

**Meeting:** IAASB Consultative Advisory Group (CAG)  
**Meeting Location:** New York, United States of America  
**Meeting Date:** September 12–13, 2016

## Agenda Item E

### **ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures – Report Back**

#### **Objectives of Agenda Item**

1. The objectives of this agenda item are to:
  - a. Inform Representatives and Observers on the ISA 540 Task Force's (the Task Force) activities since the March 2016 CAG meeting;
  - b. Obtain Representatives' and Observers' views on the issues paper regarding the revision of International Standard on Auditing (ISA) 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*; and
  - c. Provide a report back on comments of the CAG Representatives and Observers on this project as discussed at the March 2016 CAG Teleconference.

#### **Project Status and Timeline**

2. The Task Force and IAASB leadership engaged in outreach activities to gain further stakeholder insight into the issues arising from ISA 540. An overview of the outreach activities since the March 2016 CAG meeting is included in Appendix A.
3. Since the March 2016 CAG meeting, the Task Force met nine times by teleconference and four times physically. This represents a more intense level of activity than is common for IAASB's projects, and reflects the importance that the IAASB places on this project.
4. This is the final scheduled IAASB CAG discussion on ISA 540 prior to the anticipated approval of an exposure draft in December 2016 and, accordingly the current proposed Exposure Draft is included as **Agenda Item E-2**. Whether the draft is sufficiently advanced to be approved by the IAASB in December 2016 will be the subject of further discussions by the Task Force and the IAASB.
5. In its meetings and teleconferences the Task Force discussed the issues identified with respect to ISA 540. In view of the heavy focus in 2015 of understanding issues related to financial institutions, the Task Force's discussions and outreach since March 2016 included issues for entities other than financial institutions. The issues discussed include the definitions, risk assessment and work effort for accounting estimates, the use of third-party data sources (henceforth referred to as "external data sources"), and how to make the ISA more scalable for accounting estimates of differing levels of risk.

The results of the Task Force deliberations are included in the issues paper (**Agenda Item E-1**) and the draft of proposed revised ISA 540. While the Task Force has worked hard at producing this draft, the Task Force has not yet had the opportunity to fully discuss all aspects of the draft. Accordingly, some aspects of the draft standard will continue to be discussed and refined prior to the intended approval of the Exposure Draft in December 2016.

6. Appendix B to this paper provides a history of previous discussions with the CAG and IAASB on this topic, including links to the relevant CAG documentation. It is noted that some CAG representatives have availed themselves of the opportunity to receive informal updates on the progress of the Task Force after each IAASB meeting.

### March 2016 CAG Discussion

7. Extracts from the draft minutes of the March 2016 CAG meeting, as well as an indication of how the Task Force or IAASB has responded to the Representatives' and Observers' comments are included in the table below.

Representatives' and Observers' Comments	Task Force/IAASB Response
COMPLEXITY VERSUS ESTIMATION UNCERTAINTY	
Mr. Iinuma was of the view that further outreach would be needed to cover specific issues related to non-financial institutions such as goodwill, impairment, and revenue recognition. Messrs. Yurdakul, Hansen, and Kazuhiro agreed. Mr. Kazuhiro added that further outreach with regarding construction contracts would be useful. He also noted that the results of International Forum of Independent Audit Regulators' (IFIAR) 2015 Inspection Findings report, as discussed as part of <b>Agenda Item E</b> , showed a significant number of findings related to revenue recognition and that more outreach in that area would be warranted. Messrs. Yurdakul and Koltvedgaard noted that outreach with different stakeholder groups, like preparers, would be useful.	<p>Point accepted.</p> <p>Mr. Sharko responded by noting that the Task Force includes members with a non-financial institution background and an observer from the Public Company Accounting Oversight Board (PCAOB), and that the Task Force will continue its outreach activities with non-financial institutions, including, for example, extractive industries and corporates with a complex treasury function.</p> <p>An overview of the Task Force's outreach since the March 2016 CAG meeting, including specific outreach with preparers and entities other than financial institutions is included in <b>Appendix A</b>.</p>
Mr. Dalkin noted that accounting estimates play a critical role in government accounting and specifically highlighted the accounting estimates with respect to the fiscal sustainability of governmental debt. Ms. Molyneux added that the pharmaceutical industry also has significant accounting estimates.	<p>Point accepted.</p> <p>The Task Force included considerations specific for public sector entities in the latest version of ISA 540 and met with auditors of a pharmaceutical entity to discuss issues specific to this industry. See, for</p>

Representatives' and Observers' Comments	Task Force/IAASB Response
	example, A10A and A44A–A44B of <b>Agenda Item E-2</b> which were adapted from the relevant ISSAI. <sup>1</sup>
<p>Mr. van der Ende noted that the Basel Committee on Banking Supervision's (Basel Committee) Accounting Expert Group (AEG) discussed the issues paper. He highlighted that the AEG agrees with the issues identified but also noted several additional issues. Mr. van der Ende explained that internal control risk was not sufficiently discussed in this paper. He noted that the Basel Committee has issued guidance around governance and internal controls and that with the upcoming switch to Expected Credit Loss (ECL) models this will be even more important, given that some data will come from systems that have historically not been part of the financial reporting system. He noted that weak internal controls and governance systems increase the risk of earnings management. Mr. Dalkin noted that internal control starts with management. Mr. E. Bradbury agreed and added that obtaining an understanding of internal control over financial reporting is extremely important, but providing too much prescription can lead to less auditor judgment. Mr. Koktvedgaard agreed.</p>	<p>Point accepted.</p> <p>Mr. Sharko highlighted that the Task Force has not yet discussed all issues identified throughout the project in detail, and that Staff is working on a tracking document to show all issues identified by the Task Force to date and when these issues will be discussed by the IAASB. Among the matters that will be discussed in more detail for the upcoming Board meetings are controls and governance. He also agreed that it is not the auditor's responsibility to set internal control requirements for management and that there should be a balance between being too prescriptive and providing sufficient guidance for the auditor in the ISA.</p> <p>The Task Force included in paragraph 8A of <b>Agenda Item E-2</b> a requirement for the auditor to obtain an understanding of the entity's internal control. The related application material provides the auditor with guidance how to do so. The Task Force also notes that the IAASB has a separate project addressing ISA 315 (Revised)<sup>2</sup> which directly addresses issues around internal controls.</p>
<p>Mr. E. Bradbury highlighted that the auditor should take appropriate qualitative considerations as in the end accounting estimates are a judgment.</p>	<p>Paragraph 10 of <b>Agenda Item E-2</b> includes requirements regarding the risks of material misstatement arising from judgments exercised in the preparation of the accounting estimates.</p>

<sup>1</sup> International Standard for Supreme Audit Institutions 1540, available at [http://www.issai.org/media/13176/issai\\_1540\\_e\\_.pdf](http://www.issai.org/media/13176/issai_1540_e_.pdf).

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of. Material Misstatement through Understanding the. Entity and Its Environment*

Representatives' and Observers' Comments	Task Force/IAASB Response
Mr. Hansen noted that the paper did not address the use of experts and specialists by a company or retained by an audit firm and questioned whether the project to revise ISA 540 will address this.	<p>Mr. Sharko noted that revising ISA 620<sup>3</sup> is not part of this project but that the Task Force will assess where ISA 540 can be enhanced with respect to the use of experts and specialists, including conforming amendments to ISA 620 as needed. Ms. Healy added that, in the revision of ISA 540, the Task Force can give a steer as to how ISA 620 can be applied when auditing accounting estimates. She also noted that there might be opportunities to highlight the role of the engagement partner and that some relevant material in IAPN 1000<sup>4</sup> might be incorporated into ISA 500<sup>5</sup> or ISA 540.</p> <p>Draft requirements addressing the need for experts in both risk assessment and in performing audit procedures are included in paragraphs 9A and 11A of <b>Agenda Item E-2</b>.</p>
Ms. McGeachy noted the importance of Small and Medium Practices (SMPs) to be involved in this project to provide a different view. Mr. Koktvedgaard agreed.	<p>Point accepted.</p> <p>The Task Force leadership met via teleconference with the International Federation of Accountants' SMP Committee.</p>
Mr. E. Bradbury questioned what the Task Force has discussed with respect to the documentation requirements for accounting estimates given that regulators, like IFIAR, are looking for evidence about the auditor's judgments. Mr. James agreed and added that he is interested in the Task Force's way forward with respect to the documentation of professional skepticism and professional judgment in auditing accounting estimates.	<p>Mr. Sharko noted that the Task Force has to find the right balance by meeting the needs of regulators, while not unreasonably burdening auditors of small- and medium-sized entities.</p> <p>Paragraphs 23 and A128 of <b>Agenda Item E-2</b> include strengthened requirements addressing documentation, particularly regarding the auditor's exercise of professional skepticism.</p>
Mr. van der Ende congratulated the Task Force and the IAASB on the release of the ISA 540 Project Publication. He noted that the Basel Committee had asked for such a document and that its AEG	Support noted.

<sup>3</sup> ISA 620, *Using the Work of an Auditor's Expert*

<sup>4</sup> International Auditing Practice Note (IAPN) 1000, *Special Considerations in Auditing Financial Instruments*

<sup>5</sup> ISA 500, *Audit Evidence*

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>was pleased to see a draft version of the Project Publication at its February 2016 meeting. Mr. van der Ende noted that the AEG was generally satisfied with the topics included in the Project Publication and that the AEG is of the view that the Project Publication will help in its work. However, a few members were skeptical that the IAASB will meet the proposed deadlines as included in the Project Publication given that they are very ambitious. He also noted that the AEG's Japanese member would have liked to have the relationship between a financial institution's regulatory supervisor and the external auditor discussed in the Project Publication. However, the European members were not of the same view given the recent publication on this topic by the European Banking Authority. Mr. van der Ende concluded by noting that the Project Publication is a good example how the IAASB's dialogue with stakeholders can be fruitful.</p>	
SCOPE OF ISA 540	
<p>Mr. Rockwell noted that the Task Force should address both complexity and estimation uncertainty in ISA 540 as, for example, level 3 financial instruments have a high estimation uncertainty and are very complex. Mr. Ahmed agreed and added that both estimation uncertainty and complexity affect the risk of material misstatement. Mr. Thompson noted that the two concepts are interrelated but can also occur separately. Mmes. Lang and Molyneux agreed.</p>	<p>Point accepted.</p> <p>Mr. Sharko responded that the Task Force will consider how both concepts can be included in the revision of ISA 540.</p> <p>The current version of ISA 540 addresses both complexity and estimation uncertainty, as well as a new focus on judgment. See paragraph 10 of <b>Agenda Item E-2</b>.</p>
<p>Mr. Stewart noted that, in his view, the difference between complexity and estimation uncertainty is that complexity can be solved with the right expertise while estimation uncertainty cannot be addressed in a similar way. Also, he noted that estimation uncertainty can be more influenced by professional skepticism than complexity. He noted that, in order to address estimation uncertainty, the auditor should gather more evidence but it is</p>	<p>Point noted.</p> <p>Paragraphs A46–A49A of <b>Agenda Item E-2</b> discuss the audit implications of estimation uncertainty in depth. New application material has also been drafted to support the definition of estimation uncertainty (see paragraph A11A of <b>Agenda Item E-2</b>).</p>

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>necessary to understand that an accounting estimate will not provide an exact amount given that it is an estimate. Ms. Lang agreed.</p>	
<p>Mr. Rockwell noted the necessity to find a way to separate simpler accounting estimates from more complex accounting estimates within the standard. Ms. Lang was of the view that auditors should be able to read ISA 540 and determine what approach is necessary given the underlying uncertainty in the accounting estimate.</p> <p>Mr. Iinuma was of the view that the Task Force should investigate whether the scope of ISA 540 could be clarified by emphasizing and clarifying the scalability of ISA 540 as the other options presented by the Task Force were not practical. Mmes. Lang and Singh and Mr. Dalkin agreed with pursuing this option, noting the standard could stress the need to adequately understand the estimate. Ms. Singh added that scalability should be included in the application material. Mr. van der Ende noted that the Basel Committee's AEG unanimously favored this option given that the other options could lead to different views as to which standard a particular accounting estimate would fall into. He noted that banks have both plain vanilla accounting estimates and more complex accounting estimates like, for example, macro-economic data that is used in an ECL Loss model. Mr. van der Ende noted that the work effort between plain vanilla and complex accounting estimates should be different and that he therefore is in favor of describing proportionality in ISA 540.</p>	<p>Point accepted.</p> <p>The Task Force believes that lower risks of material misstatement arising from an accounting estimate should be subject to a different, and simpler, work effort than higher risks. Accordingly, the Task Force proposes that paragraph 12A of <b>Agenda Item E-2</b> bifurcate the work effort requirements, with "lower risk" items being dealt with by the ordinary work effort requirements of ISA 330.<sup>6</sup> This also permits ISA 540's work effort requirements to better focus on the factors that give rise to higher risks of material misstatement, and therefore a better targeted work effort.</p> <p>The Task Force also included additional specific considerations for small entities included in the application material accompanying the risk assessment requirements (see paragraph A38C-A38D of <b>Agenda Item E-2</b>).</p>
<p>Mr. Thompson noted that the Task Force would need to carefully consider the scope of ISA 540 and how various audit approaches or procedures might be set out within the standard, as for some accounting estimates events or information becomes available before the date of the auditor's</p>	<p>Point accepted.</p> <p>The Task Force has proposed a new requirement (see paragraph 12B of <b>Agenda Item E-2</b>) that states that events occurring up to the date of the auditor's report may provide sufficient appropriate audit evidence about the assessed risks of material</p>

<sup>6</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

Representatives' and Observers' Comments	Task Force/IAASB Response
report that resolves the estimation uncertainty present at year end.	misstatement, the auditor shall obtain such audit evidence. In such cases, the auditor's work on that risk of material misstatement is complete, as the auditor has obtained sufficient appropriate audit evidence.
Mr. Stewart noted that the nature of the item being audited and the related risk of material misstatement should drive the amount of work performed by the auditor and not the size of the entity. He noted if ISA 540 took this approach, then by its nature the standard would be scalable. Ms. Lang agreed.	Point accepted.  The Task Force has used this approach throughout the standard – for example the bifurcation of the work effort is based on the level of risk (see paragraph 12A of <b>Agenda Item E-2</b> ) and the specific work effort requirements are targeted on the nature and level of risk, not the size of the entity (see paragraph 13 of <b>Agenda Item E-2</b> ).
Mr. Ahmed was of the view that the Task Force could investigate if the scope of ISA 540 could be clarified by splitting ISA 540 into two standards; one for simple accounting estimates and for more complex accounting estimates, but that making one standard scalable was also a valid option.	Point not accepted.  In March 2016 the IAASB was of the view that ISA 540 should address all accounting estimates, but that the standard itself should be scalable.
Ms. Molyneux noted that the Task Force should keep the standard principles-based as that appropriately allows for auditor judgment.	Support noted.
Mr. Stewart complimented the Task Force on figure 1 as included on page of <b>Agenda Item I.1</b> .	Support noted
PROFESSIONAL SKEPTICISM	
Mr. Bini noted support for the focus on professional skepticism in ISA 540 and noted that the amendments to paragraph 21 should include that bias in valuation is often linked to the choice of the method and data sources. Mr. Rockwell agreed. Mr. van der Ende highlighted his support for this section and noted that the Task Force should add concrete requirements and application material throughout all relevant stages of the audit. Mr. E. Bradbury highlighted the risk of adding specific requirements and application material that emphasize the importance of professional	Point taken into account.  Mr. Sharko acknowledged that just adding the term professional skepticism to various requirements will not be effective and that the Task Force will liaise with the Professional Skepticism Working Group (PSWG) on how professional skepticism can be enhanced in ISA 540.  The Task Force has met with the PSWG to discuss how professional skepticism can be enhanced in ISA 540. The PSWG presented recommendations for the Task Force at the June 2016 IAASB

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<p>skepticism in a specific area, as this could dilute the importance and meaning of professional skepticism. He noted that adding it in one place could be interpreted that it is less important in other areas.</p> <p>Mr. Rockwell noted that the use of the word "challenge" may not be the right word to enhance professional skepticism and suggested the phrase "critically evaluate" may be an appropriate way to describe the expected work effort.</p>	<p>meeting. The Task Force has made some progress on these and will continue to discuss them prior to finalization.</p>
<p>Mr. Dalkin suggested that application material to paragraph 21 could be added to highlight that the auditor should do more than confirming management's accounting estimates. Mr. Hansen agreed.</p>	<p>Point noted.</p> <p>The Task Force notes that paragraph 21 of <b>Agenda Item E-2</b> follows an extensive amount of requirements about the auditor's procedures regarding the accounting estimate.</p>
<p>With regards to the material addressing auditor bias, Mr. Hansen noted that, if the auditor is biased, the auditor is not independent and therefore should not have accepted the engagement. He suggested the focus of the Task Force should be on whether the auditor appropriately considered alternative approaches. Mr. Nicholson was of the view that auditor bias is more about objectivity rather than independence. Mr. Stewart suggested that the concept of auditor bias and familiarity with the entity being audited could be described differently to clearly distinguish it from independence issues.</p>	<p>Point taken into account.</p> <p>Mr. Sharko agreed and explained that the material addressing auditor bias is about inherent biases, as everyone has a certain bias based on, for example, prior experiences or views.</p>
<p>Ms. Molyneux noted that there is also bias in the choice of models and suggested that the Task Force should elaborate more on that. Ms. Lang added that there is also industry bias as certain ranges are used in an industry, and that it is important for auditors to understand the industry in order be able to challenge an entity's assumptions.</p>	<p>Point taken into account.</p> <p>Mr. Sharko noted that the Task Force has not yet looked into industry bias, but will take it into account in future discussions.</p>
RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES	
<p>Ms. Elliott supported moving the phrase "an understanding of the data on which they are based"</p>	<p>Point accepted.</p>



Representatives' and Observers' Comments	Task Force/IAASB Response
to a separate bullet and adding the governance over such data. Messrs. Iinuma and Stewart agreed. Ms. Elliott also noted that future application material will make the changes clearer.	<p>Mr. Sharko confirmed that there has been discussions within the Task Force and during outreach about data and governance and that the Task Force has not started drafting application material yet.</p> <p>The Task Force added paragraph 8(c)(iA) of <b>Agenda Item E-2</b> which requires the auditor to obtain an understanding of how management makes the accounting estimates, including the data on which the accounting estimates are based.</p>
With respect to paragraph 8(a) of ISA 540, Mr. van der Ende asked the Task Force to consider whether, in addition to the applicable financial reporting framework, guidelines with similar status could be added. Application material could highlight, for example, that these guidelines should be set by a global organization, such as the Basel Committee, with due process.	<p>Point noted.</p> <p>The Task Force is aware of the Basel Committee guidance. The Task Force notes that the proposed International Auditing Practice Note on audits of financial institutions may be a good place for this.</p>
Mr. van der Ende noted that it should be made clearer when the auditor should perform the procedures as required by paragraph 8(c) of ISA 540.	The Task Force notes that the requirement has been revised, and is applicable to all accounting estimates.
With respect to paragraph 8(c)(ii) of ISA 540, Ms. Lopez noted the importance of application material highlighting that management should take ownership for the data on which the accounting estimate is based when it has been obtained from an external source. Mr. James added that regulators have concerns about the auditor's work effort on the reliability of data that has been obtained from external sources and urged the Task Force to address this issue in the revision of ISA 540.	<p>Point taken into account.</p> <p>Mr. Sharko noted that the Task Force has discussed the matter and that the agenda material presented at that CAG meeting includes the Task Force's preliminary views on using the work of others, including third-party data sources.</p> <p>The Task Force presented a paper to the IAASB on external data sources which was discussed in the Board's July teleconference. The material from this paper, and a summary of the IAASB's responses, is included in <b>Agenda Item E-1</b>.</p>
Mr. Stewart questioned whether paragraph 8(c)(vi) of ISA 540 covers the consistency in the process to set accounting estimate year over year given its importance.	The Task Force notes that this matter is addressed in paragraph 12(b) of <b>Agenda Item E-2</b> .

Representatives' and Observers' Comments	Task Force/IAASB Response
<p>Mr. Stewart questioned whether the role of the auditor should vary based on whether the accounting standards require management to make a best estimate and, at other times, a reasonable estimate. He furthermore noted that using the word “challenge” would be better suited when auditing a “best estimate” and “evaluate” when auditing a “reasonable estimate”. Mr. Hansen added that it would be useful to have guidance that explains how the auditor should assess wide variances between management’s accounting estimate and the auditor’s or variances within an entity.</p>	<p>Mr. Sharko noted that the Task Force has discussed ranges and variations within a range and that the matter will be brought to the CAG at a later stage. He noted that the Task Force will also consider what the effect of accounting standards is on the auditor’s work effort on accounting estimates.</p> <p>The Task Force met with the PSWG to discuss how professional skepticism can be enhanced in ISA 540 and in the June 2016 IAASB meeting the PSWG presented recommendation for the Task Force. The Task Force will take these factors into account in the revision of ISA 540.</p>
<p>Mr. van der Ende noted that a majority of the Basel Committee’s AEG was of the view that the binary choice between significant and non-significant is not sufficient as risk is a continuum and that the ECL model should always be a significant risk. He also noted that the auditor should communicate with those charged with governance to assist the auditor in addressing some of the audit challenges that arise during the development process of models, and that the term “may assist” was not strong enough.</p>	<p>Point partially accepted.</p> <p>The work effort proposals in Agenda Item E-2 show that the auditor’s responses are primarily based on the risks of material misstatement. In particular, paragraph 13 notes that the higher the risk, the more persuasive the audit evidence needed. As proposed ISA 540 (Revised) must be able to be applied under extant ISA 315 (Revised), the Task Force does not propose, at this time, to remove the concept of a significant risk but much of the procedures that formerly applied to significant risks have been moved to the “normal” risk section and are required to be used when the relevant factor is present.</p>
<p>Mr. Stewart noted that adding back testing as an option for performing a retrospective review could be useful as this draws out any bias that might have been included in management’s past processes.</p>	<p>The Task Force will discuss this point prior to December 2016.</p>
<p>Mr. van der Ende supported the principles behind new requirement 8A of ISA 540.</p>	<p>Support noted.</p>
<p>Ms. Molyneux noted that professional skepticism in the risk assessment could be enhanced by adding application material that would have the auditor focus on the internal consistency of management’s assumptions so that similar assumptions are used</p>	<p>Point accepted.</p> <p>The consistency in the data and assumptions used to make the accounting estimate is included in</p>

Representatives' and Observers' Comments	Task Force/IAASB Response
across different departments. She also noted that professional skepticism could be strengthened by assessing the corporate culture.	<p>paragraphs 13 (Procedure 1), A25A, A26C and A31 in <b>Agenda Item E-2</b>.</p> <p>The Task Force notes that corporate culture, broadly speaking, would be relevant to ISA 315 (Revised).</p>
IDENTIFICATION AND ASSESSMENT OF THE RISK OF MATERIAL MISSTATEMENT	
<p>Mr. Stewart questioned whether revised paragraph 10 of ISA 540 as proposed by the Task Force is still principles-based and noted that the amount of detail included would be expected in application material. Mr. Dalkin agreed.</p> <p>Mr. James agreed but was not certain that the manner in which this material would be drafted would be sufficiently enforceable. Mr. Dalkin noted that if auditors are not taking application material into account, it may be more indicative of an execution issue rather than a need to change to a requirement.</p>	<p>Point taken into account.</p> <p>Mr. Sharko responded at the time that the Task Force moved application material to the requirement as regulators indicated that auditors did not appear to be taking the application material into account, and doing so further emphasizes what is expected of auditors.</p> <p>The Task Force reduced to number of factors to be considered in the identification and assessment of the risk of material misstatement to three. See <b>Agenda Item E-2</b>, paragraph 10.</p>
Mr. Dalkin noted that paragraph 10 of ISA 540 as drafted limits the scalability of ISA 540. Mr. E. Bradbury agreed and added that the requirement as redrafted is potentially limiting and could stimulate a checklist mentality and could inappropriately be perceived as an all-inclusive list. He suggested to change "shall take into account" to "may take into account" in the preface to the bullets.	<p>Point accepted</p> <p>Mr. Sharko responded that, because it is a requirement, "shall" is needed but the Task Force will consider the points raised.</p> <p>The Task Force reduced to number of factors to be considered in the identification and assessment of the risk of material misstatement to three. See <b>Agenda Item E-2</b>, paragraph 10. The Task Force has also inserted a new requirement (paragraph 1 2A) which permits a more flexible approach to the auditor's work effort regarding lower risks of material misstatement.</p>
Mr. Rockwell suggested ISA 540 have a requirement that requires the auditor to assess the relevant factors and have, in addition, in the application material a non-exclusive list of other factors.	<p>Point accepted.</p> <p>In addition to the factors included in paragraph 10, paragraph A46 of <b>Agenda Item E-2</b> includes factors the auditor may consider in identifying and assessing the risks of material misstatement. Paragraph 13 of <b>Agenda Item E-2</b> also makes clear that the auditor's procedures are in</p>

Representatives' and Observers' Comments	Task Force/IAASB Response
	responses to the assessed risks of material misstatement, which may be broader than the list of factors in paragraph 10.
RESPONSES TO IDENTIFIED RISK OF MATERIAL MISSTATEMENT	
Mr. Stewart noted that possible changes to paragraph 13 of ISA 540 requires more persuasive audit evidence for accounting estimates with a higher estimation uncertainty and he questioned whether that is audit evidence that is more persuasive or more of the persuasive evidence and if that matters. Based on Figure 1 as included in <b>Agenda Item I.1</b> , Mr. Stewart expects it to be the latter.	At the time, Mr. Sharko highlighted that this is probably the case but that the Task Force will further look into this.
Mr. E. Bradbury questioned how inspectors will assess the changed wording in paragraph 13 of ISA 540 and how much evidentiary documentation they will be expecting based on the new wording. He provided the CAG with an example how evidentiary documentation has, in his opinion, gone too far in the United States.	Point noted.  Mr. Sharko noted that, in many of the inspection findings, the lack of documentation of judgments did not mean that the auditor had not obtained sufficient and appropriate audit evidence.
OTHER CONSIDERATIONS	
Mr. James supported more guidance on third-party data sources in ISA 540 and noted that the reliability of data provided by third-party data sources depends on the observability of inputs and the complexity of the methodologies used for generating the data.  Mr. Hansen noted that the PCAOB has been looking closely at the use of third-party data sources. Since the auditor may not be able to access the third-party data sources' systems and controls, he suggested that the application material highlight that the auditor can compare the third-party data to data from another source to get comfortable with the data received from the third-party data source. Mr. Rockwell questioned whether the auditor is sufficiently competent to	Point taken into account.  At the time, Mr. Sharko noted that third-party data sources are an important topic and noted that the Task Force might include guidance from IAPN 1000. He also noted that the Task Force is closely following the PCAOB's work and the Task Force will discuss what an auditor should do when there is only one data source and what the auditor should do if there are differences between two data sources.  In June 2016, the Task Force presented a paper to the IAASB on external data sources. The material from this paper, and a summary of the IAASB's responses, is included in <b>Agenda Item E-1</b> .

Representatives' and Observers' Comments	Task Force/IAASB Response
assess which of two competing data sources is appropriate to use.	
Mr. Yoshii was of the view that the auditor's work effort on disclosures related to accounting estimates should be strengthened, as investors and analyst cannot interpret the financial results of a company without sufficient disclosures. Mr. James agreed.	Point accepted.  Paragraph 19 of <b>Agenda Item E-2</b> has been strengthened and made more specific, including with respect to financial reporting frameworks that do not require disclosures of estimation uncertainty.
Mr. Rockwell noted that, with respect to disclosures, he would support the auditing standard going beyond the financial reporting framework as financial reporting frameworks, like the International Financial Reporting Standards, don't cover all legal obligations that entities are subject to. Ms. Lang noted that adding disclosure requirements to ISA 540 should be carefully considered, as doing so will add more complexity in certain audits.	Point taken into account.  At the time, Mr. Sharko questioned whether it is desirable that financial statements under the same financial reporting framework have different disclosures and whether it is really needed that the auditing standards go beyond the financial reporting framework.  In <b>Agenda Item E-2</b> , the Task Force introduced requirement 19(b) regarding the importance of disclosures about estimation uncertainty even if the applicable financial reporting framework does not require disclosure of the estimation uncertainty regarding accounting estimates.
Ms. Molyneux noted she is in favor of a new requirement or application material that highlights that accounting estimates with a high estimation uncertainty could be a key audit matter.	Point taken into account.  As noted in <b>Agenda Item E-1</b> , ISA 701 <sup>7</sup> notes that accounting estimates are likely to be an area of significant auditor attention. Accordingly, the Task Force proposes only limited conforming amendments to ISA 701 to align with proposed ISA 540 (Revised).

## Matters for CAG Consideration

- The Representatives and Observers are asked for their views on the matters for CAG consideration included in **Agenda Item E.1**.

<sup>7</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

## **Material Presented – IAASB CAG Papers**

<b>Agenda Item E.1</b>	ISA 540 – Issues and Recommendations
<b>Agenda Item E.2</b>	Draft of ISA 540 (Marked)
<b>Agenda Item E.3</b>	Draft of ISA 540 (Clean)

## Appendix A

### Outreach Activities since March 2016 CAG Meeting

The Task Force and IAASB leadership participated in, or presented, at the following events:

- Meeting with Representatives from the Dubai Financial Services Authority – Dubai, United Arab Emirates (Sharko, James)
- Participation in the International Association of Insurance Supervisors Accounting and Auditing Working Group Meeting – Teleconference (Dohrer, Pickeur, James, Williams)
- Meeting with the Basel Committee on Banking Supervision's Accounting Experts Group – Madrid, Spain (Sharko, van den Hout)
- Meeting with International Federation of Accountants' Small and Medium Practices Committee (by teleconference) (Sharko, Pickeur, James, van den Hout)
- Meeting with International Accounting Standards Board Leadership – London, United Kingdom (Schilder, Blascos, Grabowski, Sharko)
- Meeting with the International Forum of Independent Audit Regulators' Standards Coordination Working Group – Amsterdam, Netherlands (Schilder, Köhler, Sharko, Zietsman, Gunn, Healy, Williams)
- Participation in the Institute of International Finance's Three-way Dialogue Meeting – London, United Kingdom (Sharko, van den Hout)
- Meeting with Auditors of Mining, and Oil and Gas Entities (by teleconference) (Sharko, Pickeur, Salole, van den Hout)
- Meeting with Representatives from the Confederation of Netherlands Industry and Employers (VNO-NCW) – The Hague, Netherlands (Sharko)
- Meeting with Auditors of a Pharmaceutical Entity (by teleconference) (Sharko, Shannon)
- Meeting with Representatives of the International Accounting Standards Board on International Financial Reporting Standard 4, *Insurance Contracts* (by teleconference) (Sharko, Pickeur, Shannon, James, van den Hout, with many Task Force members in attendance)
- Meeting with Practitioners on the Financial Accounting Standards Board's Current Expected Credit Loss Model (by teleconference) (Sharko, Pickeur, Bandyopadhyay, Grabowski, Pera, Stone, Vanich, Billing, Jackson, Shannon, James, van den Hout)
- Meeting with the Basel Committee on Banking Supervision's Accounting Experts Group – Basel, Switzerland (Sharko (by teleconference), Pickeur, James (by teleconference), van den Hout)
- Participation in the International Association of Insurance Supervisors Accounting and Auditing Working Group Meeting (by teleconference) (Sharko, Campbell)
- Presentation at a workshop for the World Bank's Centre for Financial Reporting Reform – Vienna, Austria (Pickeur)

## Appendix B

### Project History

#### Project: ISA 540

##### Summary

	CAG Meeting	IAASB Meeting
Preliminary discussions on audit issues relevant to financial institutions and ISA 540	September 2015	March 2015 June 2015 September 2015
Discussion on project proposal to revise ISA 540	December 2015 Teleconference	December 2015
Discussion on project publication		January 2016
Discussion on audit issues relevant to ISA 540	March 2016	March 2016 June 2016 July 2016

##### CAG Discussions: Detailed References

Preliminary Discussions	<u>September 2015</u> See IAASB CAG meeting material included in Agenda Items D, D.1, D.2, and D.3. <a href="http://www.iaasb.org/cag/meetings/new-york-usa-0">http://www.iaasb.org/cag/meetings/new-york-usa-0</a>
Project Proposal	<u>December 2015</u> See IAASB CAG meeting material included in Agenda Items A, and I.1. <a href="http://www.iaasb.org/cag/meetings/iaasb-cag-conference-call-december-2-2015">http://www.iaasb.org/cag/meetings/iaasb-cag-conference-call-december-2-2015</a>
Issues	<u>March 2016</u> See IAASB CAG meeting material included in Agenda Items I, and A.1. <a href="http://www.iaasb.org/cag/meetings/paris-france">http://www.iaasb.org/cag/meetings/paris-france</a>