

Post-implementation review of ISA (UK) 540 (Lecture A810 – 6.58 minutes)

On 4 October 2022, the FRC opened a post-implementation review of ISA (UK) 540 (Revised December 2018) *Auditing Accounting Estimates and Related Disclosures*.

ISA (UK) 540 was revised to address issues from evolving financial reporting frameworks and concerns expressed by regulators and other stakeholders. These concerns included:

- Financial reporting frameworks require more complex accounting estimates with high estimation uncertainty and related disclosures. Other accounting standards require greater use of forward-looking information.
- Complex accounting estimates are becoming more prevalent and a fundamental part of financial statements for some entities. In addition, the use of complex models and/or the use of experts is on the increase where accounting estimates are concerned.
- Reviews of audit work raised concerns about audit quality for accounting estimates, including in relation to:
 - The performance of sufficient risk assessment procedures;
 - The extent of the auditor's understanding and further consideration of the appropriateness of methodologies used by management;
 - Sufficiency of testing over the accuracy and completeness of data used and the reasonableness of assumptions adopted by management;
 - Consideration of contradictory or inconsistent evidence, where available; and
 - Application of an appropriately independent and challenging sceptical mindset.

1.1 ISA (UK) 540 (Revised December 2018)

There was a lot of technical publicity surrounding the revised ISA (UK) 540 given the changes that were reflected in the standard as follows:

- Enhanced requirements and application material for risk assessment procedures and the auditor's work effort in responding to the assessed risk of material misstatement where accounting estimates are concerned. In addition to addressing risks related to estimation uncertainty, specific attention to other risk factors in making accounting estimates (such as complexity and subjectivity) is required.
- Enhanced work effort requirements based one or more of:

- Considering events occurring up to the date of the auditor's report;
- Testing how management has made the accounting estimate; or
- Developing an auditor's point estimate or range.

If the auditor develops an auditor's range, the auditor is specifically required to determine that the range only includes amounts that are supported by sufficient appropriate audit evidence.

- Amending the objective and the requirements to the effect that audit procedures address whether both the accounting estimates and the related disclosures are 'reasonable' in the context of the applicable financial reporting framework (prior to the revisions to the standard, it only addressed whether the disclosures were 'adequate').
- Enhancements to reinforce the application of professional scepticism. These include:
 - Using wording to drive questioning or challenging management where appropriate;
 - More focus on identifying indicators of possible management bias;
 - Requiring further audit procedures to be designed and performed in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory; and
 - Enhanced retrospective review and an overall evaluation based on audit procedures performed.
- Emphasising the importance of the need to consider internal control, with improved cross-references to ISA (UK) 315 *Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and Its Environment* and ISA (UK) 330 *The Auditor's Responses to Assessed Risks*. Both ISA (UK) 315 and ISA (UK) 330 are more specific to the consideration of internal controls.
- A new requirement to remind auditors of their responsibilities to communicate certain matters to those charged with governance and to consider the matters to communicate regarding accounting estimates, taking into account the reasons given to the risks of material misstatement.
- Enhanced documentation requirements.

1.2 Call for feedback responses

The FRC's post-implementation review of ISA (UK) 540 (Revised December 2018) invites comments from stakeholders until 13 January 2023. There are 11

questions in the Call for Feedback document, although respondents are welcome to comment on any matter they wish to by sending their feedback to:

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