

Linkages between Proposed 540 and Other AU-C Sections

Proposed AU-C 540 addresses the auditor's responsibilities relating to accounting estimates and disclosures in an audit of financial statements. It includes requirements and guidance that refer to or expand on how other relevant AU-C sections are to be applied in relation to accounting estimates. This diagram shows the interrelationship of the requirements in proposed 540 and the requirements in other AU-C sections assist auditors in understanding the key linkages and in applying all relevant requirements in relation to the audit of accounting estimates and disclosures.

Risk Assessment Procedures and Related Activities

Proposed 540

Obtain an understanding of the entity and its environment, including the entity's internal control related to the entity's accounting estimates (Par. 13)

AU-C 315

Obtain an understanding of the entity and its environment, including the entity's internal control (Par. 12-25)

Identifying and Assessing the Risks of Material Misstatement

Proposed 540

Identify and assess the risks of material misstatement relating to an accounting estimate and related disclosures at the assertion level (Par. 16)

- Separately assess inherent risk and control risk
- Take into account the degree to which the accounting estimate is subject to, or affected by, estimation uncertainty, complexity, subjectivity and other inherent risk factors

AU-C 315

Identify and assess the risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures (Par. 26(b))

Determine whether any of the identified and assessed risks of material misstatement are a significant risk (Par. 17)

Determine whether any of the risks identified are, in the auditor's judgment, a significant risk when excluding the effects of identified controls related to the risk (Par. 28)

For significant risks, obtain an understanding of the entity's controls, including control activities, relevant to that risk (Par. 17)

For significant risks, obtain an understanding of the controls, including control activities, relevant to that risk (Para. 30)

Responses to the Assessed Risks of Material Misstatement

Proposed 540

Design and perform further audit procedures responsive to the assessed risks of material misstatement at the assertion level, considering the reasons for the assessment given to those risks (Par. 18)

Take into account that the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be (Par. 18)

Design and perform tests of controls if: (Par. 19)

- The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively; or
- Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

Obtain more persuasive audit evidence the greater the reliance on the effectiveness of a control (Par. 19)

For significant risk: (Par. 20)

- Include tests of controls in the current period if the auditor plans to rely on controls
- Include tests of details if the approach consists only of substantive procedures

AU-C 330

Design and perform further audit procedures responsive to the assessed risks of material misstatement at the assertion level (Par. 6)

Consider the reasons for the assessment given, including likelihood of material misstatement characteristics of classes of transactions, account balance or disclosure, and control risk assessment (Par. 7(a))

Obtain more persuasive evidence the higher the risk assessment (Par. 7(b))

Design and perform substantive procedures for each material class of transaction, account balance and disclosure (Par. 18)

Design and perform tests of controls if: (Par. 8)

- The auditor plans to rely on the controls; or
- Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level

Obtain more persuasive evidence the greater the reliance on effectiveness of controls (Par. 9)

If planning to rely on controls over a significant risk, test controls in the current period (Par. 15)

For each significant risk, perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, include tests of details (Par. 22)

Responses to the Assessed Risks of Material Misstatement (Cont.)

Proposed 540

Three Testing Approaches

Obtain audit evidence from events occurring up to the date of the auditor's report (Par. 21)

Test how management made the accounting estimate (Par. 22–27)

Develop an auditor's point estimate or range (Par. 28–29)

AU-C 330

Irrespective of the assessed risks of material misstatement, design and perform substantive procedures for each material class of transactions, account balance, and disclosure (Par. 18)

AU-C 500

Design and perform audit procedures to obtain sufficient appropriate audit evidence (Par. 6)

Consider the relevance and reliability of the information to be used as audit evidence, including the work of a management's expert (Par. 7–9)

Comply with the relevant requirements on audit evidence in ISA 500 (Par. 30)

The requirements in paragraphs 21–29 of proposed 540 (may assist in evaluating the appropriateness of the expert's work as audit evidence for a relevant assertion in accordance with paragraph 8(c) of AU-C 500 (Par. 30)

Overall Evaluation Based on Audit Procedures Performed

Proposed 540

Evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate (Par. 33(a))

Evaluate whether management's decisions relating to the recognition, measurement, presentation and disclosure are in accordance with the applicable financial reporting framework (Par. 33(b))

AU-C 330

Evaluate whether the assessments of risks of material misstatement at the assertion level remain appropriate (Par. 27)

Evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework (Par. 26)

Consider whether the financial statements present the appropriate: (Par. A72)

- Classification and description of financial information
- Form, arrangement, and content of the financial Statements including the related notes

Overall Evaluation Based on Audit Procedures Performed (Cont.)

Proposed 540

Evaluate whether sufficient appropriate audit evidence has been obtained (Par. 33(c))

If unable to obtain sufficient appropriate audit evidence, evaluate the implications for the audit or the auditor's opinion on the financial statements (Par. 34)

Take into account all evidence obtained, whether corroborative or contradictory (Par. 34)

Determine whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated (Par. 35)

Evaluate whether disclosures achieve fair presentation of the financial statements (Par. 36(a))

AU-C 330

Conclude whether sufficient appropriate audit evidence has been obtained (Par. 28)

AU-C 705

Modify the opinion when the financial statements as a whole are materially misstated or when unable to obtain sufficient appropriate evidence (Par. 7)

Determine the type of modification to the auditor's opinion (Par. 8–16)

Comply with the required form and content of the auditor's report when the opinion is modified (Par. 17–30)

AU-C 330

Consider all audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements (Par. 28)

Evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework (Par. 26)

AU-C 700

Evaluate whether financial statements achieve fair presentation (Par. 16)

Communication with Those Charged with Governance, Management or Other Relevant Parties

Proposed 540

Communicate with those charged with governance, management and other relevant parties as appropriate
(Par. 37)

AU-C 260

Communicate with those charged with governance views about qualitative aspects of the entity's significant accounting practices (Par. 12(a))

AU-C 265

Communicate in writing with those charged with significant deficiencies in internal control (Par. 11)

Documentation

Proposed 540

- Document key elements of understanding of the entity and its environment, including internal control related to accounting estimates (Par. 38(a))
- Document linkage of further audit procedures with the assessed risks of material misstatement at the assertion level (Par. 38(b))
- Document auditor's response(s) when management has not taken appropriate steps to understand and address estimation uncertainty (Par. 38(c))
- Document indicators of possible management bias related to accounting estimates, if any, and implications for the audit (Par. 38(d))
- Document significant judgments in determining whether accounting estimates and related disclosures are reasonable, or are misstated (Par. 38(e))

ISA 230

Prepare documentation that is sufficient to enable an experienced auditor to understand the nature, timing and extent of audit procedures performed, results and significant findings or issues arising (Par. 8)

Record identifying characteristics of matters tested, who performed the work, date of completion, who reviewed the work and date of the review (Par. 9)

Document significant findings or issues discussed with those charged with governance, management and others (Par. 11)

Document how the auditor addressed any inconsistency identified with a final conclusion on a significant finding or issue (Par. 12)