

ISA 540:

Presentation by:

Ronald N. Bwosi

Managing Partner, Ronald's & Associates,

Thursday, 14th March 2019

Independent Member

B K R
INTERNATIONAL



INTERNATIONAL STANDARD ON AUDITING (ISA 540)





WHY ISA 540?



- Use Of estimation in the preparation of financial statements.
- Selling products that cannot necessarily be measured as accurately as in the past
- Financial instruments are becoming more complex
- Assets are often more intangible





Previously....



.....*Fair value estimates were dealt with separately.*



BUT NOW.....

ISA 540 (Revised) not only includes fair value estimates but also all accounting estimates and related disclosures, *For periods beginning on or after December 15, 2019.*



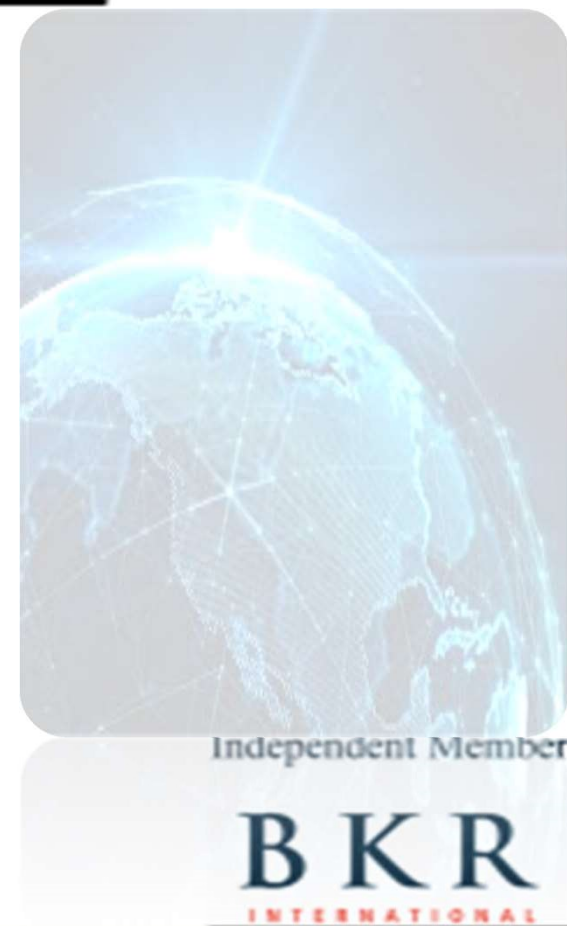


Objectives of ISA 540



- Establish more:

1. Robust requirements and
2. Appropriate detailed guidance to foster audit quality by **driving auditors** *to perform appropriate procedures in relation to accounting estimates and related disclosures.*
3. Emphasize the importance of the appropriate *application of professional skepticism* when auditing accounting estimates.





Objectives of ISA 540



4. Determine whether non-authoritative guidance and support tools, such as,
- a. International Auditing Practice Notes*
 - b. Staff publications*
 - c. project updates or other materials*

should be developed in the future to address special audit considerations relevant to financial institutions to supplement the revisions to ISA 540 and oversee the development of the guidance material considered necessary.





HENCE...



- ISA 540 will deal with
 1. Auditing accounting estimates,
 2. Issues arising from the adoption of Expected Credit Loss models
 3. Issues related to audits of financial institutions.



NB: While ISA 540 is already a robust standard, the IAASB believes that it is worth examining whether changes to it are needed in light of evolving accounting standards, audit practice, and audit inspection findings.





ISA 540 Will help Address:



A. Evolving audit risks relating to Accounts Estimation (Aes), in complex business environment

1. *Such risks evolving and increasing due to:*

- *FR frameworks evolving to require more complex AEs with high estimation uncertainty*
- *Such AEs becoming more prevalent and a fundamental part of financial statements for some entities*





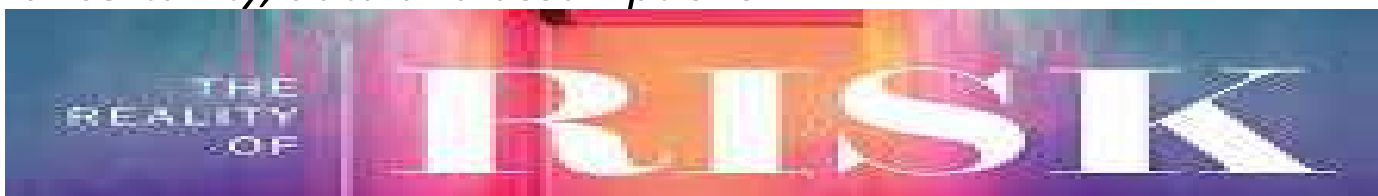
ISA 540 Will help Address:



A. Evolving audit risks relating to Accounts Estimation (Aes), in complex business environment

2. Audit risks may arise because such AEs require:

- *Significant management judgment with potential for management bias and fraud*
- *Use of more forward-looking information and more related disclosures of such information*
- *More disclosures about measurement basis, estimation uncertainty, data and assumptions*





ISA 540 Will help Address:



A. Evolving audit risks relating to Accounts Estimation (Aes), in complex business environment

3. Financial regulator concerns that complex processes in making such AEs give rise to risks due to:

- *Reliance on technology to make such AEs, when they require large volumes of system-generated data*
- *Reliance on greater oversight by management and governance in using complex models*



Independent Member

B K R
INTERNATIONAL



ISA 540 Will help Address:



B. Audit quality and foster improved exercise of professional skepticism

➤ *Inspection findings raise significant concerns about audit quality and exercise of PS for AEs*

C. And realize public interest benefits of audit by improved communication & transparency





Address Evolving Audit Risk



A. Risk Assessment

- Enhanced the risk assessment procedures relating to obtaining an understanding of the entity and its environment, including the entity's internal control
- Introduced separate assessment of inherent and control risk
- In assessment of inherent risk, and determining whether a risk is a significant risk, included consideration of the effect of the inherent risk factors and their inter-relationships
 - Complexity
 - Subjectivity
 - Estimation uncertainty
 - Other (e.g. change or misstatement due to management bias or fraud)





Address Evolving Audit Risk



B. Work Effort

- Introduced objectives-based requirements to respond to assessed risks of material misstatement. These are directed to
 - Methods (including when complex modelling is involved)
 - Assumptions
 - Data
- Reference is made to relevant requirements in ISA 315 (Revised) and ISA 330 to emphasize the importance of testing controls
- Strengthened requirement on when management has not appropriately understood estimation uncertainty
- Enhanced the approach to the use of an auditor's point estimate or range
- Clarified that the auditor also is required to comply with the relevant requirements in ISA 500





Address Evolving Audit Risk



C. Disclosures

- Changed the objective of the standard to obtain sufficient appropriate audit evidence about whether “accounting estimates and related disclosures” in the financial statements are “reasonable” (was ‘adequate’) in the context of the applicable financial reporting framework
- Enhanced requirements to obtain audit evidence about whether the related disclosures are “reasonable”





Address Evolving Audit Risk



– Enhanced the overall evaluation requirement to determine whether the related disclosures are “reasonable” in the context of the applicable financial reporting framework, or are misstated

D. Documentation requirement expanded

E. Application material restructured and expanded





Address Evolving Audit Risk



F. Conforming Amendments

– ISA 500 – external information source

- Definition
 - o Focused on the information being suitable for use by a broad range of users
 - o Added service organization to avoid confusion with services for which ISA 402 applies





Address Evolving Audit Risk



G. Enhanced application material

- o Examples of why and when different approaches to considering an EIS are likely needed
- o Included guidance with respect to the implications of restricted access to an EIS's information, or proprietary models – Other Conforming Amendments to ISA 200, 230, 240, 260 (Revised), 580, 700 (Revised) and 701



BKR
INTERNATIONAL



Address Evolving Audit Risk



H. Scalability

- Explicitly recognized concept of spectrum of inherent risk by
 - Building on existing concepts in ISA 200, ISA 315 (Revised), and ISA 330
 - Describing spectrum and emphasizing scalability in key concepts paragraphs
- Used wording in requirements to enhance scalability
- Provided application material, with examples where appropriate, to explain how certain requirements can be applied in a scalable manner



Independent Member

B K R
INTERNATIONAL



Professional Skepticism



A. Several changes made to enhance the exercise of professional skepticism

- Other inherent risk factor includes misstatement due to management bias or fraud
- Requirement to design and perform further audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory
- Focus on indicators of possible management bias in work effort





Professional Skepticism



- Requirements to “stand back” and evaluate the audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence
- Use of stronger language (“challenge”, “question”, “reconsider”) in application material to reinforce the importance of exercising professional skepticism
- ISA 230, paragraph A7 highlights importance of documenting the exercise of professional skepticism in relation to accounting estimates





Communication & Transparency



B. Several changes made to enhance the communication and transparency

- Included requirement to communicate with those charged with governance about significant qualitative aspects of the entity's accounting practices
- Specifically noted that, in certain circumstances, the auditor is required by law or regulation to communicate about certain matters with other relevant parties, such as regulators and prudential supervisors





Communication & Transparency



– Noted in the application material that if the auditor's consideration of estimation uncertainty associated with an accounting estimate, and its related disclosures, is a matter that required significant auditor attention, then this may constitute a key audit matter





QUESTIONS.....



Independent Member

B K R
INTERNATIONAL



Get in Touch

Ronalds & Associates
3rd Floor, Rhapta Heights
Rhapta road, Westlands
P. O. Box 41331 – 00100 Nairobi,
Kenya



www.ronaldsassociates.co.ke



+254 717 558 212, 720 131 650

ndent Member

BKR
INTERNATIONAL