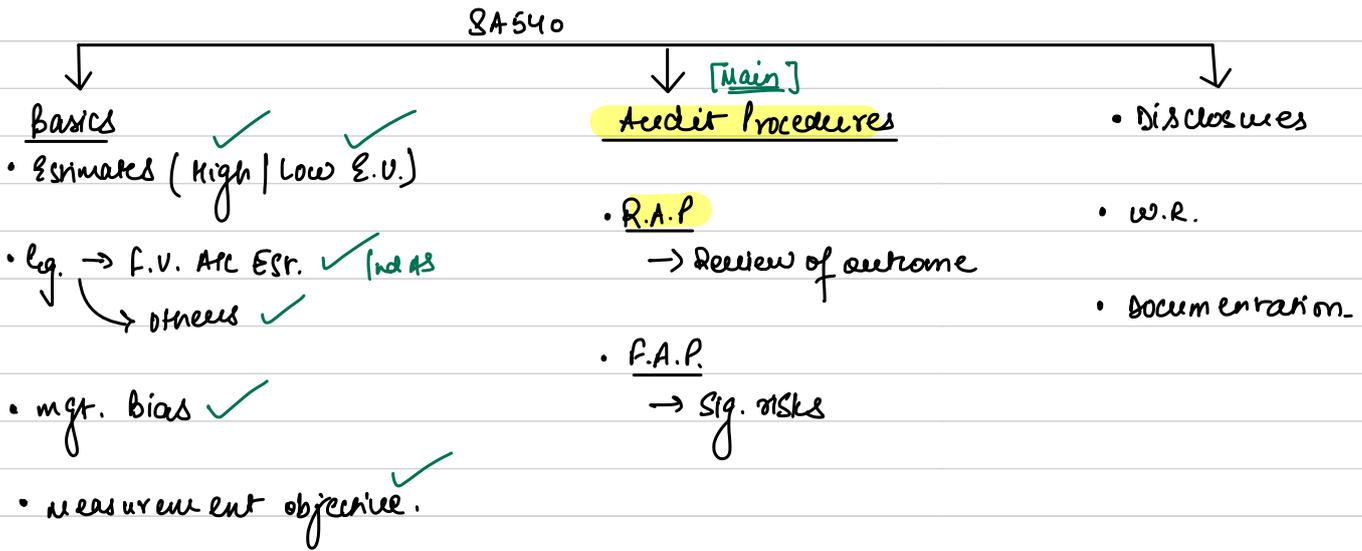


# SA 540: Auditing A/c Estimates including Fair value A/c Est. & Disclosures. [logical + Strong]

Info. used to make A/c Estimate, <sup>(penalty)</sup> varies widely [by legal case → proceedings] that affects degree of Estimation Uncertainty [E.V.]

Estimate vs. Actual

This affects Romm.



## A/c Estimates with Low Estimation Uncertainty [Estimate = Actual]

1. A/c Estimate derived from data readily available. Reputed as observable for fair value A/c Estimates.

Ind AS 113 F.V. measurement level 1 inputs.

eg. <sup>(Present value)</sup> published int rates or exchange traded prices. [F.V. of share]

2. A/c Estimates for entities whose business activities are not complex.

3. A/c Estimates frequently made & updated related to routine transactions.

eg. simple trading business → simple provisions for expenses / Dep<sup>n</sup> etc. (Rent → Agreement)

Fair value A/c Estimates where:

4. Model is well known / generally accepted      5. Method is simple & applied easily to Asset / Liability.

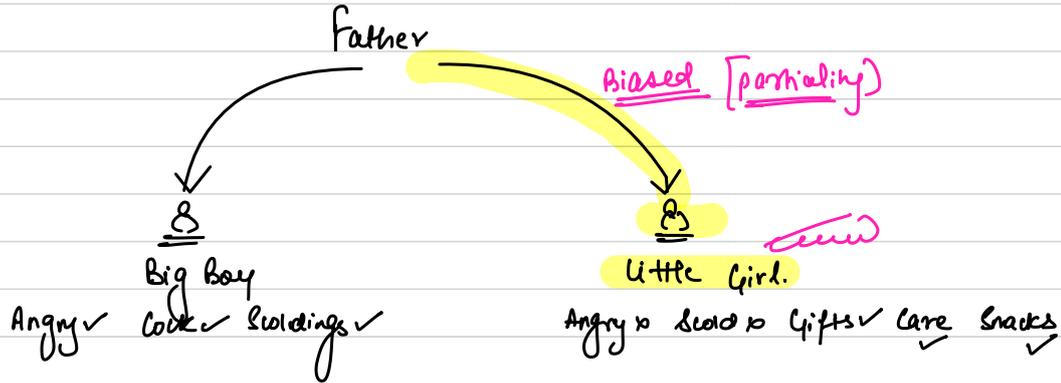
eg. DCF [Discounted Cash flow].



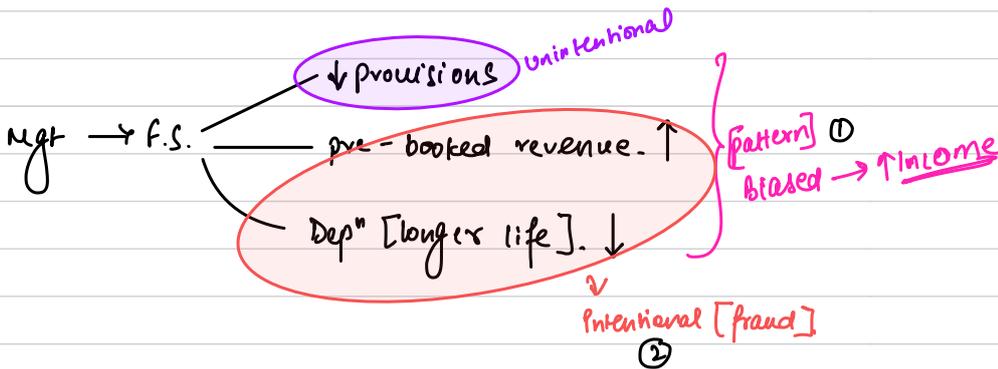
(model)  
 ① well known/generally accepted + ② frequently made/updated.

③ method is simple / ④ Not complex (Bus. Acts)

⑤ Data is readily available.



leg



③ P.Y. Audit → Bias → C.Y. Audit → Romm ↑

④ Detect Mgt. Bias → (a) A/c level.  
 or  
 → (b) Group of A/c Estimates / No. of A/c periods.  
 (purpose)  
Measurement objective of A/c Estimate [Why?]

1. Court case against Entity → provision? Penalty / win

[forecast outcome of Trans<sup>n</sup>, event or Cond<sup>n</sup> (TEC)]

2. Purchased building in exchange of land

fair value [How? similar trans<sup>n</sup> b/w 2 unrelated parties at similar location] (Arm's length Price)

3. Fair value = ₹5 cr (Books)

• After 1 month prices increase & it's sold for ₹6 cr.

• Is it a misstatement? No, fair value changes with change in conditions.

### Risk Assessment Procedures. [Understanding]

• When identifying & assessing **form**, evaluate degree of **£.v.**

• whether any Acc estimate with **high £.v.** leading to **sig. risk.**

Obtain 'Understanding' of :

Requirements of **AFRF**

Incl AS 8 [Acc Est → Disclosures + Reasonable].

1) Inquire how mgt identifies **TEC** [Trans<sup>n</sup>, Events or Cond<sup>n</sup>] that need acc estimates

ii) Estimation making process.

Data → Assumptions & Methods → Findings & Concl<sup>n</sup>

③ Any change in method?

④ used an expert?

⑤ Relevant controls.

main

### lg of Inquiries [Trans<sup>n</sup>, Events or Cond<sup>n</sup>]

Trans<sup>n</sup>  
[New / change]

• Engaged in **New type of trans<sup>n</sup>**?

• Terms of existing trans<sup>n</sup> **changed**?

New Etc<sup>n</sup>

• New Etc<sup>n</sup> has occurred?

[New Inq<sup>n</sup>]

[CR4 → RO] (You Commit Cr4)  
AP RO not

• **Acc policy changed**?

• **Regulatory / other changes**?

lg Policy

DR. overrule > 3 yrs.

↓

100% provision

lg

Incl AS 116 Lease → ROU Asset  
[Discount value of future lease payments]

New Lease

change in lease term.

main

→ Identified A/c Estimates → mgt x record → ICs [sig. deficiency]

## Review of outcome of A/c Est. made in prior period [5\*]

Intro: Review **outcome** of prior period a/c est. / their **subsequent re-estimation**.

eg court case [A.23-24] 31.3.24 provision ₹2cr → C.4.24-25 Actual outcome [Penalty ₹1.8cr].

Est. making process ✓  
E.V. ↓

OR

→ court proceedings continue  
31.3.25 provision ₹4cr  
(subsequent re-estimation)

- Nature & extent of review considers, **nature** of a/c estimate & to identify & assess **Romm** Pnc.4.

Does mgt?

- Review **not intended** to question **mgt's judgment** on prior period.
- Outcome is often **different** from estimate.

Why? • Auditor may obtain evidence about:

**Outcome** ✓

→ **effectiveness** of mgt's **estimation making process**

→ **E.V.** that may require disclosure in fs.

**Re-estimation**

- **Re-estimation** in current period, of prior period a/c estimates.

Conclude: • May identify **circumstances** that indicate possible **mgt. bias**.

**Professional skepticism** can assist in identifying such circumstances.



[Sequel] Auditor's Response to Assessed Risk (SA 330) [F.A.P. < T.O.L.S. & subs. pro.]

Determine → mgt has properly applied AFRF to A/c Estimates  
 &  
 methods are appt. & consistently applied.

if any changes, they are appt.

F.A.P. [Simple] whether subsequent events provide evidence of A/c estimate.

[Basic] Test operating effectiveness of controls & substantive pro.

- Evaluate: [Data] - Test check data
  - consider nature, source & relevance of external data.
- Assumptions are reasonable as per AFRF
- Method is appt.

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00

A/c Estimates with Sig. Risk [E.V. ↑]

Additionally evaluate the following: [Assumptions]

leg penalty notice  
5k - 5cr  
↓  
provision ₹ 10k  
min

- i) How mgt considered alternate assumptions / outcomes &
  - why it rejected them?
  - how they dealt with E.V.\*?

[choose]

ii) whether sig. assumptions are reasonable?

iii) Evaluate intent & ability to carry out specific course of action.

iv) If in auditor's h.t, mgt has not addressed E.V. properly,

develop a range to evaluate reasonableness of A/c Estimate.



# IAS 40 Auditing ALC Est. Including FV & Disclosures

**Basics** • Info (ALC Estimate) → E.V. → R.O.M.M.  
(vary)

- **ALC Estimates** → low (E.V.) **Maggi**
  - Well known (model)
  - Method is simple
  - Data readily available.
  - Frequently made & updated
  - Not complex (B. Acts)
- ↓
- **High E.V.** **MoDe**
  - Model (Highly specialised entity developed)
  - Derivative F.I. x publicly traded.
  - Outcome of litigation

**Eg.** ALC Estimates → Fair value: Ind AS 102, 103, 105, 109, 16. (non-monetary exchange)  
↓  
[Others] P.O.D., Inventory, Depreciation, warranty, Investments, litigation.

• **mgt. bias** - FRF (neutrality) → ALC Est. (mgt judgment) → Bias (intentional / unintentional) + fraud.  
• Previous audit + multiple ALC

• **Measurement objective** can vary (items / cond<sup>n</sup>)
 

- forecast outcome (TEC)
- fair value

 • Difference betw ALC Est & outcome → misstatement x

**Procedures** R.A.P. a. Degree of E.V. ? b. ↑ E.V. → Sig. Risk.

Understand • FRF requirements

• **Inquire<sup>x</sup> mgt** → how identifies T.E.C → ALC Estimates?

↓  
**Estimation making process**

(Assumptions, methods, change, expert, controls, E.V.)

**Review of outcome of P.P. ALC Est.** • Review outcome / Subs. re-estimation of P.P. ALC Est.  
(Qx) • Not intended to Over mgt judgment (Why?) Evidence of (Effectiveness of process + E.V. + re-estimation)  
• Outcome is diff. from estimate.  
(Bias) • may identify circumstances → possible mgt bias. (Prof. skepticism)

**Auditor's Response to Romm (FAP)** • Determine - FRF applied properly

• Subs. Events • T.O.s & Subs. Pro. • Evaluate (Data, Assumptions, methods) Reasonable appt.  
↳ method / changes appt?

**Sig. Risk (Assumptions)** • Alt. Assumptions (Reject? / Deal with E.V.?)  
• Assump. → Reasonable? • mgt intent + ability • E.V. not addressed x Develop a range ✓

**Disclosures:** Sig Risk → E.V. + (Est. process) • Assump. • E.V. • methods. • change?  
(AFRF → inadequate)