

Key principles

ISA 540 - AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

ISA 540.11	Ensure that the auditor obtained 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.
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Key conclusions

On completion of inspection procedures in this area, the inspection team shall assess in conclusion whether the auditor obtained sufficient appropriate audit evidence to conclude adequately on the reasonableness of the accounting estimates and related disclosures in the financial statements

Definitions and List of Acronyms

AE	Accounting Estimate
FS	Financial Statements
IR	Inherent Risk
RoMM	Risk of Material Misstatement
TCWG	Those Charged With Governance

Step	Test objective	Reference	Inspection procedures
Risk assessment procedures			
1.	Evaluate that the auditor adequately identified and assessed the RoMM arising from AE	<p>ISA 540.13, A19-A54</p> <p>ISA 540.16, A64-A79</p> <p>ISA 540.5-6 A10 A71 ISA 540.17, 20 A80</p> <p>ISA 540.14, A55-60 ISA 540.15 A61-63</p>	<p>1. Review whether the auditor obtained an adequate understanding of the relevant matters about the entity and its environment relating more specifically to the accounting estimates, including the entity’s internal control over management’s process for determining the accounting estimates.</p> <p>2. Review whether the auditor made an appropriate separate assessment of IR for the purpose of assessing RoMM at the assertion level for AE taking into account the degree to which the AE is subject to, or affected by, estimation uncertainty, complexity, subjectivity and other inherent risk factors (management bias or change in the nature or circumstances of the relevant FS items or requirements of the of the applicable financial reporting framework for instance).</p> <p>3. Review whether the auditor made an appropriate separate assessment of control risk when assessing the RoMM at the assertion level for accounting estimates.</p> <p>4. Evaluate whether the auditor adequately determined whether any of the identified IR are a significant risk. For those significant risks:</p> <ul style="list-style-type: none"> • review how the audit team evaluated the design and implementation of controls; and • review whether the audit team’s risk identification and assessment of significant risks and planned response to those risks appear appropriate. <p>5. Evaluate that the auditor adequately performed the back-testing of previous accounting estimates.</p> <p>6. Evaluate whether the auditor adequately determined the need for specialized skills or knowledge to perform the risk assessment procedures and/or to identify and assess the RoMM at the assertion level for accounting estimates.</p>

Step	Test objective	Reference	Inspection procedures
Responses to the assessed risks of material misstatement			
2.	Evaluate that the auditor designed and implemented appropriate responses to the RoMM arising from AE	<p>ISA 540.18-19, 27 A.81 – A89</p> <p>ISA 540.19-20</p> <p>ISA 540.22-26 A.94-A117</p> <p>ISA 540.28-29 A.94-A108 A118-125</p> <p>ISA 540.31</p> <p>ISA 540.32, A133-A136</p> <p>ISA 540.30 A.126-132 ISA 500.8</p>	<p>1. Taking into account the assessed RoMM at the assertion level and the reasons for the assessment given to those risks, evaluate whether the auditor designed and performed appropriate further audit procedures, one or more of the following approaches:</p> <ul style="list-style-type: none"> a) Obtaining audit evidence from events occurring up to the date of the auditors' report, and/or b) Testing how management made the accounting estimate and the data on which it is based, and/or c) Developing a point estimate or a range to evaluate management's point estimate. <p>2. Evaluate whether the auditor tested the operating effectiveness of the relevant controls in the current period. This is mandatory if:</p> <ul style="list-style-type: none"> • the auditor's assessment of the RoMM at the assertion level includes an expectation that the controls are operating effectively; or • if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level; <p>When doing so, assess whether the tests of operating effectiveness are sufficient and adequate, and whether appropriate conclusions have been taken.</p> <p>3. When approach b) was taken by the auditor (i.e. "testing how management made the AE"), evaluate whether the auditor obtained sufficient appropriate audit evidence regarding the RoMM relating to:</p> <ul style="list-style-type: none"> • the selection and application of the methods, significant assumptions and the data used by management in making the AE; and • how management selected the point estimate and developed related disclosures about estimation uncertainty. <p>4. When approach c) was taken by the auditor (i.e. "developing an auditor's point estimate or range"), evaluate whether the auditor obtained sufficient appropriate audit evidence regarding the RoMM relating to:</p> <ul style="list-style-type: none"> • the selection and application of the methods, significant assumptions and the data used in making the AE; • the reasonableness of all amounts included in the range; and • the disclosures in the FS that describe the estimation uncertainty. <p>5. Evaluate that the auditor adequately assessed whether disclosures in the financial statements related to AE are in accordance with the applicable financial reporting framework.</p> <p>6. Review whether the auditor adequately:</p> <ul style="list-style-type: none"> • identified any indicators of possible management bias in the judgments and decisions made by management in making the AE; • evaluated the implications for the audit when such indicators have been identified. Where there is intention to mislead, management bias is fraudulent in nature. <p>7. When using the work of a management's expert, consider whether the auditor adequately evaluated the work performed by the expert and the conclusions reached;</p>
Overall evaluation and audit report			
3.	Evaluate whether the auditor performed an appropriate overall evaluation based on the performed audit procedures and communicated appropriately with TCWG and other relevant parties	<p>ISA 540.33-36, A137-144</p> <p>ISA 540.38 A146-148</p> <p>Regulation 537/2014¹</p> <p>Article 10.2 & 11.2</p> <p>ISA 540.37, A145</p>	<p>1. Evaluate whether the auditor's overall evaluation is appropriate based on the audit procedures performed</p> <p>2. Evaluate that the auditor adequately determined whether estimates giving rise to significant risks have been adequately addressed in the audit report and in the additional report to the audit committee.</p> <p>3. Evaluate that the auditor obtained written representations from management and where appropriate from TCWG whether they believe the methods, significant assumptions and the data used in making accounting estimates and the related disclosures are reasonable.</p>

¹ Effective from 16 June 2016.