



Attachment to AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **3(f)(i)**
Meeting Date: 12 June 2018
Subject: ISA 540 Auditing Accounting Estimates and Disclosures
Date Prepared: 6 June 2018

AUASB Technical Group Feedback (views may not be representative of the AUASB)

IAASB Project Objective	AUASB SMEs
(i) Propose revisions to ISA 540, establishing more robust requirements and appropriately detailed guidance to foster audit quality by driving auditors to perform appropriate procedures in relation to accounting estimates and related disclosures. It is anticipated that these revisions would also seek to emphasize the importance of the appropriate application of professional scepticism when auditing accounting estimates. (ii) Determine whether non-authoritative guidance and support tools, such as International Auditing Practice Notes, Staff publications, project updates or other materials, should be developed in the future to address special audit considerations relevant to financial institutions to supplement the revisions to ISA 540 and oversee the development of the guidance material considered necessary.	Ashley Wood / Rene Herman
AUASB Project Objectives (refer AUASB updated project plan 17 April 2018 AUASB meeting papers)	
(i) To provide comments on ED ISA 540 based on stakeholder input (completed - Phase 1). (ii) To release an amended ASA 540 based on the amended ISA, after making appropriate Australian amendments to conform to the Australian regulatory and statutory requirements, and further amendments where is a compelling reason to do so (Phase 2)	

I. Update to the AUSAB on the April 2018 ISA 540 IAASB teleconference:

Subsequent to the March IAASB meeting, the IAASB held a teleconference on 22 April 2018 to discuss ISA 540, the summary points that arose from that teleconference are:

1. For purposes of the AUASB, no changes of real substance. The changes were in the detail of wording, flow, clarity and simplification.
2. Two of the most significant areas raised were in relation to:
 - the lead in to the risk assessment paragraph, using the words “to the extent necessary” – while these words allow for scalability, some IAASB members were concerned that this could be seen as an “opt out” of the risk assessment process, which is clearly not the intention
 - documentation para 27(b) – several IAASB members saw this as confusing and needing clarity
3. There was a clear steer from the IAASB Chair that the June IAASB meeting is about fatal flaws to the standard.
4. *AUASB technical group overall comment: no areas of concern to be brought to AUASB attention.*

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II. Key changes to ISA 540 since March IAASB meeting and April IAASB teleconference:

1. *Scalability:*
 - a. Para 12: the lead in to the risk assessment requirements drives scalability but not by varying the extent of understanding the entity and its environment but rather by varying the extent of risk assessment procedures to obtain such an understanding
2. *Enhancements to exercise of professional scepticism:*
 - a. Language: inclusion of words such as reassess, call into question, challenge
 - b. Para A59: retrospective review
 - c. Para 17/A82: sufficient appropriate audit evidence neither biased towards corroborative nor biased toward not obtaining contradictory evidence. With no expectation for an exhaustive search
 - d. A97: giving examples where it may be appropriate to challenge management regarding methods, assumptions data
 - e. A152: Examples of documenting exercise of professional scepticism
3. *Response to assessed risk of material misstatement (“ROMM”)*
 - a. Application para A85 was added to signal the importance of testing the design, implementation and effectiveness of controls when the inherent risk (“IR”) is higher on the spectrum of IR (even where the identified ROMM is not a significant risk).
4. *Developing an auditor’s point estimate or range:*
 - a. Para 27 has been revised and simplified to clarify that the intent of the requirement is for the auditor to include further procedures to evaluate whether the methods, assumptions, data (“MAD”) used in making the estimate is appropriate in light of the financial reporting framework, irrespective of whether the auditor uses managements or their own MAD.
 - b. A125 and A139: There are circumstances where a range may be multiples of materiality and is more common in some sectors. Where a range is wide and may be multiples of materiality – challenge whether auditor has obtained sufficient appropriate audit evidence.
5. *Management’s Expert:*
 - a. New application para A129: MAD that may be made or identified by a management’s expert becomes management’s assumptions when used by management in making an accounting estimate – those assumptions become subject to the requirements of para 21-26 (testing how management made the assumption)
6. *Documentation:*
 - a. Simplification of the documentation requirements including direct linkage to ISA 330
 - b. New paras A149 and A150 – provides guidance about the documentation requirements dependent upon the auditor’s decision whether or not to rely on controls.
7. *AUASB technical group overall comment: point 5 above may be viewed as a requirement coming through in application material and may be viewed as an uplift in audit effort.*

III. IAASB consideration of effective period

1. At the time of ED – considered an appropriate effective date if for financial reporting periods ending approximately 18 months after the approval of a final ISA with early adoption permitted.
2. Currently mixed views about periods beginning on or after 15 December 2018 (ED) or 15 December 2019 and **taskforce has not come to consensus.**
3. Considerations impacting both sides include: translation, changes to methodologies, education, training, comments on exposure that 18 months is an appropriate period, public interest, IFRS 9.

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4. Further consideration of whether the effective date should be for ‘periods beginning’ or ‘periods ending’ – task force has landed on ‘periods beginning’ since ISA 540 impacts the planning stage of the audit.
5. Task forces notes that with a June 2018 approval, the earliest standard would be published after PIOB approval would be October 2018; however IAASB will update ISA 540 and make final version (pre PIOB approval) available after the June IAASB meeting.
6. *AUASB technical group overall comments: the AUASB technical group considers that the effective period should be for periods beginning on or after 15 December 2019 (with early adoption allowed) for the following reasons:*
 - *ISA 540 impacts the planning stage of the audit engagement meaning very little time for implementation of the standard*
 - *Smaller firms would be significantly impacted by an effective period beginning on or after 15 December 2018*
 - *Users of the standard still need significant training on the standard*
 - *The AUASB still has a public exposure to undertake*
 - *The main target audience immediately impacted by this standard are auditors and not regulators. The push to for an earlier effective date given the significance of inspection findings should not be seen as more important than the needs of auditors.*
 - *An effective date of 2018 would result in about 10 months implementation time as opposed to 18 months (assuming planning for December 2019 audits commenced around March/April 2019). This is a very short time frame.*
 - *Even with an effective date of 2018, this standard will not align with the IFRS 9 effective date.*

IV. Taskforce consideration of re-exposure

1. The IAASB board papers included the due process requirements in respect of the consideration of the need to re-expose a draft standard. The taskforce does not believe any of the criteria have been met. While noting there has been considerable change to the layout of the standard, the Task Force believes the substance of the requirements has not changed substantially from what was proposed in the ED. Appendix A to this BMSP attachment contains more details.
2. The AUASB technical group seeks AUASB input as to whether the AUASB agrees that there has not been **substantial change** to principles of the exposed document and agrees with the taskforces recommendation not to re-expose the document. The AUASB technical group does not consider that re-exposure will bring any new information to the attention of the IAASB that has not already been considered. Additionally, the Technical Group notes that given a vote of two-thirds of the IAASB is required to approve re-exposure. Based on the March IAASB meeting and April teleconference and the continuing pressure from the Public Interest Oversight Body (setting aside the appropriateness, or otherwise, of such pressure), it seems highly unlikely that a two-thirds majority of IAASB board members will vote for re-exposure.

V. Conforming and Consequential Amendments arising from ISA 540

1. Refer appendix B to this BMSP attachment. No areas of concern noted for attention of the AUASB.

VI. Where to from here for the IAASB:

1. The IAASB intends to establish an implementation working group to respond to practical challenges encountered in the implementation of the revised ISA.
2. The IAASB intends to issue some non-authoritative guidance.
3. Post implementation review 2-3 years after the effective date of the ISA.

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VII. Next steps AUASB

1. With a June 2018 approval, the earliest the ISA 540 standard would be published after PIOB approval is October 2018; however the taskforce has noted that they will update ISA 540 and make the final version (pre PIOB approval) available after the June IAASB meeting.
2. The proposed timetable for the Australian ED and Standard is reflected in Appendix C to this BMSP attachment.

VIII. Overall comments from the AUASB technical group to the AUASB:

1. Overall support for ISA 540

The AUASB technical group is supportive of the final draft of ISA 540. The key concerns raised by the AUASB and Australian stakeholders have been addressed by the IAASB in the revised ISA 540 as follows:

<i>Issues raised on exposure</i>	<i>How addressed</i>
1. No support for IR low/not-low and general scalability issues	<ol style="list-style-type: none"> i. IR low/non-low dropped; ii. introduction of spectrum of IR concept iii. Use of wording to indicate conditionality/scalability: <ul style="list-style-type: none"> ➤ at the risk assessment phase (eg: para 12: ‘procedures to the extent necessary’ and use of wording in para 15 ‘the degree to which’ ➤ procedures responsive to <i>reasons</i> for ROMM; explicitly stating the higher the assessed risk of ROMM, the more persuasive the audit evidence (para 17)
2. No support for the concepts of complexity, judgement and estimation uncertainly <i>as the drivers</i> determining the nature and extent of audit procedures	<ol style="list-style-type: none"> i. Separate assessment of IR and CR in order to drive a focus on consideration of IR factors in identification and assessment of ROMM ii. Work effort structured around testing strategies and MAD (the way the estimate is made) with consideration of the IR factors
3. In relation to auditors range/point estimate, concerns around: <ol style="list-style-type: none"> a. designation of responsibilities between auditor and management b. auditor’s range not always within materiality 	<ol style="list-style-type: none"> i. Designation of responsibilities: developing an auditor’s range now brought under the heading of evaluating management’s point estimate. Application material when to develop point estimate/range. ii. Application material where range not always within materiality (A125 and A139).

2. Re-exposure of ISA 540:

The AUASB technical group seeks AUASB input as to whether the AUASB agrees that there has not been **substantial change** to principles of the exposed document and agrees with the taskforces recommendation not to re-expose the document. The AUASB technical group does not consider that re-exposure will bring any new information to the attention of the IAASB that has not already been considered.

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3. *Effective Period*

Further to section III para 6 above, the AUASB technical group considers that the effective period should be for periods beginning on or after 15 December 2019.

4. *Questions for the AUASB*

- a. Are there any fatal flaws that the AUASB can see in the adoption of ISA 540?
- b. Based on Section II above is there any feedback the AUASB would like to feed into the IAASB?
- c. What are the AUASBs views on re-exposure of ISA 540?
- d. What are the AUASBs views on the effective period (refer section III above)
- e. Are there any compelling reason adjustments that the AUASB can envisage upon adoption of ISA 540?
- f. Does the AUASB support the suggested timeline in Appendix C to this BMSP attachment?
- g. Since extensive outreach was conducted at the time of the IAASB exposure draft, and stakeholder feedback received and actioned as per the table above, what specific outreach on Australian exposure would the AUASB like to see?
- h. Are there any specific/non-standard questions the AUASB should address on exposure?

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Appendix A to BMSP attachment

Why the ISA 540 taskforce is suggesting that ISA 540 is not re-exposed:

1. The **principle consideration** of whether to re-expose is whether there has been **substantial change** to the exposed document. Examples of substantial change:
 - matters not aired in ED
 - matters not deliberated by IAASB
 - change in substance

The taskforce is of the view that re-exposure will not result in new information or new concerns that have not already been aired and discussed by the IAASB.

2. Key elements of the ED:
 - modernising for evolving business environments
 - reinforcing exercise of professional scepticism
 - use of IR factors in identifying and assessing ROMM.
 - work effort building on IR factors, further procedures responsive to ROMM, reinforces need to test controls in certain circumstances
 - including amounts in an auditors range to only those supported by audit evidence
 - broader approach to disclosures

The taskforce considers that all the above key elements have been retained – they may have been modified/clarified but the essence of the elements has been retained.

3. The following are the key areas of change from ED to final:
 - a. **Risk assessment:** The key comments on exposure was that the risk assessment requirements were not sufficiently scalable and did not closely align to ISA 315. The taskforce addressed these concerns by:
 - i. emphasising scalability by the lead in paragraph 12 “procedures to the extent necessary” and providing examples and explanation in application material A18 – A19.
 - ii. re-ordered/revised wording/clarification and alignment to ISA 315

The taskforce considers that these changes do not fundamentally change the substance from ED 540.

- b. **Identification and assessment of ROMM:** The key comments on exposure was that the identification and assessment of ROMM should be structured around the elements (methods, assumptions, data) of the process for making estimates (“MAD”) while considering IR factors which respondents acknowledged as being important. The taskforce made the following amendments:
 - i. requirement to separately assess control risk (“CR”) and IR in order to drive a focus on consideration of IR factors in identification and assessment of ROMM.
 - ii. introduction of spectrum of IR to drive scalability (degree to which)
 - iii. clarification that in assessing IR, the auditor considers the degree the estimate is subject to estimation uncertainty and the degree to which MAD is subject to complexity, subjectivity and other IR factors.

The taskforce considers that these changes do not fundamentally change the substance from ED 540.

- c. **Response to ROMM:** Comments on exposure were that the threshold of low/not low IR was not workable, that work effort should be based on testing strategies, that exercise of professional scepticism needed to be reinforced and work effort should not be based around the risk factors. The taskforce has made the following amendments:
 - i. Threshold removed, but further audit procedures to be responsive to assessed ROMM – thus scalability still achieved through focus of spectrum of IR.

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- ii. Signpost to 3 specific testing strategies – structure for objectives-based requirements
- iii. Professional scepticism enhanced by explicitly stating that audit evidence neither biased towards corroborative nor biased towards not obtaining contradictory.
- iv. Work effort clearer and designed around how an estimate made with IR factors considered within each testing approach

While the taskforce acknowledges that the structure and order of the requirements has changed from ED, the objectives of the requirements have not changed and are consistent with the ED and that the IAASB's expectations for the work that should have been performed has not significantly changed. Additionally the construct around testing strategies is consistent with extant ISA 540.

- d. **Documentation:** Comments on exposure were that the documentation requirements were unclear. The taskforce acknowledges that since ED there has been an uplift in documentation requirements within the body of ISA 540, however appropriate application of ISA 230 would result in the same level of documentation now specified within ISA 540.

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Appendix B to BMSP attachment

Conforming and Consequential Amendments arising from ISA 540

1. ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*
 - a. Application material: ISA 540 requires separate assessment of IR and CR.
2. ISA 230 *Audit Documentation*
 - a. Application material: examples demonstrating documentation of exercise of professional scepticism in relation to accounting estimates.
 - b. Application material: example demonstrating documentation of professional judgement in relation to reasonability of estimate and related disclosures.
3. ISA 260 *Communication with Those Charged with Governance*
 - a. Application material: TCWG may be interested on degree to which IR factors affect the selection / application of MAD used in making significant estimates as well as auditor's evaluation of reasonableness of managements point estimate and disclosures. That is, communicating significant qualitative aspects of accounting practices related to estimates and related disclosures.
4. ISA 500 *Audit Evidence*
 - a. New definition of External information source:
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.
 - b. Requirement to consider relevance and reliability of information to be used as audit evidence now expanded to include information obtained from an EIS.
 - c. Application material: significant application material to support the definition.
 - d. Application material: significant application material to support the revised requirements of assessing relevance and reliability of EIS.
5. ISA 700 *Forming an Opinion and Reporting on Financial Statements*
 - a. Requirement revised to include assessing whether disclosures made by management related to accounting estimates are reasonable.

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Appendix C to BMSP attachment

Timetable for AUASB – Australian Release of Standard

<i>Date (approximate)</i>	<i>Action</i>
23 June	IAASB approves for issue ISA 540 and conforming amendments
16 July	IAASB releases “final” ISA 540 (pre PIOB approval)
30 July	AUASB technical group circulates Australian EDs to AUASB
3 August	Teleconference: AUASB approves EDs for issue for 60 day period.
24 September	PIOB approves for issue ISA 540 and conforming amendments
25 September	End of AUASB 60 day comment period
Mid October	AUASB teleconference - disposition of comments and final comments.
Mid October	IAASB issues final standards
December AUASB meeting	AUASB to approve to issue standards
Early – mid December	Release of standards (2 months after the IAASB)

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