



1 August 2017

Our Ref.: C/AASC

International Auditing and Assurance Standards Board  
529 Fifth Avenue, 6<sup>th</sup> Floor,  
New York  
NY 10017  
USA

Dear Sirs,

**IAASB Exposure Draft, Proposed ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures***

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory body in Hong Kong that sets auditing and assurance standards, ethical standards and financial reporting standards. We welcome the opportunity to provide our comments on the captioned IAASB Exposure Draft (ED).

We support the IAASB's commitment in revising the standard such that it stays relevant in the face of continually changing circumstances.

Our responses to the specific questions in the ED are included in the attachment. We trust that our comments are of assistance to the IAASB in deciding the next steps. If you require any clarification on our comments, please do not hesitate to contact our Selene Ho, Associate Director at [selene@hkiipa.org.hk](mailto:selene@hkiipa.org.hk).

Yours faithfully,

Chris Joy  
Executive Director

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**HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS'**  
**COMMENTS ON THE IAASB'S EXPOSURE DRAFT**  
**ISA 540 (REVISED) AUDITING ACCOUNTING ESTIMATES**  
**AND RELATED DISCLOSURES**

**Overall Questions**

- 1. Has ED-540 been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates?**

The extensive update provides the key principles for auditors to apply when auditing complex accounting estimates.

- 2. Do the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates?**

We believe the requirements and application material would reinforce the application of professional skepticism, but we strongly recommend that the IAASB explicitly mentions and explains the 'stand back' concept in the body of requirements under ISA 540, not in the explanatory material.

**Focus on Risk Assessment and Responses**

- 3. Is ED-540 sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk?**

The approach to scalability appears to be clear as set out in paragraph 15. However, there seems to be a lack of further guidance when the inherent risk is low. The requirements in 15(a) are elevated mostly from extant ISA 540. However, the relevant application material does not seem to have been elevated into ED ISA 540. Such guidance would still be helpful when there is low inherent risk, in particular when applying to SMEs.

In addition, we would like to make some observations for IAASB's consideration in relation to situations under paragraph 15(a):

- the key principles discussed in paragraphs 17-20 would also be relevant when performing paragraph 15(a)(ii);
- it would be useful to provide guidance for SMPs on how to develop a point estimate or range based on available audit evidence. The application material in A126-A134 for where the inherent risk is not low would also be relevant for paragraph 15(a)(iii);
- Paragraph 15(a) should also be drafted in the context of the applicable financial reporting framework;



**4. When inherent risk is not low (see paragraphs 13, 15 and 17–20):**

- (a) Will these requirements support more effective identification and assessment of, and responses to, risks of material misstatement (including significant risks) relating to accounting estimates, together with the relevant requirements in ISA 315 (Revised) and ISA 330?**

In principle, it appears to be a robust approach enabling auditors to apply the requirements to the engagement's facts and circumstances.

However, it would be clearer if the IAASB elevates the first sentence in paragraph A78 to paragraph 13 so that auditors are aware that the relevant factors currently listed in paragraph 13 are not exhaustive.

We support the suggestion of field testing and will encourage member firms to participate.

- (b) Do you support the requirement in ED-540 (Revised) for the auditor to take into account the extent to which the accounting estimate is subject to, or affected by, one or more relevant factors, including complexity, the need for the use of judgment by management and the potential for management bias, and estimation uncertainty?**

Overall, we support the requirement in paragraph 13 for the auditor to take into account the relevant factors. In paragraph A78, the guidance provides that there may be other relevant factors other than complexity, judgement and estimation uncertainty.

We would recommend the IAASB to include further guidance on what further work or procedures the auditor should consider for other factors such as

- matters to consider when there are changes in the requirements of the applicable financial reporting framework; impacting accounting estimates
- leveraging on the work carried out in other ISAs, e.g. ISA 240, ISA 250

- (c) Is there sufficient guidance in relation to the proposed objectives-based requirements in paragraphs 17 to 19 of ED-540? If not, what additional guidance should be included?**

We believe there is sufficient guidance for the requirements.

**5. Does the requirement in paragraph 20 (and related application material in paragraphs A128–A134) appropriately establish how the auditor's range should be developed? Will this approach be more effective than the approach of "narrowing the range", as in extant ISA 540, in evaluating whether management's point estimate is reasonable or misstated?**

We consider the requirement in paragraph 20 and related application material provide sufficient guidance for developing a point estimate or a range.

In paragraph A94 of extant ISA 540, there is guidance for auditors to refer to 'performance materiality' when evaluating the reasonableness of management's point estimate. We consider it useful to include similar guidance in the revised standard.

We also recommend that the IAASB explicitly states, in the last bullet point of paragraph A131, that any reference made to other comparable conditions, transactions, events or markets should be based on 'observable references' (i.e. not hear-say).



As previously noted in comments to Q3 above, we would recommend IAASB to clarify if the guidance in relation to developing the auditor's range would also be applicable in the situation when the inherent risk is low and is required to develop a point estimate or range in accordance with paragraph 15(a)(iii).

6. **Will the requirement in paragraph 23 and related application material (see paragraphs A2–A3 and A142–A146) result in more consistent determination of a misstatement, including when the auditor uses an auditor's range to evaluate management's point estimate?**

See comments in Q5.

#### **Conforming and Consequential Amendments**

7. **With respect to the proposed conforming and consequential amendments to ISA 500 regarding external information sources, will the revision to the requirement in paragraph 7 and the related new additional application material result in more appropriate and consistent evaluations of the relevance and reliability of information from external information sources?**

Whilst it's useful to include guidance in relation to external information sources, the scope of work in considering the relevance and reliability of information used as audit evidence has expanded.

From reading the conforming changes in paragraph A1C of ISA 500, it appears "external information source" is treated as the same level as "management's expert". We would recommend IAASB to consider if certain paragraphs in the Application and Other Explanatory Material should be elevated as part of the Requirements section. We believe paragraph A33A should be elevated as a Requirement.

In addition, the additional guidance in relation to external information sources seems to have been added without considering necessary changes to other parts or if those other parts are still applicable – e.g. the first bullet in paragraph A31 "The reliability of audit evidence is increased when it is obtained from independent sources outside the entity". Proposed Paragraph A33B may have an effect on the guidance in paragraph A31 – though the statement is still valid, it may need to be considered in line with the considerations in paragraph A33B.

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