

Agenda Item 4-B

Proposed Disposition of the Present Tense and Other Statements in the Draft Revised ISA 540

I. Those That Have Been Elevated to a Requirement

| § in Agenda Item 3-A | Statements | New § in Agenda Item 4-A |
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| 14 | Obtaining an understanding of the requirements of the entity's applicable financial reporting framework assists the auditor in determining whether the financial reporting framework prescribes certain conditions or methods for the recognition and measurement of accounting estimates, or specifies required disclosures. | 9(a)(i) |
| 18 | In preparing the financial statements, management has the responsibility 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 and disclosed in the financial statements in accordance with the applicable financial reporting framework. The auditor obtains an understanding of the methods and practices followed by management for periodically reviewing the circumstances that give rise to the accounting estimates and re-estimating the accounting estimates as necessary. | 9(a)(ii) |
| 19 | ...The auditor inquires of management about changes in circumstances such as, for example, whether: | 9(a)(ii) |
| 23 | <p>In obtaining an understanding of how management made the accounting estimates, including relevant internal controls, the auditor ordinarily considers matters such as:</p> <ul style="list-style-type: none"> • The types of accounts or transactions to which the accounting estimates relate (for example, whether the estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions). • How management has applied the requirements of the applicable financial reporting framework relevant to the accounting estimate and the appropriateness of the accounting policies selected. • Whether, and if so how, management has used recognized measurement techniques for making particular accounting estimates. | 9(a)(iii) |
| 27 | In obtaining an understanding of the assumptions underlying the accounting estimates, the auditor considers how management determines that the estimates are based on assumptions that are internally consistent and conform to the entity's business plans and the external environment. | 9(a)(iii) |
| 30. | In obtaining an understanding of how management made an accounting estimate, the auditor considers whether there has been a change in, or re-estimation of, that accounting estimate from the prior period. Where there has been no change in circumstances or new information upon which the change or re-estimation is based, the change is considered arbitrary. Arbitrary changes in an accounting estimate result in inconsistent financial statements over time, in that recognized income would change without any corresponding improvement in the underlying quality of the entity's earnings. | 9(a)(iii) See also A 21 |
| 38 | In assessing the risks of material misstatement, the auditor considers the existence of | |

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| | <p>factors indicating estimation uncertainty, and the degree of susceptibility to bias. Factors affecting estimation uncertainty include, but are not limited to, the following:</p> <ul style="list-style-type: none"> • The extent to which the accuracy of an accounting estimate depends on management’s judgment about the outcome of uncertain future conditions, transactions or events. • The degree of sensitivity of the accounting estimate to changes in assumptions. • The existence of recognized measurement techniques that may mitigate the estimation uncertainty. • The relevance of data drawn from past events to predict future events. | 11(a) & 11(b) |
| 39 | <p>Matters that the auditor considers in assessing the risks of material misstatement may also include the influence of such matters as:</p> <ul style="list-style-type: none"> • The actual or expected magnitude of an estimate; • The recorded amount of the estimate in relation to the amount expected by the auditor to be recorded; and • The outcome of prior year estimates review. | <p>11(c)</p> <p>[Note: last bullet covered by 9(b)]</p> |
| 42 | <p>In determining which accounting estimates have high estimation uncertainty, the auditor disregards the materiality of the amount currently recognized or disclosed in the financial statements.</p> | 12 |
| 49 | <p>...For such events to remove the need to perform additional audit procedures on the estimate, the auditor obtains sufficient appropriate evidence about the events.</p> | 13(a) |
| 55 | <p>Testing management’s process ordinarily involves:</p> <ul style="list-style-type: none"> • Testing the extent to which both internal and external data on which the accounting estimate is based, is accurate, complete and relevant, and whether the estimate has been properly determined using such data and management assumptions; • Verifying the source of relevant external data; • Recalculating the accounting estimate, and reviewing information about an accounting estimate for internal consistency; • Considering whether the significant assumptions made by management provide a reasonable basis for the accounting estimate; • Considering management’s review and approval processes; and • Considering whether there are any indicators of possible management bias in the making of the accounting estimate. | <p>13(b)</p> <p>See also A40</p> |
| 57 | <p>The auditor considers the assumptions, collectively and individually, in evaluating whether they reasonably support the accounting estimates. Assumptions are frequently interdependent, and therefore need to be internally consistent. An assumption that may appear reasonable when taken in isolation</p> | 13(b) |

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| 74 | <p>The auditor's range is useful and effective when it is sufficiently narrow to be able to identify a material misstatement. Both the range itself and the outcomes within the range therefore need to be, in the auditor's judgment, reasonable. This is achieved by narrowing the range by eliminating from the range those outcomes at the extremities of the range judged by the auditor to be unlikely to occur, and continuing to narrow the range, based on audit evidence available, to the point audit evidence indicates that there is one outcome within the range that is likely to occur, or to the point where the auditor is unable to, based on the audit evidence, distinguish further the relative likelihood of occurrence of the remaining outcomes, and accordingly all outcomes within the range are considered equally likely to occur.</p> | 15 |
| 75 | <p>... In some cases, however, particularly in certain industries, it may not possible to narrow the range below tolerable error. This does not necessarily preclude recognition of the estimate nor does it indicate that the range, or the outcomes within the range, are not reasonable. It may indicate, however, that the estimation uncertainty associated with an estimate is such that it gives rise to a significant risk....</p> | 16 |
| 71 | <p>When the auditor makes a point estimate or a range, the auditor may use assumptions different from those used by management. In such circumstances, the auditor still obtains an understanding of management's assumptions in order to establish that the auditor's model takes into account relevant variables, and to be able to understand and evaluate any significant differences from management's point estimate. The auditor also establishes that the underlying internal data used in making the point estimate is reliable...</p> | 14 |
| 74 | <p>When the auditor develops a range with which to evaluate the reasonableness of management's point estimate (the 'auditor's range'), to be useful, the range cannot be one that comprises all possible outcomes. Such a range would be too wide to be effective for purposes of the audit. The auditor's range is useful and effective when it is sufficiently narrow to be able to identify a material misstatement. This is achieved by narrowing the range by eliminating from the range those outcomes at the extremities of the range judged by the auditor to be unlikely to occur, and by continuing to narrow the range, based on audit evidence available, to the point where:</p> <ul style="list-style-type: none"> • The audit evidence indicates that there is one outcome within the range that is likely to occur; or • The auditor is unable to, based on the audit evidence, distinguish further the relative likelihood of occurrence of the remaining outcomes, and accordingly all outcomes within the range are considered equally likely to occur. | 15 and A58 |
| 75 | <p>...Further, in such cases, the auditor considers whether recognition criteria and disclosure requirements of the financial reporting framework have been met</p> | 19 |
| 95 | <p>... a misstatement exists when management's point estimate lies outside such the auditor's range. The misstatement is measured as the difference between management's point estimate and the nearest point of the auditor's range. Where the auditor is able to determine a point estimate, the difference between the auditor's point estimate and management's point estimate constitutes a financial statement misstatement.</p> | 22 |

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| 88 | Where management has recognized an accounting estimate in the financial statements, the auditor evaluates whether its measurement is sufficiently reliable to meet the recognition criteria of the applicable financial reporting framework. The auditor also evaluates whether the measurement of an accounting estimate that has not been recognized is, in fact, sufficiently reliable to meet the recognition criteria of the applicable financial reporting framework. | 19(a) |
| 89 | With respect to accounting estimates that have not been recognized, the auditor considers the adequacy of the disclosures in the notes to the financial statements and also whether to modify the auditor's report, to draw the reader's attention to the significant uncertainty, by adding an emphasis of matter paragraph... | 19(b) |
| 93 | Where the applicable financial reporting framework does not prescribe disclosure of estimation uncertainty, the auditor nevertheless encourages management to describe, in the notes to the financial statements, the circumstances relating to the estimation uncertainty. | 20 |
| 99. | The auditor considers whether judgments and decisions made by management give rise to indicators of possible management bias. Such indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. However, the presence of indicators of possible management bias may affect the auditor's conclusion as to whether the auditor's risk assessment remains 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 of material misstatement. ISA XXX establishes standards and provides guidance on these considerations. | 23 |

II. Those That Have Been Treated as Application Guidance and Redrafted

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| 11 | ... The auditor obtains this understanding by performing risk assessment procedures, which involve gathering, updating and analyzing information throughout the audit. | A5 |
| 21 | 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. If so, the auditor considers why the entity's risk assessment process failed to identify them and whether the process is appropriate for the circumstances. ISA 315 provides guidance... | Deleted-unnecessary to repeat ISA 315 |
| 24 | <p>In obtaining an understanding of relevant internal controls, the auditor ordinarily considers matters such as:</p> <ul style="list-style-type: none"> • The experience and competence of those who make the accounting estimates. • How management determines the completeness, relevance and accuracy of the data used to develop accounting estimates. • The controls over the review and approval of accounting estimates by appropriate levels of management and, where appropriate, those charged with governance. • Other internal controls relevant to the accounting estimation process. | A16 |
| 32. | <p>In obtaining an understanding of whether, and if so how, management has assessed the effect of estimation uncertainty, the auditor considers matters such as:</p> <ul style="list-style-type: none"> • Whether and how management has considered alternative assumptions or outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the assumptions on an accounting estimate. • How management determines the accounting estimate when analysis indicates that there may be a number of outcome scenarios. • Whether management monitors the outcome of accounting estimates made in the prior period and whether management has appropriately responded to the outcome of that monitoring procedure. | A23 |
| 35. | A similar retrospective review is required by ISA 240. That review is conducted as part of the requirement for the auditor to design and perform procedures to review accounting estimates for biases that could result in material misstatements due to fraud, in response to the risks of management override of controls. However, as a practical matter, the auditor's review of the outcome , or re-estimation, of accounting estimates made in the prior period financial statements as a risk assessment procedure in accordance with this ISA is usually carried out in conjunction with the review required by ISA 240. | A26 |
| 51 | When events contradict the accounting estimate made, the auditor considers whether this may be indicative of management having ineffective processes for the making of accounting estimates. | A38 |

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| 59 | <p>....While the extent of audit evidence to be obtained about management’s intent is a matter of professional judgment, the auditor’s procedures ordinarily include the following:</p> <ul style="list-style-type: none"> • Considering management’s history of carrying out its stated intentions. • Reviewing written plans and other documentation, including, where applicable, formally approved budgets, authorizations, minutes, etc. • Considering management’s stated reasons for a particular course of action. • Considering management’s ability to carry out a particular course of action given the entity’s economic circumstances, including the implications of its existing commitments. | A43 |
| 65 | When performing tests of the operating effectiveness of controls, the auditor obtains audit evidence about how controls were applied at relevant times during the period under audit.... | A49 |
| 66 | When the auditor has assessed the identified risk as a significant risk, the auditor is required, to the extent not already done, to evaluate the design of the entity’s controls.... | A50 |
| 72 | ... When using the work of an expert, the auditor obtains sufficient appropriate audit evidence that such work is adequate for the purposes of the audit, and complies with the requirements of ISA 620, “Using the Work of an Expert.” | A56 |
| 80 | Management’s consideration of alternative assumptions or outcomes may not be a formal process supported by extensive documentation, particularly in smaller entities. Smaller entities may use less formal means and simpler procedures to assess the estimation uncertainty. In these circumstances, in addition to the auditor’s review of available documentation, the auditor generally obtains audit evidence of management consideration of alternative assumptions or outcomes by inquiry of management. It is management’s thoughtful assessment of how estimation uncertainty may affect the accounting estimate that is important, not the specific manner in which that is done. | A64 |
| 82 | Where management has not considered alternative assumptions or outcomes, the auditor requests that management support how it has addressed the effects of estimation uncertainty on the accounting estimate. | A65 |
| 92 | The auditor also considers any additional requirements of the applicable financial reporting framework for disclosures regarding uncertainties. | Deleted – unnecessary as this is carried out as part of further substantive procedures for significant risks. |