

AUDIT AND ASSURANCE FACULTY

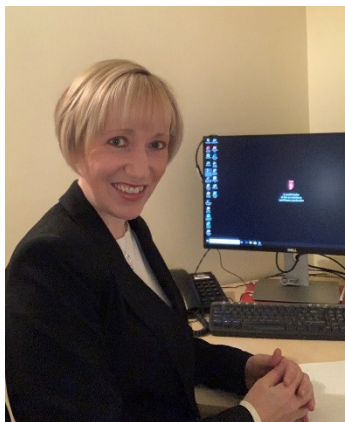


Practical considerations for auditing accounting estimates

7 MAY 2020

PRESENTED BY JOHN SELWOOD

Introduction



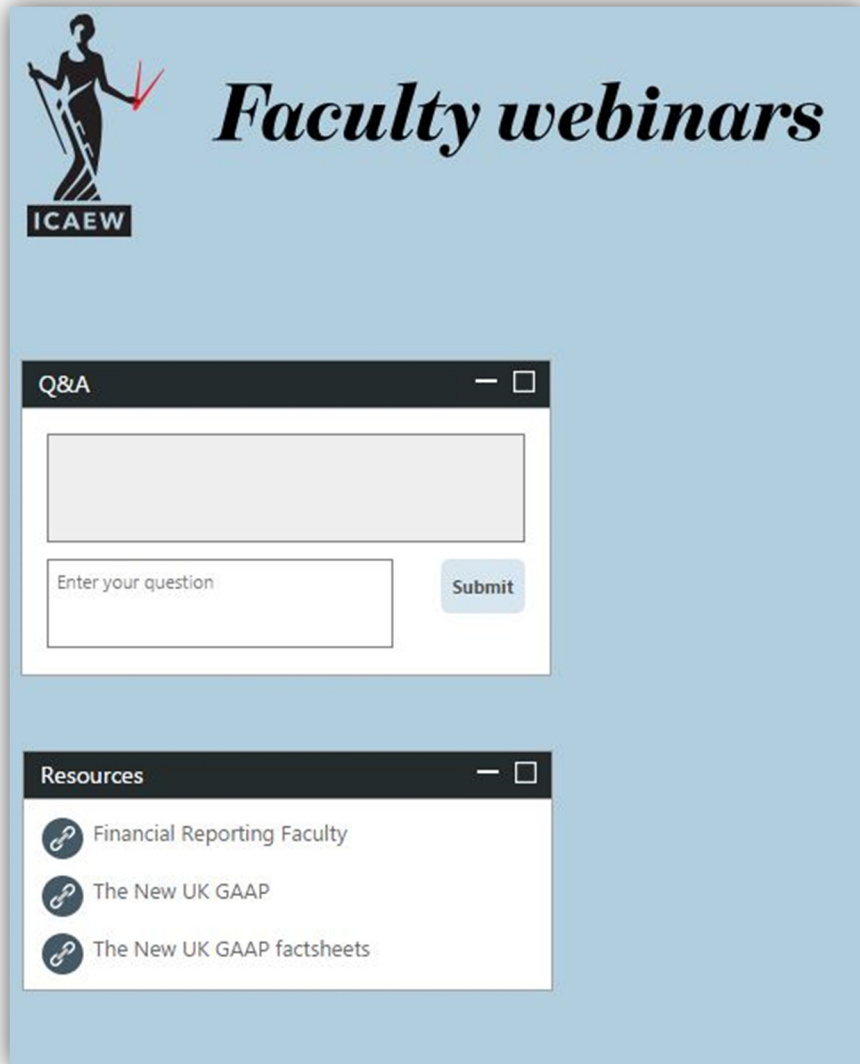
Louise Sharp
Technical Manager
ICAEW

Today's presenter



John Selwood

Ask a question



The screenshot shows the ICAEW Faculty webinars interface. At the top left is the ICAEW logo, featuring a figure holding a scale and a sword, with the text 'ICAEW' below it. To the right of the logo is the text 'Faculty webinars' in a large, bold, serif font. Below this is a 'Q&A' section with a large text input box, a smaller input box labeled 'Enter your question', and a 'Submit' button. Below the Q&A section is a 'Resources' section with three links, each preceded by a chain-link icon: 'Financial Reporting Faculty', 'The New UK GAAP', and 'The New UK GAAP factsheets'.



Audio problems?

- Ensure your volume is turned on
- If you experience poor sound quality try refreshing your page.

Ask a question

Type your question into the question box then click submit.

Download resources here

Contents - Practical considerations for auditing accounting estimates

Revised ISA 540

The audit impact of COVID-19 lockdown

Key features of new ISA

Practical examples

What more is the Faculty doing?

Practical considerations for auditing accounting estimates

REVISED ISA 540 - OVERVIEW

ISA 540 Accounting estimates

New standard

- Periods commencing 15 December 2019
- Early adoption permitted

Standard
Audit and Assurance

 Financial Reporting Council

December 2018

International Standard
on Auditing (UK) 540 (Revised)

Auditing Accounting Estimates and
Related Disclosures

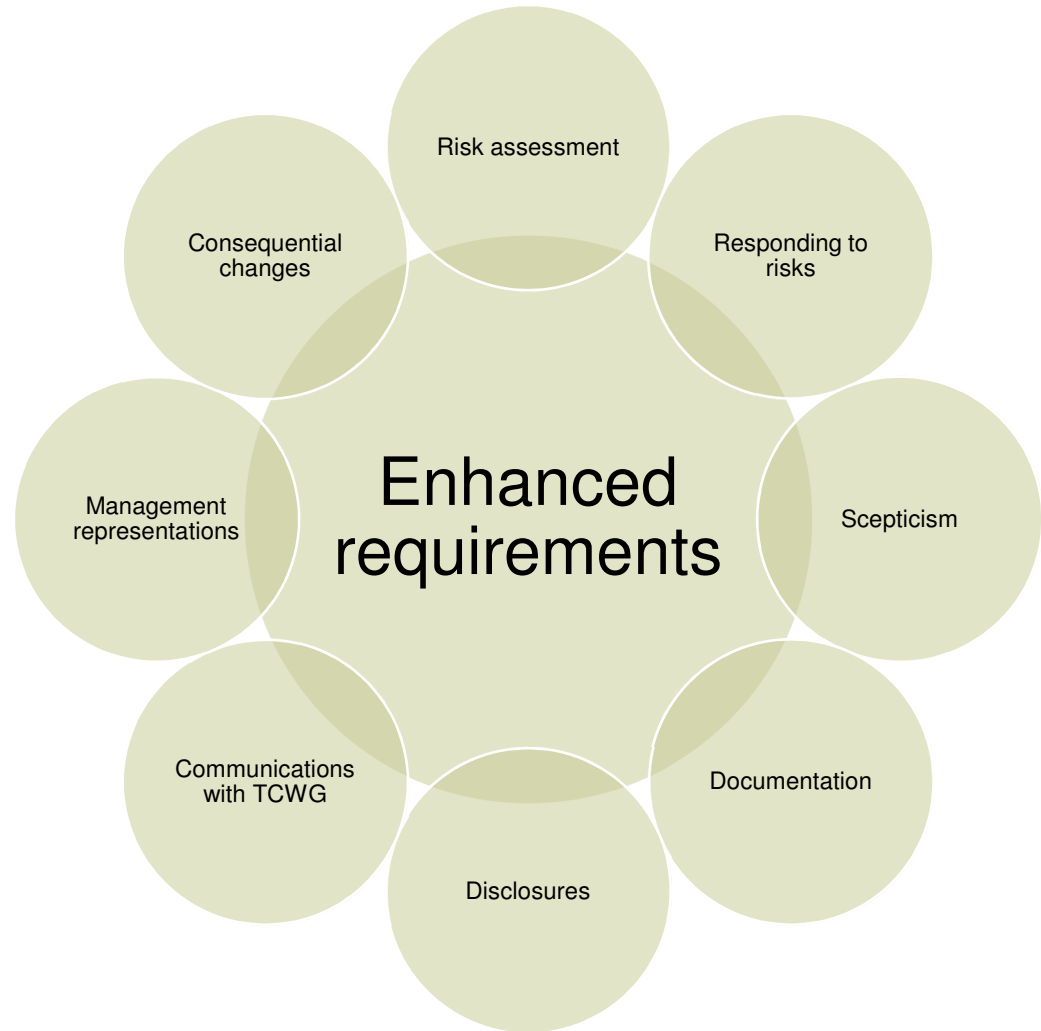
ISA 540 Accounting estimates



The problems

- Numerous enhanced requirements
- Already a difficult area
- ISA 540 already not well complied with?
- Weak spot in some audit methodologies?

ISA 540 Numerous enhancements



Practical considerations for auditing accounting estimates

***AUDITING CONSEQUENCES OF
THE COVID-19 LOCKDOWN***

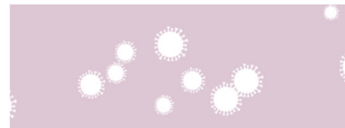
ICAEW guidance



Exams update

Information and guidance on ICAEW exams during the coronavirus (COVID-19) pandemic.

[See more](#)



Help for business

Discover vital support available for businesses affected by coronavirus.

[See more](#)



Business interruption

Coronavirus is impacting supply chains, travel, insurance, GDP and entire economies.

[See more](#)



Audit

Learn about the auditing implications of the Coronavirus (COVID-19) pandemic

[See more](#)



Financial reporting

Find guidance for preparers of financial statements on the coronavirus outbreak.

[See more](#)



Tax

Here is the latest support and advice on tax issues relating to coronavirus (COVID-19), such as statutory sick pay.

[See more](#)

Coronavirus

Coronavirus is not just a world health emergency; it is an economic one too. The economic impacts are plain to see and emergency provisions are being made worldwide in an attempt to support individuals, business and anyone who advises them. ICAEW is monitoring the situation closely and collating resources as conditions unfold.

[Practical business advice](#)

[Feedback on our coronavirus coverage](#)



First and second wave issues



31 December YE

- Going concern
- Disclosures
- PBSE



31 March YE

- Going concern
- Disclosures
- PBSE
- Asset valuations!
- Stocktakes

Audit reports

The impact of uncertainties due to Britain exiting the European Union on our audit

Uncertainties related to the effects of Brexit are relevant to understanding our audit of the financial statements. All audits assess and challenge the reasonableness of estimates made by the directors, such as recoverability of investments, intangibles assets and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the company's future prospects and performance.

Brexit is one of the most significant economic events for the UK, and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown. We applied a standardised firm-wide approach in response to that uncertainty when assessing the company's future prospects and performance. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Going concern

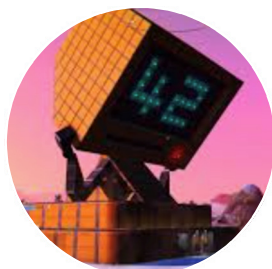
The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the group or the company or to cease their operations, and as they have concluded that the group and the company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the directors' conclusions, we considered the inherent risks to the group's business model, including the impact of Brexit, and analysed how those risks might affect the group and company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in



Audit reports – ignoring modified opinions and KAMs



Is there material uncertainty related to going concern?



Yes - material uncertainty relating to going concern paragraph



No – is there anything **fundamental** that requires an emphasis of matter?

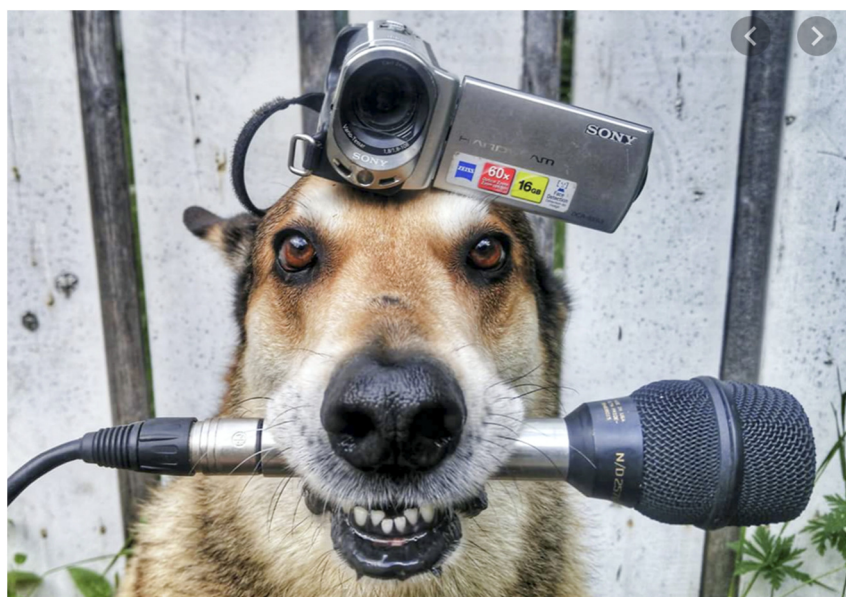


Yes - emphasis of matter with cross reference



No - clean report

Attendance at stocktakes

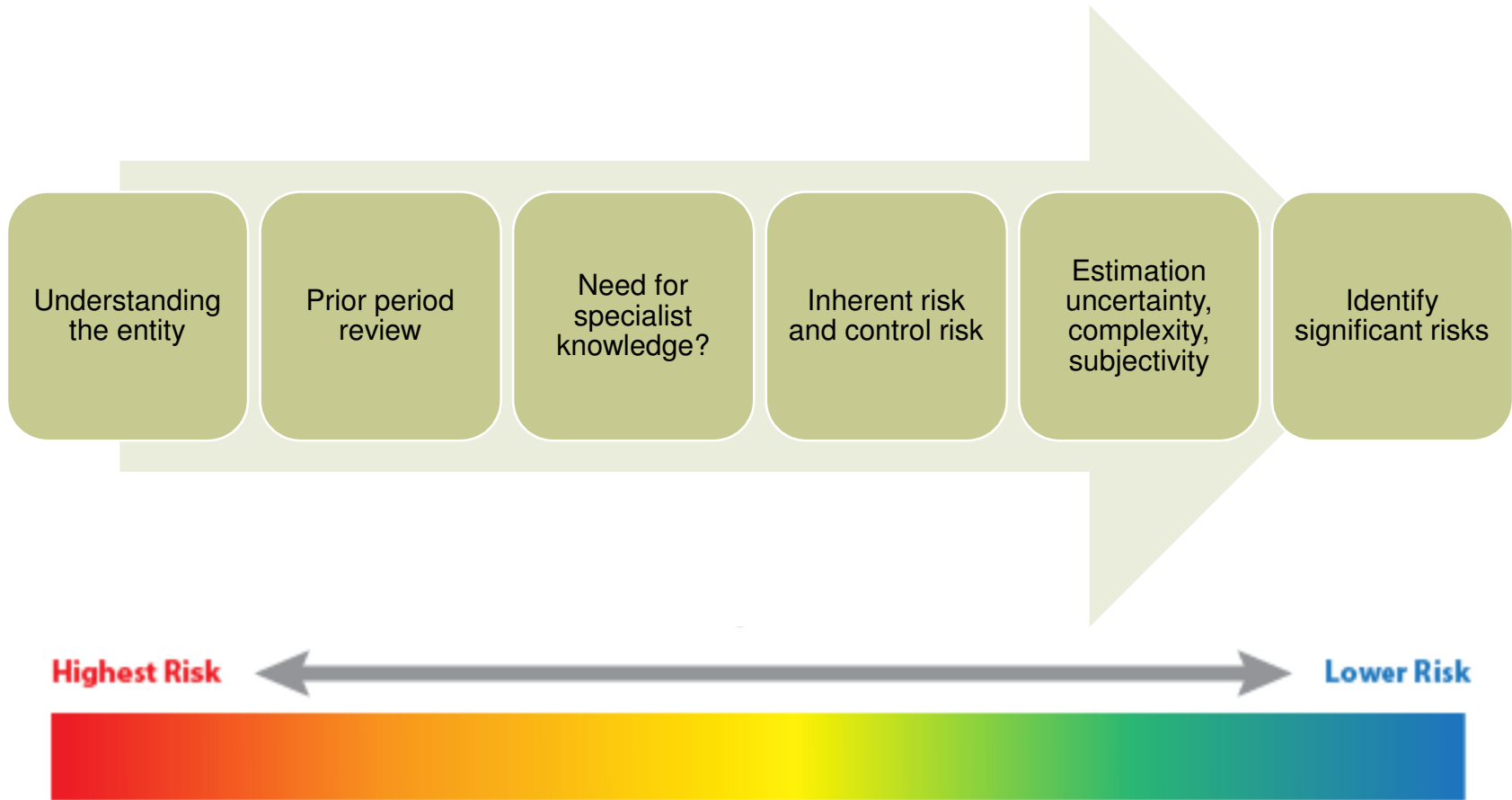


- Use tools for a virtual attendance
- Attend stocktake later and test rollback
- Test paper trail around the year end?
- Qualify/disclaimer audit opinion? – watch out for bank covenants

Practical considerations for auditing accounting estimates

KEY CHANGES IN ISA 540

Accounting estimates – risk assessment



Spectrum of inherent risk

Scepticism



New in ISA 540

- More questioning and challenge
- Not just seeking corroboration
- Evaluating and documenting contradictory evidence

Scepticism

Audit evidence

- Tests should be designed without bias
- Evidence should be evaluated taking into account both corroborating and contradictory evidence
- Don't just document corroborating evidence
- Document contradictory evidence too

Obtaining Relevant Audit Evidence Whether Corroborative or Contradictory

A82. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.⁴⁴ Obtaining audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.

Practical considerations for auditing accounting estimates

PRACTICAL EXAMPLES

Example 1 – investment property valuation



Property company

- The company owns a significant office building with several long term tenants
- The company is heavily geared with bank borrowing and bank covenants

Example – property valuation

Understand
the entity

Business strategy

GAAP – FRS 102

Internal controls? – Valuation

Prior
periods
review

Look at past trends in the valuation

If there were a number of properties,
look at prices achieved on sale.

Example – property valuation

SEPARATE
risk
assessments

Inherent risk

Consider spectrum of
risk: subjectivity,
complexity, **bias**, **fraud**

Estimation uncertainty
not likely to be low

Control risk

Understand internal;
controls

If no testing of controls:
Risk cannot be low

Note: ISA is specific on the nature of audit procedures



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
- Developing an auditor's point estimate or range

Note: ISA is specific on the nature of audit procedures



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- Obtaining audit evidence from events occurring up to the date of the auditor's report
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Example – property valuation

Approach

Testing of how management made the accounting estimate:

External valuation by professional valuer on a yield basis

Valuer & valuation?

Is the valuer qualified etc etc.....

Is it the right basis? Similar properties? DRC?

Was it carried out properly?

How was the yield derived?

Example – property valuation

Approach Developing an auditor's point estimate or range

Yield Look at third party market data - preferably from multiple sources

The auditor should develop their own understanding of how the yield basis should be applied

Example 1A – investment property valuation



Property company

- The company owns a significant office building with several long term tenants
- The company is heavily geared with bank borrowing with bank covenants

A professional valuation was obtained in the prior year. The directors are of the view that the valuation of the property has not changed in the past 12 months

Example 1B – investment property valuation

Valuation practice alert - COVID-19



Property company

- The valuation report from the valuer at 31 March 2020 contains a material uncertainty clause

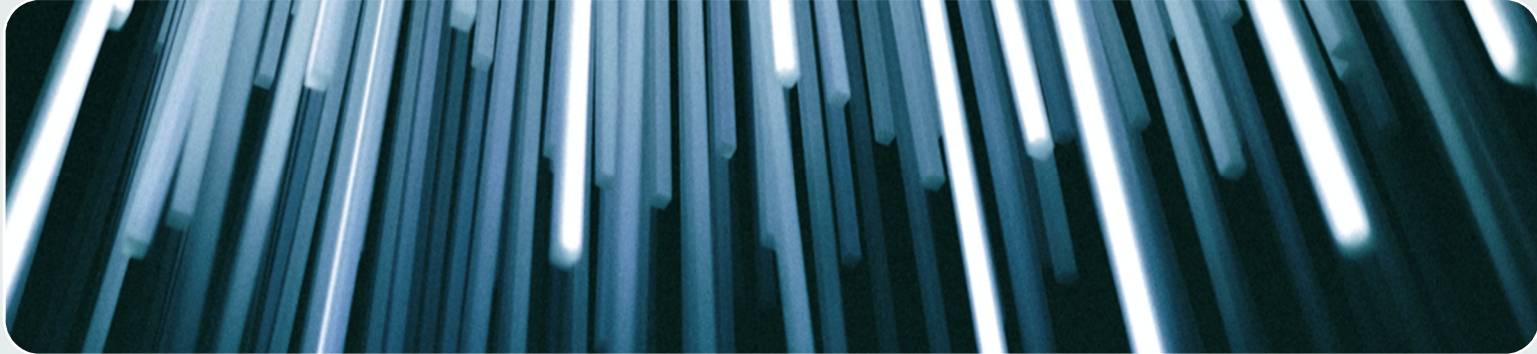


The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a “Global Pandemic” on 11 March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries.

Market activity is being impacted in many sectors. As at the valuation date, we consider that we can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement.

Our valuation(s) is / are therefore reported on the basis of ‘material valuation uncertainty’ as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty – and a higher degree of caution – should be attached to our valuation than would normally be the case. Given the unknown future impact that COVID-19 might have on the real estate market, we recommend that you keep the valuation of [this property] under frequent review

Example 2 – investment in shares



Group holding company

- A parent company holds controlling interests in three subsidiary companies. All are tech start ups.
- The accounting policy to recognise the investments at fair value through P&L

Example – valuation of investment in shares

Understand
the entity

Business strategy

GAAP – FRS 102

Internal controls?

Prior
periods
review

Look at trends in valuation

Look at any sales if
applicable

Example - valuation of investment in shares

SEPARATE
risk
assessments

Inherent
risk

Spectrum of risk:
subjectivity,
complexity, **bias**,
fraud, **estimation**
uncertainty

Control
risk

?

Note: ISA is specific on the nature of audit procedures



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**
- **Developing an auditor's point estimate or range**

Example 2B – investment in shares



Group holding company

- A parent company holds controlling interests in three subsidiary companies. All are tech start ups.
- The accounting policy to recognise the investments at fair value through P&L

The directors take the view that the valuation of the investments at 31 March 2020 is the same as in the previous year.

Practical considerations for auditing accounting estimates

IMPLEMENTATION SUPPORT



Any questions?

Thank you for attending

Please take the time to fill out our short survey.

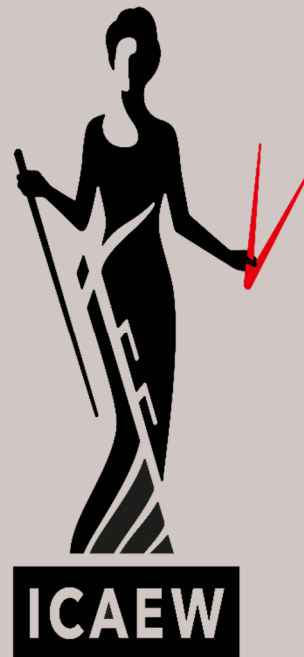
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