ISA 540 (Revised) Post-Implementation Survey

Response ID:310 Data

3. Section II: About the Respondent

1. Please provide the following information about your organization (if applicable) and other contact information:

Organization (or leave blank if you are completing the survey in your personal capacity) : UK Financial Reporting Council
Name(s) of contact(s) for this submission : Mark Babington
Job title or role : Executive Director, Regulatory Standards
E-mail address(es) of contact(s) : m.babington@frc.org.uk

2. Please select from the following options the stakeholder group to which you or your organization belongs:

Regulator or Audit and Assurance Oversight Body

3. Please select from the following options the geographical region that best matches you or your organization:

Europe

4. Did you undertake outreach activities with other stakeholders outside your organization to inform your responses to this survey?

No

5. You are welcome to provide any additional information you believe may be relevant to clarify the context in which you are completing the survey, or the circumstances or experiences that have informed your views or perspectives (or you can choose to leave this question blank).

While we have not undertaken formal outreach activities, this response has been informed by the following:
• A post-implementation review on the adoption of the UK version of ISA 540 (Revised) in 2022.
• The FRC's audit inspection activities over several years.
• Our recent initiative into supporting audits for small- and medium-sized entities, including the issuance of a Practice Note intended to support scalable application of the ISAs to audits of these entities.

4. Section III: Overall Questions

6. Please provide overall views about whether ISA 540 (Revised) has achieved its intended purpose and the objectives of the IAASB in developing the revised standard.

The FRC considers that ISA 540 (Revised) has largely achieved its intended purposes and objectives, namely to foster audit quality by driving auditors to perform appropriate procedures in relation to accounting estimates and related disclosures; and to emphasise the appropriate application of professional scepticism by practitioners when auditing accounting estimates. The revisions have encouraged:
• Improvements in risk assessment and auditor work-effort in response to assessed risks of material misstatement;
• Enhancements to the application of professional scepticism by auditors to accounting estimates;
• The design and performance of audit procedures in ways that are not biased towards obtaining evidence that is either corroborative or exclusionary towards contradictory audit evidence;
• Requiring audit procedures to be designed and performed in a manner that is not biased toward obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory;
• Enhancements to retrospective review and overall evaluation based on procedures performed as a result of the "stand back" requirement; and
• Improvements in the documentation of work performed.
The FRC would also note that practitioners have repeatedly noted some difficulty in applying ISA 540 (Revised) to less complex accounting estimates, especially within the context of small- and medium-sized companies. The IAASB should consider what further could be done to support scalable and proportionate application of this standard.

7. Are you aware of the non-authoritative guidance and support tools developed to support the implementation of ISA 540 (Revised)?

Yes

7A. Do you agree that the non-authoritative guidance and support tools developed to support the implementation of ISA 540 (Revised) are useful?

3 – Agree

Comments:

5. Section IV: Perceived Benefits from ISA 540 (Revised)

8. For each perceived benefit, indicate the extent to which you agree that ISA 540 (Revised) has led to benefits or improvements.

	4 – Strongly Agree	3 – Agree	2 – Disagree	1 – Strongly Disagree	0 – No Response
(a) Enhanced exercise of professional skepticism when auditing accounting estimates.		X			
(b) Greater consideration of the skills and competencies of the engagement team, including the need to involve specialists or experts.		X			
(c) Greater attention to understanding management's process for making estimates, including the selection of methods, assumptions and data (and the consistency of selection between periods).		X			
(d) Better or more focused assessments of the risks of material misstatements for accounting estimates.		X			
(e) More focus on understanding and testing controls related to accounting estimates.		X			
(f) Increased auditor attention to disclosures related to accounting estimates, including disclosures about estimation uncertainty.		X			
(g) Enhanced interactions and communications between the auditor and management and those charged with governance related to the audit of accounting estimates.		X			
(h) Enhanced quality of financial reporting related to accounting estimates.		X			

9. Are there any additional benefits or positive outcomes arising from the implementation of ISA 540 (Revised) that you would like to highlight?

No

6. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised)

10. ISA 540 (Revised) was designed to be capable of being applied to all accounting estimates, and for the nature, timing and extent of the risk assessment and further audit procedures to be varied in relation to the estimation uncertainty and the assessment of the risks of material misstatement. Indicate the extent to which you have observed or are aware of any issues or challenges related to scalability and proportionality.

3 – Moderate Issues or Challenges

11. Briefly describe these or any other issues or challenges you observed related to scalability and proportionality.

ISA 540 (Revised) was designed to be applied in a scalable and proportionate manner, and we consider that it is possible to do so. Some stakeholders have commented that the revised standard was designed to respond to the auditing challenges posed by the introduction of expected credit loss models in IFRS 9, and it can therefore be hard to scale of the assurance of less complex reporting. We are also aware that some audit firms believe that more guidance, not necessarily within the standard itself, would be helpful to further illustrate how the standard can be applied in a proportionate manner for less complex estimates.
• There is awareness of the IAASB's examples outside of the standard but there is still a concern that the standard is difficult to apply proportionately, particularly for less complex estimates.
• In particular, some practitioners have experienced difficulties in applying paragraph 13 of the revised standard in a scalable manner to accounting estimates in the context of small- and medium-sized entities. We have been told that scaling the procedures to obtain the understandings required by this paragraph is challenging for commonly encountered complex accounting estimates prepared by entities with less sophisticated control environments. These additional procedures may not add to the intuitive judgements that an auditor has already made with respect to risks and appropriate responses on their initial encounter with these estimates.
• In addition, some audit firms also believe that it would be helpful to have additional guidance on how to apply the standard to more complex estimates such as modelled expected credit losses.
The FRC has not adopted the IAASB's ISA for Audits of Financial Statements of Less Complex Entities. However, it has launched a campaign to support UK SMEs, part of which includes the development of a Practice Note to help support the proportionate audit of small- and medium-sized entities. This was issued in March 2026 and includes guidance in relation to the audit of accounting estimates. A copy of the Practice Note can be obtained here:
https://media.frc.org.uk/documents/Practice_Note_28_Guidance_for_audits_of_small_and_medium-sized_entities_chldawRe.pdf.

12. In your view, are the issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

No

13. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

The IAASB should consider the issuance of further non-authoritative material to further illustrate how the principles in the standard may be applied, and documented, in a scalable and proportionate manner.

7. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

14. Indicate the extent to which you have observed or are aware of the following issues or challenges relating to ISA 540 (Revised) with respect the auditor exercising professional skepticism when auditing accounting estimates and related disclosures.

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
(a) Appropriately challenging management's judgments used in making accounting estimates, particularly when they involve complex or subjective inputs.			X		
(b) Identifying and appropriately responding to potential indicators of management bias in the development of accounting estimates.				X	
(c) Appropriately considering all relevant audit evidence obtained, whether corroborative or contradictory.				X	

15. Briefly describe these or any other issues or challenges you observed related to exercising professional skepticism.

A common finding for audit inspections is that practitioners sometimes do not display adequate levels of professional scepticism, which in turn may be linked to a need for more to be done to develop and embed a culture of scepticism and challenge at the level of the firm. However, this is not primarily an issue relating to the drafting of ISA 540 (Revised).

16. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

No

17. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

The IAASB may wish to consider producing illustrative examples to demonstrate how professional scepticism and auditor challenge can be performed in the context of accounting estimates.

8. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

18. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *risk assessment procedures and identifying and assessing the risks of material misstatement related to accounting estimates*.

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
(a) The consideration of inherent risk factors and the interrelationship between them in identifying and assessing risks of material misstatement related to accounting estimates.				X	
(b) How the understanding of the entity and its environment, and the entity's internal control for accounting estimates, relates to the understanding required by ISA 315 (Revised 2019) (i.e., whether it is clear that the requirements in paragraph 13 of ISA 540 (Revised) relate specifically to accounting estimates and build on the broader requirements in ISA 315 (Revised 2019)).			X		
(c) Reviewing the outcome of previous accounting estimates or, where applicable, their subsequent re-estimation (i.e., the retrospective review of accounting estimates).				X	
(d) Understanding management's process for making accounting estimates, including how management identifies and selects relevant methods, assumptions and data, and how management understands and addresses estimation uncertainty.				X	
(e) The separate assessments of inherent and control risk relating to an accounting estimate.				X	
(f) Whether any of the assessed risks of material misstatement are significant risks.			X		

19. Briefly describe these or any other issues or challenges you observed related to risk assessment procedures and whether such issues or challenges relate primarily to estimates that have a high degree of estimation uncertainty or complexity.

As noted above, some practitioners have noted the difficulty in applying the requirements in paragraph 13 of ISA 540 (Revised) to less complex accounting estimates within the context of audits of small- and medium-sized entities. We also understand that there is sometimes a tendency for auditors of these entities to default to the treatment of highly material accounting estimates as significant risks, despite limited indications for the presence of a heightened risk of material misstatement.

20. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

No

21. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

The IAASB may consider the need for further non-authoritative guidance to address these issues to support practitioners in applying these requirements in a scalable and proportionate manner, while giving practitioners the confidence to apply appropriate professional judgement to tailor appropriate responses to the assessed risk of material misstatement.

9. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

22. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *responding to the assessed risks of material misstatement*

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
Responses to the Assessed Risks of Material Misstatement (a) Determining the most appropriate response(s) to the assessed risks of material misstatement at the assertion			X		
(b) Determining whether to test the operating effectiveness of controls related to an accounting estimate.				X	
(c) Appropriately applying the testing approach of obtaining audit evidence about events occurring up to the date of the auditor’s report, either alone or with another testing approach(es).			X		
(d) Testing how management made the accounting estimate.			X		
(e) Developing an auditor’s point estimate or range.				X	
Overall Evaluation (f) Determining whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.				X	
(g) Evaluating identified misstatements related to accounting estimates, including when the audit evidence supports a point estimate that differs from management’s point estimate or a range that does not include management’s point estimate, or when the auditor’s range is wide (in some cases, multiples of materiality for the financial statements as a whole).			X		

23. Briefly describe these or any other issues or challenges you observed related to responding to risks of material misstatement and whether such issues or challenges relate primarily to estimates that have a high degree of estimation uncertainty or complexity.

The FRC has been told that there are potential practical difficulties in instances where an auditor's point estimate is developed and misstatement in management's estimate is identified. In such instances, there is a risk that management inappropriately adopt the auditor's estimate as their own. It has been suggested that guidance beyond that in paragraph A116 could be helpful addressing the expectations of management and auditors in these circumstances.
Additionally, some practitioners have communicated to us that illustrative examples or practical guidance could assist auditors on the following matters:
• The specific actions that auditors need to follow when they have selected the approach, from those outlined in paragraph 18, to test the management process for a significant risk.
• Determining the extent of disaggregation required when considering the methods, assumptions and data of an estimate, especially for complex estimates where there may be misstatements attributable to the separate aspects of the method, assumptions or data associated with the estimate. Examples illustrating the level of detail at which the auditor might consider the methods (including models), assumptions and data in their identification and assessment of risks of material misstatement, and their response to these risks, would be helpful for practitioners.
• How the auditor may identify where it may be more appropriate to use a point estimate or range.
• How the auditor may assess their own estimates against those of the audited entity, including actions to take if there is a very large estimate with uncertainty in excess of performance materiality, and the implications for the auditor's report.
• Further guidance on the use of technological tools for auditing accounting estimates.

24. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

No

25. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

See responses to Q23 above.

10. Section V: Potential Issues or Challenges Relating to ISA 540 (Revised) (continued)

26. Indicate the extent to which you have observed the following issues or challenges in applying ISA 540 (Revised) with respect to *communication, specialized skills or knowledge, including using the work of an auditor's expert, and documentation*.

	4 – Significant Issues or Challenges	3 – Moderate Issues or Challenges	2 – Minor Issues or Challenges	1 – No Issues or Challenges	0 – No Response
Communication (a) Determining the matters, if any, to communicate related to accounting estimates, (including about significant qualitative aspects of the entity's accounting practices and significant deficiencies in internal control).				X	
Specialized Skills or Knowledge, Including Using the Work of an Auditor's Expert (b) Determining when it is appropriate to involve an auditor's expert(s) (an internal or external expert) and using the work of an auditor's expert(s) in auditing an accounting estimate(s).				X	
Documentation (c) Preparing appropriate audit documentation in accordance with the requirements in paragraph 39 of ISA 540 (Revised).			X		

27. Briefly describe these or any other issues or challenges you encountered or observed related to communications, specialized skills or knowledge (including using the work of an auditor's expert) and documentation.

It has been suggested to the FRC that further guidance on the level of documentation required to evidence completion of the specific stand back requirements would be helpful for practitioners. It has been suggested that it is not clear from the standard and guidance whether this procedure is completed for each accounting estimate, complex accounting estimates only or for estimates in general.
The FRC will also shortly issue an amended version of ISA 701 for use within the UK. This contains additional application material for auditors to include further qualitative information relating to the audit of accounting estimates where such estimates also relate to Key Audit Matters. These are in response to an appetite for further insight into the judgements involved in the preparation and audit of accounting estimates that investors have expressed for many years.

28. In your view, are the observed issues or challenges due to a lack of clarity or insufficiency of the requirements or application material in the standard?

No

29. What specific suggestions do you have for how the IAASB can best address the issues or challenges you have identified (e.g., standard-setting, non-authoritative guidance, or other actions)?

The IAASB may wish to consider further guidance and illustrative examples on the stand back requirement to support practitioners in applying the principles of ISA (540) Revised.