



## Agenda Item 1

### Estimates

#### Objective

To approve an exposure draft to revise AU-C section 540, *Auditing Accounting Estimates and Related Disclosures* and related amendments to various AU-C sections in various SASs.

#### Estimates Task Force

The Estimates Task Force (Estimates TF) members are:

- Dora Burzenski (Chair)
- Doug Bennett
- Jeanne Dee
- Ilene Kassman
- Mike Lundberg
- Martin Hurden
- Laura Schuetze

#### Background

In 2018 the International Auditing and Assurance Standards Board (IAASB) and the PCAOB finalized new auditing standards to address the auditor's responsibilities relating to auditing accounting estimates in an audit of financial statements.

#### ISA 540 (Revised)

In October 2018 the IAASB issued ISA 540 (Revised) to address 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

(Revised), *Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment* (ISA 315), ISA 330, *The Auditor's Response to Assessed Risks* (ISA 330), ISA 450, *Evaluation of Misstatements Identified During the Audit* (ISA 450), and ISA 500, *Audit Evidence* (ISA 500), 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.

ISA 540 (Revised) is effective for audits of financial statements for periods beginning on or after December 15, 2019.

### **PCAOB AS 2501**

In December 2018 the PCAOB adopted a new auditing standard *Auditing Accounting Estimates, Including Fair Value Measurements, and Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2018-005). This standard includes amendments to its standards for auditing accounting estimates and fair value measurements, under which three existing PCAOB standards will be replaced with a single, updated standard. The standard replaces AS 2501, *Auditing Accounting Estimates*; and retitles the standard and rescinds AS 2502 *Auditing Fair Value Measurements and Disclosures*; and AS 2503, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*.

The new PCAOB AS is effective for audits of fiscal years ending on or after December 15, 2020; the standard is pending SEC approval.

### **ASB Project**

The ASB's estimates task force (the task force) has been monitoring the IAASB and PCAOB projects. The task force has considered the revisions to auditing accounting estimates resulting from the IAASB and PCAOB projects in developing changes to extant AU-C section 540. At the May 2019 ASB meeting the ASB discussed the proposed SAS *Auditing Accounting Estimates and Related Disclosures* (proposed estimates SAS), which would supersede AU-C section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*. The ASB discussed issues and reviewed requirements and application material to be included in the proposed estimates SAS.

The ASB agreed to the following approach relating to developing the proposed estimates SAS:

- the proposed estimates SAS should converge with ISA 540 (Revised)
- the requirements and application material in ISA 540 (Revised) relating to risk assessment should be include in the proposed estimates SAS rather than in AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. Further consideration for including this content in AU-C section 315 may be made as part of the ASB's risk assessment project.

- the requirements and application material relating to written representations should be retained in AU-C section 580, *Written Representations* and updated to align with the proposed estimates SAS.
- limited amendments to AU-C section 501, *Audit Evidence — Specific Considerations for Selected Items* should be proposed to address any conflicts with the proposed estimates SAS. The ASB supported consideration of a future project to take a holistic approach to the auditing guidance relating to investments when the valuations are based on the investee's financial results and for investments in derivative investments and securities measured or disclosed at fair value.

The ASB also discussed certain aspects of the proposed SAS. The more detailed ASB feedback and the subsequent task force response is included in the proposed SAS in task force note boxes (green lettering) in Agenda Item 1A.

### ***Other Related ASB Projects***

#### **Audit Evidence**

On June 20, 2019, the ASB issued an exposure draft of a proposed SAS *Audit Evidence* (Audit Evidence ED) to explain what constitutes audit evidence in an audit of financial statements and address how an auditor evaluates information to be used as audit evidence. The overall objective of the audit evidence project was to assess whether revisions of AU-C section 500, *Audit Evidence*, were necessary to address the evolving nature of business. This included the use of Emerging Technologies by both preparers and auditors, Audit Data Analytics, the application of Professional Skepticism, the expanding use of external information sources as audit evidence, and more broadly the accuracy, completeness, and reliability of such audit evidence. Comments are due on the Audit Evidence ED by September 18, 2019.

#### ***External Information Sources***

The Audit Evidence ED notes that as part of ISA 540 (Revised), the IAASB issued a series of conforming amendments to other ISAs, including conforming amendments to ISA 500. In general, the conforming amendments to ISA 500 included a new definition of *external information sources*, and related application material. The Audit Evidence ED includes the IAASB's conforming amendments to ISA 500 that were finalized in connection with ISA 540 (Revised).

The ASB made certain modifications to this content in order to achieve consistency with the attributes and factors of information put forth in the Audit Evidence ED. Paragraph 8 of the Audit Evidence ED defines *external information sources*. The application material and other information is presented primarily in appendix A, *Considerations Regarding the Use of External Information Sources*, and paragraphs A32 and A43 of the Audit Evidence ED.

#### **Risk Assessment**

The Risk Assessment task force has been monitoring the IAASB's project to revise ISA 315. Currently, the IAASB is discussing the ISA 315 task force's proposed changes in response to

issues identified in the comment letters as a result of the Exposure Draft and thus, the project is in progress. The ASB's Risk Assessment Task Force's timetable to revise AU-C section 315 will reflect the timing of the IAASB's ISA 315 project.

In July 2019, the Risk Assessment Task Force will discuss issues with the ASB that it has identified as a result of monitoring the ISA 315 project (see agenda item 5).

### **Agenda Items Presented**

- Item 1 — Estimates Cover Letter and Issues Paper
- Item 1A — Estimates Exposure draft of proposed SAS (marked to reflect changes from ISA 540 (Revised))
- Item 1B — Estimates Exposure draft of proposed SAS (clean)
- Item 1C-1— AU-C 501 Analysis and Rationale
- Item 1C-2— AU-C 501 mapping document
- Item 1D — Estimates WRAP document
- Item 1E — Estimates Flowchart of linkage between the proposed SAS other AU-C sections

Ms. Burzenski will refer to agenda items 1, 1A, 1C-1, and 1D.

Agenda item 1A presents the proposed SAS, *Auditing Accounting Estimates and Related Disclosures* with ISA 540 (Revised) as a base and is marked to reflect changes for the proposed SAS. The task force is not providing a mark-up of changes from extant AU-C section 540 because of the significant differences between ISA 540 (Revised) and extant AU-C section 540. Note boxes (in green) have been included throughout this agenda item to highlight task force discussions and conclusions.

Agenda item 1C-1 provides an analysis of certain sections of AU-C section 501 *Audit Evidence—Specific Considerations for Selected Items* and provides the rationale for whether the task force is recommending the ASB retain, revise, relocate, or remove the content.

Agenda item 1E is provided for informational purposes and shows the linkage between the proposed SAS and other AU-C sections.

## Issues for ASB Consideration

### Issue 1 – AU-C section 501

At the May 2019 ASB meeting, the task force discussed AU-C section 501 *Audit Evidence—Specific Considerations for Selected Items* and whether the requirements and application material relating to valuation of investments in securities and derivative instruments either conflicted with ISA 540 (Revised) or should be considered for movement into the proposed SAS. The task force proposed, and the ASB agreed to making limited amendments to AU-C section 501 to address any conflicts with the proposed estimates SAS. The ASB supported consideration of a future project to take a holistic approach to the auditing guidance relating to investments when the valuations are based on the investee’s financial results and for investments in derivative investments and securities measured or disclosed at fair value.

Subsequent to the May 2019 ASB meeting, the task force performed a thorough review of AU-C section 501 for consistency with the proposed SAS. Specifically, the task force considered whether the content in paragraphs .01-.10 of AU-C section 501 and related application material in paragraphs .A1-.A19 aligned with the proposed SAS and has proposed conforming amendments to eliminate any inconsistencies (see the proposed amendments in appendix 3 of the proposed SAS).

#### *Investments in Securities When Valuations are Based on Investee’s Results*

The task force has proposed amendments to the content in paragraphs .04-.05 of AU-C section 501 relating to investments in securities when valuations are based on the investee’s financial results, to align with the proposed SAS. As discussed at the May 2019 ASB meeting, there may be further changes that can be made to enhance those paragraphs of AU-C section 501 in light of the issuance of further guidance from the PCAOB relating to audit evidence regarding the valuation of investments based on investee financial results (Appendix B to PCAOB AS 1105). The task force continues to support having the ASB undertake a separate project to enhance AU-C section 501.

#### *Investments in Derivative Instruments and Securities Measured or Disclosed*

The task force has proposed removing paragraphs .06-10 from AU-C section 501 because the task force believes that the requirements in those paragraphs relating to investments in derivative instruments and securities measured or disclosed a fair value were mainly related to the audit procedures that should be performed, and not related to evaluating audit evidence. The task force concluded that the requirements in those paragraphs were generally duplicative of the requirements in the proposed SAS and therefore should be removed from AU-C section 501 to avoid having similar requirements in two places (i.e., AU-C 501 and the proposed SAS). The task force is proposing that the essential guidance in the application material in paragraphs .A11-.A19 of AU-C section 501 be included as application material in the proposed SAS (unless such guidance no longer reflects current GAAP). Agenda item 1C-1 contains a detailed analysis of AU-C section 501 and the task force’s recommendations.

***Action Requested of the ASB***

1. The ASB is asked to review Agenda item 1C-1 and provide the task force with feedback.
2. Does the ASB agree with removing paragraphs .06-.10 and related application material from AU-C section 501 and retaining certain essential guidance in the proposed SAS?

**Issue 2 — Proposed SAS (Agenda Item 1A)**

The proposed SAS in Agenda Item 1A contains ISA 540 (Revised) marked to reflect changes for the proposed SAS. This is a compilation of the various sections of the proposed SAS from the May 2019 ASB meeting materials and therefore the ASB has seen much of this content. This version of the proposed SAS has been updated to reflect further revisions based on input from the ASB at the May meeting. Agenda item 1B contains a clean version of the proposed SAS. The ASB is asked to review the proposed SAS.

***Action Requested of the ASB***

3. Are the proposed revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements?

**Issue 3 — External Information Sources and proposed Evidence SAS**

The Exposure Draft of proposed SAS *Audit Evidence* (Audit Evidence ED) includes the IAASB's conforming amendments to ISA 500 that were finalized in connection with ISA 540 (Revised). In general, the conforming amendments included a new definition of *external information sources*, related application material to the definition, and other application material that further explained the concept of external information sources.

The ASB made certain modifications to this content in order to achieve consistency with the attributes and factors of information put forth in the Audit Evidence ED and to make the concept of *external information sources* more broadly applicable to all aspects of audit evidence as it relates to the body of US GAAS. Paragraph .08 of the Audit Evidence ED defined external information sources. The application material and other information is presented primarily in appendix A, *Considerations Regarding the Use of External Information Sources*, and paragraphs A32 and A43 of the Audit Evidence ED.

The following identifies certain differences related to *external information sources* between ISA 500 and the Audit Evidence ED for the ASB’s consideration.

<b><i>Audit Evidence ED as Marked for Changes from ISA 500</i></b>	<b><i>Comments</i></b>
<p>External information source. —An <u>individual or organization</u> external <del>individual or organization</del> to the entity that <del>provides</del> <u>develops</u> information <del>that has been</del> used by the entity in preparing the financial statements; or <del>that has been obtained</del> <u>used</u> by the auditor as audit evidence, when such information is <del>suitable</del> <u>available</u> for use by a broad range of users. When information has been provided by an individual or organization acting in the capacity of a management’s <del>expert</del> <u>specialist</u>, service organization,<sup>1</sup> or auditor’s <del>expert</del> <u>specialist</u>,<sup>2</sup> the individual or organization is not considered an external information source with respect to that particular information.</p>	<p>1. The Audit Evidence ED includes a change from “provides” to “develops” because “provides” was considered to be too broad in this context and would include accumulators of information such as internet service providers and popular internet search engines such as Google within the requirements of the Audit Evidence ED. Does changing “provides” to “develops” in the definition of external information sources exclude an individual or organization that is an accumulator of information as being an external information source? If so, are there unintended consequences for the proposed estimates SAS?</p> <p>2. The Audit Evidence ED included a change from “suitable for use by a broad range of users” to “available for use by a broad range of users” to make the concept of external information sources more broadly applicable across US GAAS and to reflect the structure of the Audit Evidence ED in which information to be used as audit evidence would only be considered for suitability if the information was actually available to the entity or the auditor. In the context of the proposed estimates SAS information could be suitable but if the external source decides to “sell” it to only one person or doesn’t make it widely available that source would not be considered an external information source in accordance with the Audit Evidence ED. Does this change therefore have unintended consequences for the proposed estimates SAS?</p>
<p><b><u>Appendix A — Considerations Regarding the Use of External Information Sources</u></b></p>	
<p><u>A43.A33f</u>. In some situations, there may be only one provider of certain information <u>external to the entity</u>, for example, information from a central bank or</p>	<p>The content in paragraph A33f of ISA 500 has been included in paragraph A43 of the Evidence ED. The changes made to this content in the Audit Evidence ED were to reflect the overall concept that for audit evidence</p>

<sup>1</sup> ~~ISA~~ See AU-C section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, ~~paragraph 8.~~

<sup>2</sup> ~~ISA~~ See AU-C section 620, *Using the Work of an Auditor’s Expert*, ~~paragraph 6 Specialist.~~

<i>Audit Evidence ED as Marked for Changes from ISA 500</i>	<i>Comments</i>
<p>government, such as an inflation rate, <del>or a single recognized industry body</del>. In such cases, the auditor's <u>consideration of the reliability of such information</u> <del>determination of the nature and extent of audit procedures that may be appropriate in the circumstances</del> is influenced by the nature and credibility of the source of the <u>external</u> information, the assessed risks of material misstatement to which that external information is relevant, and the degree to which the use of that information is relevant to the reasons for the assessed risk of material misstatement. For example, when <del>the</del> information <u>from an external information source</u> is from a credible and authoritative source, <u>such information may be more persuasive than information obtained from another source</u>. <del>the extent of the auditor's further audit procedures may be less extensive, such as corroborating the information to the source's website or published information.</del> In other cases, if <u>an external information</u> <del>a</del> source is not <u>considered assessed</u> as credible, the auditor may determine that more <u>persuasive audit evidence is necessary</u> (see paragraph 9 in appendix A). <del>extensive procedures are appropriate and, in the absence of any alternative independent information source against which to compare, may consider whether performing procedures to obtain information from the external information source, when practical, is appropriate in order to obtain sufficient appropriate audit evidence.</del></p> <p>[content included in paragraph A43 of the proposed audit evidence SAS and not in the appendix.]</p>	<p>to be considered sufficient and appropriate, the audit evidence needed to be persuasive for the auditor's intended purposes. In addition, as approved by the ASB, the Audit Evidence ED is not a "performance" standard in the sense that it does not require specific procedures to be performed by the auditor. Do the changes proposed to this paragraph in the Audit Evidence ED create unintended consequences for the proposed estimates SAS because the ISA 500 content has a focus on audit procedures and the interrelationship with the source?</p>



***Action Requested of the ASB***

4. The ASB is asked to consider the changes reflected in the Audit Evidence ED as discussed above, and the interplay with the proposed estimates SAS.

**Issue 4 — Effective Date**

The task force is proposing that if issued as final, the proposed SAS would be effective for audits of financial statements for periods ending on or December 15, 2022. The task force believes that because this proposed SAS has implications for the auditor's risk assessment, there needs to be sufficient time for auditor's to revise their methodology to adopt the new requirements. Accordingly, the task force believes period ending on or after December 15 2022 would be sufficient for auditor's to revise their methodology.

***Action Requested of the ASB***

5. Does the ASB agree that the proposed effective date for the proposed estimates SAS?