

SA 540 - Auditing Accounting Estimates (AE), Including Fair Value (FV) AE & Related Disclosures

<p>RAP for AE (Minimizing ROMM)</p> <p>Auditor shall obtain below understanding -</p> <ul style="list-style-type: none"> • How Mgt identify those transactions, events or conditions that give rise to need for AE <p>Inquiries of Mgt about changes in circumstances that may give rise to need for AE may include inquiries about whether -</p> <ul style="list-style-type: none"> ○ Entity has new types of transactions ○ Terms of transactions have changed ○ A/c policies for A/c AE have changed ○ Regulatory changes outside control of Mgt ○ New conditions or events have occurred <ul style="list-style-type: none"> • How Mgt makes AE - Including - <ul style="list-style-type: none"> ○ Method & model, used in making AE ○ Whether there is change from prior period in methods for making AE & if so, why ○ Whether Mgt has used expert ○ Relevant controls ○ Assumptions underlying AE ○ Whether & how Mgt has assessed effect of estimation uncertainty • Requirements of AFRF relevant to AE 	<p>Responses to Assessed ROMM (FAP)</p> <ul style="list-style-type: none"> • Auditor shall determine - <ul style="list-style-type: none"> ○ Whether Mgt has applied AFRF for AE ○ Whether methods for making AE are appropriate & are applied consistently ○ Changes in AE or methods from prior period, are appropriate in circumstances • In response to assessed ROMM, auditor shall undertake following - <ul style="list-style-type: none"> ○ Test check data used for making AE ○ Determine if events occurring up to date of auditor's report provide SAAE for AE ○ Evaluate if method used for measurement is appropriate & assumptions made by Mgt are reasonable ○ This can be achieved by - <ul style="list-style-type: none"> ▪ Testing control effectiveness over AE ▪ Testing whether data on which AE is based is accurate, complete & relevant ▪ Considering source, relevance & reliability of external data ▪ Recalculating & reviewing Info about AE
<p>AE that give rise to Significant Risks</p> <p>In addition to SA 330, auditor shall evaluate -</p> <ul style="list-style-type: none"> • How Mgt has considered alternative assumptions & why it has rejected them • If significant assumptions are reasonable • Mgt's intent for specific action & its ability • If Mgt has not adequately addressed effects of estimation uncertainty on AE of significant risks, auditor shall develop range with which to evaluate reasonableness of AE 	<p>Degree of Estimation Uncertainty - Varies Based on</p> <ul style="list-style-type: none"> • Nature of AE • Extent of generally accepted method • Subjectivity of assumptions used to make AE <p>Evaluation of Outcome of AE</p> <ul style="list-style-type: none"> • Diff B/w outcome of AE & amount originally disclosed in FS does not necessarily represent misstatement in FS • Particularly for FV AE, as outcome is affected by subsequent events
<p>AE of Prior Period</p> <ul style="list-style-type: none"> • Auditor shall review AE of prior period, or, their re-estimation for current period, taking A/c of nature of AE & whether Info 	<p>Disclosures Related to AE</p> <ul style="list-style-type: none"> • Auditor shall obtain SAAE about whether disclosures in FS are as per AFRF

<p>obtained from review is relevant to identify & assess ROMM of AE made in current period</p> <ul style="list-style-type: none"> • Outcome of AE will differ from AE recognised in prior period. By performing RAP to identify & understand reasons for such differences, auditor may obtain - <ul style="list-style-type: none"> ○ Info of effectiveness of Mgt's prior period estimation process to judge likely effectiveness of current process ○ Audit evidence for re-estimation, in current period, of prior period AE ○ Audit evidence of matters, such as estimation uncertainty to disclose in FS • Review of prior period AE may also assist auditor, to identify situations that increase susceptibility of AE to possible Mgt bias • Auditor's professional skepticism assist to identify circumstances & assess NTE of FAP • However, review does not question judgments made in prior periods that were based on Info available at that time 	<ul style="list-style-type: none"> • For AE having significant risk, also about disclosure of its estimation uncertainty in FS <p>Presentation of FS includes below disclosure</p> <ul style="list-style-type: none"> • Method & Model of estimation used • Any changes in method of estimation from prior period & its subsequent effect • Assumptions used • Basis for selection of estimation • Sources of estimation uncertainty • For AE having significant risk, even if disclosures are as per AFRF, auditor may conclude that disclosure of estimation uncertainty is inadequate <p>Written Representations Whether Mgt & TCWG believe significant assumptions used in making AE are reasonable</p> <p>Documentation of AE</p> <ul style="list-style-type: none"> • Basis for conclusions for reasonableness of AE & disclosure giving rise to significant risks • Indicators of possible Mgt bias, if any
<p>Low estimation uncertainty & lower ROMM AE</p> <ul style="list-style-type: none"> • Entities not having complex business activity • FV AE where method is simple & easy • AE from data that is readily available • FV AE where model is well-known/generally accepted • AE are frequently made & updated as they relate to routine transactions 	<p>High estimation uncertainty AE</p> <ul style="list-style-type: none"> • AE relating to outcome of litigation • FV AE for derivative financial instruments not publicly traded • FV AE for which highly specialised entity-developed model is used or assumptions or inputs that cannot be observed in marketplace
<p>Eg of AE, other than FV AE are</p> <ul style="list-style-type: none"> • Warranty obligations • Outcome of long-term contracts • Inventory obsolescence • Allowance for doubtful A/c • Provision against carrying amount of investment • Depreciation method or asset useful life • Financial Obligation/Cost from litigation 	<p>Eg of FV AE are (IND AS)</p> <ul style="list-style-type: none"> • Share-based payments (102) • Asset/liability in business combination (103) • Property or equipment held for disposal (105) • Complex financial instruments, which are not traded in active & open market (109) • Transactions involving exchange of assets or liabilities b/w independent parties without monetary consideration (16)