

ACCOUNTING AND AUDIT

PROFESSIONAL COMPETENCE FOR USING ACCOUNTING ESTIMATES IN CORPORATE FINANCIAL STATEMENTS

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Abstract: The IAS adopted in Bulgaria following its accession to the European Union introduced some new terms in the field of accounting, such as “accounting policy”, “accounting estimate”, and “accounting error”. Generally, the indigenous scepticism of professional accountants is an obstacle to their accepting the new knowledge and points of view and subsequently applying them in practice. The aim of this paper is to investigate the possibilities of unifying the professional competence of accountants and auditors in terms of using accounting estimates in financial statements of non-financial enterprises in compliance with the accounting legislation in force.

In order to achieve this aim, the author has tried to outline the different meanings attributed to this term by accountants and auditors in related standards.

Keywords: professional competence, accounting estimate, conceptual views, financial statements, applicable standards.

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Introduction

Accountants' professional competence is essential for creating financial information according to the established accounting standards. "It is often provided for by laws and regulations. However, the requirements

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PROFESSIONAL COMPETENCE FOR USING ACCOUNTING ESTIMATES ...

are not always sufficient for achieving the required quality." (Veysse A., 2014, p. 1). It is instrumental for the implementation of new ideas, techniques, and approaches in order to establish competitive advantages based on original managerial accounting assessments and solutions, such as accounting estimates (AEs). The specific characteristics of AEs are difficult to track in financial statements. They are rarely used in practice because of the uncertainty of their tax interpretation.

"The aim of the audit is to increase the level of confidence of the intended users of financial statements." (Ivanov, Kostova, 2012, p. 68) Auditor's professional competence is associated with the opinion on the reliability in all material aspects of the audited financial statements as well as on the true and fair representation of the financial position of the audited entity in accordance with the applicable financial reporting regulations. The auditor's responsibility is to obtain a reasonable degree of certainty and to draw a report regarding the compliance of the financial statement with the financial reporting regulations in force. In order to obtain a reasonable degree of certainty, the auditor processes sufficient and relevant audit evidence to mitigate the audit risk to a sufficiently low level adhering to the principles set out in the International Standards on Auditing (ISA).

Accounting estimates in accounting

The use of accounting estimates is a controversial issue in accounting. Accounting legislation is generally vague and does not provide for a methodology for their use. This is why the interpretations of this problem in theory and practice may be ambiguous and controversial. Generally, the use of AEs is avoided because they can easily be mistaken for accounting errors, changes in accounting policy, non-compliance with tax regulations, or financial misstatement.

The term "accounting estimate" was introduced by the International Accounting Standards (IAS). After the changes in IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", which supersedes IAS 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes

in Accounting Policies”², the term “estimate” was replaced with the term “accounting estimate”. Presently there is no legal interpretation or definition of the term “accounting estimate” but only a definition of the term “change in accounting estimate”.³ This adds to the general uncertainty about and the controversial interpretations of the practical use of accounting estimates.

Generally, estimation excludes the “accuracy” of financial information associated with AEs. “The main requirement for accounting estimation is the use of reasonable estimates. It should not compromise the reliability of the financial statements.” (Bonev J., 2014, p. 3). However, the “subjective” assessment of the management should always be based on a *concrete managerial decision, past experience, good practices, or expert opinion that must be justified through measurable indicators* (time, value, quantity, quality, etc.) so that convincing evidence can subsequently be submitted to the control authorities.

As a result of many years of research, analysis and reviews of publications related to AEs, the author has realised the need to define their characteristics. This need is also supported by the nature of the managerial decision, which is always associated with the expected benefits and obligations associated with assets and liabilities in the normal course of business. The term “accounting estimate” is defined (Staneva, 2016, pp. 253-254) as: “a **measurable amount** associated with a **managerial decision** on the **expected economic benefit** of a particular **asset or liability** based on existing or new, **uncertain (approximate, hypothetical) information, experience, or interpretation of facts, phenomena and processes** associated with the assessment of the **carrying amount of assets, liabilities, or components of equity.**”

Based on the above definition, the author (Staneva, 2016, p. 254) has determined the main characteristics that unambiguously distinguish AEs from other accounting assessments – the possibility to choose a measure; the possibility of a subsequent change in the value of the originally determined AE measure; managerial decisions; time of

² IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors” is applicable as of 1 Jan. 2005.

³ See Art. 5 of IAS 8.

PROFESSIONAL COMPETENCE FOR USING ACCOUNTING ESTIMATES ...

occurrence of the managerial decision; expected economic benefit associated with the assets/liabilities; economically justified expectation or probability and purpose of the assessment.

Table 1 shows five criteria that are applicable for categorization of the various types of accounting assessments.

*Table 1.
Criteria for categorization of accounting assessments*

	Criteria	Type of accounting assessment		
		Initial (current)	Subsequent (periodic)	Accounting estimate
1.	Type of accounting information used	Accurate values	Approximate values	Approximate values, expectations and probabilities
2.	Assessment time	Initially, at the time of acquisition	Periodically, by managerial decision	Initially, by managerial decision
3.	Use of approximate values	No	Yes	Yes
4.	Conditions for change	The initial is replaced by subsequent	Changed by decision of the management and at certain periods according to the applicable accounting standards	Changed by decision of the management according to the expected benefit
5.	Assessor	Accountant	Accountant and/or licensed assessor	Accountant and/or external specialist

Audit of Accounting Estimates

The audit of accounting estimates is provided for by ISA 540 "Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures." This standard on auditing defines the term "accounting estimate" as "an approximation of a monetary amount in the absence of a precise means of measurement." The term is used for an

amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. The outcome of an accounting estimate is the actual monetary amount, which results from the resolution of the underlying transaction, event or condition addressed by the accounting estimate. Therefore, there are no differences in the perceptions of accountants and auditors regarding the **reporting of accounting estimates** in financial statements.

Fair value and AEs

There is, however, a significant difference between the meaning of the term “fair value” used for auditing purposes and the meaning of the same term in the international accounting standards with respect to accounting estimates, i.e. the underlying concepts of “fair value” and “accounting estimate.” The author proposes a model for their practical differentiation based on comparative analysis of the main characteristics that define the accounting estimate shown in Table 2 below.

*Table 2.
Model for practical differentiation between AEs and fair value*

	Comparison criteria	Fair value (assessment)	Accounting estimate
1.	Type of accounting information used	Market values	Approximations, estimations, probabilities
2.	Assessment time	Periodically, following the initial assessment and by managerial decision upon occurrence of certain market conditions	Initially at acquisition or upon the occurrence of a certain condition (provision), by managerial decision
3.	Conditions for change	Changed by decision of the management and at certain periods according to the applicable accounting standards	Changed by decision of the management according to the expected benefit
4.	Determined by	Market participants	Management
5.	Assessor	Accountant and/or licensed assessor	Accountant and/or external specialist

PROFESSIONAL COMPETENCE FOR USING ACCOUNTING ESTIMATES ...

From accounting point of view, fair value may be considered in two aspects – as a value used in various accounting valuation methods based on fair value and as a fair market value.

The new IFRS 13 *Fair Value Measurement* provides for valuation techniques to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A change in a valuation technique (the market approach, the cost approach and the income approach) or its calibration is appropriate if the change results in a measurement that is equally or more representative of fair value in circumstances, such as new market development; access to new information or change/unavailability of information previously used; improvement of valuation techniques and change of market conditions.

Revisions resulting from a change in the valuation technique or its application is accounted for as a change in accounting estimate in accordance with IAS 8.⁴ In fact, this may result in a **confusion regarding the differentiation** between fair value valuation techniques and changes in accounting estimates, although the disclosures in IAS 8 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

The above distinction explains the role of fair value in determining the fair market value. The concept of fair value is provided for by various accounting and auditing standards. In addition to the data available from various economic sources (e.g. stock quotes and market prices), we can also use special valuation techniques for observable non-current assets and liabilities that are difficult to value using observable market inputs. Usually, these valuations are made by licensed valuers in a subsequent valuation (revaluation or impairment). The valuation is made according to strictly defined rules by an external valuator, whose participation is required in most cases by law while AEs are made by the management of the enterprise or by an external expert.

From a conceptual point of view, neither the IFRS nor the new NAS provide a single concept regarding the valuation base and refer to either of the two basic accounting models – “Historical cost” or “Fair value.” This is

⁴ See Art. 66 of IFRS 13.

why each international or national accounting standard gives a definition for and provides for a valuation technique, which does not exclude the possibility of mixing the accounting models depending on the applied valuation base, i. e. the use of more than one valuation technique. At this stage, financial statements are prepared on the basis of the historical cost accounting model. Fair value matches the AEs only when the entity's financial statements are prepared using the fair value accounting model. In this case, it matches the book value resulting from the management decision for the accounting estimate and the initially recognized fair value of the asset. The economic nature of fair value and AE is closely related but different in content.

To draw a conclusion on the reasonableness of accounting estimates, the auditor must review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates. On the grounds of the obtained written representations from management and, where appropriate, those charged with governance, auditors draw conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks and indicators of possible management bias, if any.

“The auditor should obtain sufficient and relevant evidence regarding the reliability of these items. Thus the financial statement prepared according to the general financial reporting framework would satisfy the overall need for financial information of the general public as well as of specific users.” (Kostova S., sp. Dialog, 2014, p. 40)

ISA 540 gives the following examples of indicators of possible management bias with respect to accounting estimates:⁵ changes in an accounting estimate or the method for making it, where management has made a subjective assessment that there has been a change in circumstances and the use of an entity's own assumptions for fair value accounting estimates when they are inconsistent with observable marketplace assumptions. The first example contradicts the accounting

⁵ Виж A125 на МOC 540.

PROFESSIONAL COMPETENCE FOR USING ACCOUNTING ESTIMATES ...

concept of making accounting estimates. The difference is that auditors assume that every change of accounting estimates is an indicator for management bias, while in the established accounting practices a change in accounting estimates may result from changes in the underlying circumstances. When the management has adopted an internal model for making accounting estimates or when the method of estimation used differs from the method commonly used in the concrete sector or environment, there are conditions for reporting a significant risk for material misstatement.

To check the probability that an accounting estimate gives rise to a significant risk, the auditor is required to obtain an understanding of the entity's control and information regarding the experience and qualification of the persons responsible for making the accounting estimates as well as of control related to procedures for making and approval of accounting estimates.

When the management has used an expert with the required qualification and experience in making accounting estimates, the auditor obtains understanding of the controls by checking the reasons for using external experts for making the accounting estimate. For example, an entity in the mining industry needs technical expertise for the evaluation model for accounting estimates of the natural resources that includes frequency of occurrence of specific conditions. Note that AEs are made by **accounting experts** on the basis of a measurable indicator that may require the expert opinion of an expert who is not a specialist in accounting. Therefore, it is clear that there is a slight difference between auditors' and accountants' perception of the role of the external expert in making AEs. Entities often use external experts as independent valuers who evaluate the assets adhering to professional competence principles such as "possessing and maintaining professional knowledge of applicable law and the standards and methods required for performing valuations." (Independent Valuers Act, 2008). This expertise is usually not related to the entity's accounting estimates but is perceived differently by accountants and auditors. The criterion for distinction is the purpose of the expertise - an accurate assessment of an asset's value at a given time based on predetermined valuation

methods and methods in accordance with applicable valuation standards that is different from the conditions for a change in the AEs based on management's estimation of the expected economic benefits.

Therefore, we may conclude that auditors' and accountants' approaches slightly differ, which creates opportunities for different interpretations and subjectivism in reporting and auditing of AEs in the entity's financial statements. Auditors seek to obtain audit evidence for completeness and accuracy in justifying the assumptions used by the management of the entity being audited, while the accounting standards do not provide for specific parameters and limits for such completeness and accuracy. Some assumptions of the management may be based on specific information that may have been obtained illegally in some cases. Due to its nature, this information is most often classified as a trade secret, the disclosure of which will certainly harm the economic interests of the entity. This is a fair enough reason not to disclose such information to the auditor. On the other hand, the reliability of such illegally obtained information is very likely to be challenged by the auditor and therefore the management's assumption based on such information may not be considered acceptable. Assuming that the auditor trusts the management of the audited entity and assumes that the information thus obtained is reliable, the audit conclusion will not be justified. Thus, the problem of obtaining reliable audit evidence may undermine the results of the audit report and the AEs may be classified as misstatements.

Conclusion

We may thus conclude that professional competence and effective control over the use of AEs in the financial statements of enterprises can be achieved by harmonizing accountants' and auditors' understanding and interpretation of the concepts, processes and facts associated with the AEs defined in the applicable accounting and auditing standards.

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CONTENTS

MANAGEMENT practice

THE ADMINISTRATIVE CAPACITY INDEX OF STATE ADMINISTRATION

Prof. Borislav Borisov, PHD..... 5

MANAGEMENT

THE CORE COMPETENCES OF POLISH INDUSTRIAL ENTERPRISES

Assoc.Prof. Dariusz Nowak, PhD..... 23

ACCOUNTING and audit

PROFESSIONAL COMPETENCE FOR USING ACCOUNTING ESTIMATES IN CORPORATE FINANCIAL STATEMENTS

Assoc. Prof. Valentina Staneva, PhD 44

POSSIBILITIES FOR OPTIMIZING THE REPORTING OF MONETARY FUNDS IN THE BANK ACCOUNTS OF BUDGETARY ORGANIZATIONS

Assist. Prof. Radi Stefchov Dimitrov, PhD 54

INFORMATION AND COMMUNICATIONS technologies

HOW TO ADD VALUE TO BUSINESS BY EMPLOYING DIGITAL TECHNOLOGIES AND TRANSFORMING MANAGEMENT APPROACHES

Natalia Altukhova, Ph.D.

Prof. Elena Vasileva, DEc

Prof. Vitaliy Yemelyanov, DScTech 71

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