

## Chartered Accountants Ireland or CCAB-I material

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### Technical Alerts

#### TA 02/2020 - Information and support in implementing the revised ISA 540 (Revised December 2018) Auditing Accounting Estimates and Related Disclosures

November 2020

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### **1.Introduction and purpose of this Technical Alert**

International Standard on Auditing (ISA) 540 (Revised) Auditing Accounting Estimates and Related Disclosures was published in October 2018 by the International Auditing and Assurance Standards Board (IAASB).

In December 2018 the Irish Auditing and Accounting Supervisory Authority (“IAASA”) and the Financial Reporting Council (FRC) in the UK followed suit, publishing ISA (Ireland) 540 (Revised)”) and ISA (UK) 540 (Revised) respectively.

This ISA supersedes ISA 540 issued in June 2016.

Throughout this document where we refer to ISA 540 (Revised) we are referring to the Irish and UK versions of the standard. We also refer to other standards such as ISA 315 etc, again these references encompass standards in both UK and Ireland.

The purpose of this Technical Alert (TA) is to provide a brief outline of the significant changes to the standard and is to direct members to additional sources of information and guidance on the implementation of the revised ISA 540. This includes discussion on the need for preparers of financial statements to engage with their auditors to discuss the accounting estimates included in the financial statements.

### **2.Objective and scope of ISA 540 (Revised)**

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework.

ISA 540 (Revised) deals with the auditor’s responsibilities relating to accounting estimates and related disclosures in an audit of financial statements.

Specifically, it includes requirements and guidance that refer to, or expand on, how ISA 315; ISA 330 (Revised August 2018); ISA 450 (Revised July 2017); ISA 500 (Revised July 2017) and other relevant ISAs are to be applied in relation to accounting estimates and related disclosures. It also includes requirements and guidance on the evaluation of misstatements of accounting estimates and related disclosures and indicators of possible management bias.

The key changes in ISA 540 (Revised) are:

- More emphasis on the need for the auditor to exercise professional scepticism.
- More granular assessments regarding the risk that accounting estimates may be materially misstated.
- Focus on appropriately responding to the levels of estimation uncertainty, complexity and subjectivity in accounting estimates.
- Audit work effort based on the selected approach(es) (testing management’s process, developing own estimate, subsequent events) including a more detailed understanding of the significant matters considered in making key judgements and decisions affecting accounting estimates.
- More emphasis on auditing accounting estimate disclosure in the financial statements.
- More detailed written representations.

This publication from IAASB provides an overview of the changes made to ISA 540 (Revised)

<https://www.ifac.org/system/files/publications/files/ISA-540-At-a-Glance.pdf>

This article from the International Federation of Accountants (IFAC) discusses the changes to ISA 540 and the work auditors need to do to tackle the requirements in the revised standard including appropriately capturing the changes into audit methodologies.

<https://www.ifac.org/knowledge-gateway/supporting-international-standards/discussion/preparing-changes-isa-540-auditing-accounting-estimates>

### **3. Effective date of ISA 540 (Revised December 2018)**

ISA 540 (Revised December 2018) was issued in December 2018 and is effective for audits of financial statements for periods beginning on or after **December 15, 2019**.

For many auditors this means the first application is for audits of financial statements for the year to **31 December 2020**.

### **4. Where to access the standards**

ISA (Ireland) 540 (Revised December 2018) Auditing Accounting Estimates and Related Disclosures can be downloaded from IAASA's website

[https://www.iaasa.ie/getmedia/900c0017-2966-423a-9a88-f33868235a85/ISA\\_540\\_revised\\_dec\\_18\\_website.pdf](https://www.iaasa.ie/getmedia/900c0017-2966-423a-9a88-f33868235a85/ISA_540_revised_dec_18_website.pdf)

All other ISAs are also available on the IAASA website.

[https://www.iaasa.ie/Publications/Auditing-standards/Standards-Guidance-for-Auditors-in-Ireland/International-Standards-on-Auditing-\(Ireland\)](https://www.iaasa.ie/Publications/Auditing-standards/Standards-Guidance-for-Auditors-in-Ireland/International-Standards-on-Auditing-(Ireland))

The FRC standards are available from FRC.org.uk

<https://www.frc.org.uk/auditors/audit-assurance/standards-and-guidance>

### **5. IAASB material**

The TA provides links to a number of publications from the IAASB. These provide illustrative examples of how an auditor could address certain requirements of the revised standard including describing procedures that might be performed.

The examples illustrate accounting estimates with varying characteristics and degrees of complexity. Each example illustrates a selection of requirements from ISA 540 (Revised).

Not all requirements are addressed in each example, nor do they cover all parts of those requirements that have been selected. The requirements selected across each example vary to illustrate different aspects of ISA 540 (Revised) and to focus on those requirements that are most relevant to the example.

These examples are intended to be read together with ISA 540 (Revised). This will demonstrate how an auditor's work effort, to comply with the requirements of ISA 540 (Revised), may be scaled down and scaled up when auditing simple and complex accounting estimates.

### **6. Illustrative examples for auditing simple and complex accounting estimates**

These examples are designed to illustrate how an auditor could address certain requirements of ISA 540 (Revised), and have been developed to assist the auditor in understanding how ISA 540 (Revised) may be applied to:

- Simple Accounting Estimate – Provision on Inventory Impairment

- Complex Accounting Estimate – Provision on Property, Plant and Equipment Impairment

<https://www.iaasb.org/publications/isa-540-revised-implementation-illustrative-examples-auditing-simple-and-complex-accounting>

### **7. Client Briefing - Considerations for management when determining accounting estimates and related disclosures**

#### **Changes of interest to auditors and clients**

The revisions to ISA 540 (Revised) will have important implications for chief financial officers, financial controllers and management responsible for financial statement preparation and the determination of accounting estimates. Its impact may be felt outside finance functions where others contribute to the calculation of estimates – for example, valuation specialists, taxation teams or pension specialists. It will also give

rise to additional considerations for audit committees recommending financial statements for approval.

### **Accountancy Ireland articles**

The Accountancy Ireland articles linked below discuss the impact of the changes from both the auditor and client perspective.

- New estimates auditing standard (Accountancy Ireland September 2020)

<https://www.charteredaccountants.ie/Accountancy-Ireland/Articles2/Technical/Latest-News/Article-item/new-estimates-auditing-standard>

- Justifying your accounting estimate (Accountancy Ireland June 2019)

<https://www.charteredaccountants.ie/Accountancy-Ireland/Articles2/Technical/Latest-News/Article-item/justifying-your-accounting-estimates>

### **IAASB Audit Client Briefings**

The IAASB Working Group has prepared an Audit Client Briefing (*Briefing*) based on the Canadian Auditing Standard (CAS) Audit Client Briefing of the Chartered Professional Accountants of Canada (CPA Canada), published in October 2019 and is used with permission of CPA Canada.

The purpose of this *Briefing* is to make chief financial officers, other senior management responsible for financial statement preparation, and staff directly involved in determining accounting estimates aware of matters to consider in preparing for the auditor's requests pertaining to ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*.

This *Briefing* provides an overview of:

- Management's responsibilities in determining when accounting estimates are needed;
- Management's responsibilities regarding the main components of an estimation process; and
- The impact on management because of changes to the auditor's responsibilities, including broad questions auditors are likely to ask those involved in the detailed aspects of the estimation process.

<https://www.iaasb.org/publications/isa-540-revised-implementation-support-audit-client-briefing-1>

### **8.Guidance for credit union auditors**

The Audit of Credit Unions Guidance Note 02/2019, published by IAASA, contains guidance on applying ISA (Ireland) 540 to the audit of credit unions which auditors may find useful.

Accounting estimates are used for valuation purposes in a number of areas; the most common examples in a credit union are loan impairments, the valuation of buildings and impairments of buildings and the valuation of investments not traded on an active market. Such estimates may represent significant risks.

See page 60 of the Guidance Note [https://www.iaasa.ie/getmedia/cf575fb9-1851-47a9-9dd7-616180b0c348/The Audit of Credit Unions GN.pdf?ext=.pdf](https://www.iaasa.ie/getmedia/cf575fb9-1851-47a9-9dd7-616180b0c348/The%20Audit%20of%20Credit%20Unions%20GN.pdf?ext=.pdf)

### **9.Publication from IAASA**

IAASA published a document "The audit of accounting estimates" in November 2020.

This paper explains the requirements of previous and incoming auditing standards that deal with accounting estimates. The paper gives insight into European and International audit regulators' views on the quality of audit work around accounting estimates and discusses IAASA's observations. The paper also sets out IAASA's expectations of auditors in this area going forward.

<https://www.iaasa.ie/IAASA/files/ac/ac5ccb23-7555-4a21-a96a-e61a6ce7b3eb.pdf>  
[https://charteredaccountantsireland.sharepoint.com/sites/Tech/Documents/02\\_RT\\_PMay2018/TechnicalAlerts2020/%09http://www.iaasa.ie/IAASA/files/ac/ac5ccb23-7555-4a21-a96a-e61a6ce7b3eb.pdf](https://charteredaccountantsireland.sharepoint.com/sites/Tech/Documents/02_RT_PMay2018/TechnicalAlerts2020/%09http://www.iaasa.ie/IAASA/files/ac/ac5ccb23-7555-4a21-a96a-e61a6ce7b3eb.pdf)

## **10. Illustrative examples for auditing expected credit loss accounting estimates**

The examples illustrate how an auditor could address certain requirements of ISA 540 (Revised), and have been developed to assist the auditor in understanding how ISA 540 (Revised) may be applied to:

- IFRS 9 Impairment (ECL) – Credit Card
- IFRS 9 Impairment (ECL) – Significant Increase in Credit Risk
- IFRS 9 Impairment (ECL) – Macroeconomic Inputs and Data

The examples illustrate accounting estimates with varying characteristics and degrees of complexity. Each example illustrates a selection of requirements from ISA 540 (Revised). Not all requirements are addressed in each example, nor do they cover all parts of those requirements that have been selected. The requirements selected across each example vary to illustrate different aspects of ISA 540 (Revised) and to focus on those requirements that are most relevant to the example.

The three ECL examples are intended to be read together, as requirements that are addressed in one example may also be relevant to another example. For example, the Macroeconomic Inputs and Data example is focused primarily on the audit implications of such data, and does not repeat material in the other examples, which nevertheless may be relevant and applicable to that example more broadly

- <https://www.iaasb.org/publications/isa-540-revised-implementation-illustrative-examples-auditing-expected-credit-loss-accounting>

<sup>1</sup> The International Federation of Accountants, IFAC, is the global organization for the accountancy profession, comprising more than 175 member and associate organizations in 130 countries and jurisdictions, representing nearly 3 million professional accountants. <https://www.ifac.org/>