# Methodological Approach to the Audit of Accounting Estimates

**Viktor Shatskov**
Postgraduate student,
State Tax University, Ukraine
ORCID: https://orcid.org/0000-0002-0699-0696

DOI: https://doi.org/10.32782/2707-8019/2024-2-23

***Abstract**. The audit of accounting estimates has its own specific features due to regulatory requirements. Accounting objects often require complex accounting estimates, so auditors should carefully review the valuation methods and assumptions used, as they may affect the financial results of the enterprise. However, the issues related to the audit of accounting estimates are not well researched in the scientific environment, and there is a lack of a conceptual model of accounting estimates and a methodological approach to the audit of accounting estimates. Therefore, the purpose of the article is to develop recommendations that could be important tools for conducting an effective audit of accounting estimates in accordance with the requirements of the International Standard on Auditing. To solve the tasks, the following methods were used: dialectical method – to form the concept of research; structural and logical modelling – to build a conceptual model of accounting estimates; logical generalization – in formulating a methodological approach to the audit of accounting estimates. A conceptual model of accounting valuation has been developed using the structural approach, with allocation of its most important components in the following blocks: data; valuation approaches and methods; assumptions: valuation uncertainty; regular review; transparency requirements. The conceptual model of accounting estimates provides for the identification of key assumptions within the selected methods, which helps to understand the degree of uncertainty in estimates and to adapt accounting estimates to changes in the external environment. methodological approach to the audit of accounting estimates. A methodological approach to the audit of accounting estimates has been developed, which is a clear multi-stage tool for auditors conducting an audit in accordance with international auditing standards. This approach is based on understanding the process by which accounting estimates are developed, identifying and assessing the risks of material misstatement; verifying accounting estimates using one or a combination of three main approaches: obtaining audit evidence from events occurring up to the date of the auditor's report; testing how management made the accounting estimate; and developing an auditor's point estimate or range. The main conclusions and further directions of research are formulated.*

***Keywords:** accounting estimate, method, assumptions, data, international standard on auditing.*
***JEL Classification:** M41, M42*

## 1 Introduction

Accounting estimates represent areas of greatest risk and complexity in the audit, and therefore require a special approach to obtaining audit evidence and appropriate professional skepticism. An accounting estimate refers to the process of measuring or recognizing/non-recognizing a transaction or event in the financial statements, which usually involves subjective assumptions and estimation uncertainty, and therefore accounting estimates vary widely in nature.

By their nature, accounting estimates are subject to uncertainty, complexity and subjectivity, which inherently create a source of risk of misstatement and make the estimates susceptible to management bias. As these factors increase, the risk of material misstatement of the financial statements increases. Auditors exercise professional skepticism to cast doubt whenever information and audit evidence indicate that a material misstatement may have occurred, whether due to fraud or error. This includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and preservation, where appropriate.

The auditors apply professional skepticism to accounting estimates, taking into account various factors that may cause inherent risks, and maintain professional skepticism throughout the audit, including when performing risk assessment procedures. The importance of professional skepticism increases when accounting estimates are subject to a greater degree of estimation uncertainty or are more highly affected by complexity or subjectivity.

The development and disclosure of accounting estimates in the face of uncertainty arising from changes in market conditions and technological advances presents certain significant challenges, including subjectivity of estimates due to different approaches and professional judgement, insufficient information and inadequate disclosure of methods and assumptions, failure to revise accounting estimates in response to changes in the economic environment and to adapt accounting estimates, lack of transparency in financial statement disclosures, and other.

Few scientific works are devoted to the problems of auditing accounting estimates (Ciurdaş, 2022; Oyewo, Emebinah & Savage, 2020; Korinko, 2012), most studies only consider accounting estimates as a result of the auditor's professional judgement (Stefan-Duicu, 2015; Razborska & Lesik, 2019; Sherstyuk, 2016; Tomchuk & Fabianska, 2018). This indicates the relevance of the study on the methodological approach to the audit of accounting estimates.

## 2 Conceptual Model of Accounting Estimates

Accounting estimates should be reasonable, consistent with past performance and relevant to current market conditions. To address the issues arising from the development and disclosure of accounting estimates, has developed a conceptual model of accounting estimates using a structural approach, according to which an accounting estimate is considered as an integral set of elements and a set of relationships between them. This approach provides a systematic and detailed analysis of all elements of an accounting estimate, taking into account their interrelationships and role in the overall context of financial reporting. The conceptual model identifies the most important components of an accounting estimate in the following blocks (Fig. 1):

– block – data: all the necessary data for the valuation, which may be sourced from financial reports, market price data, sales reports, technical documentation, data on market conditions, industry trends and any other objective information. The data may be represented by historical data on previous conditions, trends and transactions, as well as forecast data. Data can be used either as a direct input to an approach or method or to develop an assumption;

– block – valuation approaches and methods: the measurement method used to make an accounting estimate in accordance with the relevant measurement basis. the valuation method used, i.e., includes the applicable model and the basis for its selection. The variability of valuation approaches and methods depends on regulatory and accounting standards, the purpose of the valuation, the nature of the item, industry specifics, economic and market conditions, availability and quality of information and other factors;

– block – assumptions: judgements or decisions made in areas that involve a certain degree of subjectivity or uncertainty in the choice and range of various parameters. The choice and range of assumptions is dependent on the regulatory framework and standards, historical financial performance, financial strategy, management's experience and subjective judgement, industry specifics, economic environment and other factors;

– block – estimation uncertainty: the susceptibility of accounting estimates and related disclosures to a lack of measurement accuracy. Estimation uncertainty is an inherent risk factor and arises when there are limitations on the availability of knowledge or data required to develop the estimate. Any accounting estimate involves a degree of uncertainty and must be viewed in the context of the methods and assumptions used. Estimates that require making judgements and assumptions about the long-term future are more susceptible to a higher degree of uncertainty;

– block – regular review: Establishing and maintaining a regular process for updating and reviewing accounting estimates, and revising accounting estimates whenever significant changes in economic or market conditions occur;

– block – transparency requirements: ensuring compliance with international accounting and reporting standards; providing detailed documentation of all assumptions, methods and inputs used in the valuation process; appropriate disclosure of accounting estimates in the financial statements, including key assumptions and their impact on key financial statements, which should be transparent and understandable to its users.

## 3 Methodological Approach to the Audit of Accounting Estimates

When conducting an audit of accounting estimates, auditors are guided by the provisions of ISA 540, Auditing Accounting Estimates and Related Disclosures (ISA 540). However, these provisions are not systematized as a methodological approach with a sequence of detailed steps. To address this gap, has developed a methodological approach to the audit of accounting estimates of enterprises, which focuses on the practical application of international auditing standards

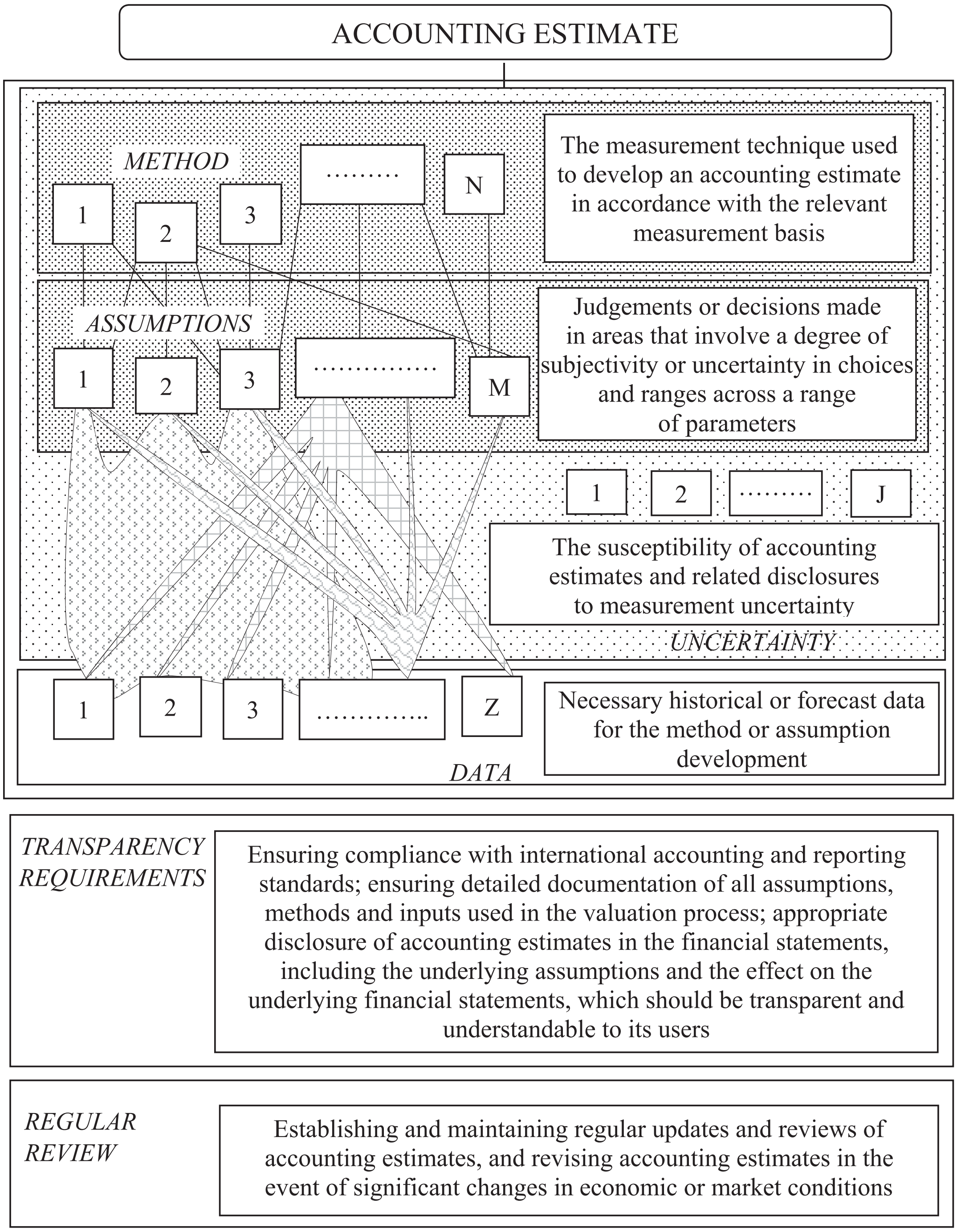


**Figure 1** Conceptual model of an accounting estimate

*Source: compiled by the author*

based on our own professional experience and best practices (Fig. 2).

The initial stage of a methodological approach audit is to understand the process by which accounting estimates are developed by an entity, including identifying regulatory factors; determining how management understands and addresses accounting estimate uncertainty; and understanding the elements of an accounting estimate: method, assumptions and inputs.

After obtaining a detailed understanding, the risks of material misstatement are identified and assessed and appropriate audit responses are developed. A retrospective review is performed for those accounting estimates for which a risk of material misstatement can be reasonably determined in the current year or where a risk of material misstatement existed in a prior year. When identifying risks of material misstatement, the extent to which an accounting estimate is

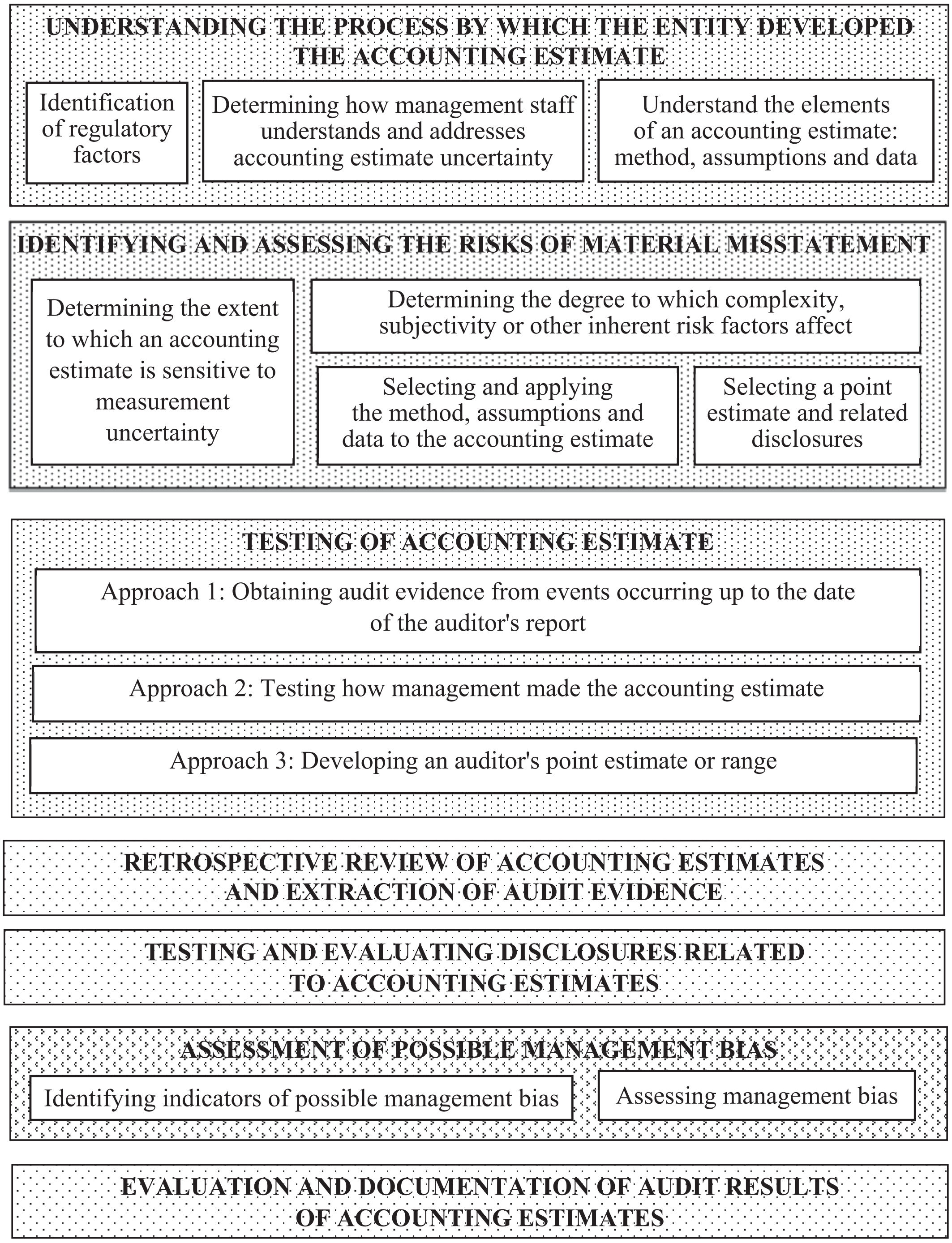


**Figure 2** Methodological approach to the audit of accounting estimates

*Source: compiled by the author*

susceptible to measurement uncertainty and the degree to which complexity, subjectivity or other inherent risk factors affect the choice (selection risk) and application (application risk) of a method, assumptions and inputs, management's choice of a point estimate and related disclosures in the financial statements are identified and assessed.

An accounting estimate is reviewed using one or a combination of three main approaches: obtaining audit evidence from events occurring up to the date of the auditor's report; testing how management made the accounting estimate; and developing an auditor's point estimate or range (ISA 540).

Testing and evaluating disclosures related to accounting estimates includes assessing whether they are appropriate in the context of the applicable financial reporting framework and the entity's disclosures about estimation uncertainty, based on complexity and significance.

Based on the identified indicators of possible management bias in accounting estimates, they are assessed. The final step is to evaluate and document the results of the audit procedures.

**4 Conclusions**

An audit of accounting estimates requires a methodological approach that takes into account all the specific risks and uncertainties associated with the current situation and reduces subjectivity in the estimates. The audit of accounting estimates requires a framework that contributes to the accuracy, objectivity and transparency of financial statements. To address this need in the face of uncertainty, the following practically orientated guidance has been developed.

A conceptual model of an accounting estimate has been developed using a structured approach, which includes the following components: inputs (what is required to disclose an accounting estimate), valuation approaches or methods (suggested by international standards), assumptions (range, selection procedure), measurement uncertainty (factors that affect the measurements), regular review (how often to review), and transparency requirements (disclosure in the notes to the financial statements). The use of a structured approach will provide detailed, reasonable information to improve the audit process, as clear criteria and assumptions allow for effective testing of the adequacy of accounting estimates and verification of financial information. It was also important to pay attention not only to the accuracy of the estimates, but also to their transparency in the process of documentation and disclosure. Regular review, proper documentation and compliance with applicable standards can significantly enhance the reliability of financial statements.

The developed methodological approach to the audit of accounting estimates is a practical methodological recommendation for auditors, as it covers the main requirements of the international standard on auditing and provides clear instructions for analyzing and verifying the estimation procedures related to accounting estimates. Using this approach will help auditors ensure the quality of financial statements and compliance with regulatory requirements.

The direction for further research is to develop recommendations on the procedure for verifying accounting estimates using three approaches: obtaining audit evidence from events occurring up to the date of the auditor's report; testing how management made the accounting estimate; and developing an auditor's point estimate or range.

**References**

Ciurdaș I. (2022). *Accounting estimates – Risks and challenges in the audit mission. Business administration.* Université Côte d’Azur; Universitatea Babeș-Bolyai (Cluj-Napoca, Roumanie). 159 p.

Oyewo B., Emebinah, E., Savage R. (2020). Challenges in auditing fair value measurement and accounting estimates: Some evidence from the field. *Journal of Financial Reporting and Accounting.* vol. 18 no. 1. pp. 51–75. DOI: https://doi.org/10.1108/JFRA-01-2019-0002

Korinko M. D. (2012). Audyt oblikovykh otsinok: dokumentalne zabezpechennia formuvannia vysnovkiv audytora [Audit of accounting estimates: documenting the formation of auditor's conclusions]. *Visnyk ZhDTU – Bulletin of ZhSTU.* no. 1 (59). pp. 95–96. DOI: https://doi.org/10.26642/jen-2012-1(59)%20Ч.1-95-96 (in Ukrainian)

Stefan-Duicu A. & Stefan-Duicu V. M. (2015) Using the Professional Judgment within the Financial Auditor's Profession. *Global Economic Observer*. "Nicolae Titulescu" University of Bucharest, Faculty of Economic Sciences; Institute for World Economy of the Romanian Academy. vol. 3(1). pp. 141–143

Razborska E., Lesik L. (2019). Formuvannia profesiinoho sudzhennia u sferi bukhhalterskoho obliku ta audytorskoi praktyky. [Formation of professional judgment in the sphere of accounting and audit practice]. *Finansy, oblik, banky – Finance, accounting, banking*. no. 1 (24). pp. 159–168. DOI: http://dx.doi.org/10.31558/2307-2296.2019.1.17 (in Ukrainian)

Sherstiuk O. L. (2016) Aspekty zastosuvannia profesiinykh sudzhen audytora [Aspects of applying auditor's professional judgement]. *Problemy teorii ta metodolohii bukhhalterskoho obliku, kontroliu i analizu – Problems of theory and methodology of accounting, control and analysis*. no. 2–3 (35). pp. 459–471. DOI: https://doi.org/10.26642/pbo-2016-2-3(35)-459-471 (in Ukrainian)

Tomchuk O. V., Fabiyanska V. Yu. (2018) Zastosuvannia profesiinoho sudzhennia audytora v konteksti rozvytku mizhnarodnykh standartiv audytu [Applying the professional judgment of the auditor in the context of the development of international auditing standards]. *Ekonomika. Finansy. Menedzhment: aktualni pytannia nauky i praktyky – Economics. Finance. Management: topical issues of science and practice*. no. 1. pp. 68–81 (in Ukrainian)

ISA 540 (Revised) “Auditing Accounting Estimates and Related Disclosures”. Available at: https://www.iaasb.org/publications/isa-540-revised-auditing-accounting-estimates-and-related-disclosures-9