

# CURRENT ISSUES FOR AUDITORS AND ACCOUNTANTS (of Latvian PIEs)

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## Current challenges /observations

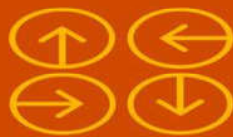
- AML + ISA 250 - Compliance with laws and regulations
- Bank + Insurance company audits ( incl use of audit experts, IT ( mainframe and modelers) experts, Valuation experts, Actuaries, Legal experts, etc etc.
- New Accounting standards in particular IFRS 9, IFRS 15 and IFRS 16 + IFRS 17
- Going Concern – proper assessment of management plans for next 12 months
- Audit v NAAE v AUP v consulting/advisory
- Revenue ( Significant risk of fraud in revenue recognition – rebuttable assumption)
- Fraud ( Significant risk of Management override of control – NOT rebuttable )
- ISQC 1 – firmwide quality control – ( new regulators are looking at this more closely )
- First year audits ( audit of opening balances + in general higher risk given less "CAKE" )
- Use of technology/Data Analytics

## Revised auditing standards coming

ISQM 1					
ISQM 2					
ISA 540	ISA 220	ISRS 4400	ISA 600	ISA 315	ISA 500
Effective periods beginning on or after:	May be effective as early as:	Expected to be effective for engagements commencing after:	May be effective for periods beginning on or after:	Expected to be effective some time during:	Not expected to be effective before:
<b>15 Dec 2019</b>	<b>15 Dec 2021</b>	<b>15 Mar 2021</b>	<b>15 Jun 2022</b>	<b>2021 or 2022</b>	<b>late 2022</b>

AND Consideration of audit standards for “less complex engagements”

### Standards that will be revised



**Change will be significant**

### Standards that will be revised

**ISA 540 (Revised)**

Periods beginning on/after December 15, 2019

ISA 220

**Management of quality at engagement level**

ISA 220

Requirements and guidance for engagement partners

Quality Management  
ISA 220, ISQM 1, ISQM 2

ISQM 1

**Quality management firm level**  
detailed requirements and guidance

Governance and leadership  
Engagement performance  
Acceptance and continuance  
Information and communication

Quality Management  
ISA 220, ISQM 1, ISQM 2

ISQM 2

**Quality management engagement quality reviews**  
detailed requirements and guidance

eligibility criteria  
appointments  
responsibilities  
cooling-off period

EQCR

Quality Management  
ISA 220, ISQM 1, ISQM 2

more granular requirements and guidance will affect the work of the EQCR

## ISRS 4400

- professional judgment
- practitioner's independence
- use of practitioner's expert
- report distribution restrictions

## Audit Regulators

- Committee of European Audit Oversight Bodies ( CEAOB ) and its Colleges
- Latvia MoF Commercial Companies Audit Policy and Oversight Unit
- LZRA

## CEAOB – European Common Audit Inspection Methodology ( CAIM)

CAIM established to “contribute to the harmonization of the inspections of audit firms across Europe.”

CAIM currently includes published programs in respect of

- Revenue ( 4 pages, 15 procedures )
- ISA 540 – Estimates ( 2 pages, 12 procedures )
- ISA 600 – Group Audits ( 3 pages, 25 procedures )
- Firmwide Quality Control ( 32 pages, >200 procedures )

## IFRS 9 Financial instruments

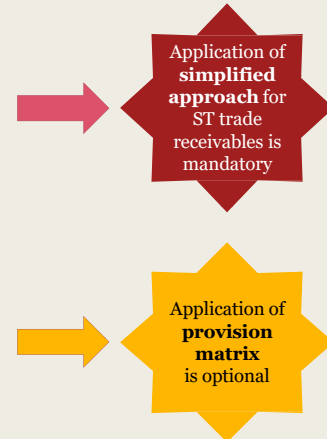
*Expected credit losses for trade receivables and other assets in practice*



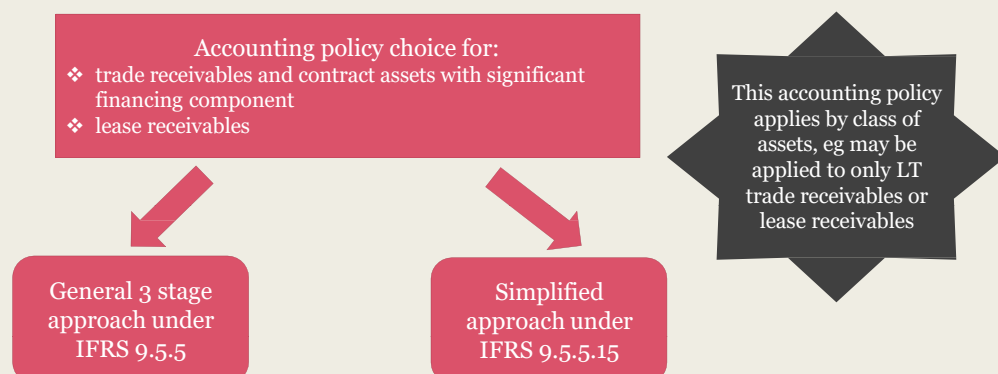
## Measurement of expected credit losses for short-term trade receivables and contract assets

### Technical guidance

- IFRS 9.5.5.15: an entity **should always measure the loss allowance at an amount equal to lifetime expected credit losses (ECL)** for trade receivables or contract assets in the scope of IFRS 15 that do not contain a significant financing component in accordance with IFRS 15
- An entity may use practical expedients when measuring expected credit losses. An example of a **practical expedient** provided in IFRS 9.B5.5.35 is the calculation of the expected credit losses on trade receivables using a **provision matrix**; the entity uses its historical credit loss experience for trade receivables, adjusted for forward-looking information to estimate the 12-month ECLs or the lifetime ECL on the financial assets as relevant



## Measurement of expected credit losses for long-term trade receivables, contract assets and lease receivables



# Thank you

## APPENDIX – illustrative worked example

### Measurement of expected credit losses for trade receivables



#### ***Background information***

- A manufacturing Company has trade receivable balances from two major corporate customers, A and B, as well as a large number of trade receivable balances from smaller clients
- The receivable balances from customer A and customer B are long-term and individually material, their carrying amounts at 31.12.2019 are EUR 2,200 thousand and EUR 1,000 thousand, respectively
- The trade receivables from smaller clients are short-term and their total carrying amount at 31.12.2019 is EUR 14,000 thousand
- The Company has chosen to measure ECL on short-term receivables using provision matrix

**How should the Company determine the total ECL for trade receivables at 31 December 2019?**

## APPENDIX – illustrative worked example - continued

## Corporate customers – accounting policy choice to apply general 3 stage approach

- **Large corporate customers**

- Trade receivables from customers A and B include a significant financing component and the Company has an accounting policy choice to either use the general 3 stage or simplified approach to calculating ECL. The Company has chosen to apply the general 3 stage approach to such receivables.
- The Company has not observed a significant increase in credit risk since the initial recognition of the receivable balance from Customer A (carrying value of EUR 2,200 thousand)
- Customer B appears to be experiencing liquidity problems and cancelled a large future order of goods from the Company – this resulted in a significant increase in credit risk related to the original receivables (carrying value of EUR 1,000 thousand), but there is no evidence of impairment

Stage 1

Stage 2

## APPENDIX – illustrative worked example - continued

## Corporate customers: measuring ECL using general approach

- **Probability of default**



- The investment rating was assessed based on some basic financial data. For Customer A the rating is from C2 to D3, with the middle point at **D1**. For Customer B the rating is from B3 to D1, with the middle point at **C2**.

*Probability of default – calculations based on the average from market data*

Rating/years	1	2	3	4	5	6	7	8
C2	0.73%	2.15%	3.87%	5.51%	6.96%	8.12%	9.21%	10.28%
C3	1.39%	3.57%	5.86%	8.09%	9.98%	11.75%	13.35%	14.86%
D1	1.92%	5.38%	8.83%	11.70%	14.08%	15.90%	17.70%	19.28%
D2	3.68%	8.32%	12.41%	16.02%	19.00%	20.92%	22.47%	23.69%
D3	5.66%	11.04%	15.34%	18.46%	21.31%	23.45%	25.25%	26.61%



## APPENDIX – illustrative worked example - continued

### Individual exposure – Customer A

#### Calculation of expected credit loss at 31.12.2019

	31.12.2019	31.12.2020	31.12.2021	31.12.2022	31.12.2023
Exposure at default	2 244	1 888	1 272	748	128
Cumulative probability of default	1,92%	5,38%	8,83%	11,70%	14,08%
Marginal probability of default	1,92%	3,46%	3,45%	2,87%	2,38%
Loss given default	100%	100%	100%	100%	100%
Discount factor	0,98	0,96	0,94	0,92	0,90
Expected credit loss:					
12-month expected credit loss	42	63	41	20	3

ECL if at stage 1	42
Lifetime ECL	169

12 months ECL

## APPENDIX – illustrative worked example - continued

### Individual exposure – Customer B

#### Calculation of expected credit loss at 31.12.2019

	31.12.2019	31.12.2020	31.12.2021	31.12.2022	31.12.2023
Exposure at default	1 020	790	530	220	-
Cumulative probability of default	0,73%	2,15%	3,87%	5,51%	6,96%
Marginal probability of default	0,73%	1,42%	1,72%	1,64%	1,45%
Loss given default	100%	100%	100%	100%	100%
Discount factor	0,98	0,96	0,94	0,92	0,90
Expected credit loss					
12-month expected credit loss	7	11	9	3	-

ECL if at stage 1	7
Lifetime ECL	30

Lifetime ECL

## APPENDIX – illustrative worked example - continued

## Expected credit loss of receivables from customers A and B

**Conclusion**

- Trade receivables from customer A (carrying value of EUR 2,200 thousand) are in stage 1 and ECL is determined as 12m expected credit losses at EUR 42 thousand
- Trade receivables from customer B (carrying value of EUR 1,000 thousand) are in stage 2 and ECL is determined as lifetime expected credit losses at EUR 30 thousand
- Total loss allowance on corporate customers' receivables is **EUR 72 thousand**

Had the Company applied simplified approach, the ECL allowance would have been higher:

EUR 169 th for A;  
EUR 30 th for B =>  
EUR 199 th in total

Disclosure requirements differ depending on the accounting policy choice

IFRS 7 requires separate disclosures by ECL stage, eg for ECL movements, movements in gross carrying amounts and exposure to credit risk (credit quality)

If the simplified approach is applied, the assessment of SICR is not necessary

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## APPENDIX – illustrative worked example - continued

## Trade receivables: example of provision matrix calculation

**Step 0**

*Breakdown of trade receivables into homogenous groups (based on shared credit characteristics)*

- Trade receivables grouped in line with historical or forecasted ECL experience – there may be different loss patterns for different customer segments. Consider: geographical region, product type, customer type or trade credit insurance
- The Company concludes that trade receivables from smaller customers represent a single homogenous group and there is no need to split them into categories for the ECL calculation

**Step 1**

*Define the period of sales and bad debts related to those sales*

- The Company defines one year as sufficient period of sales. Credit sales made during this period (i.e. trade receivables recognised)
- The total amount of bad debts incurred related to those sales (i.e. written-off with respect to the sales above)

**406,321**

**15,000**

## APPENDIX – illustrative worked example - continued

## Trade receivables: example of provision matrix calculation

**Step 2a***Calculate historical payment profile of the debtors**[Use historical data calculated in step 1]*

Total sales:	406,321	Total paid:	Ageing profile of sales (step 3):
Paid in 30 days:	(49,885)	(49,885)	356,436
Paid from 30 to 60 days:	(170,869)	(220,754)	185,567
Paid from 60 and 90 days:	(102,233)	(322,987)	83,333
Paid after 90 days:	(68,334)	(391,321)	<b>15,000</b> (written off)

## APPENDIX – illustrative worked example - continued

## Trade receivables: example of provision matrix calculation

**Step 2b***Calculate the historical loss rate**[Use ageing of payments determined in step 2 / credit loss on all sales]*

	Current sales	Sales payments outstanding after 30 days	Sales payments outstanding after 60 days	Sales payments outstanding after 90 days
Ageing profile of sales [1]	406,321	356,436	185,567	83,333
Loss: [2]	15,000	15,000	15,000	15,000
Loss rate (historical): [2]/[1]	<b>3.7%</b>	<b>4.2%</b>	<b>8.1%</b>	<b>18.0%</b>

## APPENDIX – illustrative worked example - continued

## Trade receivables: example of provision matrix calculation

**Step 3***Adjust the loss rates for current and forward looking information***Assumptions:**

- There is historical correlation between unemployment rates and the loss increase in unemployment rates is expected
- The sales and payment profile are expected to remain materially the same
- The loss rate was increased by 20%, to EUR 18 thousand

	Current receivables	Receivables paid from 30 to 60 days	Receivables paid from 60 to 90 days	Receivables paid after 90 days
Data from receivables ageing [1]	406,321	356,436	185,567	83,333
Loss: [2]	18,000	18,000	18,000	18,000
Loss ratio: [2]/[1]	4.4%	5.1%	9.7%	21.6%

## APPENDIX – illustrative worked example - continued

## Trade receivables: example of provision matrix calculation

**Step 4***Calculate the expected credit loss using the loss rates determined in Step 3*

	Total	Current [0 – 30 days]	30 – 60 days	60 – 90 days	More than 90 days
Trade receivable balances at 31.12.2019: [1]	14,000	7,760	2,940	2,300	1,000
Loss rate: [2]		4.4%	5.1%	9.7%	21.6%
Expected credit loss: [1] x [2]	<b>928</b>	<b>341</b>	<b>148</b>	<b>223</b>	<b>216</b>

**The total ECL on trade receivables from smaller customers: EUR 928 thousand**

## APPENDIX – illustrative worked example - continued

## Trade receivables: expected credit loss

**Summary**

- The total ECL recorded by the Company is EUR 1,000 thousand including EUR 72 thousand related to receivables from 2 major customers and EUR 928 thousand related to receivables from smaller customers
  - The Company should disclose movements in ECL separately for
    - ✓ ECL allowance measured at 12m ECL (Customer A),
    - ✓ ECL allowance measured at lifetime ECL due to a significant increase in credit risk (Customer B) and
    - ✓ ECL allowance measured at lifetime ECL under the simplified model (other trade receivables)
  - The Company should also disclose the gross carrying amount and exposure to credit risk separately, as explained above
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