, in certain circumstances, the auditor is required by law or regulation to communicate about certain matters with other relevant parties, such as regulators and prudential supervisors (see paragraph 38 of ISA 540 (Revised) in Agenda Item K.1)).</p>

⁷ http://www.iaasb.org/system/files/meetings/files/20180616-IAASB_Agenda_Item_2-F-Examination_of_Changes-final.pdf

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
Development of Final ISA	March 2018	January 2018 March 2018 April 2018
Approval of Final ISA		June 2018

CAG Discussions: Detailed References

<p>Preliminary Discussions</p>	<p><u>September 2015</u> See IAASB CAG meeting material and CAG meeting minutes (Agenda Item D). www.iaasb.org/cag/meetings/new-york-usa-0</p>
<p>Project Proposal</p>	<p><u>December 2015</u> See IAASB CAG meeting material and CAG meeting minutes (Agenda Item A). www.iaasb.org/cag/meetings/iaasb-cag-conference-call-december-2-2015</p>
<p>Issues</p>	<p><u>March 2016</u> See IAASB CAG meeting material and CAG meeting minutes (Agenda Item I) www.iaasb.org/cag/meetings/paris-france</p> <p><u>September 2016</u> See IAASB CAG meeting material (Agenda Item E). www.iaasb.org/cag/meetings/new-york-usa</p>
<p>Exposure Draft</p>	<p><u>March 2017</u> See IAASB CAG meeting material (Agenda Item D). www.iaasb.org/cag/meetings/iaasb-cag-meeting</p>
<p>Discussion of Feedback from Exposure Draft and Development of Final ISAs</p>	<p><u>September 2017</u> See IAASB CAG meeting material (Agenda Item B) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</p>
<p>Development of Final ISA</p>	<p><u>March 2018</u> See IAASB CAG meeting material (Agenda Item B) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny</p>