

ISA 540 (Revised) deals with 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 ISAs are to be applied in relation to accounting estimates. This diagram shows the interrelationship of the requirements in ISA 540 (Revised) and the requirements in other ISAs to 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

ISA 540 (Revised)

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

ISA 315 (Revised)

Obtain an understanding of the entity and its environment, including the entity's internal control (Para. 11–24)

Identifying and Assessing the Risks of Material Misstatement

ISA 540 (Revised)

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

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

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

ISA 315 (Revised)

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 (Para. 25(b))

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 (Para. 27)

For significant risks, obtain an understanding of the controls, including control activities, relevant to that risk (Para. 29)

Responses to the Assessed Risks of Material Misstatement

ISA 540 (Revised)

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 (Para. 18)

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

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

For a significant risk: (Para. 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

ISA 330

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

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

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

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

Design and perform tests of controls if: (Para. 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 (Para. 9)

If planning to rely on controls over a significant risk, test controls in the current period (Para. 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 (Para. 21)

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

ISA 540 (Revised)

Three Testing Approaches

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

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

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

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

The requirements in paragraphs 21–29 of ISA 540 (Revised) 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 ISA 500 (Para. 30)

ISA 330

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

ISA 500

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

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

Overall Evaluation Based on Audit Procedures Performed

ISA 540 (Revised)

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

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

ISA 330

Evaluate whether the assessments of risks of material misstatement at the assertion level remain appropriate (Para. 25)

Evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework (Para. 24)

Consider whether the financial statements present the appropriate: (Para. 24)

- Classification and description of financial information and the underlying transactions, events and conditions; and
- Presentation, structure and content of the financial statements

Overall Evaluation Based on Audit Procedures Performed (Cont.)

ISA 540 (Revised)

Evaluate whether sufficient appropriate audit evidence has been obtained (Para. 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 (Para. 34)

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

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

For a fair presentation framework, evaluate whether disclosures achieve fair presentation of the financial statements (Para. 36(a))

For a compliance framework, evaluate whether disclosures are those necessary for financial statements not to be misleading (Para. 36(b))

ISA 330

Conclude whether sufficient appropriate audit evidence has been obtained (Para. 26)

ISA 705 (Revised)

Modify the opinion when the financial statements are not free from material misstatement or when unable to obtain sufficient appropriate evidence (Para. 6)

Determine the type of modification to the auditor's opinion (Para. 7–15)

Comply with the required form and content of the auditor's report when the opinion is modified (Para. 16–29)

ISA 330

Consider all audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements (Para. 26)

Evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework (Para. 24)

ISA 700 (Revised)

For a fair presentation framework, evaluate whether financial statements achieve fair presentation (Para. 14)

For a compliance framework, discuss with management if financial statements are misleading (Para. 19)

Written Representations

ISA 540 (Revised)

Request written representations from management and, when appropriate, those charged with governance (Para. 37)

ISA 580

Request written representations from management and, where appropriate, those charged with governance (Para. 6 and 9)

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

ISA 540 (Revised)

Communicate with those charged with governance, management and other relevant parties as appropriate (Para. 38)

ISA 260 (Revised)

Communicate with those charged with governance views about significant qualitative aspects of the entity's accounting practices (Para. 16(a))

ISA 265

Communicate in writing with those charged with governance significant deficiencies in internal control (Para. 9)

Documentation

ISA 540 (Revised)

- Document key elements of understanding of the entity and its environment, including internal control related to accounting estimates (Para. 39(a))
- Document linkage of further audit procedures with the assessed risks of material misstatement at the assertion level (Para. 39(b))
- Document auditor's response(s) when management has not taken appropriate steps to understand and address estimation uncertainty (Para. 39(c))
- Document indicators of possible management bias related to accounting estimates, if any, and implications for the audit (Para. 39(d))
- Document significant judgments in determining whether accounting estimates and related disclosures are reasonable, or are misstated (Para. 39(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 matters arising (Para. 8)
- Record identifying characteristics of matters tested, who performed the work, date of completion, who reviewed the work and date of the review (Para. 9)
- Document significant matters discussed with those charged with governance, management and others (Para. 10)
- Document how the auditor addressed any inconsistency identified with a final conclusion on a significant matter (Para. 11)