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# **Estimates and Judgments – Issues Today**

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# The Takeaway

- **At the end of this session**
  - Better understanding of why we ask the questions we do (or will)
  - Characteristics of
    - Well supported judgments and estimates
    - Good disclosure

# The WHY

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- **Why we do the things we do?**

# New CAS 540 – Auditing Accounting Estimates

- More “shalls”
- ...when testing how estimate was made ... audit procedures SHALL include procedures to obtain SAAE ... relating to
  - Selection of methods, assumptions and data
  - How point estimates were selected

# New CAS 540

- **Significant Assumptions**
- Whether
  - Appropriate
  - Give rise to indicators of possible management bias
  - Consistent
  - Management has intent to carry out course of action and capability to do so

# The WHY

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- **Once again, why we do the things we do (judgments and estimates)?**

# IAS 1.122

- **Requires disclosure of judgments** (apart from those involving estimates) that management has made in applying accounting policies

# IAS 1.125

- **Requires information** about the assumptions the entity makes about the future, and other significant sources of estimation uncertainty



# The Difference

- NOT that one requires judgment and the other doesn't
- Simply that judgments under IAS 1.122 **explicitly exclude** those that involve estimates

# Keep in Mind

- IAS 1.122 and 125 are primarily concerned with
  - The **most complex and/ or subjective** judgments and estimates
  - Uncertainty (assumptions or estimates) that presents a **risk of material misstatement of carrying amounts** within the next year

# Common Judgments

- Useful lives and depreciation of assets
- Functional currency
- Convertible notes (liability or equity)
- Impairment (what constitutes a triggering event)
- Business combinations vs asset acquisition

# How do you support Judgments?

- **D**ocument them
- **D**emonstrate you understand the facts
- **D**etail the process used
- **D**escribe why it is common to the industry
- **D**iscuss the alternatives considered
- Examples
  - *Business combination rather than asset acquisition*
  - *Useful life of intangible asset*
  - *Selected valuation approach*

# Expend Efforts Wisely

- The higher the complexity, the more need there is for clear documentation

# Common Estimates

- Biological assets (stage of growth, costs, yields, etc)
- Share-based compensation (expected life, volatility)
- Fair value of financial instruments (probabilities, etc.)
- Purchase price allocations

# Common Estimates

- Impairment testing (inputs used in the determination of FVLCTD and VIU)
  - **R**evenues
  - **C**osts
  - **T**axes\*
  - **W**orking capital\*
  - **C**apital expenditure\*
  - **M**arket participant assumptions\*

# How do you support Estimates?

- **Document** them
- **Demonstrate** that they are
  - Common to the industry (Consistent with market participants)
  - Reference to budgets / forecasts etc
  - Supportable (mechanics – the how and why)\*
  - Internally consistent
  - Tie to facts (Look harder)
  - Free of bias /Include sensitivities



# Good Disclosure

- Good disclosure describes
  - The **issue, areas affected**, why **relevant**
  - **How** it was **resolved**
  - The **support** for that resolution
  - The **alternatives** considered

# More specifically

- Good disclosures
  - Distinguish between
    - **Key judgments** in applying accounting policy
    - **Assumptions** and other sources of estimation uncertainty
  - Explain the judgments ... and their effect on the FS
  - Contain the **key sources** of estimation uncertainty
  - Include **sensitivities/ ranges** of outcomes

# The Takeaway

- **Why to we ask the questions we do (or will)**
  - We have to

# The Takeaway

- **Characteristics of well supported judgments**
  - **D**ocument
  - **D**emonstrate
  - **D**etail
  - **D**iscuss

# The Takeaway

- Good disclosure
  - **Distinguish** between key judgments estimates
  - Clearly **explain** the judgments made and their effect on the FS
  - Contain the **key sources of estimation** uncertainty
  - Include **sensitivities**/ ranges of outcomes

# The End

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- Thank you