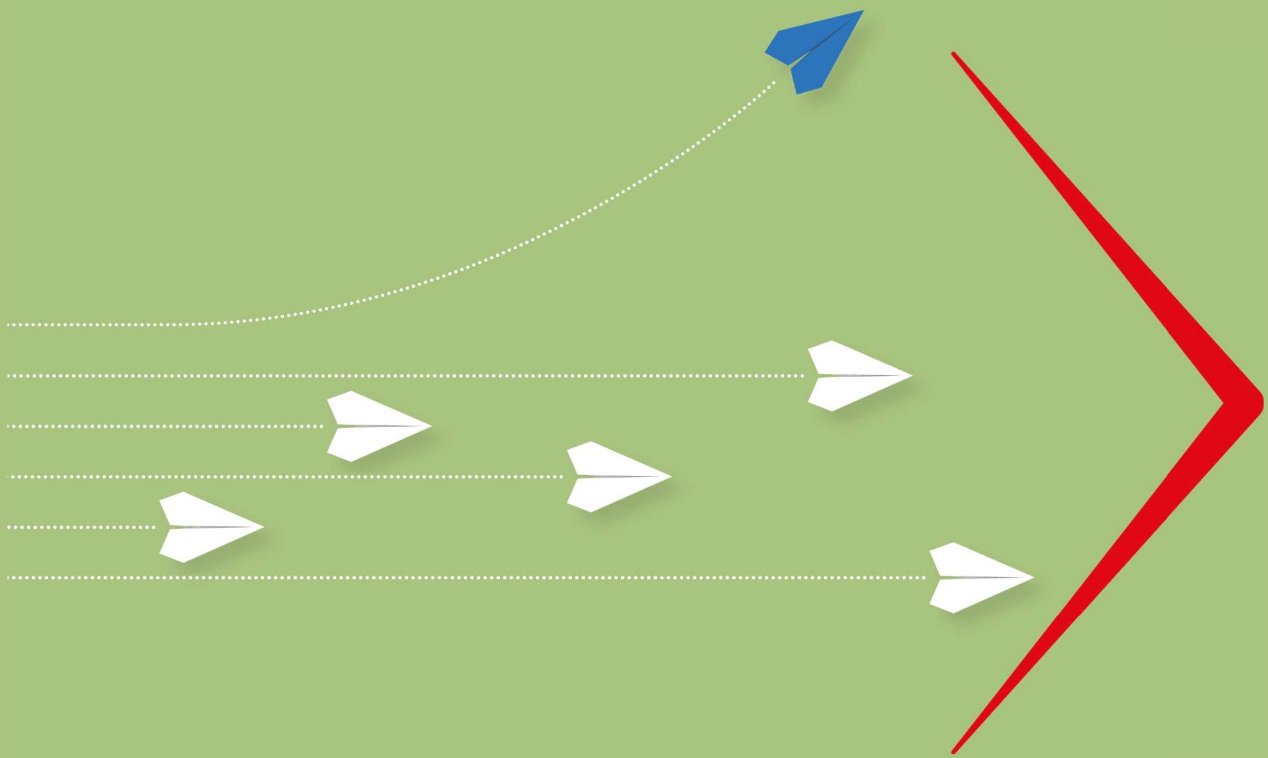
ICAEW KNOW-HOW

AUDIT AND ASSURANCE FACULTY



Identifying specific risks in relation to estimates

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Risk of Material Misstatement at Assertion Level

Assertion level risks are:

- Representations by management that are embodied in the financial statements
- Associated with relevant assertions

Assertion level risks:

- Relate to significant classes of transactions, account balances, or disclosures
- Include a separate assessment of inherent risk and of control risk
- Drive the nature, timing and extent of the response

Risk of Material Misstatement at Assertion Level

Accuracy, valuation and allocation

Assets, liabilities and equity interest have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described

Estimates

Existence

Assets, liabilities and equity interests exist

Completeness

All assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included

Inherent Risk Factors

- Estimation Uncertainty
- Complexity
- Subjectivity
- Change
- Management bias or fraud

Identifying and Assessing the Risks of Material Misstatement

Paragraph 16 of ISA 540 (Revised)

The auditor shall take the following into account in identifying the risks of material misstatement and in assessing inherent risk	(a) the degree to which the accounting estimate is subject to estimation uncertainty, and	
	(b) the degree to which the following are affected by complexity, subjectivity or other inherent risk factors	(i) the selection and application of the method, assumptions and data in making the accounting estimate, or
		(ii) the selection of management's point estimate and related disclosures for inclusion in the financial statements

Example – Impairment of Inventories

- The entity assesses its inventory for impairment at its year end in accordance with FRS 102
- The entity carries 50 different products all with a determined and observable selling price
- The products are all finished goods and the entity does not manufacture or alter the products in any way; there are no costs to complete
- The products are all held on consignment, there are no additional costs to sell
- Management uses internally developed spreadsheets to calculate the value of an impairment loss on a per product basis

Example – Pension Liability Measurement

- The entity values its net defined benefit liability in accordance with IAS 19. The measurement of this net liability requires the use of certain actuarial assumptions. These include assumptions relating to:
  - mortality – based on the mortality of plan members during and after employment
  - discount rate – based on market yields on high quality corporate bonds
  - expected salaries and benefits – reflecting terms of the plan, future salary increases, etc
- The entity uses an actuarial expert to make estimate
- The model used is a standard industry model