



ISA 540 (Revised): Update on Analysis of ED-540 Q3

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IAASB meeting

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IAASB

**International Auditing
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Standards Board**

What's Been Done

Question 3

Is ED-540 sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk?

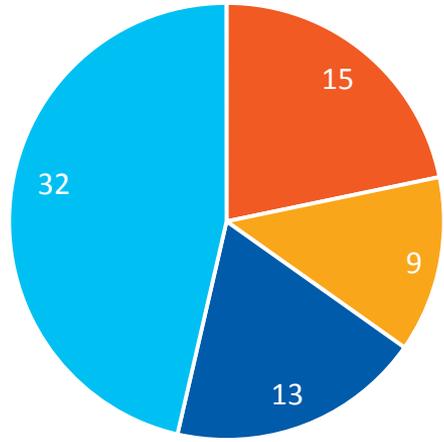
- Task Force completed a preliminary analysis of responses to Q3 and discussed with the IAASB in October 2017
 - Support for IAASB's efforts to make the standard scalable, but concerns about how it was done and whether the intended objective of scalability would be achieved
 - Mixed views about the low/not low inherent risk threshold, including its operability
- Based on the preliminary analysis, Task Force suggested that the threshold be deleted and scalability introduced and emphasized in other ways
 - Agreed to do a further analysis of the responses to validate this direction

Overall Observations from Further Analysis

- Difficult to summarize responses on scalability
 - Limited number of respondents provided an unequivocal view on scalability or the threshold (either positive or negative)
 - Many expressed some support or otherwise made positive statements
 - Many concerns or calls for additional clarification, guidance or examples
 - Comments on scalability were not always confined to Q3, so respondent views on scalability need to be considered in the context of overall comments on ED-540, including with respect to the length, complexity and operability of the standard
 - Comments on the threshold need to be considered in the context of respondent views on scalability overall (that is, a recognition that the threshold was intended as a mechanism to drive scalability of the standard, but might not work as intended)
 - Based on the above, it is more useful to consider scalability in terms of the nature of the comments received, and less of a “numbers” exercise

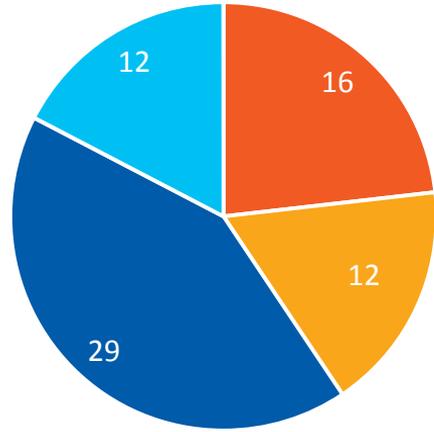
Overall Observations

Threshold



- Support/positive
- Does not support
- Comments/concerns
- No direct comment

Scalability



- Sufficient
- Not sufficient
- Comments/concerns
- No direct comment

Further Analysis –Threshold

- Support or positive statements
 - Helps to drive a risk-differentiated approach to the work effort
 - Provides scalability for low IR estimates
 - Support the approach, but more explanation or guidance needed to implement
- Do not support or concerns expressed
 - Threshold approach and response based on risk factors is overly complicated and difficult to operationalize
 - Not clear how to differentiate between low and not low IR, and lack of clarity on how risk factors affect IR assessment
 - Perceived inconsistency with risk model and terminology in ISA 315
 - Low IR may have been intended to drive scalability for SMEs, but many will have estimates with not low IR

Further Analysis - Scalability

- Many respondents believed ED-540 was generally sufficiently scalable, but ...
 - Differing views as to whether scalability was sufficient only for low or not low IR
 - Not for risk assessment procedures (paragraph 10)
 - Concern that some auditors might try to inappropriately label estimates as low IR
- Other positive comments on scalability
 - Should be scalable if auditors focus on RoMM and recognize that the higher the risk, the more persuasive the audit evidence needs to be
 - Focus on sufficient appropriate audit evidence provides a level of scalability, and SMEs can benefit from this
 - Important to focus on nature of estimates and not the size of the entity
 - More prominent focus on obtaining evidence from subsequent events helps scalability

Further Analysis – Concerns about Scalability

Concern	How Addressed
Insufficient recognition that there is a scale of risk	Spectrum of risk approach with examples
ISA 540 should not be scalable in only one direction (i.e., ensure that appropriate procedures are performed when RoMM is at high end of spectrum)	Spectrum of risk approach with examples
Approach in ED-540, including the structure of and lack of clarity in the requirements, will lead to increased work effort for low IR estimates	Restructured requirements and focused work effort on components
More guidance and examples needed at both ends of risk spectrum, but particularly for low IR estimates	Comprehensive review of AM, with additional guidance and examples to be added

Further Analysis - Conclusions

- Concerns raised about scalability of ED-540 were often linked to questions or concerns about
 - The threshold itself, or how it would operate in practice
 - Overall structure of the standard or lack of clarity in the requirements, particularly for paragraph 10 (obtaining an understanding) and how the threshold and risk factors affect the work effort (paragraphs 17-19)
- The further analysis validates the current direction of deleting the threshold and using other means to introduce scalability, as discussed in **Agenda Item 2**
 - Nature of comments suggests it would not be beneficial to try to revise and further explain the low/not IR threshold approach
- Preliminary analysis document will be updated, but only minor revisions needed



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