

Implementing ISA 540 (revised) in the 2020/21 reporting season

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Today's presenters



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Ask a question



The screenshot shows a mobile application interface for asking questions. At the top, it says 'Q&A'. Below that, there is a section for a question and answer. The question is 'What happens when I raise my hand?' with a timestamp of 18:03. The answer is 'I can take you off of mute.' with a timestamp of 18:04. Below the answer is a large empty text input field with the placeholder text 'Please input your question'. At the bottom left, there is a checkbox labeled 'Send Anonymously'. At the bottom right, there is a blue button labeled 'Send'.

To ask a question

Click on the **Q&A** button in the bottom toolbar to open the submit question prompt.

Type your question and click send

NOTE: If you wish to ask your question anonymously check the **send anonymously** box shown on the illustration.

Contents

Reminder of the new Standard

The Risk Assessment

Current issues

Documentation and Disclosures

Questions

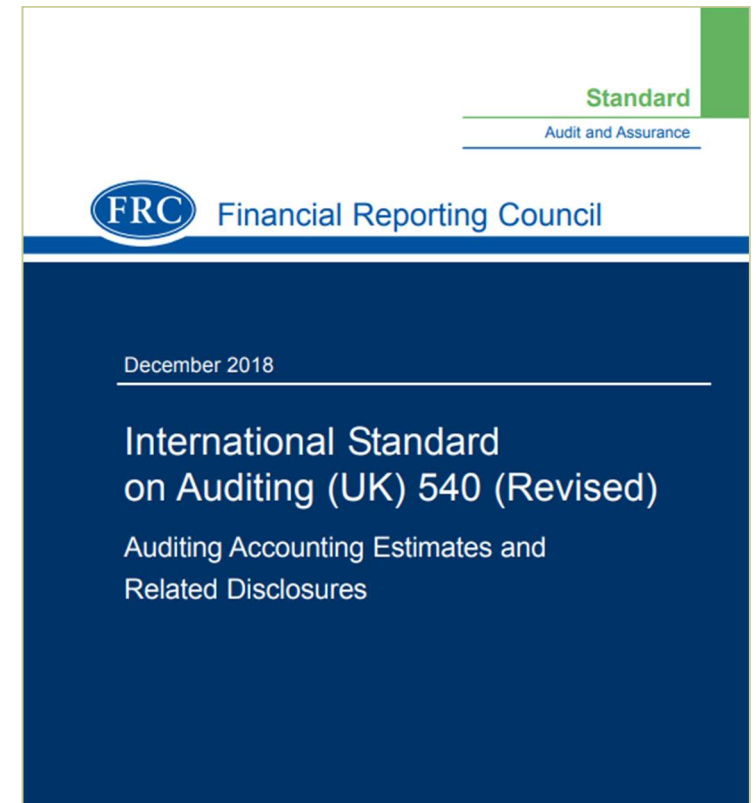


ISA (UK) 540 (Revised)

A REMINDER OF THE NEW STANDARD

ISA (UK) 540: Implementation

- Effective for accounting periods commencing on/after 15 December 2019
 - So typically, it is 31 December 2020 year ends and onwards that are affected
- Significant increase in the number of requirements and the Application Guidance



ISA (UK) 540: Drivers for change

- More complex accounting estimates being reflected in financial statements
 - Accounting standards (in particular IFRS 9, 15 and 16) have been updated to require the recognition of more complex accounting estimates;
 - Entities have more complex transactions, resulting in more complex estimates
- Regulatory feedback
 - Audit inspectors regularly identify weaknesses in the audit of accounting estimates
 - Emphasis on challenging management's assumptions more and exercising professional scepticism

ISA (UK) 540: A reminder of the key changes

- Emphasis on risk assessment
- Enhanced documentation requirements
- Requirement for “stand back”, including emphasis on professional scepticism
- Enhanced requirements around disclosures



The Risk Assessment

Risk assessment procedures

- For each material estimate, specific risk assessment procedures are required, covering:
 - Understanding of the entity, including the internal control environment
 - Review of previous estimates
 - Determine whether specialists are needed
 - Inherent risk assessment, taking into account inherent risk factors
 - Assess control risk (if no reliance on controls, this must be high)



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Inherent risk factors and the spectrum of inherent risk

- When assessing inherent risk, need to consider:
 - Estimation uncertainty
 - Complexity
 - Subjectivity
 - Other inherent risk factors, such as management bias or fraud, or change in the estimate
- ISA (UK) 540, paragraph 4:

“The assessment of inherent risk depends on the degree to which the inherent risk factors affect the likelihood or magnitude of misstatement, and varies on a scale that is referred to in this ISA (UK) as the spectrum of inherent risk”



Current issues

CONSIDERING THE IMPACT ON YOUR AUDIT WORK

The impact of COVID-19 and Brexit

- COVID-19 and Brexit have resulted in many accounting estimates being brought into focus:
 - Valuation of PPE and Investment Properties
 - Valuation of financial instruments
 - Stock obsolescence
 - Impairment
 - Onerous contract provisions
 - Restructuring provisions

The auditor's response to the assessed risks

- ISA (UK) 540 paragraph 18 states:
- *“The auditor’s further audit procedures shall include one or more of the following approaches:*
 - *Obtaining audit evidence from events occurring up to the date of the auditor’s report;*
 - *Testing how management made the accounting estimate; or*
 - *Developing an auditor’s point estimate or range”*
- *“The auditor shall design and perform further audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory”*

Key point

- Challenge management's assumptions



Evaluating the evidence: “Stand back”


- Must be alert to indicators of management bias
 - Where management’s point estimates consistently trend toward one end of the auditor’s range of reasonable outcomes that provide a more favourable financial reporting outcome for management, such circumstances may indicate possible bias by management (para A133)
- Need to take into account all audit evidence gathered, whether contradictory or corroborative
- Explicit requirement to maintain professional scepticism throughout
- Stand back and evaluate the evidence obtained

Audit report implications

- Possible modifications may arise due to:
 - Inability to obtain sufficient information over the valuation of a property;
 - An indication of a material impairment that has not been recognised.
- ISA 705, Application Guidance

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

ICAEW KNOW-HOW
AUDIT AND ASSURANCE FACULTY



PREPARING AN ADVERSE OPINION AUDIT REPORT

GUIDE January 2019

Audit and Assurance Faculty Helpsheets are now known as 'Guides'. This Guide was last updated in January 2019 and is based on the relevant laws and regulations that apply as at 1 January 2019.

Introduction

This Guide is designed to explain the main changes that are needed to the audit report when an auditor considers it necessary to issue an adverse opinion on the financial statements due to a material and pervasive misstatement in the financial statements. This assumes that aside from the matter giving rise to the adverse opinion, the auditor has obtained all other necessary evidence to support the opinion.

The example wording in this Guide has been adapted from the examples in the Appendix to ISA (UK) 705 and updated for UK legal and regulatory requirements. In this example, primarily based on Illustration 2, while consolidated financial statements have been prepared, one subsidiary has not been included in that consolidation and the effect of this is considered material and pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so.

While the Guide comments on specific areas impacted by the adverse opinion for consolidated financial statements and the requirements for listed entities, Public Interest Entities as defined by the EU Regulation and entities applying the UK Corporate Governance Code, it does not deal with all of the changes that would be required.

Appendix 1 also gives details of the impact of the adverse opinion on subsequent years' audit reports.

Pervasive changes to the audit report

There are numerous significant changes to the audit report and these have been set out below.

Addressee of the report

The addressee of the report is unchanged.

Adverse opinion

The opinion section is required to be headed up "Adverse opinion".

Even though there is an adverse opinion, it is important that the titles of the primary statements precisely match those used by the entity.

The section still needs to reflect whether the financial reporting framework is either UK GAAP (including either FRS 101 or 102) or IFRSs.



Documentation and Disclosures

Documentation

- Paragraph 39 sets out the Documentation requirements:
 - Key elements of understanding the entity and its environment;
 - Linkage of audit procedures to the assessed risk;
 - Auditor's response where management have not understood estimation uncertainty;
 - Indicators of possible management bias;
 - Significant judgements made by the auditor as to whether estimates and related disclosures are reasonable

Don't forget the disclosures

- Must determine whether the disclosures relating to accounting estimates are reasonable
- Are sufficient disclosures provided to achieve a true and fair view?
- Remember the requirements of FRS 102 paragraph 8.7:

Information about key sources of estimation uncertainty

- 8.7 An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the **reporting date**, that have a significant risk of causing a **material** adjustment to the **carrying amounts** of **assets** and **liabilities** within the next financial year. In respect of those assets and liabilities, the notes shall include details of:
- (a) their nature; and
 - (b) their carrying amount as at the end of the **reporting period**.

Key points recap

- Familiarise yourselves with the updated documentation
- Ensure your risk assessments are based on the inherent risk factors
- Audit work must appropriately respond to the assessed level of risk
- Exercise professional scepticism
- Document your considerations



Any questions?

Thank you for attending



Please take the time to fill out our short survey:
[Survey link](#)



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