



## **CONSULTATION PAPER**

### **Proposal to Revise ISA (Ireland) 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures**

**August 2018**

## **MISSION**

**To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest**

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## 1. Summary

The purpose of this consultation paper is to obtain the views of stakeholders with regard to IAASA's proposal to issue a revised version of ISA (Ireland) 540 *Auditing Accounting Estimates, Including Fair Values Accounting Estimates, and Related Disclosures*, to reflect recent revisions to the international standards on auditing issued by the International Auditing and Assurance Standards Board (IAASB<sup>1</sup>).

The proposed revised standard is provided in the Exposure Draft which can be found [here](#).

The changes proposed are in line with the changes that are proposed and currently under consultation by the Financial Reporting Council (FRC), which can be found [here](#).

## 2. Introduction

ISAs (Ireland) are based on ISAs (UK), which, in turn are based on the corresponding standards issued by the IAASB. The revisions made by the IAASB are designed to address issues arising from evolving financial reporting frameworks and concerns expressed by regulators and other stakeholders that have developed since the current standard was originally issued in 2009. The revised ISA 540 approved by the IAASB is subject to approval by the Public Interest Oversight Board (PIOB).

IAASA is not proposing to add any new Irish requirements to the changes made at the international level, in line with the FRC who do not propose any new UK requirements.

## 3. Overview of revision

1. On 22 June 2018, the IAASB approved ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* and related conforming amendments to other ISAs. This is subject to approval by the Public Interest Oversight Board (PIOB) in September 2018 to confirm that due process has been followed with proper regard to the public interest. The effective date of the revised and amended standards is for audits of financial statements for accounting periods beginning on or after 15 December 2019.
2. IAASA supports this revision and related amendments, noting their importance in supporting an enhanced focus by auditors on management estimates and disclosures. Revisions to International Financial Reporting Standards mean the importance of estimates in corporate reporting will increase still further, for example in the areas of financial instruments; revenue recognition from contracts; and insurance contracts. IAASA believes that they represent an improvement to the current standards and

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<sup>1</sup> IAASB is a committee of the International Federation of Accountants (IFAC). The IAASB's constitution and due process is described in its 'Preface to the International Quality Control, Auditing, Review, Other Assurances, and Related Services Pronouncements'.

they are also designed to address concerns expressed by regulators and other stakeholders. The revision includes:

- Enhanced requirements and application material for risk assessment procedures and the auditor's work effort in responding to the assessed risks of material misstatement. These include, in addition to addressing risks related to estimation uncertainty, specific attention to other risk factors in making accounting estimates such as complexity and subjectivity.
- Enhanced work effort requirements based on one or more of:
  - Considering events occurring up to the date of the auditor's report;
  - Testing how management made the accounting estimate; or
  - Developing an auditor's point estimate or range.
- If the auditor develops an auditor's range, the auditor is specifically required to determine that the range includes only amounts that are supported by sufficient appropriate audit evidence.
- Amending the objective and the requirements to the effect that audit procedures address whether both the accounting estimates and the related disclosures are "reasonable" in the context of the applicable financial reporting framework (the current ISA addresses whether disclosures are "adequate").
- Enhancements to reinforce the application of professional scepticism. These include using wording to drive questioning or challenging management where appropriate; more focus on identifying indicators of possible management bias; requiring further audit procedures to be designed and performed in a manner that is not biased toward obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory; and an enhanced retrospective review and an overall evaluation based on procedures performed.
- Emphasising the importance of the need to consider internal control, with improved cross references to ISAs (Ireland) 315 and 330 (those standards being more specific to the consideration of internal control).
- A new requirement to remind auditors of their responsibilities to communicate certain matters to those charged with governance and to consider the matters to communicate regarding accounting estimates, taking into account the reasons given to the risks of material misstatement.
- Enhanced documentation requirements.

The revised standard is applicable to all estimates. It has been designed to be scalable, recognising that some estimates may not require significant judgments and the processes for making them may not be complex.

3. Conforming amendments are being made by the IAASB to:

ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing* - including identifying in the application material that ISA 540 (Revised) requires a separate assessment of inherent risk and control risk.

ISA 230, *Audit Documentation* - including identifying in the application material that documentation providing evidence of the auditor's exercise of professional scepticism may include documenting how the auditor evaluated evidence obtained that both corroborates and contradicts management's assertions. It also identifies that examples of documentation of significant professional judgments include the basis for the auditor's evaluation of whether an accounting estimate and related disclosures are reasonable in the context of the applicable financial reporting framework.

ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* - amending the application material to be clear that a retrospective review is not necessarily restricted to the prior period.

ISA 260 (Revised), *Communication with Those Charged with Governance* – including identifying in the application material that those charged with governance may be interested in the auditor's views on the degree to which complexity, subjectivity or other inherent risk factors affect the selection or application of the methods, assumptions and data used in making a significant accounting estimate, as well as the auditor's evaluation of whether management's point estimate and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework; and, when applicable, whether a significant accounting practice of the entity relating to accounting estimates is considered by the auditor not to be most appropriate to the particular circumstances of the entity. The material on qualitative aspects of accounting estimates given in Appendix 2 is moved to ISA 540 (Revised).

ISA 500, *Audit Evidence*, in relation to "external information sources" - including a definition; amending the requirement in paragraph 7 to clarify that the auditor needs to consider the relevance and reliability of information to be used as audit evidence obtained from an external information source; and extensive additional application material.

ISA 580, *Written Representations*, - amending the illustrative representation letter to align with the changes in ISA 540 (Revised).

ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* - amending the requirement in paragraph 13(c) to reflect that the auditor evaluates whether related disclosures, as well as the accounting estimates, made by management are reasonable.

ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* -editorial changes to the requirement in paragraph 9 and related application material, including to reflect ISA 540 (Revised) references to a high “degree of” estimation uncertainty.

#### 4. Matters on which IAASA is consulting

In light of the above, a number of matters are set out below on which IAASA is seeking views from stakeholders and interested parties by 5pm on **Friday 21 September 2018**.

No.	Matter on which views are sought
1.	Do you agree that ISA (Ireland) 540 and other ISAs (Ireland) should be revised to adopt the revision to the underlying international standard and the related conforming amendments to other ISAs? If not, please give your reasons and explain what action, if any, that you believe should be taken to update the ISAs (Ireland) in relation to auditing accounting estimates.
2.	If you agree that the ISAs (Ireland) should be revised to adopt the revised ISA 540 and conforming amendments, do you agree that the Irish supplementary material can be limited to that shown in the exposure draft? If not, please give your reasons and explain what supplementary material, if any, you believe should be added.
3.	Is the proposed effective date, which is consistent with the effective date of the IAASB's revised ISAs, appropriate? If not, please give reasons and indicate the effective date that you would consider appropriate.

#### 5. Making your submission

IAASA invites comments on all proposals put forward in this Consultation Paper and, in particular, on the specific matters set out in section 4 above.

Stakeholders and interested parties are invited to provide responses to the above questions by e-mail only to [submissions@iaasa.ie](mailto:submissions@iaasa.ie) no later than **5pm on the 21<sup>st</sup> of September 2018**.

Any submissions received after this time and all anonymous submissions will not be considered.

Comments are most helpful if they:

- (a) respond directly to the specific question posed;
- (b) provide a clear rationale for the position adopted by the respondent;

(c) provide supporting evidence underpinning the views expressed/rationale proposed; and

(d) describe in detail any alternative option(s) you wish IAASA to consider.

All responses from identifiable individuals and organisations received by the deadline will be considered by IAASA. Depending on the nature and scale of responses, IAASA may publish a feedback statement summarising the content of the responses. Respondents should note that, in the interest of transparency, their responses may be published in full or in part (and may be attributed to the respondent) by IAASA in that feedback statement.