

**Exposure Draft  
April 2017**

*Comments due: August 1, 2017*

ISA.

*International Standard on Auditing*

---

**Proposed International  
Standard on Auditing 540  
(Revised)**

**Auditing Accounting Estimates  
and Related Disclosures**

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 540  
(REVISED)  
AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES**

(Effective for audits of financial statements for periods  
beginning on or after [TBA].)

**CONTENTS**

	Paragraph
<b>Introduction</b>	
Scope of this ISA .....	1
Nature of Accounting Estimates .....	2–3
Key Concepts of This ISA .....	4–6
Effective Date .....	7
<b>Objective</b> .....	<b>8</b>
<b>Definitions</b> .....	<b>9</b>
<b>Requirements</b>	
Risk Assessment Procedures and Related Activities .....	10–12
Identifying and Assessing the Risks of Material Misstatement .....	13
Responses to the Assessed Risks of Material Misstatement .....	14–20
Disclosures Related to Accounting Estimates .....	21
Overall Evaluation Based on Audit Procedures Performed .....	22–23
Indicators of Possible Management Bias .....	<del>24</del>
Written Representations .....	25
Communication with Those Charged With Governance or Management .....	26
Documentation.....	27
<b>Application and Other Explanatory Material</b>	
Nature of Accounting Estimates .....	A1
Key Concepts .....	A2–A3
Definitions .....	A4–A8
Risk Assessment Procedures and Related Activities .....	A9–A70
Identifying and Assessing the Risks of Material Misstatement .....	A71–A93
Responses to the Assessed Risks of Material Misstatement .....	A94–A134
Disclosures Related to Accounting Estimates .....	A135–A138

Deleted: 3

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

Overall Evaluation Based on Audit Procedures Performed .....	A139–A141
Misstatements .....	A142–A146
Indicators of Possible Management Bias .....	A147–A152
Written Representations .....	A153–A154
Communication with Those Charged With Governance or Management .....	A155–A157
Documentation.....	66
Appendix 1: Measurement Bases of Accounting Estimates	
Appendix 2: Factors That May be Indicators of Risks of Material Misstatement for Accounting Estimates	

---

<p>International Standard on Auditing (ISA) 540 (Revised), <i>Auditing Accounting Estimates and Related Disclosures</i>, should be read in conjunction with ISA 200, <i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing</i>.</p>
---

## Introduction

### Scope of this ISA

Formatted: Font: Bold

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to accounting estimates and related disclosures in an audit of financial statements. Specifically, it expands on how ISA 315 (Revised),<sup>1</sup> ISA 330,<sup>2</sup> ISA 500<sup>3</sup> and other relevant ISAs are to be applied in relation to accounting estimates. It also includes requirements and guidance on misstatements of individual accounting estimates, and indicators of possible management bias.

### Nature of Accounting Estimates

Formatted: Font: Bold

2. Many financial statement items are susceptible to an inherent lack of precision in their measurement, which is referred to as estimation uncertainty. In the ISAs, such financial statement items are referred to as accounting estimates. Accounting estimates vary widely in nature, and their measurement may also be subject to, or affected by, complexity and the need for the use of judgment by management. The extent to which they are subject to or affected by complexity and judgment is often related closely to the extent to which they are subject to or affected by estimation uncertainty. Accordingly, the auditor's identification and assessment of the risks of material misstatement relating to accounting estimates, and the auditor's responses to those assessed risks are affected by these three factors, and the interrelationship among them. (Ref: Para: A1, Appendix 1, Appendix 2)
3. When an accounting estimate is being made, its susceptibility to misstatement may increase because of the need to:
  - (a) With respect to complexity:
    - (i) Apply appropriate specialized skills or knowledge in the selection, design or application of the method used to make the accounting estimate, including when the method involves complex modelling.
    - (ii) Appropriately consider the relevance and reliability of the data used, whether the data is obtained from internal sources or from external information sources.
    - (iii) Maintain the integrity of the data used.
  - (b) With respect to the use of judgment by management:
    - (i) Appropriately take into account available information when selecting methods, assumptions, or data.
    - (ii) Mitigate the risk of possible management bias.
  - (c) With respect to estimation uncertainty:
    - (i) Take appropriate steps to address estimation uncertainty.

Formatted: Not Highlight

<sup>1</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>2</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>3</sup> ISA 500, *Audit Evidence*

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- (ii) Select an appropriate management point estimate or make appropriate related disclosures in the financial statements.

**Key Concepts of This ISA**

Formatted: Font: Bold

4. This ISA focuses the auditor's attention on designing and performing further audit procedures (including, where appropriate, tests of controls) responsive to the reasons for the assessment given to the assessed risks of material misstatement, particularly when those reasons include complexity, judgment or estimation uncertainty. This ISA also recognizes that the factors of complexity, judgment or estimation uncertainty are interrelated and that there are inherent limitations in reducing estimation uncertainty beyond certain limits.
5. The application of professional skepticism by the auditor is particularly important to the auditor's work relating to accounting estimates. Professional skepticism also is important because there is a particular risk of management bias affecting accounting estimates due to their subjective, potentially complex and uncertain nature.
6. This ISA requires an evaluation of accounting estimates based on the audit procedures performed and the audit evidence obtained. In doing so, the auditor is required to evaluate whether the accounting estimates, and related disclosures, are reasonable in the context of the applicable financial reporting framework. (Ref: Para. A2–A3).

**Effective Date**

Formatted: Font: Bold

7. This ISA is effective for audits of financial statements for periods beginning on or after [TBA].

**Objective**

Formatted: Font: 12 pt, Bold

8. The objective of the auditor is to obtain sufficient appropriate audit evidence about whether:
- (a) Accounting estimates, whether recognized or disclosed in the financial statements; and
- (b) Related disclosures in the financial statements, are reasonable in the context of the applicable financial reporting framework.

**Definitions**

9. For purposes of the ISAs, the following terms have the meanings attributed below:
- (a) Accounting estimate – A monetary amount, prepared in accordance with the requirements of the applicable financial reporting framework, the measurement of which is subject to estimation uncertainty. (Ref: Para. A4)
- (b) Auditor's point estimate or auditor's range – An amount, or range of amounts, respectively, derived from audit evidence or developed by the auditor in evaluating management's point estimate. (Ref: Para. A5)
- (c) Estimation uncertainty – The susceptibility of an accounting estimate to an inherent lack of precision in its measurement. (Ref: Para. A6)
- (d) Management bias – A lack of neutrality by management in the preparation of information. (Ref: Para. A7)

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- (e) Management's point estimate – The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.
- (f) Outcome of an accounting estimate – The actual monetary amount that results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by an accounting estimate. (Ref: Para A8)

## Requirements

Formatted: Font: 12 pt, Bold

### Risk Assessment Procedures and Related Activities

Formatted: Font: Bold

- 10. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including its internal control, as required by ISA 315 (Revised),<sup>4</sup> the auditor shall obtain an understanding of the following: (Ref: Para. A9–A10)
  - (a) The requirements of the applicable financial reporting framework relevant to accounting estimates, including the recognition criteria, measurement bases and the related presentation and disclosure requirements. (Ref: Para. A11–A13)
  - (b) Regulatory factors, if any, relevant to accounting estimates.<sup>5</sup> (Ref: Para. A14–A15)
  - (c) The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements. (Ref: Para. A16–A17)
  - (d) How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates. (Ref: Para. A18–A23)
  - (e) How management makes accounting estimates, including: (Ref: Para. A24–A25)
    - (i) The methods used, how they are selected or designed, and how they are applied, including the extent to which they involve complex modelling; (Ref: Para. A26–A31)
    - (ii) The process used to select assumptions, including alternatives considered and how management identifies significant assumptions; (Ref: Para. A32–A38)
    - (iii) The process used to select data, including the source(s) of that data and how management identifies significant data; (Ref: Para. A39–A42)
    - (iv) The extent to which management has applied specialized skills or knowledge, including whether a management's expert has been used; (Ref: Para. A43–A44)
    - (v) How the risk of possible management bias is identified and addressed; (Ref: Para. A45)
    - (vi) How management has addressed estimation uncertainty; and (Ref: Para. A46)

Formatted: Not Highlight

<sup>4</sup> ISA 315 (Revised), paragraphs 5–6 and 11

<sup>5</sup> ISA 315 (Revised), paragraph 11(a)

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- (vii) How management has addressed the need for a change from the prior period in the methods, assumptions or data used, and if so, the nature of, and reasons for, such changes. (Ref: Para. A47).
- (f) Each of the components of internal control as they relate to making accounting estimates.<sup>6</sup>  
(Ref: Para. A48–A60)
- 11. The auditor shall review the outcome of accounting estimates included in the previous period financial statements, or, where applicable, their subsequent re-estimation to assist in identifying and assessing the risk of material misstatement in the current period. The auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review. The review is not intended to call into question judgments about previous period accounting estimates that were appropriate based on the information available at the time they were made. (Ref: Para. A61–A66)
- 12. The auditor shall ~~consider~~ determine whether specialized skills or knowledge are required, in order to perform the risk assessment procedures, or to identify and assess the risks of material misstatement. (Ref: Para. A67–A70)

Formatted: Strikethrough

**Identifying and Assessing the Risks of Material Misstatement**

Formatted: Font: Bold

- 13. In applying ISA 315 (Revised), the auditor is required to identify and assess the risks of material misstatement, at the financial statement and assertion levels, and to determine whether any of the risks of material misstatement identified are, in the auditor's judgment, significant risks. In identifying and assessing risks of material misstatements in relation to an accounting estimate, the auditor shall take into account the extent to which the accounting estimate is subject to, or affected by, one or more, relevant factors, including: (Ref: Para. A71–A78) (a) Complexity in making the accounting estimate, including:
  - (i) The extent to which the method, including ~~complex~~ modelling, involves specialized skills or knowledge; and (Ref: Para. A79–A81)
  - (ii) The difficulty, if any, in obtaining relevant and reliable data and maintaining the integrity of that data; (Ref: Para. A82)
- (b) The need for the use of judgment by management and the potential for management bias, including with respect to methods, assumptions, and data; and (Ref: Para. A83–A85)
- (c) Estimation uncertainty, including the extent to which the accounting estimate is sensitive to the selection of different methods or to variations in the assumptions and data used. (Ref: Para. A86–A93)

Formatted: Strikethrough

**Responses to the Assessed Risks of Material Misstatement**

Formatted: Font: Bold

- 14. In responding to the assessed risks of material misstatement related to accounting estimates, the auditor shall ~~consider~~ determine whether specialized skills or knowledge are required to design and perform audit procedures, or to evaluate the results of those procedures. (Ref: Para. A67–A70)

Formatted: Strikethrough

<sup>6</sup> ISA 315 (Revised), paragraphs 14–24

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

15. In applying ISA 330, the auditor is required to design and perform further audit procedures to respond to the assessed risks of material misstatement, including significant risks, at the assertion level. In doing so: (Ref: Para A94–A95)

- (a) ~~In case of smaller and less complex entities or other entities,~~ when inherent risk is low, the auditor shall determine whether one or more of the following further audit procedures would provide sufficient appropriate audit evidence regarding the assessed risk(s) of material misstatement in the circumstances: (Ref: Para A96)
- (i) Obtaining audit evidence about events occurring up to the date of the auditor's report;
  - (ii) Testing how management made the accounting estimate and the data on which it is based; or
  - (iii) Developing a point estimate or range based on available audit evidence to evaluate management's point estimate.
- (b) When inherent risk is not low, the auditor's further audit procedures shall include procedures to obtain audit evidence about the matters in paragraphs 17–20, when applicable. (Ref: Para A97)

Deleted: W

The auditor's further audit procedures shall be responsive to the reasons for the assessment given to the risk of material misstatement in accordance with paragraph 13, recognizing that the higher the assessed risk of material misstatement the more persuasive the audit evidence needs to be.

16. If the auditor intends to rely on controls relating to accounting estimates, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to their operating effectiveness.<sup>7</sup> (Ref: Para A98–A100)

*Complexity*

Formatted: Font: Italic

17. In complying with paragraph 15(b), when the reasons for the assessment given to the risk of material misstatement include complexity related to management's use of a complex method (including complex modelling), or when management's method otherwise involves the use of specialized skills or knowledge, the auditor shall obtain sufficient appropriate audit evidence about the following matters: (Ref: Para A101–A104)

Formatted: Strikethrough

- (a) Whether the method, and significant data and significant assumptions, are appropriate in the context of the applicable financial reporting framework;
- (b) Whether significant data is relevant and reliable.<sup>8</sup>
- (c) Whether management has appropriately understood or interpreted significant data, including with respect to contractual terms. (Ref: Para. A105)
- (d) Whether the integrity of significant data and significant assumptions has been maintained in applying the method; and (Ref: Para. A106)
- (e) Whether the calculations are mathematically accurate and appropriately applied.

<sup>7</sup> ISA 330, paragraph 8

<sup>8</sup> ISA 500, paragraph 7



*Judgment*

Formatted: Font: Italic

18. In complying with paragraph 15(b), when the reasons for the assessment given to the risk of material misstatement include the need for the use of judgment by management, the auditor shall obtain sufficient appropriate audit evidence about the following matters:

- (a) When the accounting estimate involves the use of significant data or significant assumptions:
  - (i) Whether management's judgments regarding the selection and use of the method and the significant data and significant assumptions: (Ref: Para A107)
    - a. Are appropriate in the context of the measurement objectives and other requirements of the applicable financial reporting framework; or
    - b. Give rise to indicators of possible management bias.
  - (ii) Whether management's judgments about changes from previous periods in the method or the significant data or significant assumptions, are appropriate (Ref: Para. A108– A110).
  - (iii) Whether significant assumptions are consistent with each other and with those used in other accounting estimates or with assumptions used in other areas of the entity's business activities.
- (b) When relevant to the appropriateness of the significant assumptions or the appropriate application of the requirements of the applicable financial reporting framework, whether management has the intent to carry out specific courses of action and has the ability to do so. (Ref: Para. A111);
- (c) When management's application of the method involves complex modelling, whether judgments made have been applied consistently and whether, when applicable:
  - (i) The design of the model meets the measurement objective of the applicable financial reporting framework and is appropriate in the circumstances;
  - (ii) Changes, if any, from the previous period's model are appropriate in the circumstances; and
  - (iii) Adjustments, if any, to the output of the model are consistent with the measurement objective of the applicable financial reporting framework and are appropriate in the circumstances. (Ref: Para A112)

Formatted: Strikethrough

*Estimation Uncertainty*

Formatted: Font: Italic

19. In complying with paragraph 15(b), when the reasons for the assessment given to the risk of material misstatement include estimation uncertainty:

- (a) The auditor shall obtain sufficient appropriate audit evidence about whether, in the context of the applicable financial reporting framework:
  - (i) Management has taken appropriate steps to understand and address the estimation uncertainty, and develop a point estimate that meets the measurement objective; and (Ref: Para. A113–A115)

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- (ii) Management's point estimate is reasonable, and the disclosures in the financial statements that describe the estimation uncertainty are reasonable. (Ref: Para. A116–A125)
  - (b) When, based on the audit evidence obtained, in the auditor's judgment, management has not appropriately understood and addressed the estimation uncertainty, the auditor shall, to the extent possible, develop an auditor's point estimate or range to enable the auditor to evaluate the reasonableness of management's point estimate and the related disclosures in the financial statements that describe the estimation uncertainty. (Ref: Para A126–A134)
20. If the auditor concludes that it is appropriate to develop an auditor's range, the auditor shall only include in that range amounts that:
- (a) Are supported by the audit evidence; and
  - (b) The auditor has evaluated to be reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework.

**Evaluating the Reasonableness of the Disclosures Related to Accounting Estimates**

Formatted: Font: Bold

21. The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures related to accounting estimates are reasonable in the context of the requirements of the applicable financial reporting framework including: (Ref: Para. A135–A138)
- (a) In the case of a fair presentation framework, whether management has provided the disclosures beyond those specifically required by the applicable financial reporting framework that are necessary to achieve the fair presentation of the financial statements as a whole, or
  - (b) In the case of a compliance framework, whether the disclosures are those that are necessary for the financial statements not to be misleading.

**Overall Evaluation of the Accounting Estimates Based on Audit Procedures Performed**

Formatted: Justified

22. In applying ISA 330<sup>9</sup> to each accounting estimate for which the auditor's further audit procedures are required to address the matters in paragraphs 17–19, the auditor shall evaluate, based on the audit procedures performed and audit evidence obtained, whether: (Ref: Para A139–A141)
- (a) The assessments of the risks of material misstatement at the assertion level remain appropriate, including when indicators of possible management bias have been identified;
  - (b) Sufficient appropriate audit evidence has been obtained; and
  - (c) Management's decisions relating to the recognition, measurement, presentation and disclosure of these accounting estimates in the financial statements are in accordance with the applicable financial reporting framework.
23. Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated. In making this evaluation, the auditor shall consider all relevant audit evidence obtained whether corroborative or contradictory. If the

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>9</sup> ISA 330, paragraphs 25 and 26

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall evaluate the implications for the audit.<sup>10</sup> (Ref: Para. A2, A142–A146)

**Indicators of Possible Management Bias**

24. The auditor shall evaluate whether judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate possible bias on the part of the entity's management. When indicators of possible bias are identified the auditor shall evaluate the implications for the audit. (Ref: Para. A147–A152)

Formatted: Font: Not Bold

**Written Representations**

25. The auditor shall obtain written representations from management and, when appropriate, those charged with governance that they believe the methods, significant data, and significant assumptions used in making the accounting estimates and their related disclosures are appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of the applicable financial reporting framework. The auditor shall also consider the need to obtain representations about specific accounting estimates, including in relation to the methods, assumptions, or data used. (Ref: Para. A153–A154)

Formatted: Font: Not Bold

**Communication with Those Charged With Governance or Management**

26. In applying ISA 260 (Revised)<sup>11</sup> and ISA 265,<sup>12</sup> the auditor is required to communicate with those charged with governance or management about certain matters, including significant qualitative aspects of the entity's accounting practices and significant deficiencies in internal control, respectively. In doing so, the auditor shall consider the matters, if any, to communicate related to the extent to which the accounting estimates and their related disclosures are affected by, or subject to, complexity, the need for the use of judgment by management, estimation uncertainty, or other relevant factors. (Ref: Para. A155–A157)

Formatted: Font: Not Bold

Formatted: Font: Not Bold

**Documentation**

27. The audit documentation shall include:<sup>34</sup>

- (a) The basis for the auditor's evaluation of the reasonableness of the accounting estimates and related disclosures; and
- (b) Indicators of possible management bias, if any, and the auditor's evaluation thereof in forming the auditor's opinion on whether the financial statements as a whole are materially misstated. (Ref: Para. A158–A159)

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

\* \* \*

<sup>10</sup> ISA 330, paragraph 27

<sup>11</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 16(a)

<sup>12</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* paragraph 9

<sup>34</sup> ISA 230, *Audit Documentation*

Deleted:

## Application and Other Explanatory Material

### Nature of Accounting Estimates (Ref: Para. 2)

A1. Examples of situations where accounting estimates may be required include:

- Inventory obsolescence.
- Warranty obligations.
- Depreciation method.
- Outcome of long term contracts.
- Estimated costs arising from litigation settlements and judgments.
- Expected credit losses.
- Insurance contract liabilities.
- Financial instruments, including complex financial instruments that are not traded in an active market.
- Employee pension / ~~Employee benefits~~ liabilities.
- Share-based payments.
- Assets or liabilities acquired in a business combination, including goodwill and intangible assets.
- Property or equipment held for disposal.
- Transactions involving the exchange of assets or liabilities between independent parties without monetary consideration, for example, a non-monetary exchange of plant facilities in different lines of business.
- Infrastructure asset valuation.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Deleted:

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

### Key Concepts (Ref: Para. 6, 23)

Formatted: Font: Not Bold

A2. The auditor is required to obtain sufficient appropriate audit evidence about whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework. Reasonable, in the context of the applicable financial reporting framework,<sup>13</sup> means that all the relevant requirements of the applicable financial reporting framework have been applied appropriately, including those that address:

Formatted: Font: Not Bold

Formatted: Font: Not Bold

- The making of the accounting estimate, including the selection of the method, assumptions and data from available alternatives in view of the nature of the accounting estimate and the facts and circumstances of the entity;
- The selection of a management's point estimate that is representative of the range of reasonably possible outcomes of the measurement process; and
- The disclosures about the accounting estimate, including disclosures about how the accounting estimate was developed and that explain the nature, extent, and sources of estimation uncertainty.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>13</sup> See also ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 13(c).

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

Other considerations that may be relevant to the auditor's consideration of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework include whether:

- The data and assumptions used in making the accounting estimate are consistent with each other and with those used in other accounting estimates or areas of the entity's business activities; and
- The accounting estimate takes into account appropriate information as required by the applicable financial reporting framework.

A3. The term "appropriate" is used in this ISA to mean in a manner that both complies with the requirements of the applicable financial reporting framework and that, in doing so, reflects judgments that are consistent with the measurement basis in the applicable financial reporting framework.

#### Definitions

*Accounting Estimate* (Ref: Para. 9(a))

A4. Accounting estimates are monetary amounts that may be classes of transactions or account balances recognized in the financial statements, but also include accounting estimates used in disclosures or used to make judgments about whether or not to recognize or disclose a monetary amount.

*Auditor's Point Estimate or Auditor's Range* (Ref: Para. 9(b))

A5. An auditor's point estimate or range may be developed for an accounting estimate as a whole (for example, the expected credit losses for a particular loan portfolio or the fair value of different types of financial instruments), or a component of an accounting estimate (for example, an amount to be used as a significant assumption or significant data for an accounting estimate). A similar approach may be taken by the auditor in developing an amount or range of amounts in evaluating an item of data or an assumption (for example, an estimated useful life of an asset).

*Estimation Uncertainty* (Ref: Para. 9(c))

A6. Estimation uncertainty is an inherent characteristic of accounting estimates. The nature and implications of estimation uncertainty are discussed further in Appendix 2.

*Management Bias* (Ref: Para. 9(d))

A7. Financial reporting frameworks often call for neutrality, that is, freedom from bias. The inherent lack of precision in the measurement of accounting estimates gives rise to the need for the use of judgment by management. Such judgment may be influenced by unintentional or intentional management bias (for example, as a result of motivation to achieve a desired profit target or capital ratio). The susceptibility of an accounting estimate to management bias increases with the extent to which there is a need for judgment in making the accounting estimate. Management bias may be difficult to detect at an account level and may only be identified when considered in groups of accounting estimates, all accounting estimates in aggregate, or when observed over a number of accounting periods.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*Outcome of an Accounting Estimate* (Ref: Para. 9(f))

- A8. Some accounting estimates, by their nature, do not have an outcome that is relevant for the auditor's work performed in accordance with this ISA. For example, an accounting estimate may be based on perceptions of market participants at a point in time. Accordingly, the price realized when an asset is sold or a liability is transferred may differ from the related accounting estimate made at the reporting date because, with the passage of time, the market participants' perceptions of value have changed.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

**Risk Assessment Procedures and Related Activities** (Ref: Para. 10)

- A9. In relation to performing the risk assessment procedures and related activities required by paragraph 10 of this ISA for the entity's accounting estimates, the auditor's primary consideration is whether the understanding obtained is sufficient to:

Formatted: Font: Not Bold

- Identify and assess the risks of material misstatement, including determining whether, in the auditor's judgment, any of those risks are significant risks; and
- Plan the nature, timing and extent of further audit procedures.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

- A10. ISA 315 (Revised) notes that smaller entities may use less structured means and simpler processes and procedures to achieve their objectives.<sup>14</sup> Further, for entities that have simple businesses, processes relevant to financial reporting may also be uncomplicated, including as they relate to accounting estimates. In those situations, the extent of the understanding of the matters in paragraph 10 is likely influenced by the extent to which these matters are relevant to the entity (for example the entity may be subject to few, if any, regulatory factors or specialized skills or knowledge may not have been applied in making the accounting estimates). Obtaining this understanding may be primarily achieved through inquiries from management with appropriate responsibilities for the financial statements. ISA 315 (Revised) also notes that the manner in which the auditor's understanding of the entity and its environment are documented is for the auditor to determine using professional judgment. For example, in audits of small entities the documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.<sup>15</sup> For entities that have simple businesses and processes, relevant to financial reporting, the auditor's documentation may be simple in form and relatively brief.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*Obtaining an Understanding of the Requirements of the Applicable Financial Reporting Framework* (Ref: Para. 10(a))

Formatted: Font: Not Bold

Formatted: Font: Not Bold

- A11. Obtaining an understanding of the requirements of the applicable financial reporting framework provides the auditor with a basis for discussion with management and, where applicable, those charged with governance about how management has applied those requirements relevant to the accounting estimates, and about the auditor's determination of whether they have been applied appropriately. This understanding also may assist the auditor in communicating with those charged with governance when the auditor considers a significant accounting practice, that is acceptable

Formatted: Font: Not Bold

<sup>14</sup> ISA 315 (Revised) paragraph A53

<sup>15</sup> ISA 315 (Revised) paragraph A152–A153 <sup>38</sup>  
ISA 260 (Revised), paragraph 16(a)

under the applicable financial reporting framework, not to be the most appropriate in the circumstances of the entity.<sup>38</sup>

A12. For certain accounting estimates, financial reporting frameworks may prescribe or provide guidance on the basis for selecting management's point estimate, which may be, for example, the most likely outcome<sup>16</sup> or a discounted probability-weighted expected value. Depending on the circumstances, it may be possible for the accounting estimate to be determined directly, or it may be possible to select a management point estimate only after considering alternative assumptions or the range of possible measurement outcomes.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A13. Financial reporting frameworks may specify criteria for, or guidance on, the disclosure of information concerning judgments, assumptions, or other sources of estimation uncertainty relating to accounting estimates.

Formatted: Font: Not Bold

*Obtaining an Understanding of Regulatory Factors* (Ref: Para. 10(b)).

Formatted: Font: Not Bold, Italic

A14. Obtaining an understanding of the regulatory factors that are relevant to accounting estimates (for example regulation established by banking and insurance regulators) may assist the auditor in determining whether the regulatory framework:

Formatted: Font: Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

- Addresses conditions for the recognition, or methods for the measurement, of accounting estimates, or provides related guidance thereon;
- Specifies, or provides guidance about, disclosures in addition to the requirements of the applicable financial reporting framework; or
- Provides an indication of areas for which there may be a potential for management bias to meet regulatory requirements.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A15. Obtaining an understanding of the applicable regulatory factors may also highlight requirements for regulatory purposes that are not consistent with requirements of the applicable financial reporting framework, which may indicate potential risks of material misstatement. For example, for certain financial statement items, the measurement basis for regulatory capital maintenance purposes may require earlier recognition of losses than the measurement basis required by the applicable financial reporting framework.

Formatted: Font: Not Bold

*Obtaining an Understanding of the Nature of the Accounting Estimates and Related Disclosures That the Auditor Expects to be Included in the Financial Statements* (Ref: Para. 10(c)).

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

A16. Obtaining an understanding of the nature of accounting estimates that the auditor expects to be included in the entity's financial statements assists the auditor in understanding the measurement basis of such accounting estimates and the nature and extent of disclosures that may be relevant. Such an understanding provides the auditor with a basis for discussion with management about how management has made the accounting estimates. The auditor may obtain an understanding of the accounting estimates that the auditor expects to be included in the financial statements through the auditor's:

Formatted: Font: Italic

Formatted: Font: Not Bold

- Understanding of the nature of the entity, including the nature of the assets and liabilities and other financial statement items that it would be expected to have, given the nature of its

Formatted: Font: Not Bold

<sup>16</sup> Different financial reporting frameworks may use different terminology to describe point estimates determined in this way.

operations, ownership and governance structures and investments, the way it is structured and financed, its objectives and strategies and related business risks;

- Understanding of the applicable financial reporting framework, and other relevant legal, regulatory and other external factors;
- Past knowledge and experience, including that obtained through other audits; and
- Previous experience with the entity.<sup>17</sup>

A17. Developing an expectation of the nature of the accounting estimates and related disclosures may also assist the auditor in understanding whether the accounting estimates are complex to make, require significant judgment by management, or have high estimation uncertainty.

*Obtaining an Understanding of How Management Identifies the Need for the Accounting Estimates* (Ref: Para. 10(d))

A18. The preparation of the financial statements requires management to determine whether a transaction, event or condition gives rise to the need to make an accounting estimate, and that all necessary accounting estimates have been recognized, measured, presented, and disclosed in the financial statements, in accordance with the applicable financial reporting framework.

A19. Management's identification of transactions, events and conditions that give rise to the need for accounting estimates is likely to be based on:

- Management's knowledge of the entity's business and the industry in which it operates.
- Management's knowledge of the implementation of business strategies in the current period.
- Where applicable, management's cumulative experience of preparing the entity's financial statements in previous periods.

Management may periodically review the circumstances that give rise to the need for accounting estimates and for re-estimating them as necessary. Further, management may have established a risk assessment process in this area which may involve a formal risk management or similar function. In such circumstances, the auditor's risk assessment procedures may be directed at understanding such a review or risk assessment processes. How management addresses the completeness of accounting estimates, particularly estimates related to liabilities, is often an important consideration of the auditor.

A20. The auditor's understanding of the entity and its environment obtained during the performance of risk assessment procedures, together with other audit evidence obtained during the course of the audit, assists the auditor in identifying circumstances, or changes in circumstances, that may give rise to the need for accounting estimates.

A21. Inquiries of management about changes in circumstances may include, for example, whether:

- The entity has engaged in new types of transactions that may give rise to accounting estimates.
- Terms of transactions that gave rise to accounting estimates have changed.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>17</sup> ISA 315 (Revised), paragraph 9



PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Accounting policies relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework or otherwise.
- Regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- New conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A22. During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. ISA 315 (Revised) deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.<sup>18</sup>

Formatted: Font: Not Bold

Considerations Specific to Smaller Entities

Formatted: Font: Not Bold

A23. Obtaining this understanding for smaller entities is often less complex as their business activities and transactions may be less complex. Further, often a single person, for example the owner-manager, identifies the need to make the accounting estimates and the auditor's inquiries may be focused accordingly.

Formatted: Font: Not Bold

Obtaining an Understanding of How Management Makes Accounting Estimates (Ref: Para. 10(e))

Formatted: Font: Not Bold, Italic

A24. The preparation of the financial statements also requires management to establish financial reporting processes for making accounting estimates, including adequate internal control. Such processes include the following:

Formatted: Font: Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

- Selecting appropriate accounting policies and prescribing estimation processes, including appropriate estimation or valuation methods, including, where applicable, models.
- Developing or identifying relevant data and assumptions that are used in making accounting estimates.
- Periodically reviewing the circumstances that give rise to the accounting estimates and reestimating as necessary.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A25. Matters that the auditor may consider in obtaining an understanding of how management makes the accounting estimates include, for example:

Formatted: Font: Not Bold

- The types of accounts or classes of transactions to which the accounting estimate relate (for example, whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions).
- Whether and, if so, how management has used recognized measurement techniques for making particular accounting estimates.
- Whether the accounting estimates were made based on data available at an interim date and, if so, whether and how management has taken into account the effect of events, transactions and changes in circumstances occurring between that date and the period end.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Methods (Ref: Para. 10(e)(i))

Formatted: Font: Not Bold

<sup>18</sup> ISA 315 (Revised), paragraph 16

A26. A method is a measurement technique used by management to apply the measurement basis in the financial reporting framework. In some cases, the applicable financial reporting framework may prescribe the method to be used for making an accounting estimate. In many cases, however, the applicable financial reporting framework does not prescribe a single method or the required measurement basis prescribes, or allows, the use of alternative methods.

Formatted: Font: Not Bold

A27. For example, one recognized method used to make accounting estimates relating to share-based payment transactions is to determine a theoretical option call price using the Black Scholes option pricing formula. This method may be applied by modelling the data and assumptions of that formula based on the terms of the transaction and market conditions relevant to the underlying share.

Formatted: Font: Not Bold

A28. A model is a tool used to make the accounting estimate that applies assumptions and data, and a set of relationships between them as specified by the method.

Formatted: Font: Not Bold

A29. A model is complex when:

Formatted: Font: Not Bold

- The method it applies requires specialized skills or knowledge;
- Relevant and reliable data needed for use in the model is difficult to obtain;
- The integrity of the data is difficult to maintain;
- It exhibits a significant degree of complexity in its design or operation, which may, for example, involve more extensive use of information technology or large volumes of data; or
- It uses multiple data sources or assumptions with complex-interrelationships.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A30. Management may design and implement specific controls around models used for making accounting estimates, whether management's own model or an external model. Controls that address complexity around models are more likely to be relevant to the audit when the model used is complex, such as an expected credit loss model or a model used for the valuation of insurance contract liabilities. Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and of related control activities include the following:

Formatted: Font: Not Bold

- How management determines the relevance and accuracy of the model;
- The validation or back testing of the model, including whether the model is validated prior to use and revalidated at regular intervals to determine whether it remains suitable for its intended use. The entity's validation of the model may include evaluation of:
  - The model's theoretical soundness; ◦ The model's mathematical integrity; ◦ The accuracy and completeness of the data and appropriate assumptions used in the model; and
  - Whether the appropriate data is used in the model and appropriate assumptions have been made;
- How the model is appropriately changed or adjusted on a timely basis for changes in market or other conditions and whether there are appropriate change control policies over the model;
- Whether adjustments, also referred to as overlays in certain industries, are made to the output of the model and whether such adjustments are appropriate under the circumstances and in accordance with the requirements of the applicable financial reporting framework; and

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Whether the model is adequately documented, including its intended applications, limitations, key parameters, required data and assumptions, the results of any validation performed on it and the nature of, and basis for, any adjustments made to its output.

Formatted: Font: Not Bold

A31. Estimates may have greater susceptibility to material misstatement relating to the use of models in certain circumstances. For example, in cases when management has developed a model internally and has relatively little experience in doing so, or uses a model that applies a method that is not established or commonly used in a particular industry or environment.

Formatted: Font: Not Bold

Assumptions Ref: Para. 10(e)(ii))

Formatted: Font: Not Bold

A32. Assumptions are integral components of accounting estimates and may include matters such as the choice of an interest rate, a discount rate, or judgments about future conditions or events. An assumption may be selected by management from a range of possible alternatives for use in applying a method to make accounting estimates.

Formatted: Font: Not Bold

A33. Matters that the auditor may consider in obtaining an understanding of the assumptions used in making the accounting estimates include, for example:

Formatted: Font: Not Bold

- The nature of the assumptions used, the alternatives considered and the basis for management's selection. The applicable financial reporting framework may provide criteria or guidance to be used in the selection of an assumption.

Formatted: Font: Not Bold

How management assesses whether the assumptions are relevant and complete.

Formatted: Font: Not Bold

- When applicable, how management determines that the assumptions are consistent with each other and with those used in other accounting estimates or areas of the entity's business activities.

Formatted: Font: Not Bold

- How the assumptions are consistent with other matters:

Formatted: Font: Not Bold

- Within the control of management (for example, assumptions about the maintenance programs that may affect the estimation of an asset's useful life), and whether they are consistent with the entity's business plans and the external environment; and

Formatted: Font: Not Bold

- Outside the control of management (for example, assumptions about interest rates, mortality rates, potential judicial or regulatory actions, or the variability and the timing of future cash flows).

Formatted: Font: Not Bold

- Management's documentation supporting the assumptions.

Formatted: Font: Not Bold

- The requirements of the applicable financial reporting framework related to the disclosure of assumptions.

Formatted: Font: Not Bold

- How management identifies significant assumptions.

Formatted: Font: Not Bold

Assumptions may be made or identified by a management's expert to assist management in making the accounting estimates. Such assumptions, when used by management, become management's assumptions.

Formatted: Font: Not Bold

A34. With respect to fair value accounting estimates, assumptions vary in terms of the sources of the data and the basis for the judgments to support them, as follows:

Formatted: Font: Not Bold

- (a) Those that reflect what marketplace participants would use in pricing an asset or liability, developed based on market data obtained from sources independent of the reporting entity.

Formatted: Font: Not Bold

- (b) Those that reflect the entity's own judgments about what assumptions marketplace participants would use in pricing the asset or liability, developed based on the best data available in the circumstances.

Formatted: Font: Not Bold

In practice, however, the distinction between (a) and (b) may not always be apparent and distinguishing between them depends on understanding the sources of data and the basis for the judgments that support the assumption. Further, it may be necessary for management to select from a number of different assumptions used by different marketplace participants.

Formatted: Font: Not Bold

#### Significant data and significant assumptions

Formatted: Font: Not Bold

A35. Data and assumptions used in making an accounting estimate are referred to as significant data or significant assumptions in this ISA if a reasonable variation in the data or assumption would materially affect the measurement of the accounting estimate. For example, an accounting estimate may be determined applying a method that uses several data sets and several assumptions, one or more of which particularly influences the measurement of the accounting estimate because the range of reasonable assumptions may be large or the model may be sensitive to specific data or assumption because of the underlying formulas.

Formatted: Font: Not Bold

#### Inactive or illiquid markets

Formatted: Font: Not Bold

A36. Some financial reporting frameworks require different accounting treatments depending on the level of activity in the market. Estimation uncertainty increases and valuation is more complex when the markets in which financial instruments or their component parts are traded become inactive. Valuation techniques selected when market information was available may not provide appropriate valuations in times of stress. However, even where markets are inactive, prices achieved may still provide relevant evidence about fair value. In these circumstances, valuations may be developed based on more unobservable inputs, requiring more judgment by management. When markets are inactive, prices quoted may not represent prices at which market participants would trade or may represent forced transactions (such as when disposal of an asset is necessary to meet regulatory or legal requirements).

Formatted: Font: Not Bold

A37. Particular difficulties may develop where there is severe curtailment or even cessation of trading in particular financial instruments. In these circumstances, financial instruments that have previously been valued using market prices may need to be valued using a model; or, where they have previously been valued using a model, the model may need to change. Reacting to changes in market conditions may be difficult if management does not possess the specialized skills or knowledge necessary to develop an appropriate model on a timely basis, or to select the valuation technique that may be most appropriate in the circumstances.

Formatted: Font: Not Bold

A38. When markets are inactive or illiquid, the auditor's understanding of how management selects assumptions may include understanding whether management has:

Formatted: Font: Not Bold

- Implemented appropriate policies for adapting the application of the method in such circumstances. Such adaptation may include making model adjustments or developing new models that are appropriate in the circumstances;

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Resources with the necessary skills or knowledge to adapt or develop a model, if necessary on an urgent basis, including selecting the valuation technique that is appropriate in such circumstances;
- The resources to determine the range of outcomes, given the uncertainties involved, for example by performing a sensitivity analysis;
- The means to assess how, when applicable, the deterioration in market conditions has affected the entity's operations, environment and relevant business risks and the implications for the entity's accounting estimates, in such circumstances; and
- An appropriate understanding of how the price data from particular external information sources may vary in such circumstances.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Data (Ref: Para. 10(e)(iii))

Formatted: Font: Not Bold

A39. Data comprises factual data, which can be observed directly, and derived data, which is data obtained through applying analytical or interpretive techniques to factual data. The analytical or interpretive techniques to be used in deriving data have a well-established theoretical basis and do not involve the application of judgment. Examples of data include:

Formatted: Font: Not Bold

- Prices agreed in market transactions;
- Operating times or quantities of output from a production machine;
- Historical prices or other terms included in contracts (for example, a loan agreement may include a contracted interest rate, a payment schedule, and term of the loan); or
- Forward looking data such as economic or earnings forecasts made publicly, or a future payment schedule in a loan agreement.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Not Highlight

Formatted: Font: Not Bold

A40. Data can come from a wide range of sources. For example, data can be:

Formatted: Font: Not Bold

- Generated within the organization or externally;
- Obtained from a system that is either within or outside the general or subsidiary ledgers;
- Observable in contracts; or
- Observable in legislative or regulatory pronouncements.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Understanding the source of the data used to make the accounting estimates may help the auditor in understanding the risks with respect to the relevance and reliability of the data.

Formatted: Font: Not Bold

A41. Matters that the auditor may consider in obtaining an understanding of the data on which the accounting estimates are based include:

Formatted: Font: Not Bold

- The nature of the data.
- How management evaluates whether the data is appropriate.
- The accuracy and completeness of the data.
- The consistency of the data used with data used in previous periods.
- The complexity of the information technology systems used to obtain and process the data, including when this involves handling large volumes of data.
- How the data is obtained, transmitted and processed and how its integrity is maintained.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

A42. When making an accounting estimate involves large volumes of data or otherwise involves complex processing, management may make extensive use of information technology. In such cases, controls relevant to the audit are likely to include general IT controls and application controls. Such controls may address risks related to:

Formatted: Font: Not Bold

- The complete and accurate extraction of data from the entity's records or from external information sources; and
- The complete and accurate flow of data through the entity's information systems and the appropriateness of any modification to the data used in making accounting estimates, such as the translation of data into a different currency. Controls to maintain the integrity and security of the data are also likely to be relevant to the audit.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Management's Application of Specialized Skills or Knowledge, Including the Use of Management's Experts (Ref: Para. 10(e)(iv))

Formatted: Font: Not Bold

A43. Management may have, or the entity may employ individuals with, the skills and knowledge necessary to make the accounting estimates. In some cases, however, management may need to engage an expert to make, or assist in making, them. This need may arise because of, for example: The specialized nature of the matter requiring estimation, for example, the accounting estimate may involve measurement of mineral or hydrocarbon reserves in extractive industries or the evaluation of the likely outcome of applying complex contractual terms.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

- The complex nature of the models required to apply the relevant requirements of the applicable financial reporting framework, as may be the case in certain measurements, such as level 3 fair values.
- The unusual or infrequent nature of the condition, transaction or event requiring an accounting estimate.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A failure by management to apply the required specialized skills or knowledge, including engaging an expert when management does not otherwise have access to an individual with such skills and knowledge, increases control risk.

Formatted: Font: Not Bold

Considerations specific to smaller entities

Formatted: Font: Not Bold

A44. In smaller entities, the circumstances requiring accounting estimates often are such that the owner manager is capable of making the required point estimate. In some cases, however, an expert will be needed. Discussion with the owner-manager early in the audit process about the nature of any accounting estimates, the completeness of the required accounting estimates, and the adequacy of the estimating process may assist the owner-manager in determining the need to use an expert.

Formatted: Font: Not Bold

Risk of Management Bias (Ref: Para. 10(e)(v))

Formatted: Font: Not Bold

A45. Matters that the auditor may consider in obtaining an understanding of how management addresses the risk of management bias in making accounting estimates includes whether, and if so how, management:

Formatted: Font: Not Bold

- Identifies and pays particular attention to accounting estimates that involve greater levels of subjectivity in related judgments.

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Monitors key performance indicators that may indicate unexpected or inconsistent performance compared with historical or budgeted performance or with other known factors.
- Identifies financial or other incentives that may be a motivation for bias.
- Monitors changes in the methods, or in significant sources of data and significant assumptions, used in making accounting estimates.
- Establishes appropriate oversight and review of models used in making accounting estimates.
- Requires documentation of the rationale for, or an independent review of, significant judgments made in making accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Estimation Uncertainty (Ref: Para. 10(e)(vi))

Formatted: Font: Not Bold

A46. Matters that may be appropriate for the auditor to consider in obtaining an understanding of whether, and if so, how management has addressed estimation uncertainty include, for example:

Formatted: Font: Not Bold

- Whether, and if so, how management has identified alternative methods, significant assumptions or sources of significant data that are appropriate in the context of the applicable financial reporting framework.

Formatted: Font: Not Bold

Whether, and if so, how management has considered alternative outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the data or assumptions on the accounting estimate.

Formatted: Font: Not Bold

- How management selects its point estimate.
- Whether management monitors the outcome of accounting estimates made in previous periods, and how management has appropriately responded to the results of that monitoring.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Changes in Methods, Assumptions or Data Used in Making Accounting Estimates (Ref: Para. 10(e)(vii))

Formatted: Font: Not Bold

A47. In evaluating how management makes the accounting estimates, the auditor is required to understand the extent to which management has identified and addressed the need for change in the methods, assumptions or data used. If management has changed the method for making an accounting estimate, it is important that management can demonstrate that the new method is more appropriate, or is itself a response to changes in the environment or circumstances affecting the entity, or to changes in the requirements of the applicable financial reporting framework or regulatory environment. It is also important that management can demonstrate, when no change has been made, that the continued use of the previous methods, assumptions and data is appropriate in view of the current environment or circumstances (for example, whether management's assumptions about marketplace transactions or price quotes reflect fair value when there is reduced market activity).

Formatted: Font: Not Bold

Components of Internal Control Relating To Accounting Estimates (Ref: Para. 10(f))

Formatted: Font: Not Bold, Italic

A48. Paragraphs 14–24 of ISA 315 (Revised) address the auditor's understanding of the components of internal control and provide useful information for the auditor in considering the components of internal control as they relate to making accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

A49. Some entities may have a wide range of accounting estimates, some of which may be significantly affected by, or subject to, complexity, the need for use of judgment by management, and estimation

Formatted: Font: Not Bold



uncertainty. In such circumstances, there may be an increased need for the application of specialized skills or knowledge, and management may make extensive use of information technology in making the estimates. In such cases, it will likely be more important for the auditor to understand the design and implementation of relevant controls, and also to test their operating effectiveness in addressing the assessed risks of material misstatements.

**The Control Environment Relevant To Making Accounting Estimates**

A50. The auditor's understanding of the control environment relevant to making accounting estimates includes consideration of the influence that the elements of the control environment would be expected to have on the risks of material misstatement.<sup>19</sup> This may include, for example, whether:

- Management, with the oversight of those charged with governance, has created and maintained a culture of transparency and proper ethical behavior; and
- The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control and whether those other components are not undermined by deficiencies in the control environment.

A51. In some industries, such as the banking or insurance industry, the term governance may be used to describe the control environment as described in ISA 315 (Revised).<sup>20</sup>

**Oversight by those charged with governance**

A52. With respect to accounting estimates, the control environment may be further influenced by such matters as the extent to which those charged with governance:

- Have the skills or knowledge to understand the characteristics of a particular method or model to make accounting estimates, or the risks related to the accounting estimate, for example, risks related to the method or information technology used in making the accounting estimates;
- Have the skills and knowledge to understand whether management made the accounting estimates in accordance with the applicable financial reporting framework; or
- Are independent from management, have the information required to evaluate on a timely basis how management made the accounting estimates, and the authority to challenge management when those actions appear to be inadequate or inappropriate.

A53. Depending on the nature of the accounting estimates, the auditor may consider obtaining an understanding of the oversight by those charged with governance over matters such as:

- Management's process for making the accounting estimates, including the use of models.
- The monitoring activities undertaken by management. This may include supervision and review of the accounting estimates designed to detect and correct any deficiencies in the design or operating effectiveness of controls over the accounting estimates.

A54. The oversight by those charged with governance may particularly be important for accounting estimates that:

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>19</sup> ISA 315 (Revised), paragraph A78  
<sup>20</sup> ISA 315 (Revised) paragraph A77



PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Require significant judgment by management, for example in the selection of the method, significant assumptions or significant data;
- Have high estimation uncertainty;
- Are complex to make, for example, because of the extensive use of information technology, large volumes of data or the use of multiple data sources or assumptions with complex interrelationships;
- Had, or ought to have had, a change in the method, assumptions or data compared to previous periods; or
- Involve significant data and significant assumptions.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

**The Entity's Risk Assessment Process**

Formatted: Font: Not Bold

A55. If the entity has a risk assessment process, the auditor is required to obtain an understanding of the process and its results in relation to the entity's accounting estimates, including how management determines the risks to be managed arising from changes in:

Formatted: Font: Not Bold

- The requirements of the applicable financial reporting framework related to the accounting estimates;
- The availability or nature of data sources that are relevant to making the accounting estimates or that may affect the reliability of the data used;
- The entity's information systems or IT environment; and
- Key personnel.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

**The Entity's Information Systems**

Formatted: Font: Not Bold

A56. With respect to the entity's information system relevant to making accounting estimates, it may be appropriate for the auditor to obtain an understanding as to whether:

Formatted: Font: Not Bold

- The information systems have the capability and are appropriately configured to process large volumes of data;
- When diverse systems are required to process complex transactions, regular reconciliations between the systems are made, in particular when the systems do not have automated interfaces or may be subject to manual intervention;
- The design and calibration of models is periodically evaluated;
- Management has controls around access, change and maintenance of individual models to maintain a strong audit trail of the accredited versions of models and to prevent unauthorized access or amendments to those models;
- When using external information sources, management considers and appropriately addresses the risks related to processing or recording the data, recognizing management's responsibility for appropriately reconciling and challenging the data from those sources; and
- There are appropriate controls over the transfer of information relating to accounting estimates into the general ledger, including appropriate controls over related journal entries.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A57. Information systems relevant to financial reporting are an important source for the quantitative and qualitative disclosures in the financial statements. This may include a system developed and

Formatted: Font: Not Bold

maintained by the entity primarily for internal reporting, but which also captures, processes and generates data that may be included in disclosures relating to accounting estimates.

#### Control Activities

Formatted: Font: Not Bold

A58. As part of obtaining an understanding of the control activities relating to accounting estimates, the auditor may consider:

Formatted: Font: Not Bold

- How management determines the appropriateness of the data used to develop the accounting estimates, including when management uses an external information source or data from outside the general and subsidiary ledgers.
- The review and approval of accounting estimates, including the assumptions or data used in their development, by appropriate levels of management and, where appropriate, those charged with governance.
- The segregation of duties between those committing the entity to the underlying transactions and those responsible for making the accounting estimates, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services. For example, in the case of a large financial institution, relevant segregation of duties may consist of an independent function responsible for estimation and validation of fair value pricing of the entity's financial products staffed by individuals whose remuneration is not tied to such products.
- The control activities included in paragraph A30 and A42.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### The Entity's Activities to Monitor Controls over How the Accounting Estimates Are Made

Formatted: Font: Not Bold

A59. For entities with an internal audit function, its work may be particularly helpful to the auditor in obtaining an understanding of:

Formatted: Font: Not Bold

- The nature and extent of management's use of accounting estimates;
- The design and implementation of control activities that address the risks related to the data, assumptions and models used to make the accounting estimates;
- The systems that generate the data on which the accounting estimates are based; and • How new risks relating to accounting estimates are identified, assessed and managed.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### Considerations Specific to Smaller Entities

Formatted: Font: Not Bold

A60. In smaller entities, accounting estimates may be generated outside the general ledger, controls over their development may be limited, and an owner-manager may have significant influence over the determination. The owner-manager's role in making the accounting estimates may need to be taken into account by the auditor both when identifying the risks of material misstatement and when considering the risk of management bias. ISA 315 (Revised)<sup>21</sup> includes specific considerations to smaller entities that the auditor might find helpful in obtaining an understanding of the components of internal control as it relates to making accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>21</sup> ISA 315 (Revised) paragraph A52, A56, A57, A88, A93, A95, A101, A102 and A108

**Reviewing the Outcome or Re-Estimation of Previous Period Accounting Estimates** (Ref: Para. 11)

A61. A review of the outcome or re-estimation of accounting estimates made in previous periods (retrospective review) assists in identifying and assessing the risks of material misstatement, specifically in circumstances when previous period accounting estimates have an outcome through transfer or realization of the asset or liability, or are re-estimated for the purpose of the current period. Through performing a retrospective review, the auditor may obtain:

- Information regarding the effectiveness of management's previous estimation process, from which the auditor can obtain insight about the likely effectiveness of management's current process.
- Audit evidence that is pertinent to the re-estimation, in the current period, of previous period accounting estimates.
- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.
- Information regarding the complexity and estimation uncertainty pertaining to the accounting estimates.
- Information regarding the susceptibility of accounting estimates to, or that may be an indicator of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.

A62. A retrospective review may be performed over accounting estimates made for prior period financial statements but also for accounting estimates made over several periods or a shorter period (such as half-yearly or quarterly). When entities make accounting estimates that are realized within a shorter timescale than full financial reporting periods, considering the outcomes of such accounting estimates may also provide important information about management's current effectiveness in making accounting estimates and other factors relevant to making estimates. Considering outcomes of accounting estimates that are realized between the end of the financial reporting period and the end of the audit may be useful for similar reasons.

A63. A retrospective review of management judgments and assumptions related to significant accounting estimates is required by ISA 240.<sup>22</sup> As a practical matter, the auditor's review of previous period accounting estimates as a risk assessment procedure in accordance with this ISA may be carried out in conjunction with the review required by ISA 240.

A64. The auditor may judge that a more detailed review is required for those accounting estimates that have changed significantly from the previous period, or for those accounting estimates for which the inherent risks were not low in the previous periods. As part of the detailed review, the auditor may pay particular attention, when possible, to the effect of significant assumptions used in making the previous estimates. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.

A65. For fair value accounting estimates and other accounting estimates based on current conditions at the measurement date, more variation may exist between the fair value amount recognized in the

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>22</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 32(b)(ii)

previous period's financial statements and the outcome or the amount re-estimated for the purpose of the current period. This is because the measurement objective for such accounting estimates deals with perceptions about value at a point in time, which may change significantly and rapidly as the environment in which the entity operates changes. The auditor may therefore focus the review on obtaining information that would be relevant to identifying and assessing risks of material misstatement. For example, in some cases, obtaining an understanding of changes in marketplace participant assumptions that affected the outcome of a previous period's fair value accounting estimates may be unlikely to provide relevant information for audit purposes. If so, then the auditor's consideration of the outcome of previous period's fair value accounting estimates may be directed more towards understanding the effectiveness of management's prior estimation process, that is, management's track record, from which the auditor can judge the likely effectiveness of management's current process.

A66. A difference between the outcome of an accounting estimate and the amount recognized in the previous period's financial statements does not necessarily represent a misstatement of the previous period's financial statements. However, it may do so if, for example, the difference arises from information that was available to management when the previous period's financial statements were finalized, or that could reasonably be expected to have been obtained and taken into account in the preparation of those financial statements. Many financial reporting frameworks contain guidance on distinguishing between changes in accounting estimates that constitute misstatements and changes that do not, and the accounting treatment required to be followed in each case.

Formatted: Font: Not Bold

#### Specialized Skills or Knowledge (Ref: Para. 12, 14)

A67. In planning the audit, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the audit engagement.<sup>23</sup> In some cases, the auditor may determine that specialized skills or knowledge are required in relation to specific areas of accounting or auditing. In addition, ISA 220 requires the engagement partner to be satisfied that the engagement team, and any auditor's external experts, collectively have the appropriate competence and capabilities to perform the audit engagement.<sup>24</sup> During the course of the audit, the auditor may identify a need for specialized skills or knowledge to be applied in relation to one or more aspects of the accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A68. Matters that may affect the auditor's determination of whether specialized skills or knowledge is required include, for example:

Formatted: Font: Not Bold

- The nature of the accounting estimates for a particular business or industry (for example, mineral deposits, agricultural assets, complex financial instruments, insurance contract liabilities).
- The degree of estimation uncertainty.
- The complexity of the method or model used.
- The complexity of the requirements of the applicable financial reporting framework relevant to accounting estimates, including whether there are areas known to be subject to differing

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>23</sup> ISA 300, *Planning an Audit of Financial Statements*, paragraph 8(e)

<sup>24</sup> ISA 220, *Quality Control for an Audit of Financial Statements*, paragraph 14

interpretation or practice or areas where there are inconsistencies in how accounting estimates are made.

- The procedures the auditor intends to undertake in responding to assessed risks of material misstatement.
- The need for judgment about matters not specified by the applicable financial reporting framework.
- The degree of judgment needed to select data and assumptions.
- The complexity and extent of the entity's use of information technology in making accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A69. Many accounting estimates do not require the application of specialized skills or knowledge. For example, for most audits it is unlikely that specialized skills or knowledge would be necessary for an auditor to evaluate a bonus accrual or inventory obsolescence. However, for expected credit losses of an internationally active banking institution or the insurance contract liability for an insurance entity, the auditor is likely to conclude that it is necessary to apply specialized skills or knowledge.

Formatted: Font: Not Bold

A70. The auditor may not possess the specialized skills or knowledge necessary when the matter involved is in a field other than accounting or auditing and may need to use an auditor's expert. ISA 620<sup>25</sup> establishes requirements and provides guidance in determining the need to employ or engage an auditor's expert and the auditor's responsibilities when using the work of an auditor's expert.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### Identifying and Assessing the Risks of Material Misstatement (Ref: Para. 13)

A71. Paragraph 13 requires the auditor, in identifying and assessing the risks of material misstatement, to take into account the extent to which the accounting estimate is subject to, or affected by relevant factors, including complexity, the need for the use of judgment by management in making the estimate, and estimation uncertainty.

Formatted: Font: Not Bold

A72. For some accounting estimates, the auditor's assessment of the risks of material misstatement may be based on low inherent risk. Examples may include:

Formatted: Font: Not Bold

- Depreciation calculations for an entity using a single depreciation method for property and equipment and a relatively low level of additions or disposals.
- Accounting estimates based on data that is readily available, such as published interest rate or foreign exchange rate data or exchange-traded prices of securities that are listed and actively traded on a recognized exchange, and has few or no assumptions. An example of such an accounting estimate is the translation of a cash balance that is held in a currency other than the reporting currency.
- A bonus accrual for management which is based on performance indicators that are clearly identified.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A73. For some accounting estimates, the auditor's assessment of the risks of material misstatement may be influenced by inherent risk that is not low. Examples may include:

Formatted: Font: Not Bold

<sup>25</sup> ISA 620, *Using the Work of an Auditor's Expert*

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Accounting estimates relating to the outcome of litigation.
- Accounting estimates for financial instruments not publicly traded.
- Accounting estimates for which a complex model is used or for which there are assumptions or data that cannot be observed directly in the marketplace (level 3 fair values).
- Accounting estimates that collate, weight and integrate assumptions and data from a wide range of internal and external sources, such as an expected credit loss model in a financial institution that is active in different markets.
- Estimates of the development costs of a new pharmaceutical product.
- Estimates relating to undeveloped mineral resources.
- Valuation of goodwill in a business combination.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A74. The reasons for the auditor's assessment of the risks of material misstatement may result from one or more of the factors of complexity, judgment and estimation uncertainty. For example:

Formatted: Font: Not Bold

- (a) Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to involve high estimation uncertainty and significant subjectivity in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities.
- (b) An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes, but may involve little judgment and the estimation uncertainty may be low, depending on the nature of the inventory.
- (c) Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgment, for example, an accounting estimate that requires a single critical judgment about a liability, the amount of which is contingent on the outcome of the litigation.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A75. The auditor's assessment of the risks of material misstatement at the assertion level may be informed by events occurring after the date of the financial statements. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise,<sup>26</sup> when relevant, inherent risk as low, regardless of the extent to which the accounting estimate was subject to, or affected by, complexity, the need for the use of judgment by management or estimation uncertainty at the time management made the estimate.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Significant Risks

Formatted: Font: Not Bold, Italic

A76. Paragraph 28 of ISA 315 (Revised) and the related application material include factors that are required to be considered when identifying significant risks. If the auditor determines that an

Formatted: Font: Not Bold

<sup>26</sup> ISA 315 (Revised), paragraph 31

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

accounting estimate gives rise to a significant risk, the auditor is required to obtain an understanding of the entity's controls, including control activities.<sup>27</sup>

A77. In some cases, the estimation uncertainty relating to an accounting estimate may cast significant doubt about the entity's ability to continue as a going concern. ISA 570 (Revised)<sup>28</sup> establishes requirements and provides guidance in such circumstances.

*Other Relevant Factors*

A78. In addition to complexity, judgment and estimation uncertainty, there may be other relevant factors that the auditor may consider in identifying and assessing the risks of material misstatement. These may include the extent to which the accounting estimate is subject to, or affected by:

- A change in the nature or circumstances of the relevant financial statement items, or requirements of the applicable financial reporting framework which may give rise to the need for changes in the method, assumptions or data used to make the accounting estimate;
- The susceptibility of the accounting estimate to the risks of a material misstatement due to fraud; and
- The regulatory environment, including relevant regulatory requirements.

*Complexity*

*Complexity Arising from the Method Used in Making the Accounting Estimate (Ref: Para. 13(a)(i))*

A79. Methods vary in the extent to which they involve complex concepts or techniques that require management to apply specialized skills or knowledge.<sup>29</sup> In addition, the nature of the measurement basis in the applicable financial reporting framework may result in the need for a complex method that requires multiple sources of historical and forward looking data or assumptions, with complex inter-relationships between them.

A80. Complex methods are often applied using a complex model, particularly when the measurement basis requires the use of discounted cash flow techniques, projected or expected future cash flows and historical and forward looking data and assumptions obtained or developed from a combination of internal and external sources. Designing and operating such models often involves specialized skills or knowledge, including in relation to valuation attributes arising from the nature and circumstances of the underlying financial statement items and in the use of information technology.

A81. Examples of accounting estimates for which complex models are likely to be used include:

- An impairment loss for goodwill or an intangible asset, which may require expectations about future cash flows from the business, asset or a group of related assets to be developed based on historical data and forward looking assumptions.
- An expected credit loss, which may require expectations of future credit repayments and other cash flows, based on historical experience data and forward looking assumptions.

<sup>27</sup> ISA 315 (Revised), paragraph 29

<sup>28</sup> ISA 570, (Revised), *Going Concern*

<sup>29</sup> See paragraph 8 of Appendix 2 for examples of complex techniques.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- An insurance contract liability, which may require expectations about future insurance contract payments to be projected based on historical experience and current and assumed future trends.
- A level 3 fair value based on cash flow projections and historical market related data.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Complexity Arising from the Data on Which the Accounting Estimate Is Based (Ref: Para. 13(a)(ii))

Formatted: Font: Not Bold

A82. Risks of material misstatement related to complexity in making accounting estimates may arise when such complexity leads to greater difficulty in obtaining, or in maintaining the integrity of, relevant and reliable data, stemming from one or more of the following:

Formatted: Font: Not Bold

- The reliability of the data source. Data from certain sources may be more reliable than from others. For example, data obtained from internal systems outside the general and subsidiary ledgers may be more susceptible to misstatements because in some entities it may be difficult to determine whether there were appropriate controls and governance over that data.
- Data from an external information source may be less relevant in making a fair value estimate if it is not based on observable market transactions. For example, it may be less relevant when it is based on brokers' quotes that reflect brokers' subjective judgments in the context of an inactive market. In addition, for confidentiality or proprietary reasons, some external information sources will not (or not fully) disclose information that may be relevant in considering the relevance and reliability of the data they provide, such as the sources of the underlying data they used or how it was accumulated and processed (including any controls over the process). It may be more difficult to consider the relevance and reliability of such data than in the case of data from more transparent external information sources.
- The integrity of the information systems. Data that is used to make the accounting estimates may be processed by information systems that may require effective general IT controls, and controls over the flow of data through the system.
- A complex organizational structure or a lack of integration between systems in different parts of the entity may give rise to difficulty in reliably and consistently aggregating.
- The volume of data or the source of the data, including data that comes from a wide variety of sources. This may lead to the risk that the data may be inappropriately used, or may be incomplete or from an incorrect data set.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Judgment (Ref: Para. 13(b))

Formatted: Font: Not Bold

A83. Judgment may be used by management in the selection or application of appropriate methods, the selection or development of appropriate assumptions, and the selection or interpretation of data. The risks of material misstatement related to judgment involved in making accounting estimates may relate to one or a combination of the following:

Formatted: Font: Not Bold

- A lack of experience or competence by management, including a lack of availability to management of necessary skills or knowledge. These factors may result in risks related to the selection of inappropriate methods, assumptions and data. When management lacks the competence or experience in a certain area and decides not to use a management's expert, there may be a risk that:

Formatted: Font: Not Bold



PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- The method selected may not comply with the applicable financial reporting framework.
- Management may select a data source that is not relevant and reliable.
- Indicators of management bias.
- The extent to which the applicable financial reporting framework does not specify the appropriate valuation approaches, concepts, techniques and factors to use in the estimation method and therefore may require significant judgment.

A84. Examples of accounting estimates that are likely to be subject to a high degree of judgment include the following:

- Accounting estimates that are based on expected future cash flows for which there is uncertainty regarding the amount or timing.
- Accounting estimates that are based on complex contractual terms. For example, the determination of cash inflows or outflows arising from commercial supplier or customer rebates may depend on very complex contractual terms that require specific expertise or competence.
- Accounting estimates with a long forecast period.

A85. When accounting estimates are subject to a high degree of judgment, the accounting estimate may be more susceptible to the potential for management bias, particularly when this judgment involves greater subjectivity. For example, such judgment may result in a wide range of possible measurement of the accounting estimate. Management may select a point estimate from that range that is inappropriate in the circumstances, or that is inappropriately influenced by unintentional or intentional management bias, and that is therefore misstated. For continuing audits, indicators of possible management bias identified during the audit of the preceding periods influence the planning and risk identification and assessment activities of the auditor in the current period.

*Estimation Uncertainty* (Ref: Para. 13(c))

A86. Estimation uncertainty arises from factors that give rise to an inherent lack of precision in the measurement of an accounting estimate. The variation in the measurement of an accounting estimate that results from estimation uncertainty is not in itself a misstatement. A risk of material misstatement related to estimation uncertainty arises from variables that increase the likelihood that management's point estimate and related disclosures are not reasonable in the context of the applicable financial reporting framework.

A87. Estimation uncertainty may arise, for example, when it is not possible (or not practical, insofar as permitted by the applicable financial reporting framework) for management:

- To make a precise and reliable prediction about the future realization of a past transaction (for example, the amount that will be paid under a contingent contractual term), or about the incidence and impact of future events or conditions (for example, the amount of a future credit loss or the amount that will be settled for a future insurance claim); or
- To obtain precise and complete information about a present condition (for example, information about valuation attributes that would reflect the perspective of market participants at the date of the financial statements, to develop a fair value estimate).

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A88. The risks of material misstatement related to estimation uncertainty may relate to one or a combination of the following:

Formatted: Font: Not Bold

- The applicable financial reporting framework, which may require:
  - The use of a method to make the accounting estimates that inherently has a high level of estimation uncertainty. For example, the financial reporting framework may require the use of a level 3 fair value.
  - The use of assumptions that inherently have a high level of estimation uncertainty, such as future cash flows for a long-term contract, assumptions that are based on data that is unobservable and are therefore difficult for management to develop or the use of the various assumptions that are interrelated.
  - Disclosures about estimation uncertainty. There may be a risk of material misstatement related to the failure to make a material disclosure about the estimation uncertainty.
- The business environment. An entity may be active in a market that experiences turmoil or possible disruption (for example, from major currency movements or inactive markets) and the accounting estimate may therefore be dependent on data that is not readily observable.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A89. A seemingly immaterial accounting estimate may have the potential to result in a material misstatement due to the estimation uncertainty associated with the accounting estimate; that is, the size of the amount recognized or disclosed in the financial statements for an accounting estimate is not, in itself, an indicator of its estimation uncertainty.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A90. In some circumstances, the estimation uncertainty is so high that a reasonable accounting estimate cannot be made. The applicable financial reporting framework may, therefore, preclude recognition of the item in the financial statements, or its measurement at fair value. In such cases, there may be risks of material misstatement that relate not only to whether an accounting estimate should be recognized, or whether it should be measured at fair value, but also to the reasonableness of the disclosures. With respect to such accounting estimates, the applicable financial reporting framework may require disclosure of the accounting estimates and the estimation uncertainty associated with them (see paragraphs A124–A125, A135–A137).

Formatted: Font: Not Bold

A91. Not all accounting estimates are affected by high levels of estimation uncertainty. For example, some financial statement items may have an active and open market that provides readily available and reliable information on the prices at which actual exchanges occur. However, estimation uncertainty may exist even when the valuation method and data are well defined. For example, valuation of securities quoted on an active and open market at the listed market price may require adjustment if the holding is significant or is subject to restrictions in marketability. In addition, general economic circumstances prevailing at the time, for example, illiquidity in a particular market, may impact estimation uncertainty.

Formatted: Font: Not Bold

A92. A sensitivity analysis may demonstrate that the accounting estimate is sensitive to one or more assumptions that then become the focus of the auditor's attention.

Formatted: Font: Not Bold

A93. The degree of estimation uncertainty associated with an accounting estimate may influence its susceptibility to management bias. When the reasons for the assessment given to the risk of material misstatement include estimation uncertainty, the auditor's application of professional skepticism is particularly important.

Formatted: Font: Not Bold

**Responses to the Assessed Risks of Material Misstatement (Ref: Para. 15)**

A94. In designing further audit procedures, ISA 330 requires the auditor to consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance or disclosure (that is, the inherent risk), and whether the risk assessment takes account of relevant controls (that is, control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively.

Formatted: Font: Not Bold

A95. Paragraph A40 of ISA 200<sup>30</sup> states that the ISAs do not ordinarily refer to inherent risk and control risk separately. However, the auditor may make separate or combined assessments of inherent and control risk. Although this ISA neither implies nor requires a separate assessment of inherent and control risk, it highlights the importance of the auditor's consideration of both inherent and control risk in designing and performing further audit procedures to respond to the assessed risks of material misstatement, including significant risks, at the assertion level in accordance with ISA 330.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*When Inherent Risk is Low* (Ref. Para: 15(a))

Formatted: Font: Not Bold, Italic

A96. If the further audit procedures in paragraph 15(a) do not provide sufficient appropriate audit evidence, the auditor is required by ISA 330 to design and perform other procedures.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*When Inherent Risk is Not Low* (Ref. Para: 15(b))

Formatted: Font: Not Bold, Italic

A97. When inherent risk is not low, this ISA does not specify the nature of the further audit procedures to be performed to respond to the assessed risk of material misstatement. Procedures such as obtaining audit evidence about events occurring up to the date of the auditor's report, testing how management made the accounting estimate, developing an auditor's point estimate or range, or performing other types of substantive analytical procedures, may assist the auditor in obtaining audit evidence about the matters in paragraphs 17–19. However, such procedures need to be designed to address the matters in paragraphs 17–19.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*When the Auditor Intends to Rely on Relevant Controls or Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence* (Ref: Para: 16)

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

A98. In certain circumstances, it may not be possible or practicable for the auditor to design effective substantive procedures that, by themselves, provide sufficient appropriate audit evidence at the assertion level. For example, this may be the case for entities such as large banks, insurers, and telecommunication entities that make extensive use of IT to conduct their business or have a large number of accounting estimates, many of which are highly judgmental or complex. Factors that may indicate that substantive procedures alone may not provide sufficient appropriate audit evidence at the assertion level include:

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

- The volume of transactions (for example, a high volume of transactions may occur in a large bank, insurer or telecommunication entity, making it more difficult to design substantive procedures that alone provide sufficient appropriate audit evidence at the assertion level).

Formatted: Font: Not Bold

<sup>30</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Whether significant information supporting one or more relevant assertions is electronically initiated, recorded, processed, or reported. For such assertions, audit evidence may be available only in electronic form. In such cases, the sufficiency and appropriateness of the audit evidence may depend on the effectiveness of controls over the accuracy and completeness of the information. In addition, the potential for improper initiation or alteration of information to occur and not be detected may be greater if information is initiated, recorded, processed, or reported only in electronic form and appropriate controls are not operating effectively.
- The need to combine information from the general and subsidiary ledgers with information obtained from outside the general and subsidiary ledgers (for example, an expected credit loss may require information from the entity's risk management system). In these situations, it may not be possible to design and perform substantive procedures that, by themselves, provide sufficient appropriate audit evidence at the assertion level.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A99. In some jurisdictions, as part of the audit of the financial statements for certain entities (such as a bank or insurer), the auditor also may be required by law or regulation to undertake additional work to provide assurance on internal controls.

Formatted: Font: Not Bold

Considerations Specific to Smaller Entities

Formatted: Font: Not Bold

A100. Controls over the process to make an accounting estimate may exist in smaller entities, but the formality with which they operate may vary. Further, smaller entities may determine that certain types of controls are not necessary because of active management involvement in the financial reporting process. In the case of very small entities, however, it is likely that the auditor will identify few controls related to accounting estimates as relevant to the audit. For this reason, the auditor's response to the assessed risks is more likely to be substantive in nature.

Formatted: Font: Not Bold

Complexity (Ref: Para. 17)

Formatted: Font: Not Bold

A101. When management uses a complex method, an important factor that the auditor may need to consider regarding the appropriateness of the method, and significant data and significant assumptions, is whether there were other available valuation concepts, techniques or factors, types of assumptions or sources of data that, in the circumstances, might have been more appropriate, or more generally accepted, in the context of the applicable financial reporting framework. The auditor may also consider whether management was able to obtain access to the appropriate skills and knowledge involved in applying the complex method.

Formatted: Font: Not Bold

Complex Modelling

Formatted: Font: Not Bold

A102. In some cases, management may use a complex model to make an accounting estimate. Whether the complex model used is appropriate in the context of the applicable financial reporting framework may depend on a number of factors, such as the nature of the entity and its environment, including the industry in which it operates, and the specific item being measured.

Formatted: Font: Not Bold

A103. The nature and extent of the procedures that may be performed with respect to the complex model depends on the source of the complexity. When complex modelling is needed, the assessed risk of material misstatement is likely to be higher and, therefore, the more persuasive the audit evidence that may need to be obtained.

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

A104. The extent to which the following considerations are relevant depends on the circumstances, including whether the complex model is obtained from a third party, or is a proprietary model. Depending on the circumstances, matters that the auditor may consider include, for example, whether:

- The model is validated prior to usage, with periodic reviews to ensure it is still suitable for its intended use. The entity's validation process may include evaluation of:
  - The model's theoretical soundness;
  - The model's mathematical integrity;
  - The accuracy and completeness of the model's data and assumptions; and
  - The model's output as compared to actual transactions.
- Appropriate change control policies and procedures exist.

Understanding or Interpreting Data (Ref: Para. 17(c))

A105. An accounting estimate may be based on data that needs to be understood or interpreted. For example, a contract may include complex terms that management needs to understand and interpret

based on the facts and circumstances of the entity. Procedures that the auditor may consider when the accounting estimate is based on complex legal or contractual terms include:

- Considering whether specialized skills or knowledge are needed to understand or interpret the contract;
- Inquiring of the entity's legal counsel regarding the legal or contractual terms; and
- Inspecting the underlying contracts, and:
  - Obtaining an understanding of, and evaluating, the underlying business purpose for the transaction or agreement; and
  - Considering whether the terms of the contracts are consistent with management's explanations.

Integrity of Significant Data and Significant Assumptions (Ref: Para. 17(d))

A106. Data may be developed internally, or may be obtained from an external information source. When obtaining audit evidence about the integrity of data and assumptions, it may be appropriate for the auditor to compare the data and assumptions with an external information source.

*Judgment*

The Selection of the Method and the Significant Data and Significant Assumptions (Ref: Para. 18(a)(i))

A107. Audit evidence regarding management's selection of methods and significant data and significant assumptions may be obtained from inquiries of management regarding management's continuing processes of strategic analysis and risk management and inspection of relevant documents (such as committee minutes). Even without formal established processes, such as may be the case in smaller entities, the auditor may be able to evaluate the significant data and assumptions through

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

inquiries of, and discussions with, management, along with other audit procedures in order to obtain sufficient appropriate audit evidence.

Changes From Previous Periods in the Method, or the Significant Data or Significant Assumptions (Ref: Para. 18(a)(ii))

Formatted: Font: Not Bold

A108. The auditor's consideration of a change in an accounting estimate, or in the method for making it from previous periods, is important because a change that is not based on a change in circumstances or new information is unlikely to be reasonable nor in compliance with the applicable financial reporting framework. Arbitrary changes in an accounting estimate result in inconsistent financial statements over time and may give rise to a financial statement misstatement or be an indicator of possible management bias. (see paragraphs A147–A152).

Formatted: Font: Not Bold

A109. As part of the process of making changes to the methods, assumptions, and data used in previous periods, management may evaluate alternative assumptions or outcomes of the accounting estimates, which can be accomplished through a number of approaches depending on the circumstances. One possible approach is a sensitivity analysis. This might involve determining how the monetary amount of an accounting estimate varies with different assumptions. Even for accounting estimates measured at fair value, there can be variation because different market participants will use different assumptions. A sensitivity analysis could lead to the development of a number of outcome scenarios, sometimes characterized as a range of outcomes by management, such as "pessimistic" and "optimistic" scenarios.

Formatted: Font: Not Bold

Considerations Specific To Smaller Entities

Formatted: Font: Not Bold

A110. Smaller entities may use simple means to assess alternative assumptions or outcomes. In addition to the auditor's review of available documentation, the auditor may obtain other audit evidence of management's consideration of alternative assumptions or outcomes by inquiry of management. In addition, management may not have the expertise to consider alternative assumptions or outcomes and, therefore, may need to obtain specialized skills or knowledge from an external party (see also paragraph 10(e)(iv)).

Formatted: Font: Not Bold

Management's Intent and Ability (Ref: Para. 18(b))

Formatted: Font: Not Bold

A111. The reasonableness of the assumptions used may depend on management's intent and ability to carry out certain courses of action. Management often documents plans and intentions relevant to specific assets or liabilities and the applicable financial reporting framework may require it to do so. Although the extent of audit evidence to be obtained about management's intent and ability is a matter of professional judgment, the auditor's procedures may include the following:

Formatted: Font: Not Bold

- Review of management's history of carrying out its stated intentions.
- Review of written plans and other documentation, including, when applicable, formally approved budgets, authorizations or minutes.
- Inquiry of management about its reasons for a particular course of action.
- Review of events occurring subsequent to the date of the financial statements and up to the date of the auditor's report.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- Evaluation of the entity's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its existing commitments and legal, regulatory, or contractual restrictions that could affect the feasibility of management's actions.
- Consideration of whether management has met the applicable documentation requirements, if any, of the applicable financial reporting framework.

Certain financial reporting frameworks, however, may not permit management's intentions or plans to be taken into account when making an accounting estimate. This is often the case for fair value accounting estimates because their measurement objective requires that assumptions reflect those used by marketplace participants.

**Model Adjustments (Ref: Para. 18(c)(iii))**

A112. When management has made adjustments to the output of the model (see paragraph A30) to meet the requirements of the applicable financial reporting framework, consideration of those adjustments is likely to be important in obtaining sufficient appropriate audit evidence over risks of material misstatement related to the need for the use of judgment by management. Several types of methods used for the valuation of accounting estimates that require adjustments are for example, fulfilment value accounting for valuing insurance contracts and overlay adjustments when accounting for expected credit losses. In the case of fair value accounting estimates, it may be relevant to consider whether adjustments to the output of the model, if any, reflect the assumptions marketplace participants would use in similar circumstances.

**Estimation Uncertainty**

**Management's Steps to Understand and Address Estimation Uncertainty (Ref: Para. 19(a)(i))**

A113. To determine an appropriate management point estimate, and related disclosures, it is necessary to understand the sources of inherent variability in the measurement outcomes, the extent of that variability, and the range of reasonably possible measurement outcomes. It also is necessary for management to identify and address the effects of complexity and judgment in the measurement process that increase the susceptibility of the accounting estimate to misstatement. This is important so that the selection of management's point estimate, and the development of related disclosures, is based only on estimation uncertainty.

A114. There is no particular method of addressing estimation uncertainty that is more suitable than another. For example, management may employ sensitivity analysis, scenario analysis, or, when more robust evaluation is considered necessary (for example, in the banking or insurance industries), stress testing and reverse stress testing. Management's consideration of alternative assumptions or outcomes may not need to be conducted through a detailed process supported by extensive documentation. What is important is whether management has appropriately assessed how estimation uncertainty may affect the accounting estimate, not the specific manner in which it is done. Accordingly, where management has not considered alternative assumptions or outcomes, it may be necessary for the auditor to discuss with management, and request support for, how it has addressed estimation uncertainty.

A115. Paragraph A46 includes a list of matters that may be appropriate for the auditor to consider in obtaining an understanding of whether, and if so, how management has addressed estimation uncertainty.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold



**Management's Determination of a Point Estimate and Related Disclosures of Estimation Uncertainty** (Ref:  
Para 19(a)(iii))

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A116. When preparing the financial statements, it also is important for management to determine that the estimation uncertainty has been properly depicted. This includes the selection of an appropriate point estimate and the related disclosures in the financial statements that describe the estimation uncertainty. For this purpose, an appropriate management point estimate is an amount that appropriately represents the range of reasonably possible outcomes, and appropriate related disclosures describe the extent of the variability in reasonably possible measurement outcomes.

A117. The requirements of the applicable financial reporting framework may specify the method that should be applied in selecting an amount from the reasonably possible measurement outcomes. Financial reporting frameworks may recognize that the appropriate amount is one that is representative of the range of reasonably possible measurement outcomes and, in some cases, may indicate that the most relevant amount may be in the central part of that range.

Formatted: Font: Not Bold

A118. For example, with respect to fair value estimates, IFRS<sup>31</sup> indicates that, if multiple valuation techniques are used to measure fair value, the results (i.e., respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances. In other cases, the applicable financial reporting framework may specify the use of a probability-weighted average of the reasonably possible measurement outcomes, or of the measurement amount that is most likely or that is more likely than not.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A119. In other cases, the framework may not specify a particular selection method and judgment will be required, having regard to the requirements of the applicable financial reporting framework, including, when applicable, requirements relating to fair presentation and faithful representation.

Formatted: Font: Not Bold

A120. The applicable financial reporting framework may require disclosures that describe the amount as an estimate and explain the nature and limitations of the process for making it, including the variability in reasonably possible measurement outcomes. The framework also may require additional disclosures to meet a disclosure objective.<sup>32</sup> In addition, in certain circumstances, it may be necessary for management to provide additional disclosures beyond those specifically required by the financial reporting framework in order to achieve fair presentation, or in the case of a compliance framework, for the financial statements not to be misleading.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A121. The applicable financial reporting framework may require disclosures about significant accounting policies related to accounting estimates. Depending on the circumstances, relevant accounting policies may include matters such as the specific principles, bases, conventions, rules and practices applied in preparing and presenting accounting estimates in the financial statements.

A122. The applicable financial reporting framework also may include requirements to disclose significant or critical judgments (for example, those that had the most significant effect on the amounts recognized in the financial statements) as well as significant forward-looking assumptions or other sources of estimation uncertainty.

Formatted: Font: Not Bold

A123. Paragraph A2 of this ISA describes considerations that may be relevant to the auditor's evaluation of whether the accounting estimate, and related disclosures, are reasonable in the context of the

Formatted: Font: Not Bold

<sup>31</sup> IFRS 13, Fair Value Measurement, paragraph 63

<sup>32</sup> IFRS 13, Fair Value Measurement, paragraph 92



PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

applicable financial reporting framework. Matters that may be relevant in obtaining sufficient appropriate audit evidence about the reasonableness of management's point estimate and related disclosures include, when applicable:

- Alternative methods for making the accounting estimate and alternative sources of data were available, and the methods and data used were selected appropriately from those alternatives.
- Valuation attributes used were appropriate and complete.
- The assumptions used were selected from a range of reasonably possible amounts and were supported by appropriate data that is relevant and reliable.
- The data used in the measurement process was appropriate, relevant and reliable, and the integrity of that data was maintained.
- The calculations applied in developing the outputs from the measurement process were mathematically accurate.
- Management's point estimate is appropriately representative of the range of reasonably possible measurement outcomes.
- The related disclosures appropriately describe the amount as an estimate and explain the nature and limitations of the estimation process, including the variability of the reasonably possible measurement outcomes.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A124. The auditor may conclude that the disclosure of estimation uncertainty is not reasonable in light of the circumstances and facts involved, even when the disclosures are in accordance with the applicable financial reporting framework. The auditor's evaluation of the reasonableness of disclosures about estimation uncertainty increases in importance the greater the range of possible outcomes of the accounting estimate (see paragraphs A133–A134).

Formatted: Font: Not Bold

A125. In some cases, the auditor may consider it appropriate to encourage management to describe, in the notes to the financial statements, the circumstances relating to the estimation uncertainty. ISA 705 (Revised)<sup>33</sup> provides guidance on the implications for the auditor's opinion when the auditor believes that management's disclosures in the financial statements are inadequate or misleading, including, for example, with respect to estimation uncertainty. If the auditor's consideration of estimation uncertainty associated with an accounting estimate, and its related disclosure, is a matter that required significant auditor attention, then this may constitute a key audit matter (see ISA 701).<sup>34</sup>

Formatted: Font: Not Bold

Formatted: Font: Not Bold

When Management Has Not Appropriately Understood or Addressed Estimation Uncertainty (Ref: Para. 19(b))

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A126. When the auditor believes that management has not appropriately understood or addressed estimation uncertainty, the auditor may consider requesting management to consider alternative assumptions or to provide additional disclosure relating to the estimation uncertainty.

Formatted: Font: Not Bold

A127. If, in the auditor's judgment, management has not appropriately understood or addressed the estimation uncertainty, the auditor is required, to the extent possible, to develop a point estimate or

Formatted: Font: Not Bold

<sup>33</sup> ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

<sup>34</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

a range to enable the auditor to evaluate the reasonableness of management's point estimate and the related disclosures in the financial statements that describe the estimation uncertainty. The appropriate methods, assumptions and data for the auditor to use depend on the requirements of the applicable financial reporting framework.

**Developing an Auditor's Point Estimate or Using an Auditor's Range**

Formatted: Font: Not Bold

A128. Whether the auditor develops a point estimate or uses an auditor's range, the auditor is designing and performing a substantive analytical procedure. ISA 520<sup>35</sup> provides requirements and guidance regarding the auditor's use of substantive analytical procedures.

Formatted: Font: Not Bold

A129. The approach taken by the auditor in developing either a point estimate or a range may vary based on what is considered most effective in the circumstances. For example, the auditor may initially develop a point estimate, and then assess its sensitivity to changes in assumptions to ascertain a range with which to evaluate management's point estimate. Alternatively, the auditor may begin by developing a range for purposes of determining, when possible, a point estimate.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A130. The ability of the auditor to develop a point estimate, as opposed to a range, depends on several factors, including the method used, the nature and extent of data available and the estimation uncertainty involved with the accounting estimate. Further, the decision to develop a point estimate or range may be influenced by the applicable financial reporting framework, which may prescribe the point estimate that is to be used after consideration of the alternative outcomes and assumptions, or prescribe a specific measurement method (for example, the use of a discounted probability-weighted expected value, or the most likely outcome).

Formatted: Font: Not Bold

A131. The auditor may develop a point estimate or a range in a number of ways, for example, by:

Formatted: Font: Not Bold

- Using a model, for example, one that is commercially available for use in a particular sector or industry, or a proprietary or auditor-developed model.
- Using management's model and selecting alternative assumptions or data sources to develop a point estimate or range.
- Developing a point estimate or range for only part of the accounting estimate (for example, when only a certain part of the accounting estimate is giving rise to the risk of material misstatement).
- Developing alternative assumptions to those used by management.
- Employing or engaging a person with specialized expertise to develop or execute the model, or to provide relevant assumptions.
- Making reference to other comparable conditions, transactions or events, or, where relevant, markets for comparable assets or liabilities.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A132. It is important for the auditor to obtain a sufficient understanding of the data, assumptions and method used by management in making the accounting estimate as this understanding also may be relevant to the auditor's development of an appropriate point estimate or range and the evaluation of whether the accounting estimate is reasonable or is misstated.

Formatted: Font: Not Bold

<sup>35</sup> ISA 520, *Analytical Procedures*

A133. The auditor also may need to consider whether there is an indication of management bias in the selection of the assumptions, data or method. For example, for a particular accounting estimate, if management has developed an appropriate range for three different assumptions, and in each case the assumption used in making the accounting estimate was from the same end of the range, the auditor may need a further discussion with management and may need to reconsider whether sufficient appropriate audit evidence has been obtained that the assumptions selected were appropriate and supportable in the circumstances.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A134. In certain circumstances, the auditor's range for an accounting estimate may be multiples of materiality for the financial statements as a whole, particularly when materiality is based on operating results (for example, pre-tax income) and this measure is relatively small in relation to assets or other balance sheet measures. In these circumstances, the auditor's evaluation of the reasonableness of the disclosures about estimation uncertainty becomes increasingly important. Considerations such as those included in paragraphs A133, A144 and A145 may also be appropriate in these circumstances.

Formatted: Font: Not Bold

#### Disclosures Related to Accounting Estimates (Ref: Para. 21)

A135. Paragraph 21 applies regardless of whether the auditor is required to perform procedures under paragraph 19.

Formatted: Font: Not Bold

A136. The presentation of financial statements in accordance with the applicable financial reporting framework includes disclosure of relevant matters. The applicable financial reporting framework may permit, or prescribe, disclosures related to accounting estimates, and some entities may disclose voluntarily additional information in the notes to the financial statements. These disclosures may include, for example:

Formatted: Font: Not Bold

- The method of estimation used, including any applicable model.
- The basis for the selection of the method of estimation.
- Information that has been obtained from models, or from other calculations used to determine estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as:
  - Assumptions developed internally; or
  - Data, such as interest rates, that are affected by factors outside the control of the entity.
- The effect of any changes to the method of estimation from the prior period.
- The sources and implications of estimation uncertainty.
- Fair value information, including when produced by management's experts.
- Information about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Such disclosures are relevant to users in understanding the accounting estimates recognized or disclosed in the financial statements, and sufficient appropriate audit evidence needs to be obtained about whether the disclosures are reasonable in the context of the applicable financial reporting framework.

Formatted: Font: Not Bold

A137. In some cases, the applicable financial reporting framework may require specific disclosures regarding uncertainties. For example, some financial reporting frameworks prescribe:

Formatted: Font: Not Bold

- The disclosure of key assumptions and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities. Such requirements may be described using terms such as “Key Sources of Estimation Uncertainty” or “Critical Accounting Estimates.”
- The disclosure of the range of possible outcomes, and the assumptions used in determining the range.
- The disclosure of specific information, such as:
  - Information regarding the significance of fair value accounting estimates to the entity’s financial position and performance; and
  - Disclosures regarding market inactivity or illiquidity.
- Qualitative disclosures such as the exposures to risk and how they arise, the entity’s objectives, policies and procedures for managing the risk and the methods used to measure the risk and any changes from the previous period of these qualitative concepts.
- Quantitative disclosures such as the extent to which the entity is exposed to risk, based on information provided internally to the entity’s key management personnel, including credit risk, liquidity risk and market risk.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Complex Script Font: Mangal, 9 pt

A138. When the financial statements are prepared in accordance with a fair presentation framework, the auditor’s evaluation as to whether the financial statements achieve fair presentation<sup>36</sup> include the consideration of the overall presentation, structure and content of the financial statements, and whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation. Depending on the facts and circumstances, given the importance of accounting estimates to the overall financial statements, the auditor may determine that additional disclosures related to accounting estimates are necessary to achieve fair presentation. This may be the case, for example, when an accounting estimate is subject to significant estimation uncertainty (see paragraphs A124–A125).

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### Overall Evaluation Based on Audit Procedures Performed (Ref: Para. 22)

A139. ISA 330<sup>60</sup> notes that an audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing or extent of other planned audit procedures. In relation to accounting estimates, information may come to the auditor’s attention through performing procedures to obtain audit evidence about the matters in paragraphs 17–19, when applicable, that differs significantly from the information on which the risk assessment was based.

Formatted: Font: Not Bold

A140. For example, the auditor may have identified that the only reason for an assessed risk of material misstatement is the need for the use of judgment by management in making the accounting estimate. However, while performing procedures to address the matters in paragraph 18, as

Formatted: Font: Not Bold

<sup>36</sup> ISA 700 (Revised), paragraph 14

<sup>60</sup> ISA 330, paragraph A60

applicable, the auditor may discover that the accounting estimate is more complex than originally contemplated, indicating that the assessment of the risk of material misstatement may need to be revised (that is, the reasons for the assessment now include complexity). Therefore, the auditor needs to perform additional audit procedures to address the matters in paragraph 17, as applicable. ISA 315 (Revised) contains further guidance on revising the auditor's risk assessment.<sup>37</sup>

A141. With respect to accounting estimates that have not been recognized, the focus of the auditor's evaluation may be on whether the recognition criteria of the applicable financial reporting framework have in fact been met. When an accounting estimate has not been recognized, and the auditor concludes that this treatment is appropriate, some financial reporting frameworks may require disclosure of the circumstances in the notes to the financial statements.

Formatted: Font: Not Bold

#### Misstatements (Ref: Para.23)

A142. ISA 450<sup>38</sup> provides guidance on distinguishing misstatements for purposes of the auditor's evaluation of the effect of uncorrected misstatements on the financial statements. In relation to accounting estimates, a misstatement, whether caused by fraud or error, may arise as a result of:

Formatted: Font: Not Bold

- Misstatements about which there is no doubt (factual misstatements).

Formatted: Font: Not Bold

Differences arising from the judgments of management, including those concerning recognition, measurement, presentation and disclosure of accounting estimates (including the selection or application of accounting policies) that the auditor considers unreasonable or inappropriate (judgmental misstatements).

Formatted: Font: Not Bold

- The auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn (projected misstatements).

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A143. Paragraphs A113 to A118 provide guidance to assist the auditor in evaluating management's selection of a point estimate to be included in the financial statements. Based on the audit evidence obtained, the auditor may conclude that there is sufficient appropriate audit evidence supporting a point estimate that does not differ from management's point estimate. When the auditor uses a range, and provided that the auditor's range only includes amounts that are supported by audit evidence obtained and the auditor has evaluated to be reasonable as required by paragraph 20 of this ISA, the auditor may determine that management's point estimate falls within the auditor's range. In either of these situations, the auditor may conclude that the accounting estimate is reasonable in the context of the applicable financial reporting framework.

Formatted: Font: Not Bold

A144. In some cases, management may have determined an amount or a range of amounts that it believes are reasonable, and that the auditor also may have determined are reasonable, based on the audit evidence obtained, in developing an auditor's point estimate or range. In other circumstances, the audit evidence obtained may support other amounts or another range of amounts as being reasonable. In each of these circumstances, the variation in such amounts or the auditor's range may be significant. Such variation does not necessarily mean that any of the amounts identified or supported or any amount in the auditor's range is not reasonable. Nonetheless, if the variation is significant it may be important for the auditor to reconsider whether

Formatted: Font: Not Bold

<sup>37</sup> ISA 315 (Revised), paragraph 31

<sup>38</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*

sufficient appropriate audit evidence has been obtained regarding the reasonableness of the amounts within the range.

A145. The audit evidence may support a point estimate that differs from management's point estimate, or a range that does not include management's point estimate. When the audit evidence supports an auditor's point estimate that differs from management's point estimate, the difference between the auditor's point estimate and management's point estimate constitutes a misstatement. When the audit evidence supports a range that does not encompass management's point estimate, the misstatement is the difference between management's point estimate and the nearest point of the auditor's range.

Formatted: Font: Not Bold

A146. Evaluating whether sufficient appropriate audit evidence has been obtained, and whether the accounting estimate is misstated, for accounting estimates and related disclosures included in the notes to the financial statements involves essentially the same types of considerations applied when auditing an accounting estimate recognized in the financial statements.

Formatted: Font: Not Bold

#### Indicators of Possible Management Bias (Ref: Para. 24)

A147. Examples of indicators of possible management bias with respect to accounting estimates include:

Formatted: Font: Not Bold

- Changes in an accounting estimate, or the method for making it, when management has made a subjective assessment that there has been a change in circumstances.
- Selection or construction of significant assumptions that yield a point estimate favorable for management objectives.

Formatted: Font: Not Bold

Selection of a point estimate that may indicate a pattern of optimism or pessimism.

Formatted: Font: Not Bold

A148. Indicators of possible management bias themselves do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. However, in some cases the audit evidence may point to a misstatement rather than simply an indicator of bias. For example, when management has changed an accounting estimate, or the method of making it, from the prior period based on a subjective assessment that there has been a change in circumstances, the auditor may conclude based on the audit evidence obtained that the accounting estimate is misstated as a result of an arbitrary change by management, or may regard it as an indicator of possible management bias.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A149. Management bias may be more difficult to detect at an account level than when considering groups of accounting estimates or all accounting estimates, or when observed over a number of accounting periods. Although some form of management bias is inherent in subjective decisions, in making such judgments there may be no intention by management to mislead the users of financial statements. When, however, there is intention to mislead, management bias is fraudulent in nature.

Formatted: Font: Not Bold

A150. For example, if each accounting estimate included in the financial statements was individually reasonable but each management point estimate trends toward one end of the auditor's range, such circumstances may indicate possible bias by management in making the estimates. Bias may also be evident from the cumulative effect of changes in multiple accounting estimates. For example, if the estimates in the financial statements are grouped at one end of the range of reasonable outcomes in the prior year and are grouped at the other end of the range of reasonable outcomes in the current year, such changes may be an indicator of possible bias in seeking to achieve an expected or desired outcome, e.g., to offset higher or lower than expected earnings.

Formatted: Font: Not Bold

A151. Indicators of management bias may affect the auditor's conclusion as to whether the auditor's risk assessment and related responses remain appropriate, and the auditor may need to consider the implications for the rest of the audit. Further, they may affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement, as discussed in ISA 700 (Revised).

Formatted: Font: Not Bold

A152. In addition, in applying ISA 240, the auditor is required to evaluate whether management's judgments and decisions in making the accounting estimates included in the financial statements indicate a possible bias that may represent a material misstatement due to fraud. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates, which may include intentionally understating or overstating accounting estimates. Possible indicators of management bias that may also be indicators of a fraud risk may cause the auditor to reassess whether the auditor's risk assessments, in particular the assessment of fraud risks, and related responses remain appropriate.

Formatted: Font: Not Bold

#### Written Representations (Ref: Para. 25)

A153. ISA 580<sup>39</sup> discusses the use of written representations. In obtaining written representations that management and, where appropriate, those charged with governance, believe the methods and significant data and significant assumptions used in making the accounting estimates and their related disclosures are appropriate, the auditor is required to consider the need to obtain representations about specific accounting estimates. These representations may address accounting estimates recognized or disclosed, or about decisions not to recognize or disclose an accounting estimate, in the financial statements and may include representations:

Formatted: Font: Not Bold

Formatted: Font: Not Bold

- That management's point estimate is reasonable in the context of the applicable financial reporting framework.
- About the appropriateness of the method selected and, when applicable, the model used for making the accounting estimate in the context of the applicable financial reporting framework.
- That the significant judgments made in making the accounting estimate have been taken into account all relevant information of which management is aware.
- About the consistency in the selection or application of the method, assumptions, and data used by management in making the accounting estimates in the context of the applicable financial reporting framework.
- That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, when relevant to the accounting estimates and disclosures.
- That disclosures related to accounting estimates, including disclosures describing estimation uncertainty, are complete and reasonable in the context of the applicable financial reporting framework.
- That appropriate specialized skills or expertise, when necessary, has been applied in making the accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>39</sup> ISA 580, *Written Representations*

- That no subsequent event requires adjustment to the accounting estimates and related disclosures included in the financial statements.

Formatted: Font: Not Bold

A154. For those accounting estimates not recognized or disclosed in the financial statements, written representations may also include representations about the appropriateness of the basis used by management for determining that the recognition or disclosure criteria of the applicable financial reporting framework have not been met.

Formatted: Font: Not Bold

#### Communication with Those Charged With Governance or Management (Ref: Para 26)

A155. In applying ISA 260 (Revised), the auditor communicates with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices relating to accounting estimates and related disclosures. This may include, when applicable, why the auditor considers a significant accounting practice, which include management's judgments in making the accounting estimates, although acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity. In communicating those views, matters specific to the accounting estimates that the auditor may consider communicating to those charged with governance include:

Formatted: Font: Not Bold

- The nature and consequences of significant assumptions used in accounting estimates and the degree of subjectivity involved in the development of the assumptions;
- The relative materiality of the accounting estimates to the financial statements as a whole;
- Management's understanding (or lack thereof) regarding the nature and extent of, and the risks associated with, accounting estimates, particularly financial instruments;
- Significant difficulties encountered when obtaining sufficient appropriate audit evidence relating to data obtained from an external information source or valuations performed by management or a management's expert;
- Significant differences in judgments between the auditor and management or a management's expert regarding valuations;
- The auditor's views about differences between the auditor's point estimate or range and management's point estimate;
- The auditor's views about the appropriateness of the selection of accounting policies and presentation of accounting estimates in the financial statements;
- The auditor's views about the qualitative aspects of the entity's accounting practices and financial reporting for accounting estimates; and
- The potential effects on the entity's financial statements of material risks and exposures required to be disclosed in the financial statements, including the estimation uncertainty associated with accounting estimates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A156. In applying ISA 265, the auditor communicates significant deficiencies in internal control to those charged with governance or management, including significant deficiencies regarding accounting estimates. For example, significant deficiencies may be identified related to controls over:

Formatted: Font: Not Bold

- The selection and application of significant accounting policies related to accounting estimates, and the selection and application of methods, assumptions, and data;

Formatted: Font: Not Bold



PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- (b) Risk management and related systems;
- (c) Data integrity, including when data is obtained from an external information source; and
- (d) The use, development and validation of models, including third-party models, and any adjustments that may be required.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A157. In addition to communicating with those charged with governance, the auditor may be permitted or required to communicate directly with regulators or prudential supervisors. Such communication may be useful throughout the audit or at particular stages, such as when planning the audit or when finalizing the auditor's report. For example, in some jurisdictions, financial institution regulators seek to cooperate with auditors to share information about the operation and application of controls over financial instrument activities, challenges in valuing financial instruments in inactive markets, expected credit losses, and insurance reserves while other regulators may seek to understand the auditor's views on significant aspects of the entity's operations including the entity's costs estimates. This communication may be helpful to the auditor in identifying risks of material misstatement.

Formatted: Font: Not Bold

**Documentation** (Ref: Para. 27)

Formatted: Font: Not Bold

A158. Paragraph 8 of ISA 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand, among other things, significant professional judgments. In the context of auditing accounting estimates, these professional judgments include the basis for the auditor's evaluation of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework. The auditor's judgments are likely to be supported by the documentation of the procedures performed to address the matters in paragraphs 17–21 including the auditor's judgment

Formatted: Font: Not Bold

about management's selection of methods, significant data, and significant assumptions, as well as the overall evaluation required by paragraphs 22–23, of this ISA. In addition, the auditor's judgments about the assessed risk of material misstatement related to accounting estimates, and the auditor's response, may likely be further supported by documentation of communications with those charged with governance and management, particularly for accounting estimates for which the assessed risk of material misstatement is based on inherent risk that is not low.

Formatted: Font: Not Bold

A159. Documentation of indicators of possible management bias identified during the audit assists the auditor in concluding whether the auditor's risk assessment and related responses remain appropriate, and in evaluating whether the financial statements as a whole are free from material misstatement. See paragraph A147 for examples of indicators of possible management bias.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

## Appendix 1

(Ref: Para. 2)

Formatted: Font: Not Bold

### Measurement Bases of Accounting Estimates

1. The purpose of this appendix is to explain the range of different types of measurement bases that may be relevant in making an accounting estimate. It is intended to provide context for the auditor's consideration of the extent to which the factors of complexity, the need for the use of judgment by management, and estimation uncertainty may be inherent in the use of a particular measurement basis.
2. Measurement bases are the measurement objectives for determining the required monetary amounts for financial statement items. They may be either historical cost or current value measurement bases. Monetary amounts for financial statement items measured at historical cost provide information derived from the transaction or event that created them and those measured at current value provide information that is updated to reflect conditions at the measurement date. A current value measurement basis may reflect either an entity-specific or a market-based perspective of value.
3. Depending on the measurement basis and on the nature, condition and circumstances of a financial statement item, the monetary amount required to be measured for the item may be a cost or price for the item at initial recognition, which thereafter may be re-measured, or adjusted to reflect certain subsequent changes in the condition and circumstances of the item. A cost or price may be directly observable in actual transactions (either of the entity or between market participants) or may need to be estimated using other valuation techniques. Adjustments to reflect subsequent changes often also require estimation. Examples of circumstances in which accounting estimates may be required, when applying a range of common measurement bases, are discussed below.
4. The nature, condition and circumstances of financial statement items vary widely and give rise to quantitative and qualitative attributes of those items that would influence the monetary amount of the item on the relevant measurement basis (valuation attributes).
5. The nature of a financial statement item may give rise to valuation attributes relating to the rights, obligations or other claims relating to resources, or changes therein, which the item embodies. The circumstances and condition of a financial statement item may give rise to valuation attributes. These may relate to general economic, regulatory, technological and market conditions. They may also relate to conditions of more specific relevance to the item, including the nature of the business, how the items are used in the business and how the risks and uncertainties inherent in the business activities affect the item.
6. Valuation attributes may affect how the item contributes to the timing and amounts of cash flows, and related risks and uncertainties, and may reflect other risks and uncertainties inherent in the item. Valuation attributes may influence the cost or price of the item on initial recognition, or on remeasurement, or may influence the monetary amount relating to subsequent changes for which adjustment is required.
7. When accounting estimates need to be made, other than by direct observation of the cost or price, valuation techniques may be used to model the cost or price of the item, or the effects of any

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

subsequent changes for which adjustments are required. Using such techniques involves measuring or estimating relevant valuation attributes and applying functions to the resulting amounts. Amounts

may be measured or estimated for valuation attributes based on observable data, where available, or otherwise based on assumptions that take into account the best available data or other information. The selection and application of appropriate valuation techniques, including the measurement or estimation of such attributes and the application of functions to the resulting amounts, are undertaken in a manner that reflects the objectives of the measurement basis and takes into account the nature, circumstances and conditions of the item.

Formatted: Font: Not Bold

8. Making an accounting estimate for a financial statement item, by modelling the amount to be measured in this way, may therefore involve determining:
- The relevant quantitative and qualitative valuation attributes;

Formatted: Font: Not Bold

- The extent to which observable data is available to measure relevant valuation attributes;
- If such data is available to measure relevant valuation attributes, the sources of data that would provide appropriate measures of those attributes;
- If such data is not available to measure relevant valuation attributes, or is not sufficiently precise or comprehensive, the types of assumptions that need to be made in estimating appropriate values for those attributes and the sources of data that would provide appropriate support in making those assumptions;
- The method (valuation technique or combination of valuation techniques) by which such data and assumptions would be used to make the estimate, and to develop information about the sensitivity of that amount to reasonably possible variations in the data and assumptions used; and
- Where applicable, the nature and extent of any adjustments that may be made to the estimated measurement arising from the application of that method, for example to reflect practical limitations in the validity of the valuation technique(s) used in measuring what it purports to measure.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### Examples of Circumstances in Which Accounting Estimates May Be Required in Applying Certain Measurement Bases

##### *Historical Cost Measurement Bases*

Formatted: Font: Not Bold, Italic

9. Some measurement bases require the use of monetary amounts at initial recognition that reflect the cost paid or consideration given (and transaction costs) for a statement asset acquired or built, and the consideration received (less transaction costs) for a liability incurred or assumed, based on the terms of the transactions that gave rise to them (historical cost). Such amounts may be directly observable (for example, they may be observed in invoices, remittance or payment advices or contract notes or other primary transaction records).

Formatted: Font: Not Bold

10. When such amounts are not directly observable, it may be necessary to estimate a deemed cost for the item(s) using a proxy such as fair value (see paragraph 19). For example, the deemed cost of an item may be the fair value of the other assets or liabilities exchanged for the item or may be the fair value of the item itself when no other assets or liabilities are exchanged for it. That deemed cost may not be known at the measurement date and may depend on the outcome of future events or

Formatted: Font: Not Bold

circumstances (such as would be the case when part or all of the amount payable for the acquisition of a business depends on the future earnings of the business). Deemed cost may therefore be difficult to determine.

*Adjustments of Historical Cost Measures after Initial Recognition*

11. Historical cost measurement bases require adjustments to reflect changes after initial recognition of the item, other than changes in prices. Such changes may occur over several reporting periods. For non-financial assets and liabilities, these changes may reflect the consumption or impairment of an asset or the fulfilment of, or the onset of onerous conditions relating to, a liability. The historical cost of a financial asset or a financial liability may be referred to as amortized cost.
12. For financial assets and financial liabilities measured using amortized cost, adjustments are made to reflect changes after initial recognition such as the accrual of interest, changes in the estimates of cash flows (including the impairment of financial assets) and payments or receipts, but not to reflect subsequent changes in prices caused by other factors.
13. The monetary amounts of adjustments to historical costs measured at initial recognition will often not be directly observable and will need to be estimated. Estimating consumption and identifying impairment losses or onerous liabilities can be subjective. Hence, the historical cost of an asset or a liability can sometimes be as difficult to estimate as a current value.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*Impairment of an Asset*

14. Impairment adjustments are made when the amount recoverable from disposal or use of an asset is less than its carrying amount, after taking account of adjustments for depreciation or amortization. Impairment may be caused by a number of factors, depending on the nature of the asset, such as obsolescence, physical damage, a reduction in creditworthiness (financial assets), a reduction in market value or a reduction in the operational use of the asset. The monetary amount of the impairment, if any, of a historical cost measure of an asset at the balance sheet date is not ordinarily directly observable, and may depend on future realizations from the use or sale of the item.
15. The amount recoverable from disposal may be required to be determined based on a fair value measurement or at net realizable value, and may require estimation. Similarly the amount recoverable from use (value in use) will ordinarily require estimation. There can also be complex considerations relating to the appropriate unit of account.
16. Even if the amount of the impairment of the asset is confirmed in transactions subsequent to the balance sheet date at a monetary amount that is then observable, that amount may not reflect the level of impairment at the balance sheet date. This is because the level of impairment at the balance sheet date may have been subject to the effects of changes in circumstances between that date and the date of such transactions.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*Depreciation or Amortization*

17. The depreciation or amortization of an asset's historical cost reflects the consumption of the underlying economic resource that constitutes the asset, during its useful life. The capacity of the economic resource (useful life of the asset), the progress of its consumption and the residual value of the asset are all uncertain. These amounts may not be known with certainty until the asset's total economic capacity and its consumption have been observed over its useful life and the asset at the

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

residual stage has been disposed of. Ordinarily, therefore, none of these amounts would be directly observable when accounting estimates for depreciation or amortization are required to be made during the asset's useful life. They would all therefore ordinarily require estimation.

*Current Value Measurement Bases*

18. Some measurement bases require the use of monetary amounts that reflect information about conditions at the measurement date rather than information based on historical transactions. Such measurement bases require the use of either a market-participant or an entity-specific perspective.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

*Fair Value*

19. The fair value measurement basis requires measurement of the price for which an asset would have been sold, or a liability transferred, in an orderly transaction (or, if no such transaction has occurred, in an assumed transaction) between market participants in an active market at the measurement date. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.
20. Financial reporting frameworks often establish a 'fair value hierarchy' that categorises the inputs used to measure fair value into three levels and gives priority to using those in the higher levels over using those in lower levels. The purpose of doing so is to increase consistency and comparability in fair value measurements and related disclosures. Quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date and that are not subject to adjustment, provide the most relevant evidence of fair value and are included in the highest level of the hierarchy (these are level 1 inputs).
21. If a level 1 input is not available or accessible, it may be possible to measure the fair value using other observable inputs, such as quoted prices for similar items in an active market or quoted prices for identical items in a non-active market or other inputs observed in or corroborated with active markets (e.g., interest rates, yield curves, implied volatilities or credit spreads) (such other observable inputs are level 2 inputs).
22. Otherwise, it may be necessary to measure the fair value, sometimes using discounted cash flow techniques, based on the best information available in the circumstances, including unobservable inputs to the extent observable inputs are not available, and taking into account all information about market participant assumptions that is reasonably available (unobservable inputs are level 3 inputs).
23. In some circumstances, fair value may be measured using inputs from more than one level of the hierarchy, or using a level 1 input that has been adjusted. Fair value measurements are categorized in their entirety in the same level of the hierarchy as the lowest level of input that is significant for the entire measurement. If so, their categorizations are ordinarily based on the lowest level of input used that is significant to the measurement as a whole, and on categorizing a fair value measurement that uses an adjusted level 1 input into a level lower than level 1.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

*Value in Use and Fulfilment Value*

24. Some measurement bases require the use of monetary amounts that reflect the present value of the future cash flows that the entity will obtain from using and disposing of an asset (value in use) or will incur in fulfilling its obligations inherent in a liability (fulfilment value). For example, value in use

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

is frequently used to test for impairment (see paragraph 15). Certain types of provisions may be measured using fulfilment value, such as provisions for pension obligations, product warranties, reinstatement obligations, or legal disputes. The monetary amounts required by such measurement bases cannot be observed directly and are estimated using discounted cash flow techniques. In principle, accounting estimates measured using value in use and fulfilment value, reflect an entity-specific perspective but some valuation attributes used in making them may be required to reflect a market-participant perspective, such as market interest rates.

### Valuation Techniques Commonly Used in Making Current Value Measurements

#### Valuation Techniques

25. Valuation techniques can be categorized within three different approaches: the market approach; the cost approach; and the income approach.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

#### Market Approach

26. Valuation techniques within the market approach typically use prices and other relevant information generated by market transactions involving identical or similar assets, liabilities or groups of assets and liabilities, such as businesses. Examples include the use of valuation techniques for measuring fair value that use level 1 and level 2 inputs and valuation techniques for measuring fair value of real estate by reference to comparable properties.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

#### Cost Approach

27. Valuation techniques within the cost approach typically reflect the amount that would be required to replace the service capacity of an asset at the measurement date (often referred to as current replacement cost). For example, current replacement cost is used to measure the fair value of tangible assets used in combination with other assets or liabilities.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

#### Income Approach

28. Valuation techniques within the income approach typically convert future amounts, such as cash flows, or income and expenses, to a single discounted current amount. Valuation techniques that apply this approach include, for example, present value techniques and option pricing models. For example, discounted cash flow is a valuation technique within the income approach, which applies present value techniques to cash flows that are commonly used in measuring value in use and fulfilment value and sometimes used in measuring fair value.

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

#### Discounted Cash Flow

29. Measurement bases that involve the use of discounted cash flow in making accounting estimates generally require valuation attributes such as the following to be addressed: • Estimates of the amount and timing of future cash flows arising from the item;

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

- Possible variations in the amount and timing of those cash flows, resulting from uncertainty inherent in those cash flows;
- Time value of money;
- Price (a risk premium or discount) for bearing the uncertainty inherent in the cash flows;
- Other attributes, such as liquidity, that would be taken into account in the circumstances; and

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- If used to measure fair value of a liability, the price for bearing the entity's own credit risk.

Formatted: Font: Not Bold

30. The assumptions reflected in the discount rate should be consistent with the assumptions inherent in the cash flows – if uncertainty about future defaults is reflected in the discount rate, then the cash flows should be the contractual flows. If the cash flows are probability-weighted and therefore already reflect assumptions about uncertainty of future default, then the discount rate should not doublecount that risk.

Formatted: Font: Not Bold

31. Assumptions about cash flows and discount rates should also be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation and after-tax cash flows should be discounted using after-tax discount rates.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

## Appendix 2

(Ref: Para. 2, A6)

Formatted: Font: Not Bold

### Factors That May be Indicators of Risks of Material Misstatement for Accounting Estimates

1. Paragraphs 2, 3 and 13 of this ISA, respectively, introduce the factors of complexity, judgement and estimation uncertainty and require the auditor to take them, and any other relevant factors, into account in the identification and assessment of the risks of material misstatement related to an accounting estimate. Accordingly, these factors are referred to throughout this ISA and this appendix provides additional background information in relation to them. In responding to the assessed risks of material misstatement the auditor is required, in accordance with paragraph 15(b) of this ISA, to perform procedures to obtain sufficient appropriate audit evidence about certain matters, when specified circumstances are applicable, related to each of these factors.

Formatted: Font: Not Bold

#### Circumstances Where the Three Factors Are Likely To Be More Prevalent

2. As explained in Appendix 1, the nature of the measurement basis applied and the nature and circumstances of the financial statement item will also influence the extent to which these factors are present and need to be taken into account by management, when applicable, in:
- (a) Making an accounting estimate of the required monetary amount;
  - (b) Understanding the sensitivity of the accounting estimate to variation in those factors;
- and (c) Considering the related disclosures that may be required.
3. Estimates are more likely to be affected by the interrelationship of these three factors, and to a greater extent, when the method by which they are made involves complex modelling.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### Estimation Uncertainty

4. Estimation uncertainty is the inherent uncertainty that makes accounting estimates susceptible to a lack of precision in their measurement. Depending on the nature of the measurement basis applied and on the nature and circumstances of the financial statement item, the monetary amount of the item may be directly observable before the financial statements are finalized or may only be directly observable at a later date or, in some cases, may not be directly observable at all. Estimation uncertainty arises when the required monetary amount for a financial statement item cannot be determined with precision and the outcome of the estimate is not known before the date the financial statements are finalized.
5. Estimation uncertainty may give rise to variation in the possible methods, data sources and types of assumptions that could be used to make the accounting estimate and therefore may give rise to the need for the use of judgment in making estimates. This in turn may give rise to variation in the possible outcomes of the estimation process (both in the amount of the accounting estimate and in information developed about the sensitivity of that amount to variations in the data or assumptions used). Such variation is relevant in considering how to depict accounting estimates in the financial statements, in accordance with the recognition, measurement, presentation and disclosure requirements of the applicable financial reporting framework.

Formatted: Font: Not Bold

Formatted: Font: Not Bold



6. As a result of inherent limitations in information, it is not possible to reduce estimation uncertainty beyond certain limits. Furthermore, most accounting frameworks acknowledge that the information that should be taken into account may also be limited (and that it is therefore not practical to reduce estimation uncertainty beyond this limit) when the cost of obtaining it would exceed the benefits (the cost constraint).
7. The extent to which there is residual estimation uncertainty is reflected in the sensitivity of the amount of the accounting estimate to the use of different methods, to variations in the available data, or in the values for the assumptions that could be used, in making the accounting estimate. Although an estimate subject to higher levels of estimation uncertainty may be less precisely measurable than one subject to lower levels, the accounting estimate may still have significant relevance for users of the financial statements if the description of the nature and extent of the estimation uncertainty in the financial statements is reasonable in the context of the applicable financial reporting framework. Addressing the estimate in the financial statements is accomplished by selecting a reasonable point estimate to use in the financial statements and describing the extent, nature and measurement effect of the estimation uncertainty i.e., the range of possible outcomes. In some cases, estimation uncertainty associated with an accounting estimate may be so great that the recognition criteria in the applicable financial reporting framework are not met and the accounting estimate cannot be recognized in the financial statements, though there may still be relevant disclosure requirements.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### Complexity

8. Complexity in making accounting estimates arises when there are multiple valuation attributes and multiple or non-linear relationships between them. Management may require specialized skills or knowledge may, for example, be needed in relation to:
- Available valuation concepts and techniques that could be used in the context of the measurement basis and objectives or other requirements of the applicable financial reporting framework and how to apply those concepts or techniques;
  - Experience of the underlying valuation attributes that may be relevant given the nature and circumstances of the financial statement items for which accounting estimates are being made; or
  - Identifying available appropriate sources of data (including data relevant to the development of appropriate assumptions) from internal sources (including from sources outside the general or subsidiary ledgers) or from external information sources, or how to address difficulties in obtaining data from such sources or in maintaining its integrity in applying the method.
9. Complexity in applying valuation concepts or techniques may exist when concepts or techniques involve the use of, for example probability-based methods, option pricing formulae or simulation techniques to predict uncertain future outcomes or hypothetical behaviors. Complexity in relation to the method may also exist when multiple sources of data, assumptions or valuation concepts or techniques need to be used in determining the output(s) of the estimation process, including when such items need to be interpreted or processed to be appropriate for use or to support the development of assumptions.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

10. Complexity in applying valuation concepts or techniques may also relate to data (including data relevant to the development of appropriate assumptions), including when the data is inherently difficult to identify, capture, access or understand. For example:
- (a) Data may be difficult to obtain when it relates to transactions that are not generally transparent to the public at large. Even when such data is accessible through an external information source, it may be difficult to understand unless the external information source discloses adequate information about the underlying data sources it has used and about any data processing that has been performed.
  - (b) Data reflecting an external information source's views about future conditions or events, which may be relevant in developing support for an assumption, may be difficult to understand without transparency about the rationale and information taken into account in developing those views.
  - (c) Certain types of data may be inherently difficult to understand because they require an understanding of technically complex business or legal concepts, such as may be required to properly understand data that comprises the terms of legal agreements about transactions involving complex financial instruments or insurance products.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

#### Judgment

11. When an accounting estimate is required, the applicable financial reporting framework may not fully specify, for each type of financial statement item and in each possible circumstance, the most appropriate approach to make that accounting estimate. It is also generally not practical for the applicable financial reporting framework to specify all the particular valuation attributes, concepts and techniques that should be used to determine an accounting estimate and related disclosures. As a result, consideration of these matters generally requires the need for the use of judgment by management in making the accounting estimate.
12. Judgments are generally also needed to address the inherent limitations in available information. In some cases, the level or nature of the inherent limitations in available information may introduce a high degree of subjectivity in making some judgments.
13. The applicable financial reporting framework may provide a basis for making certain judgments, such as explicit or implied objectives relating to measurement, disclosure, the unit of account, or the application of a cost constraint. The applicable financial reporting framework may also highlight the importance of such judgments through requirements for related disclosures.
14. Judgments are generally needed in determining some or all of the following:
- To the extent not specified under the requirements of the applicable financial reporting framework, the appropriate valuation approaches, concepts, techniques and factors to use in the estimation method, having regard to available knowledge;
  - To the extent valuation attributes are observable but there are various potential sources of data available, the appropriate sources of data to use;
  - To the extent valuation attributes are not observable, the appropriate assumptions or range of assumptions to use, having regard to the limited data available, including, for example, market views;

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

PROPOSED INTERNATIONAL STANDARD ON AUDITING 540 (REVISED) AUDITING  
ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

- The range of point estimates that could be reasonable to use in the financial statements and the relative likelihood that certain points within the range would be consistent with the objectives of the measurement basis required by the applicable financial reporting framework; and
  - The reasonable amount to use for the accounting estimate, and the reasonable related disclosures to be made, in the financial statements.
15. Management may also need to make judgments about cost constraints, including valuation attributes that need to be taken into account but are not directly observable and about the best information available in the circumstances.
16. Making assumptions about future events or conditions involves the use of judgment, the difficulty of which varies with the extent to which those events or conditions are uncertain. The precision with which it is possible to predict uncertain future events or conditions depends on the extent to which those events or conditions are determinable based on available knowledge, including knowledge of past conditions, events and related outcomes. The lack of precision also contributes to estimation uncertainty, as described above.
17. Not all features of a future outcome may be uncertain and assumptions will only need to be made in respect of those features of the outcome that are uncertain. For example, in considering the measurement of a possible impairment of a receivable for a sale of goods at the balance sheet date, the amount of the receivable may be unequivocally established and directly observable in the related transaction documents. What may be uncertain is the amount, if any, for loss due to impairment. In this case, assumptions may only be required about the likelihood of loss and about the amount and timing of any such loss.
18. However, in other cases, the amounts of cash flows embodied in the rights relating to an asset may be uncertain (for example, the amount of compensation for loss claimed in an ongoing litigation may be highly uncertain). In those cases, assumptions may have to be made about both the amounts of the underlying rights to cash flows and about potential losses due to impairment depending on the creditworthiness of the party against whom the claim is made.
19. Some uncertain outcomes may be relatively easy to predict with a high level of precision for an individual item. For example, the useful life of a production machine may be easily predicted if sufficient technical information is available about its average useful life. When it is not possible to predict a future outcome, such as an individual's life expectancy based on actuarial assumptions, with reasonable precision, it may still be possible to predict that outcome for a group of individuals with greater precision. Measurement bases may, in some cases, indicate a portfolio level as the relevant unit of account for measurement purposes, which may reduce inherent estimation uncertainty.
20. In other cases, it may be necessary to consider information about past conditions and events, together with current trends and expectations about future developments. Past conditions and events provide historical information from which repeating historical patterns of behavior relating to uncertain valuation attributes may be discerned and extrapolated in evaluating future outcomes. Such historical information may also indicate changing patterns of such behavior over time (cycles or trends). These may suggest that the underlying historical patterns of behavior have been changing in somewhat predictable ways that may also be extrapolated in evaluating future

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

outcomes. Other types of information may also be available that indicate possible changes in historical patterns of such behavior or in related cycles or trends. Difficult judgments may be needed about the predictive value of such information.

21. ▲ The extent and nature (including the degree of subjectivity involved) of the judgments taken in making the accounting estimates may create opportunity for management bias in making decisions about the course of action that, according to management, is appropriate in making the accounting estimate. When there is also a high level of complexity or a high level of estimation uncertainty, or both, the risk of, and opportunity for, management bias and the ability to conceal it may also be increased.

**Formatted:** Font: Not Bold

**Formatted:** Font: Not Bold

## CONFORMING AND CONSEQUENTIAL AMENDMENTS ARISING FROM DRAFT PROPOSED ISA 540 (REVISED)

### ISA 260 (Revised), Communication with Those Charged with Governance Requirements

#### Matters to Be Communicated

*Note: Paragraph 18 is provided for reference purposes only.*

#### Significant Findings from the Audit

16. The auditor shall communicate with those charged with governance: (Ref: Para. A17–A18) [
- a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity; (Ref: Para. A19–A20)
  - b) Significant difficulties, if any, encountered during the audit; (Ref: Para. A21)
  - c) Unless all of those charged with governance are involved in managing the entity:
    - (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management; and (Ref: Para. A22)
    - (ii) Written representations the auditor is requesting;
  - d) Circumstances that affect the form and content of the auditor's report, if any; and (Ref: Para. A23–A25)
  - e) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process. (Ref: Para. A26–A28)

\*\*\*

#### Application and Other Explanatory Material

#### Matters to Be Communicated ...

#### Significant Findings from the Audit

#### Significant Qualitative Aspects of Accounting Practices (Ref: Para. 16(a))

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold, Italic

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A19. Financial reporting frameworks ordinarily allow for the entity to make accounting estimates, and judgments about accounting policies and financial statement disclosures, for example, in relation to the use of key assumptions in the development of accounting estimates ~~for which there is significant measurement uncertainty~~. In addition, law, regulation or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective or complex judgments made by management in preparing the financial statements.

Formatted: Font: Not Bold

A20. As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph A19, those charged with governance may be interested in the auditor's evaluation of the adequacy~~reasonableness~~ of disclosures of the estimation uncertainty and significant judgments relating to accounting estimates that give rise~~are affected by, or subject to significant risks, estimation uncertainty, complexity, the need for the use of judgment by management, or other relevant factors~~. Open and constructive communication about significant qualitative aspects of the entity's accounting practices also may include comment on the acceptability of significant accounting practices and the quality of the disclosures. Appendix 2 identifies matters that may be included in this communication.

Formatted: Font: Not Bold

**Appendix 1**

(Ref: Para. 3)

Formatted: Font: Not Bold

**Specific Requirements in ISQC 1 and Other ISAs that Refer to Communications with Those Charged With Governance**

This appendix identifies paragraphs in ISQC 1<sup>40</sup> and other ISAs that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

- *ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* – paragraph 30(a) • *ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraphs 21, 38(c)(i) and 40-42 • *ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraphs 14, 19 and 22–24 • *ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* – paragraph 9 • *ISA 450, Evaluation of Misstatements Identified during the Audit* – paragraphs 12-13
- *ISA 505, External Confirmations* – paragraph 9
- *ISA 510, Initial Audit Engagements—Opening Balances* – paragraph 7
- *ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures* – paragraph 22A
- *ISA 550, Related Parties* – paragraph 27
- *ISA 560, Subsequent Events* – paragraphs 7(b)-(c), 10(a), 13(b), 14(a) and 17
- *ISA 570 (Revised), Going Concern* – paragraph 25
- *ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* – paragraph 49
- *ISA 610 (Revised), Using the Work of Internal Auditors* – paragraph 18; *ISA 610 (Revised 2013), Using the Work of Internal Auditors* – paragraphs 20 and 31
- *ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements* – paragraph 46 • *ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report* – paragraph 17 • *ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report* – paragraphs 12, 14, 23 and 30 • *ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* – paragraph 12 • *ISA 710, Comparative Information—Corresponding Figures and Comparative Financial Statements* – paragraph 18 • *ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information* – paragraph 17–19

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

**Appendix 2**

(Ref: Para. 16(a), A19–A20)

Formatted: Font: Not Bold

**Qualitative Aspects of Accounting Practices**

<sup>40</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

The communication required by paragraph 16(a), and discussed in paragraphs A19–A20, may include such matters as:

Formatted: Font: Not Bold

## Accounting Policies

...

Formatted: Font: Not Bold

## Accounting Estimates

For items for which estimates are significant, issues discussed in ISA 540 (Revised), including, for example:

Formatted: Font: Not Bold

Formatted: Font: Not Bold

- How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements.
- Changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.
- Whether management's ~~decision~~decisions relating to recognize, or to not recognize, the recognition, measurement, presentation and disclosure of the accounting estimates in the financial statements ~~is~~are in accordance with the applicable financial reporting framework. ○ Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates and, if so, why, as well as the outcome of accounting estimates in prior periods.
- ~~Management's process~~Whether management's method for making the accounting estimates (e.g., including when management has used a model), including whether the selected measurement basis for the accounting estimate, is in accordance with the applicable financial reporting framework.
- Whether the significant ~~data and~~ assumptions used by management in ~~developing~~making the accounting estimate are reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework.
- Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.
- Risks of material misstatement. ○ Indicators of possible management bias.
- How management has considered alternative assumptions or outcomes and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
- The ~~adequacy~~reasonableness of disclosure of estimation uncertainty in the financial statements.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

## ISA 500, Audit Evidence Definitions

5. For purposes of the ISA, the following terms have the meanings attributed below:

Formatted: Font: Not Bold

- (a) Accounting records – The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and

Formatted: Font: Not Bold



CONFORMING AND CONSEQUENTIAL AMENDMENTS ARISING FROM DRAFT PROPOSED ISA 540 (REVISED)

subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

- (b) Appropriateness (of audit evidence) – The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.
- (c) Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and information obtained from other sources.
- (cA) External information source – An individual or organization, other than a management's expert, that provides publicly available information used by the entity in preparing the financial statements. (Ref: Para. A1A–A1C)
- (d) Management's expert – An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.
- (e) Sufficiency (of audit evidence) – The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

## Requirements

Formatted: Font: Not Bold

### Information to Be Used as Audit Evidence

- 7. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence, including information obtained from an external information source. (Ref: Para. A26–A33J)

Formatted: Font: Not Bold

\*\*\*

Formatted: Font: Not Bold

## Application and Other Explanatory Material

### External Information Source (Ref: Para 5(cA))

A1A. In preparing the financial statements, management may make use of information obtained from an external information source. An important consideration in determining whether an individual or organization is acting as an external information source is whether the individual or organization meets the definition of a management's expert with respect to that information. Indicators that an external organization may be acting as an external information source rather than as a management's expert include the following:

Formatted: Font: Not Bold

- The information is not specifically generated for the entity; and
- The information is available to the public.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

When such indicators are present, it is less likely that management will be able to influence the external information source. Whether or not management pays a fee to access information from an

Formatted: Font: Not Bold

CONFORMING AND CONSEQUENTIAL AMENDMENTS ARISING FROM DRAFT PROPOSED ISA 540 (REVISED)  
external information source is not relevant in considering whether an individual or organization is acting as an external information source.

A1B. External information sources may include pricing services, governmental organizations, central banks or recognized stock exchanges. Examples of information that may be obtained from external information sources include: • Prices and pricing related data:

- Macro-economic data such as historical and forecast unemployment rates and economic growth rates, or census data;
- Credit history data;
- Industry specific data such as an index of reclamation costs for certain extractive industries or viewership information or ratings used to determine advertising revenue in the entertainment industry; and
- Mortality tables used to determine liabilities in the life insurance and pension sectors.

A1C. Depending on the facts and circumstances, an individual or organization may, in respect of any particular set of information, be either an external information source or a management's expert but not both. Professional judgment may be needed to determine whether a specific organization is acting as an external information source or as a management's expert with respect to a particular set of information. For example:

- An external organization may be acting as an external information source with respect to data about real estate prices for a particular geographical region that it makes generally available to the public and that management uses in preparing the financial statements. The same external organization may at the same time be acting as a management's expert for the same entity in providing management with a valuation service with respect to the entity's real estate portfolio.
- Some actuarial organizations publish mortality tables for general use which, when used by an entity, may be information from an external information source, while the same actuarial organization may be a management's expert when helping management to calculate the pension liability for several of its pension plans.
- An individual or organization may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the individual or organization applies that expertise in making an estimate specifically for the entity and which the entity uses in preparing its financial statements, the individual or organization is a management's expert. If, on the other hand, that individual or organization merely provides price data regarding private transactions to the public, and the entity uses that information in its own estimation methods, the individual or organization is an external information source.

...

#### Information to Be Used as Audit Evidence ...

##### External Information Sources

A33A. Obtaining an understanding of why management uses an external information source, and how management considered the relevance and reliability of the information for use in preparing its financial statements, helps to inform the auditor's consideration of the relevance and reliability of that information.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A33B. Depending on the circumstances, the following factors may be important considerations about the relevance and reliability of information obtained from an external information source:

- The nature and authority of the external information source used by the entity. For example, a central bank or government statistics office with a legislative mandate to provide industry information to the public is likely to be an authority for certain types of information;
- The ability of management to influence the information obtained from the external information sources;
- The competence and reputation of the external information source with respect to that particular type of information;
- Past experience of the auditor with the reliability of the information provided by the external information source;
- When available, information about the methods used in preparing the information, how the methods are being applied including, where applicable, how models have been used in such application, and the controls over the methods;
- The entity's controls over the information obtained from external information sources;
- Whether the information was developed taking into account the applicable financial reporting framework;
- The nature and extent of disclaimers or other restrictive language relating to the information obtained; and
- Whether information is available regarding the appropriateness of techniques, assumptions and inputs applied by the external information sources in developing the information obtained.

A33C. The auditor's consideration of the reliability of the information from the external information source, including its accuracy and completeness, may depend on the nature of the external information source and the circumstances. In many circumstances, the auditor may not be able to consider the accuracy and completeness of the information received from an external information source as there may be no contractual relationship between the external information source and the entity that requires the provision of information, or the external information source may refuse to provide information considered to be intellectual property. For example, when an entity uses a central bank's inflation rate to make an accounting estimate, as part of considering the accuracy and completeness of the information, the auditor may, depending on the significance of the information, consider the nature and authority of the source or, the auditor may obtain information from a different information source, when available.

A33D. The availability of information to understand the methods and assumptions used by the external information source may influence the auditor's consideration of the nature, timing and extent of procedures to test management's use of the sources. For example, pricing services often provide information about their methods and assumptions by asset class rather than individual securities. Brokers often provide only limited information about their inputs and assumptions when providing broker indicative quotes for individual securities.

A33E. The observability of inputs and complexity of methods used to generate the information from the external information source may also influence the auditor's considerations related to the reliability of information from the external information source, including considerations related to the nature and extent of procedures to perform to test the reliability of that information.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

A33F. As part of the consideration of the relevance and reliability of information from external information sources, one or more of the following may be relevant:

- Performing procedures at the external information source to understand and, where relevant, test the controls and processes, techniques, and assumption used.
- Performing procedures, including when relevant, tests of the operating effectiveness of controls management has in place to assess the reliability of the information from external information sources.
- Considering whether the information is intended to be used in the manner management is using it.
- When the information received from the external information source relates to security prices, obtaining an independent price from another information source.

A33G. For fair value measurement, additional considerations of the relevance and reliability of information obtained from external information sources may also include the following:

- (a) Whether fair values are based on trades of the same instrument or active market quotations;
- (b) When the fair values are based on transactions of comparable assets or liabilities, how those transactions are identified and considered comparable;
- (c) When there are no transactions either for the asset or liability or comparable assets or liabilities, how the information was developed including whether the inputs developed and used represent the assumptions that market participants would use when pricing the asset or liability, if applicable, and
- (d) When the fair value measurement is based on a broker quote, whether the broker quote:
  - (i) Is from a market maker who transacts in the same type of financial instrument;
  - (ii) Is binding or nonbinding, with more weight placed on quotes based on binding offers; and
  - (iii) Reflects market conditions as of the date of the financial statements, when required by the applicable financial reporting framework.

A33H. In some situations, management and the auditor may use the same information source, for example, because there is only one provider of certain information. When the information obtained from that information source is used to make an accounting estimate, the auditor may consider whether using the same information source as management is appropriate, or whether additional audit evidence is needed. In such cases, additional consideration may need to be given to whether the information is accurate and complete (see also A33C for additional considerations related to the nature and authority of an external information source). This may include accessing a different information source, when available, from that used by management to evaluate the external information source used by management.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

## ISA 580, *Written Representations*

### Appendix 1

(Ref: Para. 2)

Formatted: Font: Not Bold

#### List of ISAs Containing Requirements for Written Representations

This appendix identifies paragraphs in other ISAs that require subject-matter specific written representations. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

Formatted: Font: Not Bold

- ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraph 39 • ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraph 16 • ISA 450, *Evaluation of Misstatements Identified during the Audit* – paragraph 14 • ISA 501, *Audit Evidence—Specific Considerations for Selected Items* – paragraph 12 • ISA 540 (Revised), *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* – paragraph 22
- ISA 550, *Related Parties* – paragraph 26
- ISA 560, *Subsequent Events* – paragraph 9
- ISA 570 (Revised), *Going Concern* – paragraph 16(e)
- ISA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements* – paragraph 9 • ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – paragraph 13(c)

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

### Appendix 2

(Ref: Para. A21)

Formatted: Font: Not Bold

#### Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other ISAs. It is assumed in this illustration that the applicable financial reporting framework is International Financial Reporting Standards; the requirement of ISA 570 (Revised)<sup>41</sup> to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions. (Entity Letterhead)

Formatted: Font: Not Bold

Formatted: Font: Not Bold

(To Auditor)

(Date)

Formatted: Font: Not Bold

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 20XX<sup>42</sup> for the purpose of expressing an opinion as to

Formatted: Font: Not Bold

Formatted: Font: Not Bold

<sup>41</sup> ISA 570 (Revised), *Going Concern*

<sup>42</sup> Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

CONFORMING AND CONSEQUENTIAL AMENDMENTS ARISING FROM DRAFT PROPOSED ISA 540 (REVISED)  
whether the financial statements are presented fairly, in all material respects, (or *give a true and fair view*)  
in accordance with International Financial Reporting Standards.

We confirm that (, to the best of our knowledge and belief, having made such inquiries as we considered  
necessary for the purpose of appropriately informing ourselves):

**Formatted:** Font: Not Bold

*Financial Statements*

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert  
date], for the preparation of the financial statements in accordance with International Financial  
Reporting Standards; in particular the financial statements are fairly presented (or *give a true and  
fair view*) in accordance therewith.
- SignificantThe methods, the significant data, and the significant assumptions used by us in making  
the accounting estimates, including those measured at fair value, and their related disclosures are  
appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of  
the applicable financial reporting framework. (ISA 540) (Revised))
- Related party relationships and transactions have been appropriately accounted for and disclosed  
in accordance with the requirements of International Financial Reporting Standards. (ISA 550)

**Formatted:** Font: Not Bold

**Formatted:** Font: Not Bold

**Formatted:** Font: Not Bold

**Formatted:** Font: Not Bold

**Formatted:** Font: Not Bold

**Formatted:** Font: Not Bold

**COPYRIGHT, TRADEMARK, AND PERMISSIONS INFORMATION**

Formatted: Font: Not Bold

Formatted: Font: Not Bold

The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants® or IFAC®.

Formatted: Font: Not Bold

The IAASB and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Formatted: Font: Not Bold

International Standards on Auditing, International Standards on Assurance Engagements, International Standards on Review Engagements, International Standards on Related Services, International Standards on Quality Control, International Auditing Practice Notes, Exposure Drafts, Consultation Papers, and other IAASB publications are published by, and copyright of, IFAC.

Formatted: Font: Not Bold

Copyright © April 2017 by IFAC. All rights reserved. Permission is granted to make copies of this work to achieve maximum exposure and feedback provided that each copy bears the following credit line: *Copyright © April 2017 by the International Federation of Accountants® or IFAC®. All rights reserved. Used with permission of IFAC. Permission is granted to make copies of this work to achieve maximum exposure and feedback.*

Formatted: Font: Not Bold

The 'International Auditing and Assurance Standards Board', 'International Standards on Auditing', 'International Standards on Assurance Engagements', 'International Standards on Review Engagements', 'International Standards on Related Services', 'International Standards on Quality Control', 'International Auditing Practice Notes', 'IAASB', 'ISA', 'ISAE', 'ISRE', 'ISRS', 'ISQC', 'IAPN', and IAASB logo are trademarks of IFAC, or registered trademarks and service marks of IFAC in the US and other countries.

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Field Code Changed

Formatted: Font: Not Bold

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

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

Formatted: Font: Not Bold

▲	Formatted: Font: Not Bold
▲	Formatted: Font: Not Bold
▲	Formatted: Font: Not Bold
▲	Formatted: Font: Not Bold



International Auditing  
and Assurance  
Standards Board

529 Fifth Avenue, New York, NY 10017  
T + 1 (212) 286-9344 F +1 (212) 286-9570  
[www.iaasb.org](http://www.iaasb.org)