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Significant Estimates

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Statement on Auditing Standards (SAS) 143 – Auditing Accounting Estimates and Related Disclosures

□ Scope

- Includes requirements and guidance that refer to or expand on how AU-C section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement; AU-C section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained; AU-C section 450, Evaluation of Misstatements Identified During the Audit; and AU-C section 500, Audit Evidence are to be applied with regard to accounting estimates and related disclosures.
- Also includes requirements and guidance related to the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias.

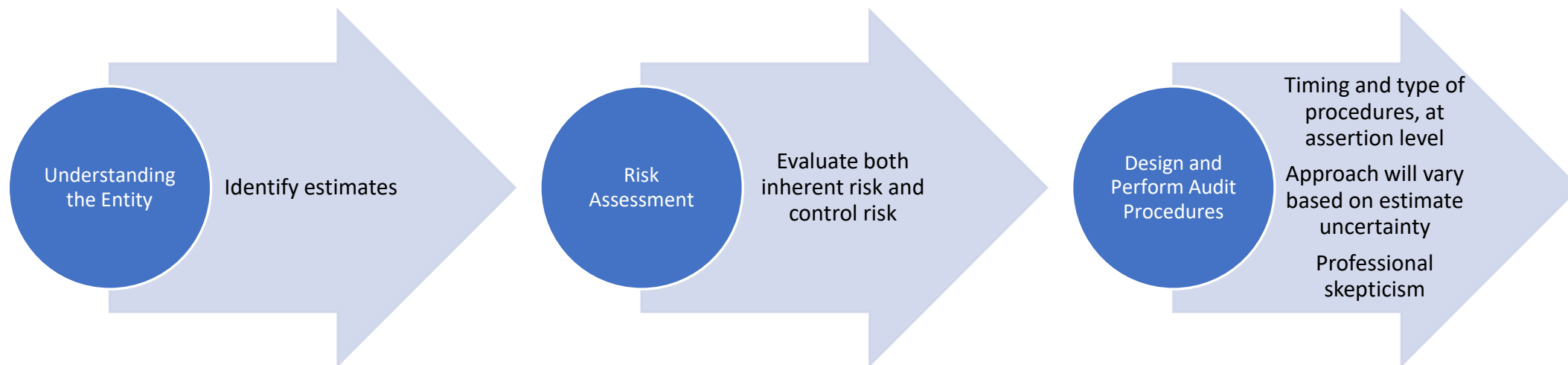
□ Effective Date

- Audits of financial statements for periods ending on or after December 15, 2023.

Key Definitions

- ❑ **Accounting Estimate**
 - A monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty.
- ❑ **Estimation Uncertainty**
 - Susceptibility to an inherent lack of precision in measurement
- ❑ **Management bias**
 - A lack of neutrality by management in preparation of information
- ❑ **Management's point estimate**
 - The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate
- ❑ **Auditor's point estimate (auditor's range)**
 - An amount, or range of amounts, respectively, developed by the auditor in evaluating management's point estimate.
- ❑ **Outcome of an accounting estimate**
 - The actual monetary amount that results from the resolution of the transactions, events, or conditions addressed by an accounting estimate.

Auditor's Responsibilities



Common Estimates in Governmental Financial Statements

Depreciation

Leases,
SBITAs, PPP
Arrangements

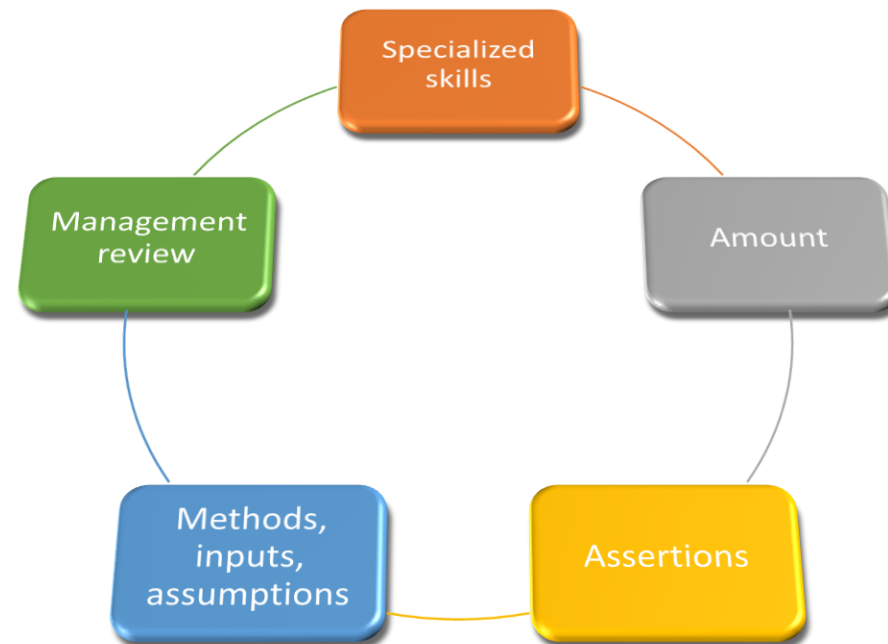
Pension &
OPEB

Allowance for
uncollectible
receivables

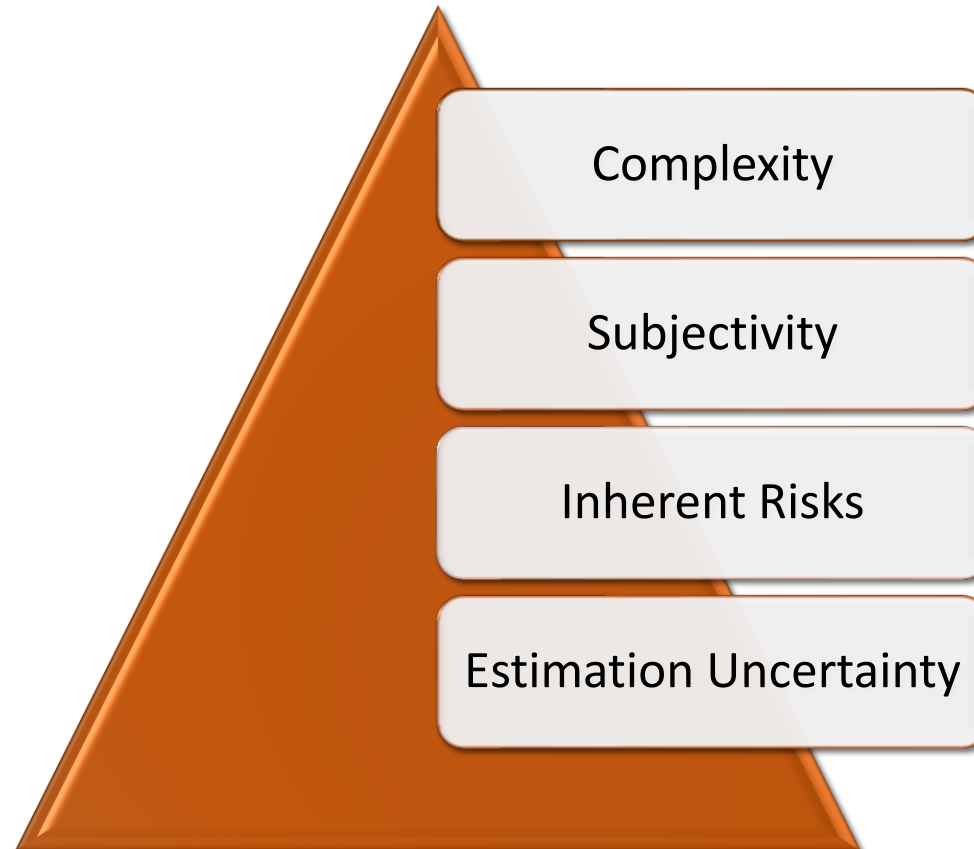
Investments &
Derivatives

Unbilled
Revenues

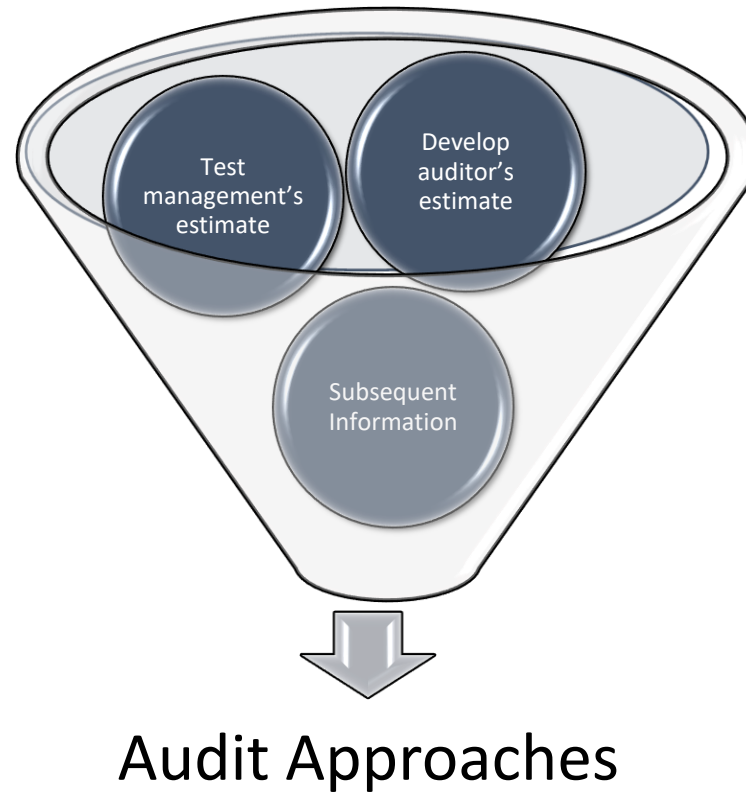
Risk Assessment Considerations



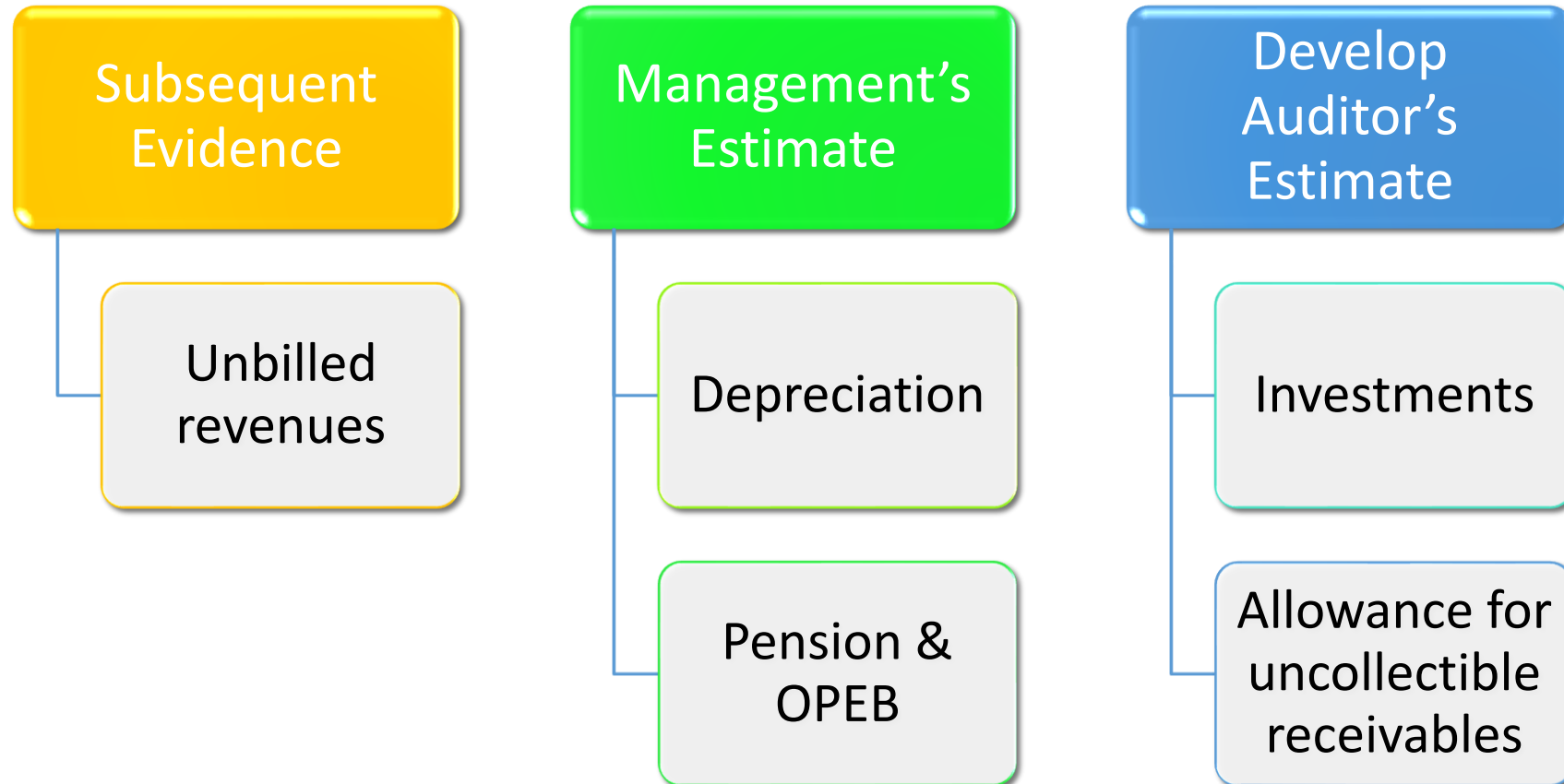
Nature of Estimates



Audit Response



Audit Responses



Audit Evidence

- ❑ Management's use of a specialist
- ❑ Management bias
- ❑ Sufficient appropriate evidence
- ❑ Relevance and reliability of evidence
- ❑ Corroborating or contradicting evidence
- ❑ Auditor's use of a specialist

Conclusion and Audit Documentation

- ❑ Reasonableness of estimate (or misstatement)
- ❑ Reasonableness of financial statements and related disclosures
- ❑ Understanding estimates and management's process and controls
- ❑ Risk of Material Misstatement at Assertion Level
- ❑ Link between risk assessment and audit procedures performed

Conclusion and Audit Documentation (Continued)

- ❑ Document indicators of management bias and the response
- ❑ Conclusions about estimates and related disclosures, including significant judgements
- ❑ Communications with those charged with governance



Application

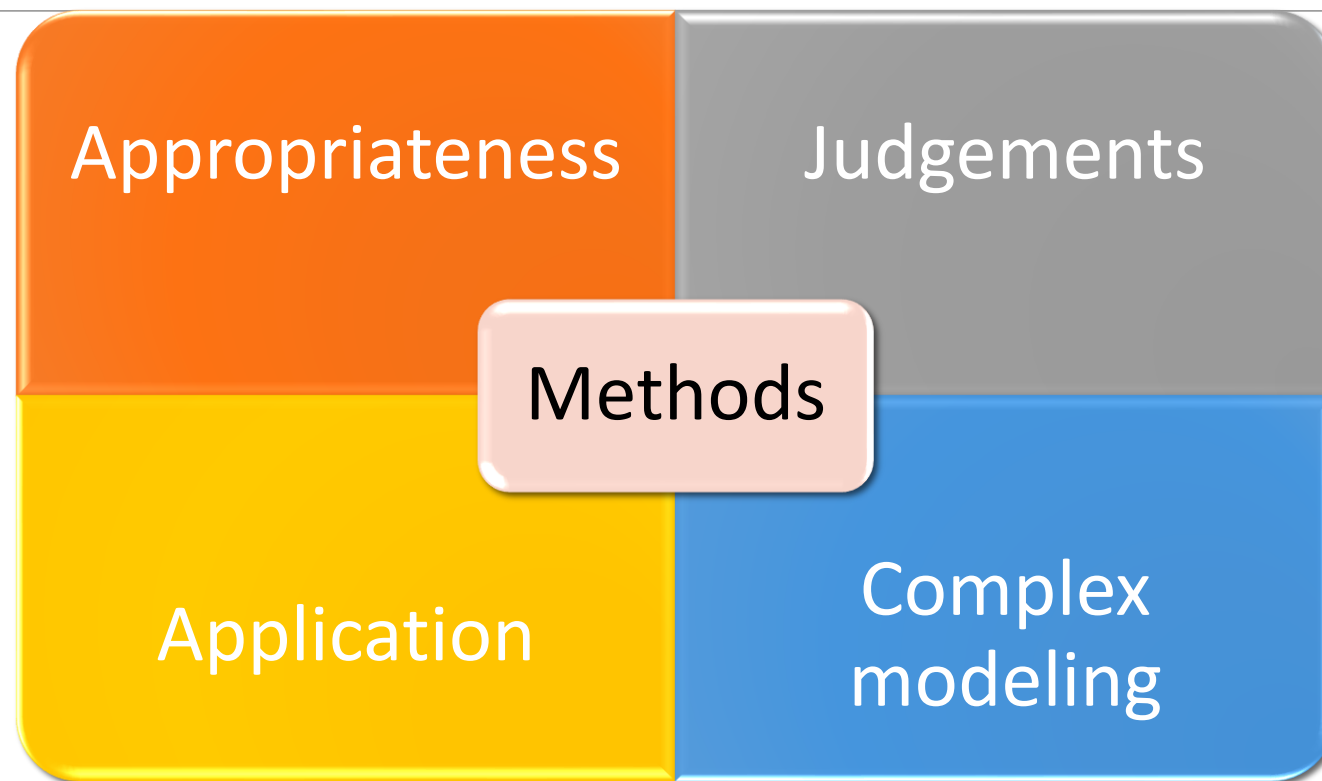
Audit Approach #1 – Obtaining Audit Evidence from Events Occurring up to the Date of the Auditor’s Report

- ❑ Reminder – even if the auditor decides not to use this testing approach, the auditor is still required to comply with AU-C Section 560, Subsequent Events and Subsequently Discovered Facts
- ❑ In many cases, this approach would not provide sufficient appropriate audit evidence regarding the account estimate.
- ❑ Where is this approach likely to provide sufficient appropriate evidence?

Audit Approach # 2 – Testing Management’s Estimate

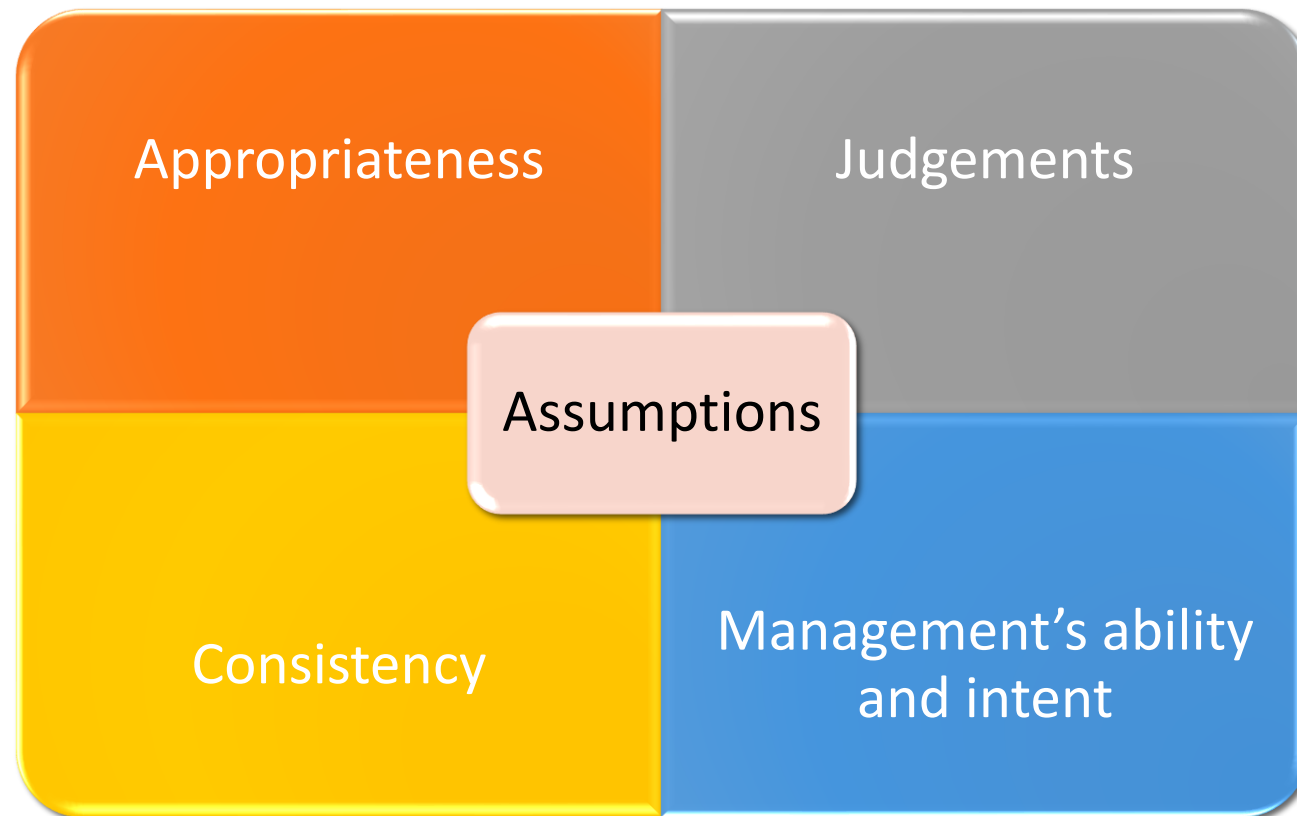
- ❑ Use alone or in combination with one of the other testing approaches
- ❑ Appropriate Approach when:
 - Auditor’s review of similar accounting estimates made in the prior year financial statements suggests management’s current process is appropriate
 - Accounting estimate is based on a large population of items of a similar nature that individually are not significant
 - Applicable financial reporting framework specifies how management is expected to make the accounting estimate (expected credit loss provision)
 - Accounting estimate is derived from the routine processing of data
- ❑ But consider further discussions when:
 - changes from prior periods in a method or significant assumption
 - data is not based on new circumstances or new information
 - significant assumptions are inconsistent with each other and with those used in other accounting estimates or with related assumptions used in other areas of the entity’s business activities

Audit Approach #2 – Testing Management’s Estimate



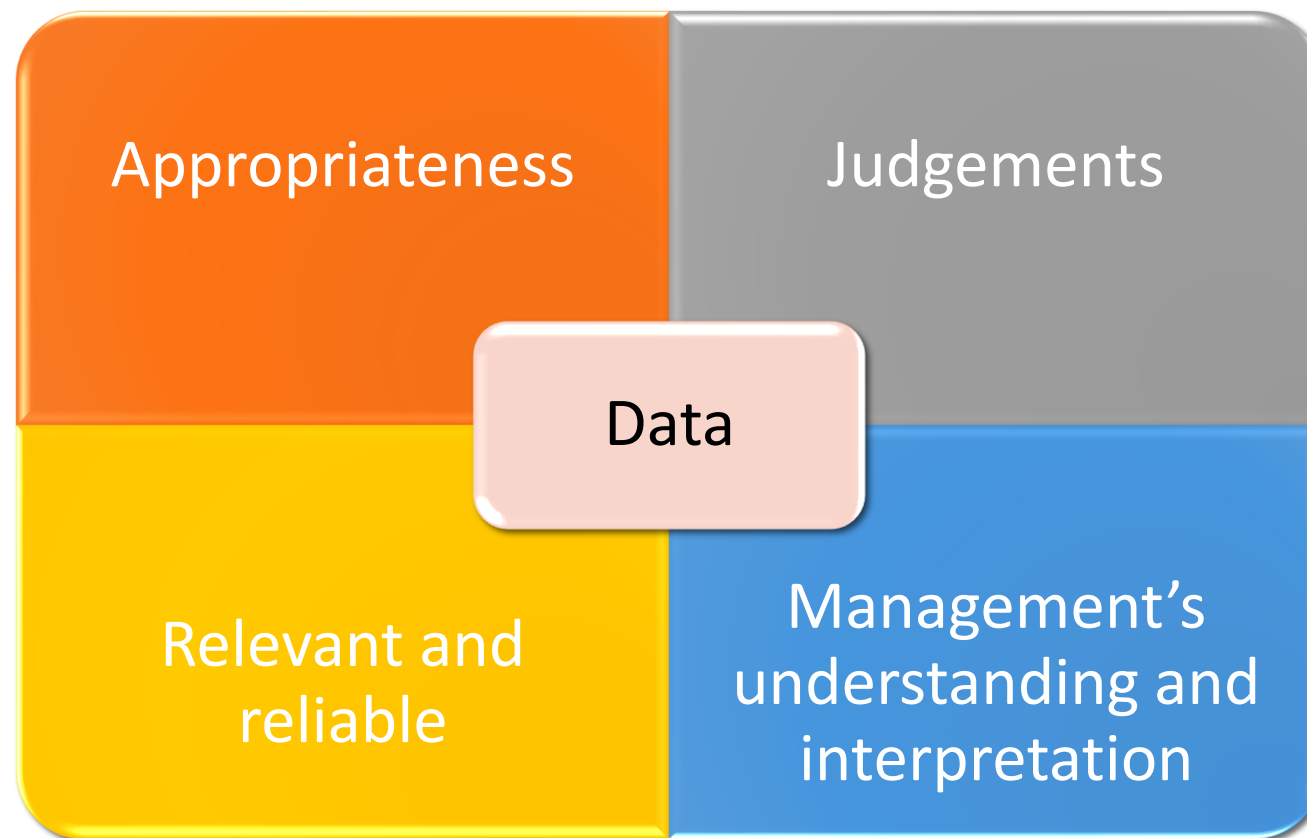
A method is a measurement technique used by management to make an accounting estimate in accordance with the required measurement basis. A method is applied using a computational tool or process, sometimes referred to as a model, and involves applying judgements and data and taking into account a set of relationships between them

Audit Approach #2 – Testing Management’s Estimate



Assumptions involve judgements based on available information about matters such as the choice of an interest rate, a discount rate, or judgements about future conditions or events. An assumption may be selected by management from a range of appropriate alternatives. Assumptions that may be made or identified by a management's expert become management's assumptions when used by management in making an accounting estimate.

Audit Approach #2 – Testing Management’s Estimate



Data is information that can be obtained through direct observation or from a party external to the entity. Information obtained by applying analytical or interpretive techniques to data is referred to as derived data when such techniques have a well-established theoretical basis, and therefore, less need for management judgement. Otherwise, such information is an assumption.

Audit Approach #2 – Testing Management’s Estimate

- ❑ Management’s Selection of a Point Estimate
 - Does management understand estimation uncertainty
 - Has management addressed estimation uncertainty by selecting an appropriate point estimate and by developing related disclosures about estimation uncertainty
 - If audit evidence indicates this has not occurred, an the auditor may need to evaluate whether this is a deficiency in internal control

- ❑ Where is this approach likely to provide sufficient appropriate evidence?

Audit Approach #3 – Developing an Auditor’s Point Estimate or Range

- ❑ Determine the range includes only amounts that are supported by sufficient appropriate audit evidence and have been evaluated by the auditor to be reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework
- ❑ Design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risk of material misstatement relating to the disclosures in the financial statements that describe estimation uncertainty.
- ❑ Also have to address methods, assumptions and data, regardless of using management’s or their own.
- ❑ Where is this approach likely to provide sufficient appropriate evidence?



Examples

Depreciation

□ Risk Assessment

- Dollar amount – usually significant
- Methods, Inputs, Assumptions
 - Straight-line depreciation, consistently applied useful lives to classes of assets, management expects to use asset over entire useful life
 - Estimation uncertainty – low to moderate
 - Complexity – low
 - Subjectivity – low to moderate
 - Other
- Control risk – how is depreciation calculated and reviewed (software, manually, etc.)

Depreciation

□ Audit Approach

- Accounting estimate is based on a large population of items of a similar nature that individually are not significant
 - Management's estimate – appears management understands estimation uncertainty
 - Evaluate methods, assumptions, data
 - No additional procedures necessary to address significant risk related to estimate

Leases, SBITAs, and PPP Arrangements

□ Risk Assessment

- Dollar amount – usually significant
- Methods, Inputs, Assumptions
 - Discount rate, consistently applied useful lives to classes of assets, management expects to use asset over entire term
 - Estimation uncertainty - moderate
 - Complexity - moderate
 - Subjectivity – moderate
 - Other
- Control risk – how are balances and contracts tracked, calculated and reviewed (software, manually, etc.)

Leases, SBITAs, PPP Arrangements

□ Audit Approach

- Applicable financial reporting framework specifies how management is expected to make the accounting estimate
 - Management's estimate – appears management understands estimation uncertainty
 - Evaluate methods, assumptions, data
 - No additional procedures necessary to address significant risk related to estimate

Pension & OPEB

- Risk Assessment
 - Dollar amount – usually significant
 - Methods, Inputs, Assumptions
 - Use of management’s specialist (actuary)
 - Estimation uncertainty - High
 - Complexity - Moderate
 - Subjectivity – low
 - Other
 - Control risk – Review of data inputted, review of actuary report

Pension & OPEB

□ Audit Approach

- Accounting estimate is derived from the routine processing of data
 - Management's estimate – appears management understands estimation uncertainty
 - Evaluate methods, assumptions, data
 - More likely to result in additional procedures necessary to address significant risk related to estimate

Allowance for Uncollectible Receivables

□ Risk Assessment

- Dollar amount – sometimes significant
- Methods, Inputs, Assumptions
 - Auditor's point estimate used to evaluate management's point estimate
 - Estimation uncertainty - Moderate
 - Complexity - Moderate
 - Subjectivity – High
 - Other
- Control risk – Review of calculation

Allowance for Uncollectible Receivables

□ Audit Approach

- Auditor's review of similar accounting estimates made in the prior year financial statements suggests management's current process is appropriate
 - Management's estimate – appears management understands estimation uncertainty
 - Evaluate methods, assumptions, data
 - More likely to result in additional procedures to respond to significant risk related to estimate

Investments & Derivatives

□ Risk Assessment

- Dollar amount – sometimes significant
- Methods, Inputs, Assumptions
 - Auditor's point estimate used to evaluate management's point estimate
 - May require use of management's or auditor's specialist
 - Estimation uncertainty - High
 - Complexity – Moderate/High
 - Subjectivity – Low
 - Other
- Control risk – Review of calculations, data input, and information provided by specialists

Investments & Derivatives

□ Audit Approach

- Auditor's review of similar accounting estimates made in the prior year financial statements suggests management's current process is appropriate
 - Management's estimate – appears management understands estimation uncertainty
 - Evaluate methods, assumptions, data
 - More likely to result in additional procedures to respond to significant risk related to estimate

Unbilled Revenues

□ Risk Assessment

- Dollar amount – sometimes significant
- Review of information subsequent to year end up to auditor's report date
 - Estimation uncertainty - Moderate
 - Complexity – Low
 - Subjectivity – High
 - Other
- Control risk – Review of calculations and data input

Unbilled Revenues

□ Audit Approach

- Auditor's review of similar accounting estimates made in the prior year financial statements suggests management's current process is appropriate
 - Management's estimate – appears management understands estimation uncertainty
 - Evaluate methods, assumptions, data
 - Unlikely to result in additional procedures to respond to significant risk related to estimate

Auditor Documentation

- ❑ Make sure your risk assessment identifies significant risk related to estimate
- ❑ If you have a significant risk, understand internal controls surrounding the risk, and perform a walkthrough
- ❑ Additional procedures performed
- ❑ You can arrive at a place where multiple estimates exist, and none are considered high risk.

Key Take Aways





Questions
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SOURCES: STATEMENT ON AUDITING STANDARDS
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