

ISA 540

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IAASB Meeting
June 2016
Agenda Item 5

Overview

- Objectives of IAASB Discussion
- Outreach and Interactions with other IAASB Working Groups
- Introduction and Scope
- Definitions
- Risk Assessment
- Response to Identified Risks of Material Misstatement
- Way Forward

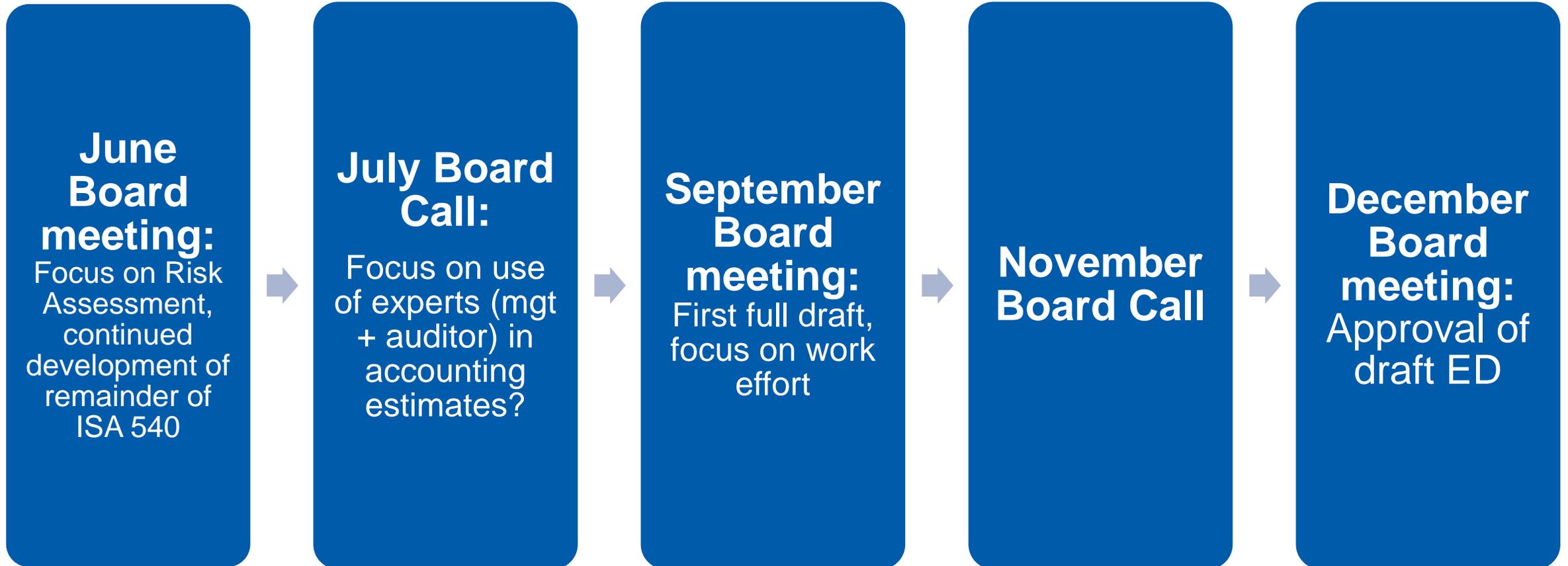
Objective of IAASB Discussion

The objective is to receive input on the ISA 540 Task Force's proposed responses to selected issues and related proposed amendments to ISA 540.

Outreach and Interactions with other IAASB Working Groups

- Outreach since March 2016 Board meeting
 - Non-financial institutions
 - Financial institutions
- Interactions with IAASB Working Groups
 - Professional Skepticism
 - ISA 315 (Revised)

Anticipated Project Timeline for 2016



Matters for IAASB Consideration

1. Members are asked to provide an overview of their reactions to the papers presented, and to highlight areas that they particularly wish to discuss

Introduction and Scope

- Application of ISA 540 for simple estimates
 - New paragraph in introduction section
- Incorporation of the concept of complexity
- Application of the ISA to individual accounting estimates or to the accounting estimates as a whole
 - “accounting estimate” vs. “accounting estimates”
 - “an accounting estimate” vs. “the accounting estimate”

Matters for IAASB Consideration

2. The IAASB is asked for its views on draft paragraph 4A.
3. The IAASB is asked for its views on whether certain requirements should be addressed to individual accounting estimates rather than accounting estimates more generally.

Definitions

- Definitions currently included in ISA 540
 - Accounting estimate
 - Auditor's point estimate or auditor's range
 - Estimation uncertainty
 - Management bias
 - Management's point estimate
 - Outcome of an accounting estimate

Definitions

- New definitions
 - Assumptions
 - Data
 - Method
 - Model
 - Complex model

4. The IAASB is asked for its views on the new and amended definitions and the discussion thereon.

Risk Assessment

- Sensitivity of accounting estimates to particular data and assumptions
- Risk assessment procedures
 - Governance
 - Language similar to ISA 315 (Revised) used
 - New requirements (8(d) and 8(f)) and related application material to highlight importance of control, review, oversight over the processes to make an accounting estimate
 - Models and data
 - New requirement to obtain an understanding of the data on which an accounting estimate is based
 - New application material on models and data

Risk Assessment

- Other changes to the risk assessment procedures
 - Alignment of introduction paragraph 8 with ISA 315 (Revised)
 - Include requirement to independently assess the sources that drive the accounting estimate's complexity and estimation uncertainty
 - Include concept of the sensitivity of accounting estimate to particular data and assumptions

5. The IAASB is asked for its views on the changes made to paragraph 8 and the related application material and specifically whether:
- The changes related to paragraph 8(d), (e) and (f) are sufficiently granular to address the issues identified by the Task Force with respect to the control environment over making accounting estimates;
 - The changes related to models and data are sufficiently granular to address the issues identified by the Task Force; and
 - There are other areas where further requirements or guidance would be useful.

- Retrospective Review

- Discussion about the purpose and utility of this requirement (and overlap with ISA 240 requirement)
- No significant changes to requirement at this stage
- Application material added:
 - Retrospective review over assumptions to which the accounting estimate is particularly sensitive
 - Retrospective review over several financial reporting periods, the current period or a shorter period, such as half-yearly or quarterly
 - For accounting estimates with a high estimation uncertainty, the difference between prior year's accounting estimate and the outcome may be significant

6. The IAASB is asked for its views on the changes made to paragraph 9 and the related application material.

Risk Assessment

- Identification and Assessment of the Risks of Material Misstatement
 - More granularity included in the requirement
 - TF brainstormed and identified the following factors that auditor, at a minimum, should consider
 - Subjective judgment (including assumptions)
 - High estimation uncertainty
 - Data that is unobservable, from outside the general and subsidiary ledgers, or difficult to obtain or complex
 - The complexity in making the accounting estimate (modelling, large volumes of data)
 - Complex legal or contractual terms
 - The sensitivity to changes in data or assumptions.

- Identification of significant risk
 - Task Force discussed merging paragraph 10 and 11
 - Pros: Most, if not all, factors used to identify significant risks are the same as to identify RoMM, in line with practice, less duplication in AM
 - Cons: navigation through risk assessment for accounting estimates harder and not in line ISA 315 (Revised)

7. The IAASB is asked for its views on paragraph 10 and related application material and specifically whether:

- Paragraph 10 and 11 should be combined or kept separated (as per extant ISA 540);
- There are any factors missing or whether any factors included should be deleted.

8. The IAASB is asked whether it agrees with the Task Force's approach of applying the concept of the sensitivity of the accounting estimates to factual or judgmental misstatements in using data and assumptions. This approach is demonstrated in requirements relating to the risk assessment (paragraph 8(c)(vi)) and the identification of and assessment of the risk of material misstatement (paragraph 10(f)).

Response to Identified Risks of Material Misstatement

- Preliminary thinking on the work effort requirements and application material
- IAASB's input will enable the Task Force to better progress its work in this area
- Events occurring after the date of the financial statements
 - Possible “short cut” if estimation uncertainty resolved before the date of the auditor's report
 - No further procedures necessary

9. The IAASB is asked for its views on the discussion on the treatment of events occurring after the date of the financial statements.

Response to Identified Risks of Material Misstatement

- A Principles-Based Work Effort Requirement
 - Auditors designs detailed procedures to respond to specific circumstances, in accordance with ISA 330
 - If needed, more procedures are required to obtain sufficient and appropriate audit evidence

10. The IAASB is asked for its views on the utility of an overarching principles-based work effort requirement

Response to Identified Risks of Material Misstatement

- Detailed Procedures Linked to the Risk Assessment
 - Aligning the required work effort with the identified and assessed risk
 - Helpful to ensure that appropriate procedures are performed in response to identified RoMM
 - Task Force needs to explore this approach further
- Task Force Discussions on Extant ISA Work Effort Requirements for “Normal” Risks
 - Work effort on models/complex models, third party data sources
 - Making sure that ISA 540 supports an appropriate work effort based on the risk of the accounting estimate (i.e. not a one-size-fits-all approach)

Response to Identified Risks of Material Misstatement

- Task Force Discussion on Extant ISA Work Effort Requirements Regarding Significant Risks
 - What additional procedures should be required for significant risks
 - Extant ISA 540 has enhanced procedures regarding:
 - Possible alternative assumptions
 - The reasonableness of the assumptions selected by management
 - Response when management has not adequately addressed the effect of estimation uncertainty
 - Obtaining evidence regarding management’s decisions to recognize/not recognize accounting estimates
 - » This may be suitable to apply to all estimates

Matters for IAASB Consideration

11. The IAASB is asked for its views on the Task Force's proposals related to strengthening the work effort
12. The IAASB is asked for its views on approaches or procedures that the Task Force could investigate relating to accounting estimates that give rise to significant risks.

Response to Identified Risks of Material Misstatement

- Standback requirement
 - Consider whether sufficient and appropriate audit evidence has been obtained
 - Particularly relevant for accounting estimates with high estimation uncertainty and complexity

Matters for IAASB Consideration

13. The IAASB is asked for its views on the possible standback requirement described in paragraph 72 of the issues paper.
14. Members are asked to share their views on whether there are matters not covered in the issues paper that should be considered for inclusion in the work effort requirements.

Update from ISA 540 Task Force meeting: Professional Skepticism

- Task Force discussed Agenda Item 2-A recommendations related to ISA 540
- Support for many of the recommendations
 - Some recommendations dealt with already but many where PS paper provides good food for thought
 - Places where contradicts/inconsistent or challenge/question could be used
 - Key question is how will the auditor be able to evidence/document the different actions
 - Discussion amongst engagement team members – more to think about but concerns that it is more suited to larger audits and is difficult to scale
 - Think about whether the same objective can be accomplished by different means

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