

**Meeting:** IAASB Teleconference  
**Meeting Location:** Teleconference  
**Meeting Dates:** January 25, 2016

## Agenda Item 1

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

#### **Objective of Agenda Item**

1. The objectives of the IAASB discussion at its January teleconference is to obtain input on the Project Publication, *Project to Revise ISA 540, An Update on the Project and Initial Thinking on The Auditing Challenges Arising From the Adoption of Expected Credit Loss Models* (the Project Publication).

#### **ISA 540 Task Force**

2. The Task Force is comprised of the following members:
  - Rich Sharko (Task Force Chair, IAASB Member) (supported by Jamie Shannon, IAASB Technical Advisor)
  - Marc Pickeur (Task Force Co-Chair, IAASB Member)
  - Abhijit Bandyopadhyay (IAASB Member)
  - Jean Blascos (IAASB Member)
  - Marek Grabowski (IAASB Member)<sup>1</sup> (supported by Josephine Jackson, IAASB Technical Advisor)
  - Ron Salole (IAASB Member)
  - Dora Burzenski (IAASB Technical Advisor)<sup>1</sup>
  - Jean-Jacques Dussutour (representing the International Association of Insurance Supervisors)
  - Emilio Pera (Practitioner)
  - Nicolaas van der Ende (Banking Regulator)<sup>2</sup>

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<sup>1</sup> Joined the Task Force in December 2015

<sup>2</sup> Pat Sucher left the Task Force as of December 31, 2015. The Basel Committee on Banking Supervision (BCBS) Accounting Expert Group has been asked to consider a replacement. In the meantime, Nicolaas van der Ende will monitor the Task Force's work and provide the Task Force with input on the BCBS Accounting Expert Group's activities and its observations on the Task Force's activities.

Barbara Vanich, who is representing the United States Public Company Accounting Oversight Board, is an official observer to the Task Force.

### **Task Force's Activities since the December 2015 IAASB Board Meeting**

3. Since the December 2015 Board meeting, the Task Force had two teleconference calls in which it discussed the matters raised by the Board and the IAASB Consultative Advisory Group (CAG) and considered areas that could be enhanced or that could be included. A summary of the IAASB Discussion at its December 2015 Meeting is included in the **Appendix**. In addition, input was received electronically from representatives of the Banking Working Group IAASB Liaison Sub-Working Group of the Global Public Policy Committee.<sup>3</sup>
4. The Task Force has revised the Project Publication to respond to the feedback received. In this respect, the Task Force also noted the calls regarding the possible benefits of making public a list of action items for the project. The Task Force has discussed the matter, and will investigate the possibility further after the release of the project publication.

#### **Matters for IAASB Consideration**

1. Members are asked to share their views on the draft project publication as shown in Agenda Item 1-A

#### **Material Presented**

Agenda Item 1-A

Project Publication, *Project to Revise ISA 540, An Update on the Project and Initial Thinking on The Auditing Challenges Arising From the Adoption of Expected Credit Loss Models*

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<sup>3</sup> The Global Public Policy Committee comprises the six largest international accounting networks: BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG and PwC.

### Summary of the IAASB Discussion at its December 2015 Meeting

Mr. Sharko introduced the topic and explained the outreach conducted with regulators, practitioners and others since the September 2015 Board meeting. He noted that the Working Group drafted a project proposal to revise ISA 540<sup>4</sup> and developed a publication to update stakeholders on the project's progress (the Project Publication). He highlighted that the Project Publication identified the audit issues relating to Expected Credit Losses (ECL), and the preliminary views of the Working Group on what related action the Board may consider in the revision of ISA 540.

#### PROJECT PROPOSAL

Mr. Sharko introduced the project proposal to revise ISA 540 by highlighting the objectives of the project proposal, the issues to be addressed, and how the project to revise ISA 540 serves the public interest. He also highlighted the key comments that the IAASB Consultative Advisory Group (CAG) raised in its December 2015 teleconference.

Board members expressed broad support for the project proposal as presented in **Agenda Item 4-B**. In addition to some editorial comments, the following matters were noted with regard to the clarifying or further enhancing the project proposal and the actions to be taken in commencing the project:

- Emphasize the importance of exercising professional skepticism throughout the audit of accounting estimates and the Task Force should consider whether the definition of management bias needs to be enhanced.
- Consider whether guidance is necessary to help auditors better understand the sources and characteristics of high estimation uncertainty.
- Clarify that accounting estimates, in addition to impacting the balance sheet, have corresponding impacts on statements of performance, and that greater use of complex accounting estimates can stem from fair value measurements but also other measurement bases. It was also noted that often only certain aspects of accounting estimates are challenging.
- Clarify that it is not the intent of the project to increase the disclosures beyond those required by financial reporting frameworks.
- Conduct outreach with organizations that represent small and medium practices (SMPs) beyond the IFAC SMP Committee.
- Clarify that future publications to update stakeholders on the project's progress may be issued periodically to inform stakeholders about the evolving discussions at the Task Force and IAASB levels.

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<sup>4</sup> ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

*PIOB Observer Remarks*

Mr. Holm noted that the proposed timetable is challenging. Given the effective date of IFRS 9,<sup>5</sup> he highlighted the importance of meeting the proposed deadlines. He also highlighted the importance of taking into account the audit implications of accounting estimates for insurance contracts.

*IAASB CAG Chairman's Remarks*

Mr. Waldron noted that CAG Representatives and Observers supported the project proposal to revise ISA 540 and agreed with the key comments raised by the CAG as presented by the Task Force. He also noted the CAG's interest to be frequently engaged on this topic.

*Approval*

Subject to addressing the matters noted above, the IAASB unanimously approved the project proposal to revise ISA 540 with 17 affirmative votes out of the 17 Board members present.

PROJECT PUBLICATION

Mr. Sharko introduced the Project Publication by noting that its purpose is to provide an outline of the project proposal and to highlight the significant audit challenges that may arise as a result of ECL. He explained that the project publication will explain the audit issues identified by the Working Group regarding ECL, highlight the Working Group's thinking on those issues in light of existing ISAs and International Auditing Practice Notes (IAPNs), and identify areas that the Working Group may explore as part of the project to revise ISA 540. Mr. Sharko also highlighted the drivers and the challenges of issuing the Project Publication and the feedback received from stakeholders.

Generally the Board supported the Project Publication as included in **Agenda Item 4-C**. Board members provided, in addition to editorial suggestions, the following comments:

- The IAASB asked the Task Force to consider whether the document could be restructured and retitled to make the two objectives of the document clearer. It was suggested that the material on how the identified issues may be addressed in the ISA 540 project could be expanded to make it more useful to readers.
- Some Board members questioned if another form of non-authoritative guidance, such as a Staff Alert, might be more appropriate, as some practitioners might find comments about the future direction of the project to revise ISA 540 unhelpful. Others disagreed, noting that requests for audit guidance had come from both practitioners and regulators and therefore it is important for the IAASB to provide these stakeholders with guidance to help facilitate auditors' early responses to the challenges posed by ECL models. It was also noted that the CAG generally supported the section that describes the possible future direction of the project and that including this section in the Project Publication signals that the needed responses from auditors to ECL models will likely have an impact on ISA 540.

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<sup>5</sup> International Financial Reporting Standard (IFRS) 9, *Financial Instruments*

- It was noted that a clear list of issues or “action items” may help readers track the IAASB’s progress on the issues.
- Support was noted for the outreach that the Working Group has conducted to date. The Task Force was encouraged to engage in further outreach throughout the project to ensure that relevant issues are being appropriately considered.

The Board also highlighted several areas that could be enhanced or that could be included in Section IV of **Agenda Item 4-C**, as follows.

- Several suggestions were made on how to clarify and expand the possible future direction sections to provide more detail on the possible changes to ISA 540.
- It was noted that the Task Force could include material linking to the auditors’ responsibility to communicate with those charged with governance as described in ISA 260 (Revised)<sup>6</sup> and ISA 265.<sup>7</sup>
- With respect to challenges with data and assumptions, it was noted that the controls around systems and high volume accounting estimates could be emphasized in the considerations that may aid the auditor in considering management’s use of data, including forward-looking data. The importance of consistent use of data within an entity and the role that regulators play therein was also highlighted.
- Support was noted for the proposed more granular risk assessment and the proposed stronger link between significant risks and certain characteristics of accounting estimates. It was questioned whether rebuttable presumptions would be the best future direction.
- With respect to understanding and assessing models and controls thereon, the importance of being involved in the implementation process was highlighted given the ability to suggest adjustments early on in the implementation process. Mr. Holm agreed and highlighted that small changes in a model can have a material impact on the financial statements and therefore stressed the importance of change management controls over models.
- It was suggested to elaborate on management’s and the auditor’s use of experts in dealing with ECL models and to emphasize that key audit matters in accordance with ISA 701<sup>8</sup> can also be applied voluntarily for entities other than listed entities.
- It was suggested to combine the possible future direction sections into one section in order to reduce repetition and improve the readability. The combined possible future direction section would also enable the Task Force to summarize matters that are more holistic. Others preferred the approach taken by the Task Force as this approach could make future updates easier.

Mr. Waldron highlighted the importance of obtaining the CAG’s input on the project on a timely basis and

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<sup>6</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

<sup>7</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

<sup>8</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

more frequently than may be the case for other projects.

**WAY FORWARD**

The IAASB will consider an updated version of the Project Publication at its January 2016 teleconference. The ISA 540 Task Force will bring issues around the revision of ISA 540 to the March 2016 IAASB meeting.