



# ISA 540 (Revised): Update

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IAASB December Board Meeting

December 11, 2017

**IAASB**

**International Auditing  
and Assurance  
Standards Board**

## Overview

- Update on Timing
- Task Force activities since October 2017 Board meeting
- Key issues
  - Scalability
  - Use of the term “reasonable”
  - Professional skepticism
  - Application material
- Changes to proposed ISA 540 (Revised)
- Conforming and consequential amendments
- Next steps

## Update on Timing

- The Task Force is of the view that the most likely approval date is June 2018 given the
  - Need for outreach
  - Extent and number of comments
  - Complexity of the standard and underlying concepts

## Task Force Activities since October 2017 Board meeting

- Outreach
  - IOSCO Committee 1
  - Basel Committee – Auditing Sub Group
  - International Valuation Standards Council
  - PCAOB Staff
  - CFA Institute
- Informal update call with the IAASB CAG

## Scalability

- In October 2017, the Board concluded that the TF should continue exploring the removal of the threshold and how to reinforce the existing concept of a spectrum of inherent risk
- The Task Force proposes a number of ways to reinforce scalability
  - Recognize the spectrum of risk, building on concepts in ISA 200, ISA 315(Revised) and ISA 330
    - Ongoing coordination with ISA 315 Task Force needed
    - Further examples and application material needed to explain concept
  - Use wording that indicates conditionality
  - Provide application material, including examples, to illustrate scalability of requirements
  - Provide a more comprehensive example of scalability in an appendix
  - Retain that the auditor's further audit procedures take into account that the higher the assessed RoMM the more persuasive the audit evidence needs to be (paragraph 15)
  - Retain requirement that the auditor's further audit procedures shall be responsive to the reasons for the assessment of the RoMM at the assertion level (paragraph 15)

## Scalability – Matters for IAASB Consideration

The IAASB is asked for its views on:

1. The use of the spectrum of risk to demonstrate scalability, and in particular the wording in paragraphs 3A and A71–A71B in **Agenda Item 2-B**
2. The approaches to demonstrating scalability described in paragraph 9 of **Agenda Item 2**, and whether any other approaches should be considered by the Task Force
3. Whether the IAASB continues to support the current direction of the Task Force to eliminate the low/not low inherent risk threshold and address scalability in the standard through the spectrum of risk concept and other ways

## Use of the Term “Reasonable”

- Respondents to ED-540 commented as follows on the use of the term “reasonable”
  - Whether the change from adequate to reasonable for disclosures is appropriate
  - Whether “reasonable” should be included in the definitions
  - Whether using “reasonable” as the evaluation criterion for disclosures related to accounting estimates creates a stronger criterion compared with other disclosures in the financial statements
  - Consistency of the use of the terms “reasonable,” “appropriate,” and “adequate” throughout ED-540
- The Task Force continues to believe that “reasonable” is the appropriate criterion for both the accounting estimate and related disclosures in the objective
  - Proposing conforming amendment to ISA 700 (Revised), paragraph 13(c), to remove inconsistency
  - Not proposing to include a definition of “reasonable” but has clarified the intent in new paragraph 6
  - Will undertake a thorough review of the use of the terms “reasonable,” “appropriate,” and “adequate” throughout the standard to ensure consistent use

## Use of the Term “Reasonable” – Matters for IAASB Consideration

The IAASB is asked for its views on:

4. Whether it supports the proposed conforming amendment to paragraph 13(c) of ISA 700 (Revised) as presented in **Agenda Item 2-D**
5. Whether any additional conforming amendments may be needed to address the comments received with respect to the term “reasonable”
6. The changes to paragraphs 6 and A3 of **Agenda Item 2-B**

## Professional Skepticism

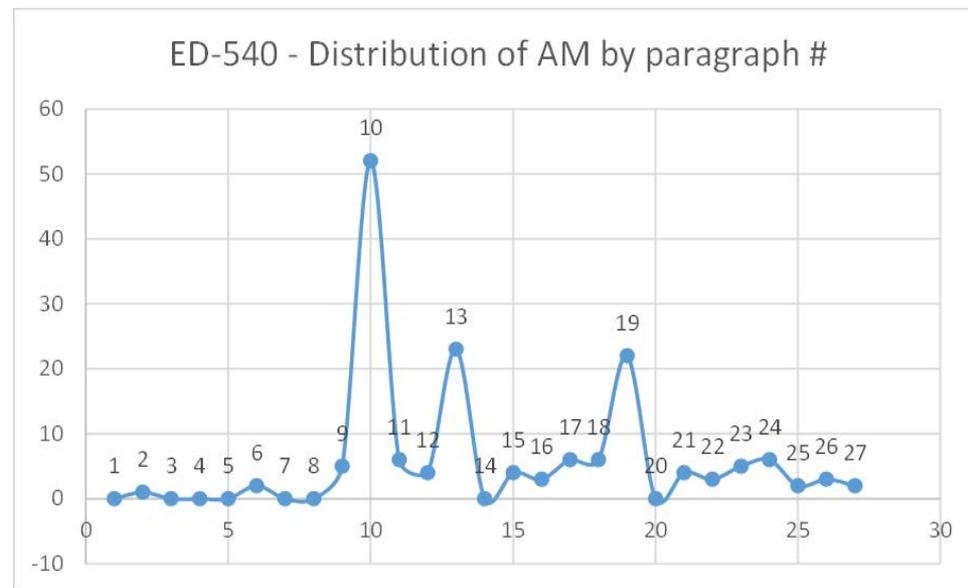
- Respondents generally believed that the approach in ED-540 appropriately reinforces the application of professional skepticism when auditing accounting estimates
  - Some respondents suggested to use stronger terminology (e.g. "challenge" or "question")
- In response to the comments received the Task Force:
  - Will seek input from the IAASB's Professional Skepticism Working Group on the use of stronger terminology, such as 'question' or 'challenge' relating to management actions or positions
  - Added a new requirement to seek to obtain relevant audit evidence from available sources, whether it corroborates or contradicts management's assertions (paragraph 15)
  - Continues to discuss ways to reinforce the link between the application of professional skepticism and the consideration of possible management bias and the need for management judgment in making accounting estimates

## Professional Skepticism – Matter for IAASB Consideration

7. The IAASB is asked for its views on the proposed additional wording to paragraph 15 of **Agenda Item 2-B** as described in paragraph 30

## Application Material

- 151 paragraphs of AM in ED-540 for 18 requirements (159 paragraphs in total)
- 3 requirement paragraphs (10, 13, 19) accounted for roughly two thirds of the AM relating to requirements
- About 50 paragraphs relating to requirements are educational in style (provide information about the subject matter – often explaining management’s process – but do not say what the auditor could or would be expected to do in relation to it, in applying the requirements)



## Application Material

- Work performed to date includes
  - Analyzing and categorizing extracts from all responses that include comments on AM or calls for more guidance, and developing strategies for responding (Pillar 1)
  - Identifying indicators of possible ways the AM in ED-540 could be further clarified and restructured (Pillar 2)
    - For example, AM that is educational in style, or AM that duplicates material in another ISA or ED-540
  - Addressing requests to elevate AM (Pillar 3)
  - Responding to restructuring and amendments of the requirements (Pillar 4)
- Analysis highlights that there is much support for the AM and many requests for additional guidance and examples
- TF will need to balance these requests with comments received regarding the overall length, complexity and readability of the standard

## Application Material – Matters for IAASB Consideration

8. The Board is asked for its views on:
  - a) The approach being adopted to address the restructuring and enhancement of the application material
  - b) The findings of the analysis of comments in responses to ED-540 that refer to guidance or the application material (Pillar 1), and the broad preliminary strategies that are being developed to address them, as set out in the summary of categories of themes in the comments (**Agenda Item 2-E.1**) and in the summary of major classifications of those themes (**Appendix C**)
  - c) The findings of the separate critical review of the application material (Pillar 2) completed to date, or on the working strategies developed to address them, as set out in the application material inventory (**Agenda Item 2-E.2**)
  - d) The approaches being taken to the requests for elevation (Pillar 3, see Appendix D) and the implications for the application material of the proposed restructuring and enhancement of the requirements (Pillar 4)

## Definitions

- The Task Force does not support the addition of any new definitions
  - However, the Task Force proposes to move some application material that addresses definitional or descriptive matters to the “Key Concepts” section or related application material
- Propose adding the term “further audit procedures” to the Glossary, using the wording from paragraph A10(b) of ISA 500
- The Task Force continues to believe that the term ‘monetary amount’ is an essential part of the definition of an accounting estimate

## Risk Assessment

- The Task Force made the following changes to paragraph 10
  - Better align the requirement with ISA 315 (Revised)
    - Addition of subheadings within the requirement
    - Re-purposed paragraph 10(d) and 10(e)
    - Removed paragraph 10(f) as it was seen to be redundant due to the revised structure
  - Reordered the material and simplified wording where possible
- Merged paragraphs 12 and 14 from ED-540 into a single requirement
- Task Force did not make significant changes to paragraph 13 since Oct. Board meeting
  - Reorganized and refined the wording to make requirement clearer
  - Added that the auditor shall take into account how the selection of the related amount and disclosures for inclusion in the financial statements are affected by complexity, subjectivity or other relevant risk factor
  - Proposed conforming amendment to ISA 200 to remove reference to a combined assessment IR and CR

## Work Effort

- Task Force did not make significant changes to what was proposed to Board in Oct. 2017
  - Exploring alternatives to the threshold – see scalability discussion
  - Clarified that the testing strategies are available for all accounting estimates
  - Based the response to the reasons given to the assessed risks of material misstatement around the testing strategy selected
  - The objectives-based requirements under each testing strategy are based around methods, assumptions and data
    - Allocated the objectives-based requirements that were included in paragraphs 17-20 in ED- 540 to each of the testing strategy requirements and added, where needed, new requirements
- Enhanced paragraph 16 by highlighting that ISA 330 requires that:
  - The design and performance of tests of relevant controls shall be responsive to the RoMM
  - Greater reliance placed on the effectiveness of a control, more persuasive the evidence needs to be
- Reinforced link between ISA 540 and ISA 500 by adding paragraphs 17E and 17F

## Work Effort – Ranges

- Since the October 2017 meeting the Task Force developed requirements for when the auditor develops a range or a point estimate (paragraph 18-18C)
- Paragraph 18C (ED-540, paragraph 20)
  - Some respondents asked the Task Force to clarify that this paragraph applies in all instances when the auditor develops a point estimate or range. Given its new location, the Task Force is of the view that it is clear that this requirement applies whenever the auditor's strategy includes developing a point estimate or range to evaluate management's point estimate
- Task Force will give further consideration to elevating paragraph A126 and discuss other ways to address comments received

## Stand-Back Requirement

- Clarified that the stand-back requirement applies to each accounting estimate
- Brought the sentence addressing corroborative or contradictory evidence together with the sentence addressing the consequences of an inability to obtain sufficient appropriate audit evidence to give them greater prominence
- Task Force will give further consideration to how the stand-back addresses disclosures

## Other Requirements

- The Task Force made limited changes, to address specific comments received, on the following paragraphs:
  - Disclosures (paragraph 21)
  - Management bias (paragraph 24)
    - Moved before the stand back requirement
  - Written representations (paragraph 25)
  - Communications TCWG (paragraph 26)
    - Conforming amendment to ISA 260 (Revised) – alignment between the matters in paragraph A155 and those in Appendix 2 of ISA 260 (Revised)
  - Documentation (paragraph 27)
    - Suggestions to broaden the documentation requirement
    - Task Force proposes a conforming amendment to ISA 230 to strengthen documentation regarding the auditor's significant judgments in evaluating whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated

## Conforming and Consequential Amendments – ISA 500

- Definition: removed reference to information being "publicly available"
  - Focus on the information being suitable for use by a broad range of users
  - Added service organization to avoid confusion with those services for which ISA 402 applies
- Enhanced application material based on suggestions received
  - Streamlined the application material to reduce complexity and volume
  - Emphasized consideration of completeness and accuracy (A33A and A33B)
  - Provided examples of why and when different approaches to considering an EIS are likely to be necessary (A33Fa)
  - Provided guidance when there are divergent market views related to an input (A33Fa)
  - Enhanced the guidance with respect to the implications of restricted access to an EIS's information, or proprietary models, including the likely limitation on scope that results (A33Ga)
  - Clarified that A26 and AA33a apply equally to an auditor's use of an EIS as it does to considerations relating to management's use of an EIS

## Conforming and Consequential Amendments – Matter for IAASB Consideration

9. The Board is asked to provide its views on **Agenda Item 2-D**. The Board is also asked to decide on the balance between ISA 540 and ISA 260 regarding matters that may be communicated to those charged with governance (see paragraphs 62–63 of **Agenda Item 2**)

## Next Steps

- After December Board meeting, the Task Force will focus on the redrafting and restructuring of the application material
  - Detailed analysis and review of comments received on application material will serve as the basis for further revisions to the application material
- First read of full standard in March 2018
- Outreach to key stakeholders around March 2018 meeting based on the March 2018 papers
  - IAASB CAG meeting in March 2018



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