MALAYSIAN INSTITUTE
OF ACCOUNTANTS

27 July 2017

Mr Matt Waldron
Technical Director, International Auditing and Assurance Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, 10017 USA

Dear Matt

INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD (IAASB) EXPOSURE DRAFT, PROPOSED INTERNATIONAL STANDARD ON AUDITING (ISA) 540 (REVISED), AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

The Auditing and Assurance Standards Board (AASB) of the Malaysian Institute of Accountants (MIA or the Institute) welcomes the opportunity to provide its comments on the International Auditing and Assurance Standards Board's (IAASB's) proposed International Standard on Auditing (ISA) 540 (Revised), *Auditing Accounting Estimates and Related Disclosures.*

The attachment sets out our responses to the questions contained in the Exposure Draft.

Yours sincerely,
MALAYSIAN INSTITUTE OF ACCOUNTANTS

DR. NURMAZILAH DATO' MAHZAN
Chief Executive Officer

Our comments to the questions are as follows:

Q1. Has ED-540 been appropriately updated to deal with evolving financial reporting frameworks as they relate to accounting estimates?

The AASB supports the initiatives taken by the IAASB in relation to the proposed ED-540. In particular, the AASB welcomes the stand back provision in paragraph 22 of the proposed standard as it re-emphasises the overall objective of auditing accounting estimates. The AASB recommends for the IAASB to consider enhancing this provision to take into consideration the auditor's understanding of the business model and environment to the extent that they affect the accounting estimates.

Further, the AASB recommends for the application guidance in the proposed standard to be expanded to reflect contemporary requirements of International Financial Reporting Standards (IFRS) in particular those relating to management's intention, for example:

(a) Business model test in IFRS 9 to classify financial assets at amortised cost requires management's intention to hold such financial assets to collect contractual cash flows. What is considered sufficient, appropriate audit evidence to support management's intention in ED-540?
(b) Assessment of lease period with embedded derivatives (e.g. renewal options and termination options) involves management's intention as well as assessment of environmental factors (e.g. economic conditions). Consequently, what is considered sufficient, appropriate audit evidence to support management's intention in ED-540?

Q2. Do the requirements and application material of ED-540 appropriately reinforce the application of professional skepticism when auditing accounting estimates?

The AASB agrees that the application of professional scepticism has been reinforced in the requirements on management bias in paragraph 24 and stand back provision in paragraph 22. There will be a certain level of judgement involved in deriving an accounting estimate by management and hence the existence of an element of management bias. Applying the principle of ISA 240, the AASB recommends the IAASB to consider that when the inherent risk of the accounting estimate is assessed as significant, the auditor shall, based on the presumption that management bias exists, address the bias according to the requirements of paragraph 24. If the auditor concludes that management bias does not exist, the auditor shall include in the audit documentation the reasons for the conclusion.

Q3. Is ED-540 sufficiently scalable with respect to auditing accounting estimates, including when there is low inherent risk?

The AASB is of the view that the ED-540 is sufficiently scalable and it addresses the assessed risk of accounting estimates accordingly.

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Comments (continued)

Q4. 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?

(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?

(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?

(a) The ED-540 uses the term inherent risk in response to the assessed risks of material misstatements. Application material A42 of ISA 200 states that the ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risk of material misstatement." There appears to be inconsistency in the use of terminology. If the IAASB has a specific reason to specify only inherent risk, perhaps this should be made clear in the application material of the proposed standard.

The ED-540 adopts the term "when inherent risk is not low" in paragraph 15(b). Such a concept is not defined in ISA 315 and the ED-540 also does not specify the response to "when inherent risk is not low". The audit procedures referred to in paragraphs 17-19 only address the situation when the risk of material misstatement is assessed to be a significant risk in accordance with paragraph 13.

In addition, there should be consequential amendments to be made to ISA 315 or ISA 330 regarding understanding control activities and responses to assessed risks in order to maintain consistency in obtaining additional persuasive audit evidence when the assessed risk of material misstatement is higher.

(b) The AASB recommends for the IAASB to enhance paragraph 15(b) to clarify when the requirements in paragraph 17-20 would be applicable. For example, there should be clarity on whether it is required that some level of further audit procedures be performed to address all 3 factors as appropriate while more persuasive audit evidence needs to be obtained for factors resulting in significant risk; or further audit procedures are only required for factors resulting in significant risk.

(c) Please see our comment in part (b) above and Question 1.

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Comments (continued)

Q5. 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?

The AASB supports the requirement in paragraph 20 that is clearer than the extant ISA. The AASB notes the practical challenges in developing auditor's range particularly in the current business environment that is subject to rapid changes and disruptions. It may be particularly challenging to obtain audit evidence on industry benchmark or past trend to appropriately support the auditor's range. Nevertheless, the AASB is of the view that clarity in the audit procedures where the auditors' range exceeds performance materiality would be helpful.

Q6. 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?

The AASB is of the view that the requirement in paragraph 23 and related application material will result in more consistent determination of a misstatement.

Similar to question 5, the AASB notes the practical challenges in applying this requirement. However, there may be unintended consequences of this requirement as the management may tend to rely on the auditor's range.

Q7. 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?

The AASB is of the view that the revision to the requirement in paragraph 7 and the related new additional application material will result in more appropriate and consistent evaluations of the relevance and reliability of information from external information sources.

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Comments (continued)

Q8. In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:

(a) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-540.

(b) Effective Date—Recognizing that ED-540 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods ending approximately 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

(a) Not applicable.

(b) As there are substantive revisions to the standard, the AASB is of the view that the proposed effective date is reasonable and provides a sufficient period for the AASB to support effective implementation of the final revised standard.

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