



Overview of ISA 540 (Revised) and Conforming and Consequential Amendments to Other International Standards

IAASB

International Auditing
and Assurance
Standards Board

Project Timeline

Information gathering commenced
in January 2015

Information
Gathering

Project Proposal approved in
December 2015

Project
Proposal

Exposure
Draft

Exposure Draft approved in March
2017 and published in April 2017
for comment by August 1, 2017

Final
Standard

Final standard approved in June
2018 and released in October 2018

Effective Date

Effective for periods beginning on or
after December 15, 2019, early
adoption permitted and encouraged

Public Interest Issues Addressed

Evolving audit risks due to a more complex business environment

- Financial reporting frameworks require more complex accounting estimates with high estimation uncertainty
- Complex accounting estimates becoming more prevalent and a fundamental part of financial statements for some entities

Addressing audit quality and fostering improved exercise of professional skepticism

- Findings by audit inspectors raised significant concerns about audit quality for accounting estimates, and a need to address this by fostering a more independent and challenging skeptical mindset in auditors

Realizing public interest benefits through improved communication and transparency

- Two-way dialogue between the auditor and those charged with governance about complex accounting estimates and those with high estimation uncertainty or subjectivity
- Communication with regulators or prudential supervisors

Key Enhancements

- With respect to **external information sources**, conforming and consequential amendments to ISA 500
- New and enhanced **application material**
- Expanded **documentation** requirement
- Emphasized requirement when **communicating with those charged with governance**
- Enhanced requirements addressing **disclosures**
- Explicitly recognized **spectrum of inherent risk**
- Introduced concept of **inherent risk factors**
- Enhanced **risk assessment** procedures
- Required **separate assessment of inherent risk and control risk**
- Emphasized the importance of the auditor's decisions about **controls**
- Introduced **objectives-based work effort** requirements
- Enhanced the “**stand-back**” requirement



Key Enhancements: Inherent Risk Factors

Inherent risk factors are characteristics of conditions and events that may affect the susceptibility of an assertion to misstatement, before consideration of controls

ISA 540 (Revised) focuses on the inherent risk factors of

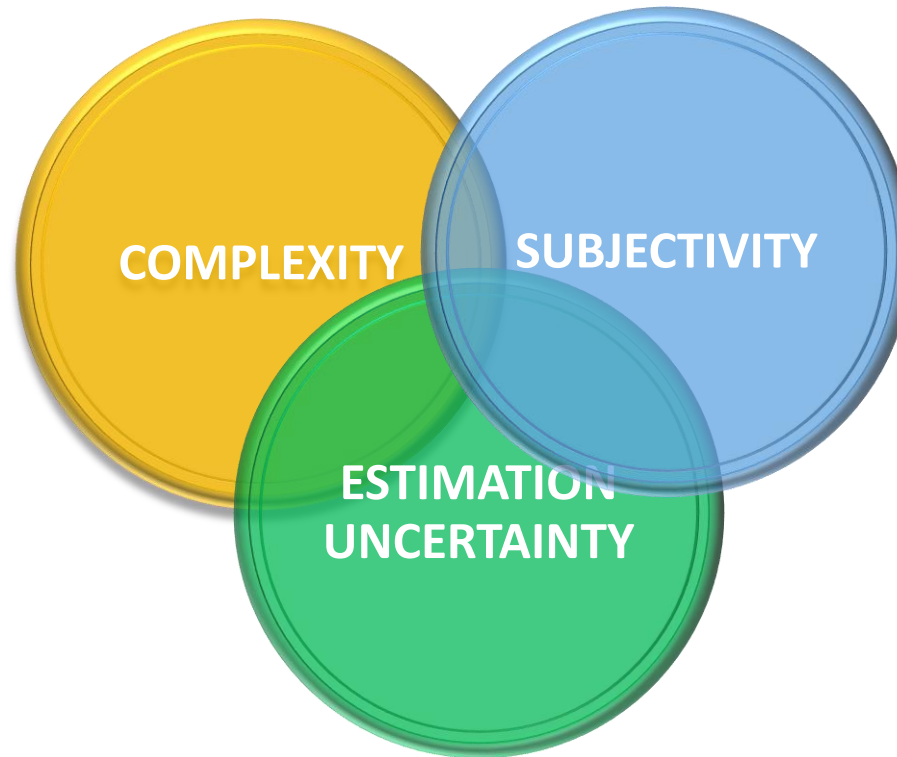
- **Estimation Uncertainty**
- **Complexity**
- **Subjectivity**

There may be other inherent risk factors that the auditor is required to take into account, for example

- Change
- Susceptibility to misstatement due to management bias or fraud

Key Enhancements: Inherent Risk Factors (Continued)

Complexity - is the complexity inherent in the process of making an accounting estimate, such as when multiple data sets or assumptions are required or when complex models are used



Subjectivity - arises from inherent limitations in the knowledge or data reasonably available about valuation attributes

Estimation Uncertainty - is the susceptibility to an inherent lack of precision in the measurement of an accounting estimate. Estimation uncertainty influences the other inherent risk factors.

Key Enhancements: Risk Assessment

Requiring a **separate assessment of inherent risk and control risk** for accounting estimates

Enhanced **risk assessment** procedures relating to obtaining an understanding of the entity and its environment, including the entity's internal control

Explicitly recognized a **spectrum of inherent risk**, building on existing concepts in ISA 200, ISA 315 (Revised), and ISA 330, to drive scalability

Key Enhancements: Control Testing

Emphasized the importance of the auditor's decisions about **controls** relating to accounting estimates by highlighting relevant requirements in ISA 315 (Revised) and ISA 330

Testing the operating effectiveness of controls is required if:

- There is an expectation that the controls are operating effectively; or
- Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level

For significant risks, test of controls in the current period is required if the auditor plans to rely on those controls

Key Enhancements: Work Effort

Introduced **objectives-based work effort** requirements which are directed to:

- Methods (including specifically when complex modelling is involved)
- Assumptions
- Data

Kept extant ISA 540's testing strategies

Enhanced approach for developing an auditor's range

Strengthened the requirement when management has not appropriately understood or addressed estimation uncertainty

Clarified that the auditor is also required to comply with the relevant requirements in ISA 500

Key Enhancements: Focus on Disclosures

Changed the objective of the standard to obtain sufficient appropriate evidence about whether both "accounting estimates and related disclosures" are "reasonable" in the context of the applicable financial reporting framework (was previously whether disclosures are "adequate")

Enhanced requirements to obtain audit evidence about whether the related disclosures are "reasonable"

Enhanced the overall evaluation requirement to determine whether the related disclosures are "reasonable" in the context of the applicable financial reporting framework, or are misstated

Other Enhancements

Enhanced the “**stand back**” requirement

- Added an evaluation of the audit evidence obtained regarding the accounting estimates, whether corroborative or contradictory

New and enhanced **application material**

Expanded **documentation** requirement

Emphasized requirement when **communicating with those charged with governance**

Conforming and Consequential Amendments

- **ISA 500 – external information sources**

An external individual or organization that provides information that has been used by the entity in preparing the financial statements, or that has been obtained by the auditor as audit evidence, when such information is suitable for use by a broad range of users. When information has been provided by an individual or organization acting in the capacity of a management's expert, service organization, or auditor's expert the individual or organization is not considered an external information source with respect to that particular information.

- Enhanced requirements and new definition and application material addressing audit evidence considerations related to external information sources.
- **Other conforming amendments to ISA 200, 230, 240, 260 (Revised), 580, 700 (Revised) and 701**

Professional Skepticism

How does ISA 540 (Revised) enhance the auditor's exercise of professional skepticism?

A requirement to design and **perform further audit procedures in a manner that is not biased** towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory

Requirement to “**stand back**” and evaluate the audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence

Use of **stronger language** (“challenge”, “question” and “reconsider”) in application material to reinforce the importance of exercising professional skepticism

Focus on **management bias** in risk assessment (other inherent risk factors include misstatement due to management bias or fraud) and work effort

Scalability

How is ISA 540 (Revised) scalable?

The standard emphasizes that the **nature, timing and extent of risk assessment and further audit procedures will vary** based on the assessment of the risks of material misstatement

The standard includes **specific paragraphs in the application material that demonstrate how ISA 540 (Revised) is scalable** in the risk assessment and the responses to the assessed risks of material misstatement

The standard emphasizes that **the auditor's further audit procedures need to be responsive to the reasons for the assessment of the risks of material misstatement** at the assertion level and that the auditor's further audit procedures shall take into account that the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be

ISA 540 (Revised) Implementation Working Group

• Objectives of the Working Group

- Promoting awareness
- Informing and educating users
- Opening a dialogue to learn about the experiences of those responsible for adopting and implementing the standard
- Preparing for post-implementation review efforts

• Planned activities

- Outreach and other communications
- ISA 540 (Revised) Toolkit
- Post-implementation review



ISA 540 (Revised) Implementation Working Group

OBJECTIVE

The ISA 540 (Revised) Implementation Working Group is responsible for the implementation of ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures, with the objectives of:

- Promoting awareness of the revised standard;
- Informing and educating users;
- Opening a dialogue to learn about the experiences of those responsible for adopting and implementing the standard; and
- Preparing for post-implementation review efforts.

PROJECT CONTACT

Jasper van den Hout ✉
Hankenson Jane Talatala ✉

WORKING GROUP

Rich Sharko, Chair
Fernando Ruiz Monroy
Andrew Gambier
Sachiko Kai
Eric Turner
Sylvia Van Dyk
Keith Billing

ISA 540 (Revised) Toolkit

- **ISA 540 (Revised) implementation webpage:**
<http://www.iaasb.org/projects/isa-540-revised-implementation>
- **Available now**
 - Basis for Conclusions
 - 'At a Glance' publication
- **Coming in 2019**
 - An explanation of the range of different types of measurement bases
 - Flowcharts
 - Webcasts
 - Answers to FAQs
 - Illustrative examples on how the requirements are scalable





**International Auditing
and Assurance
Standards Board®**

www.iaasb.org

IAPN_™

ISA_™

ISAE_™

ISQC_™

ISRE_™

ISRS_™

For copyright, trademark, and permissions information, please go to [permissions](#) or contact permissions@ifac.org.