Suruhanjaya Sekuriti
Securities Commission
Malaysia

AUDIT OVERSIGHT BOARD ANNUAL INSPECTION REPORT 2022

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2022

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The cut-off date for the data included in this report was 31 December 2022.

CONTENTS

MISSION STATEMENT

Fostering high quality independent auditing to promote confidence in the quality and reliability of audited financial statements of public-interest entities and schedule funds in Malaysia.

VISION STATEMENT

To promote high standards of audit quality and to foster public trust in the audit profession.

OUR REMIT

The Audit Oversight Board was establised under Part IIIA of the *Securities Commission Malaysia Act 1993*.
Our mandate are as follows:

- To assist the Securities Commission Malaysia in discharging its regulatory function by regulating auditors of public-interest entities and schedule funds to promote confidence in the quality and reliability of the audited financial statements
- To exercise oversight over any person who prepares a report relating to financial information of public-interest entities and schedule funds in relation to capital market activities

INTRODUCTION

CONTINUED FOCUS ON AUDIT QUALITY IN A DYNAMIC AND CHALLENGING ENVIRONMENT

Year 2022 marks the sixth edition of the *Annual Inspection Report* (AIR) issued by the Securities Commission Malaysia's (SC) Audit Oversight Board (AOB). While it is recognised that the responsibility for improving audit quality resides with audit firms (firms), the AOB has over the years sought to influence the progress towards independent high-quality audits through its various efforts. The AIR aims to enhance the AOB's commitment in providing greater transparency and availability of information to the various stakeholders in the Malaysian financial reporting ecosystem. The AOB hopes this annual publication will create awareness of the common findings affecting auditors and assist in meaningful conversations with all key stakeholders about corporate reporting, audit quality and corporate governance.

Promoting confidence in the quality and reliability of audited financial statements (AFS) of public-interest entities (PIEs) and schedule funds has always been the main objective of the AOB's inspection efforts. The AOB's inspection is not only designed to detect audit deficiencies but also to understand the root causes of those deficiencies.

The strength of the financial reporting system relies on various stakeholders executing different but interconnected roles in a process designed to provide investors with high-quality, reliable AFS. To further enhance audit quality, the AOB endeavours to educate and inform auditors, Audit Committee (AC) members and relevant stakeholders on observations detected through the inspections of firms and audit engagements of PIEs.

In 2022, the AOB continued its commitment to uphold high-quality standards of auditing amid the challenges highlighted by the audit industry, which among others included the following:

Professional talent shortage in the marketplace added pressures on the firm's ability to uphold audit quality;

The push for increased professional scepticism and professional judgement by the auditors due to increased complexity of PIEs' business models;

The acceleration of digitalisation in the audit industry that changes conventional audit practices; and

The need for a deeper understanding of audit clients' business and corporate strategy to facilitate a robust audit process.

The AOB aims to keep abreast of emerging issues and global developments in financial reporting and the audit industry. The AOB will continuously evaluate its commitment and focus on specific areas to ensure that the AOB and its registered auditors are responsive to market developments.

AIR 2022 is a cumulation of the AOB's findings and observations. The AOB's inspection leveraged existing resources including the use of newly acquired digital capabilities and collaborative technological platforms.

Part I provides insights into the audit profession and its current landscape in Malaysia. This section highlights the statistics of the audit landscape and the data collection relating to the Audit Quality Indicators (AQIs) of Major Audit Firms and Other Audit Firms, including the description of the respective AQIs. These analyses help supplement the AOB's efforts to achieve effective regulation through active monitoring and engagements. Part I also includes the results of the survey conducted with AC members on the Annual Transparency Reports by firms.

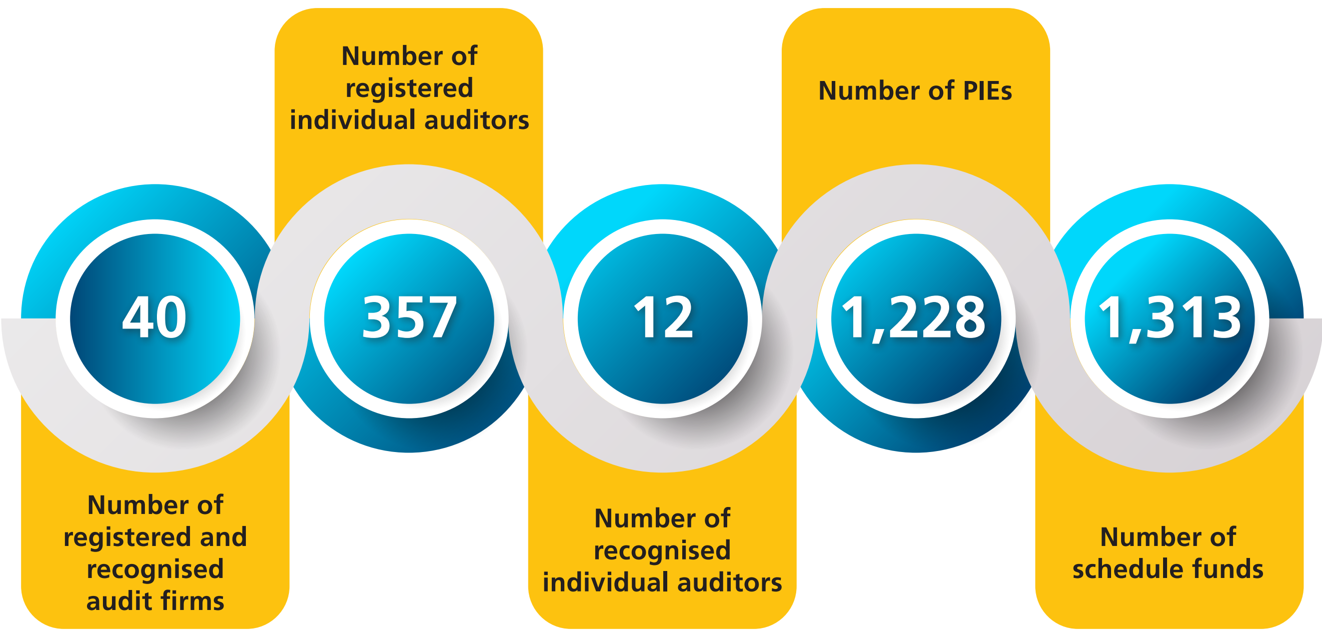
Part II aims to provide insights into a deeper understanding of audit firm culture and sustainability of audit practices. It also highlights common inspection findings identified during the AOB's inspections at the firm level.

Part III covers the engagement findings of the AOB's inspection for 2022. This section further elaborates the AOB's Risk Monitoring Index (RMI), while providing some examples on various key areas such as going concern and ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement.*

Part IV presents the remediation efforts of inspected firms to address the AOB's inspection findings.

The AOB strongly encourages directors and ACs to understand and discuss the findings and firm-level statistics shared in this report with their respective auditors. This is to ensure that the risk areas specific to their entities are adequately addressed and enable them to gauge the firms' commitment and approach to audit quality.

2022 AOB SNAPSHOT



WHAT HAPPENS DURING AN INSPECTION?

An inspection includes an assessment of the degree of compliance by auditors with auditing and ethical standards applicable in Malaysia, and the quality of the auditors' reports relating to the AFS of PIEs and schedule funds.

An inspection may involve either a firm level review or engagement level review or both. A firm level review assesses a firm's compliance with the requirements of the *International Standard on Quality Management 1* (ISQM 1) while an engagement review involves an assessment of the auditor's compliance with the *International Standards on Auditing* (ISAs) and relevant ethical standards at the audit engagement level. The engagement review also seeks to determine whether sufficient appropriate audit evidence has been obtained to support the conclusion reached on the audit of PIEs or schedule funds.

HOW ARE ENGAGEMENTS SELECTED FOR INSPECTION?

The AOB adopts a risk-based approach in the planning and engagement selection of its inspections and monitoring programmes, taking into consideration various factors as reported in Part III: Engagement Level Inspection Findings and Observations. An inspected firm is issued with a *Final Inspection Report*, which summarises all findings arising from the inspection.

WHAT IS A FINDING?

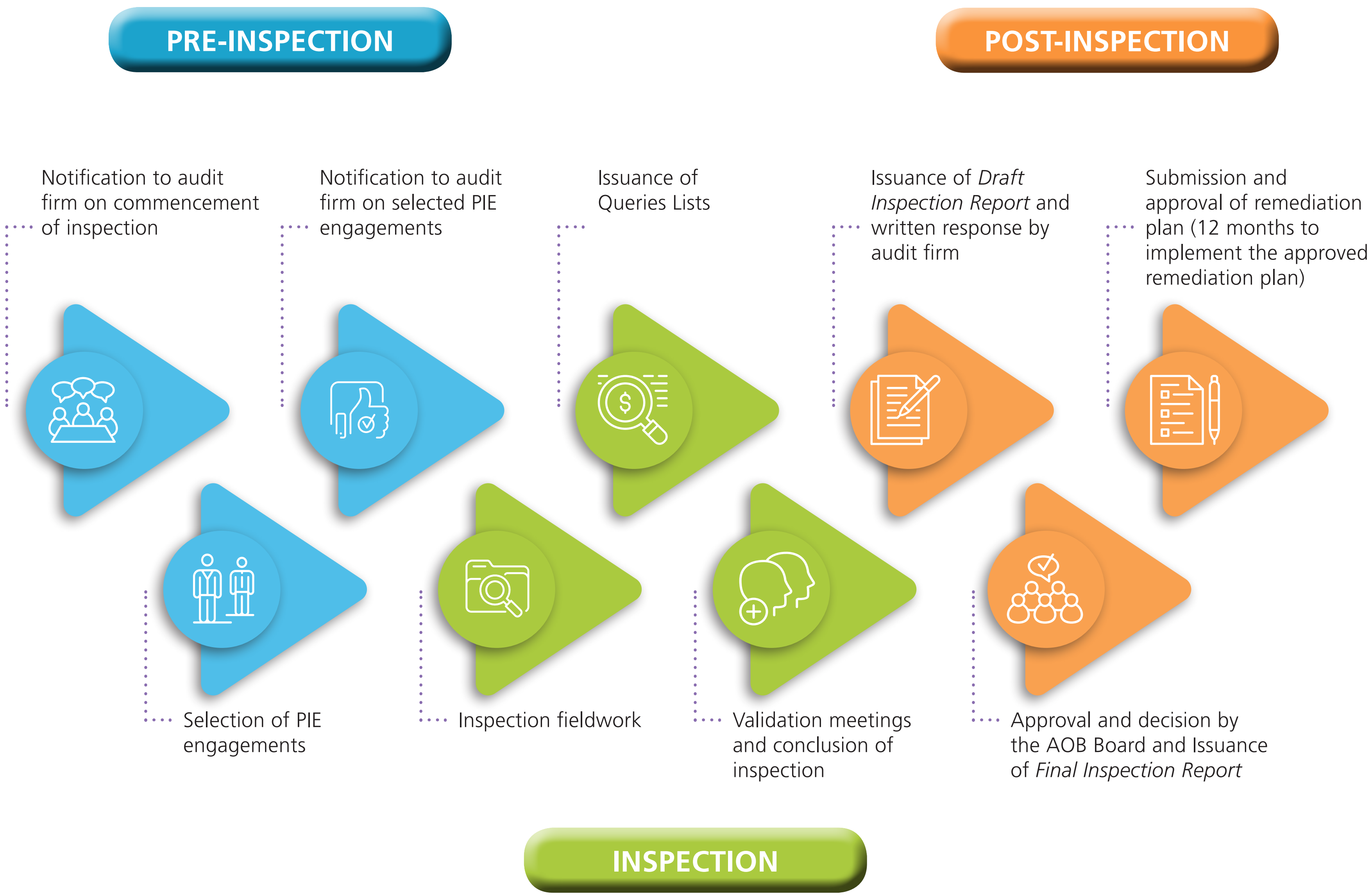
Findings identified during the engagement reviews are individually critical deficiencies that may have an impact on the basis of audit opinion or pervasive issues where the impact cannot be easily quantified. These are usually in relation to the sufficiency and appropriateness of audit procedures performed and audit evidence obtained, or the basis of judgements made by the auditors in relation to key aspects of an audit.

> *While verbal representation may have been provided to the AOB during the inspection and taken into consideration, in the absence of sufficient documentation, there is no evidence that the necessary audit procedures have been carried out appropriately. In such situations, the AOB would conclude that the firm has failed to perform the required audit procedures.*

However, findings identified do not necessarily indicate a breach of laws and regulations or that the AFS of the PIEs are not reliable. The AOB's scope of inspection is not intended to identify each and every deficiency in the firm's system of quality management or its entire audit assurance practice throughout the year.

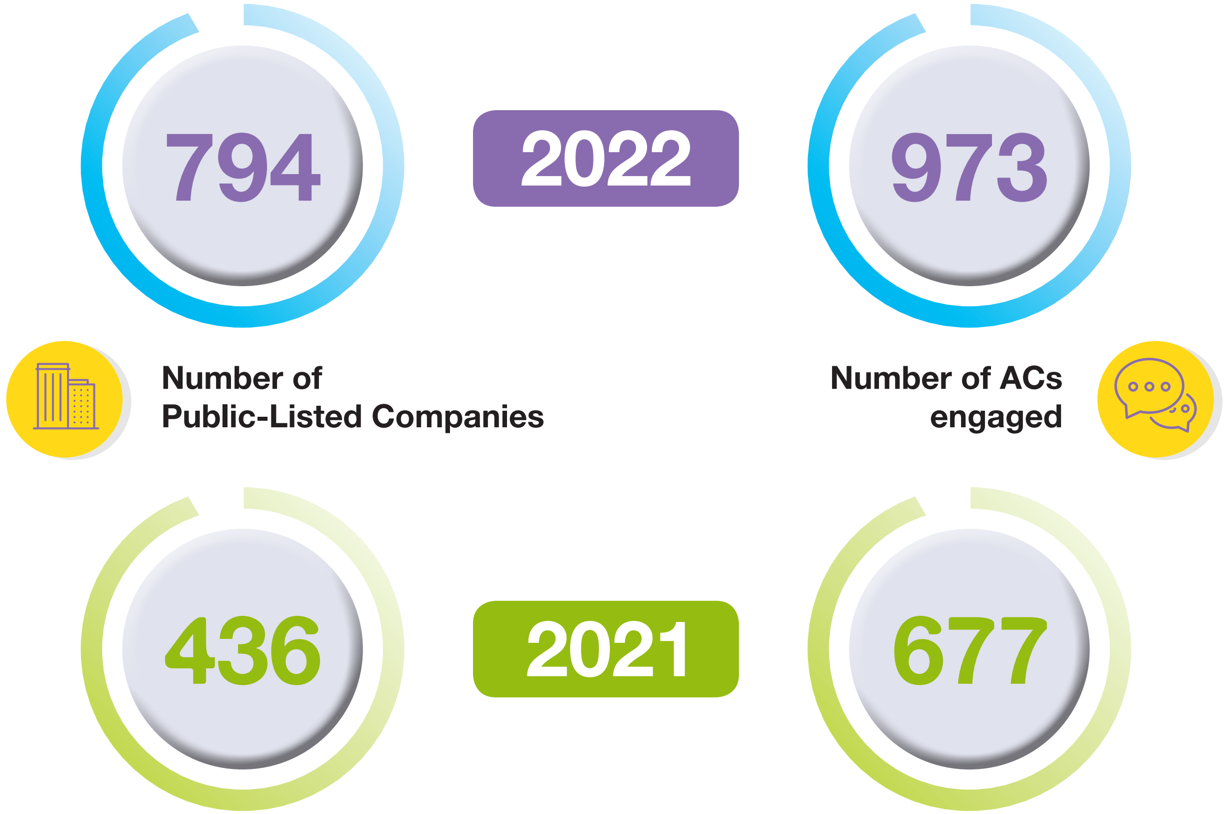
The AOB's inspection process is summarised in the diagram on the next page.

THE AOB'S INSPECTION PROCESS



COMMON AUDIT COMMITTEE CONCERNS

AUDIT COMMITTEE ENGAGEMENT COVERAGE



INFLUENCING THE FINANCIAL REPORTING ECOSYSTEM

The AOB has organised conversations with AC members since 2016 to facilitate their oversight responsibilities and strengthen corporate governance in public-listed companies (PLCs). This is to ensure that AC members are better positioned to rigorously challenge and scrutinise the company's financial reporting process, internal controls, risk management and governance.

In engaging with AC members over the years, the AOB noted recurring themes and areas of concern that ACs frequently focused on. The AOB strives to address these concerns with as much context as possible during these conversations.

Nonetheless, to provide further clarity on some of these concerns, the following section highlights a compilation of the common areas of concern raised by AC members over the last couple of years.

COMMON AUDIT COMMITTEE CONCERNS

1

HOW DO WE BALANCE THE COST OF COMPLIANCE AND THE NEED FOR PIEs TO MANAGE THEIR OWN COSTS IN CHALLENGING TIMES?

The need for internal controls and corporate governance is vital for any PIE to function. The onus is on the PIE to factor in the cost of compliance into their overall cost management structure. ACs should be aware that failure to ensure adequate consideration on proper controls and processes has far-reaching impact on the PIE whether from a reputational standpoint or the cost involved in managing the repercussions of any corporate failures.

Short-term cost savings gained by ignoring the cost of compliance would be damaging. However, there is a clear division between what is required to be addressed by the PIE as compared to only implementing controls as a 'box-ticking' exercise. ACs should play an active role in communicating with both internal and external auditors to determine the key controls required for their PIEs and ensure that the controls are reviewed regularly. For instance, the COVID-19 pandemic has prompted many PIEs to change their traditional ways of doing business. This opportunity to transform necessitates PIEs to revisit their internal controls and implement more effective controls to manage existing and emerging risks.

ACs should be mindful of such changes to the business and be cognisant of its impact to the overall internal controls and corporate governance environment of their respective PIEs.

2

CAN THE AOB SHARE FINDINGS FROM THEIR INSPECTION OF AUDITORS AND AUDIT FIRMS?

On some occasions, the AOB has highlighted the findings from its inspections to the ACs of the respective PIE. The AOB shared its findings when it considered that the findings have a severe impact on the PIE's financial reporting and requires immediate escalation. Since the inception of the AOB in 2010, it has only done so on two occasions.

In addition, the AOB goes through the meticulous process of assembling all common findings arising from its inspections of firms and auditors into the AIR on a yearly basis. The AIR provides great insights with regards to what the AOB does and the results of the inspections undertaken on an annual basis. From the AIR, those within the audit community as well as other stakeholders will also be able to gain a better understanding of current and future challenges for the audit industry. Please refer to Part II and Part III of this AIR for further details.

3

HOW DOES THE AOB ADDRESS COMPLAINTS ON AUDITORS?

The responsibility to address any concerns on auditors remain under the purview of the PIEs' respective ACs. Upon exhausting all internal avenues available within the PIE, should the ACs think that the issues fall within the AOB's remit, the relevant matters can be raised via the SC's general complaints avenues.

Complaints have to be supported with relevant facts and evidence. Any genuine concerns on auditors particularly in relation to their work in PIEs and schedule funds will be addressed in the best possible manner.

Scan the QR code to submit a complaint form via the SC website

4

WHAT ARE THE SIGNIFICANT AREAS TO FOCUS ON WHEN PREPARING FINANCIAL STATEMENTS?

The AIR provides insights into the areas within the AFS that were the primary focus of the AOB's inspection. ACs can use the AIR as a useful resource to identify potential concerns in their own PIEs.

The overarching observations in 2022 were in areas surrounding accounting estimates and going concern. From a technical point, the AOB produced articles and guidance on areas such as Going Concern and IT perspective on ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement.* These articles provide guidance on key areas that were encountered during the AOB's inspection as well as an understanding into the common areas that the auditors should focus on.

The AOB does not prescribe a set number of areas of focus as each audit is unique and pose its own set of challenges to the auditors. Nonetheless, some of the common areas in which the AOB has continued to see an increase in findings were accounting estimates and audit sampling. Please refer to Part III for further details. ACs are recommended to actively engage with their respective auditors from the onset of the audit to ensure that any issues encountered during the audit are addressed and that ACs facilitate co-operation between the PIE management and auditors.

5

DOES THE AOB PERFORM ITS OVERSIGHT ROLE ON PIEs?

The AOB carries out its oversight role on the auditors of PIEs and schedule funds in carrying the mandate to foster high quality independent auditing to promote confidence in the quality and reliability of AFS.

Notwithstanding, the AOB works closely with the SC's Corporate Surveillance function to address concerns related to PIEs.

6

DOES THE AOB NEED TO REGULATE AUDIT FEES CHARGED AND ROTATION OF AUDIT FIRMS?

The AOB does not establish any fee structure for firms. The fees charged are subject to negotiations between the auditors and the PIE's board of directors which should be driven by market forces. Audit fees should also be reflective of the work performed by the auditors and the expected quality of work.

The AOB's role in this area is to ensure that the auditors maintain their independence while providing assurance on the financial statements of the PIE.

PART I:
INSIGHTS INTO THE AUDIT PROFESSION

REGISTRATION AND RECOGNITION STATISTICS

TABLE 1
Registration and recognition of audit firms and individual auditors as of 31 December 2021 and 31 December 2022

	No. of audit firms		No. of individual auditors	
	2022	2021	2022	2021
Registered				
Major Audit Firms*	8	6	229	198
Other Audit Firms	28	31	128	147
Recognised				
Foreign Audit Firms#	4	4	12	12
Total	**40**	**41**	**369**	**357**

TABLE 2
PIEs and schedule funds audited by AOB-registered and AOB-recognised audit firms as of 31 December 2021 and 31 December 2022

	% of total no. of PIEs		% of total PLCs' market capitalisation		No. of schedule funds		% of total net asset value (NAV)	
	2022	2021	2022	2021	2022	2021	2022	2021
Registered								
Major Audit Firms*	73.5	61.0	95.3	92.4	1,269	1,212	98.5	98.3
Other Audit Firms	26.1	38.6	4.6	7.4	44	43	1.5	1.7
Recognised								
Foreign Audit Firms#	0.4	0.4	0.1	0.2	-	-	-	-
Total	**100.0**	**100.0**	**100.0**	**100.0**	**1,313**	**1,255**	**100.0**	**100.0**

Note:
* Major Audit Firms are audit firms that have more than 50 PIE audit clients with a total market capitalisation of above RM15 billion.
\# Foreign auditors who audit foreign incorporated companies listed on Bursa Malaysia.

In 2022, two AOB-registered firms met the criteria of a Major Audit Firm which led to an increase in the number of Major Audit Firms from six to eight. This change is retrospectively reflected in Chart 1 below.

CHART 1

Number of PIEs audited by Major Audit Firms and Other Audit Firms

The dynamics of the Malaysian audit industry remained largely unchanged from previous years as 74% of PLCs continued to appoint Major Audit Firms to conduct their annual statutory audits. This is similarly reflected in the audit of schedule funds where 97% of schedule funds were audited by Major Audit Firms covering 99% of the Malaysian funds size.

In recent years, the AOB noted an increasing trend in the movement of PIEs from Major Audit Firms to Other Audit Firms. This trend indicated a reduction in market concentration of the audit industry which can contribute towards healthy competition in the market and indirectly improve the overall audit quality in the capital market.

Other Audit Firms are reminded to build up their respective firms' resources and technological capacity while keeping abreast with current developments in the capital market to ensure that they have capable and competent resources to perform quality audits.

Auditors are required to complete the evaluation for the acceptance and continuance of clients before accepting the audit engagement. Robust client acceptance and risk assessment processes should be put in place to help firms assess the risks associated with prospective audit clients. Firms should obtain an understanding of the industry in which the entity operates, the nature of the entity, the integrity and ethical values of the client and review the entity's financial performance to determine the magnitude of the client acceptance risk.

The AOB strongly urges firms to prioritise the outcome of the risk assessment performed on new and existing audit clients and should not merely focus on the firm's profitability. Furthermore, firms should decline or withdraw from the engagement if the risk profile of new or existing clients is not commensurate with the firm's risk appetite.

Firms should be mindful that these processes are put in place as a key mechanism to protect the firms and assist them in identifying risks associated with prospective clients and engagements.

AUDITORS' CONSIDERATIONS WHEN ACCEPTING AND CONTINUING WITH CLIENT RELATIONSHIPS AND AUDIT ENGAGEMENTS

ISQM 1 requires firms to establish policies and procedures to address acceptance and continuance of client relationships and audit engagements. The following areas should be considered in the firm's assessment:

Industry in which the entity operates
- Whether the entity operates in a specialised industry e.g., banking and insurance, aviation, plantation, oil and gas, property development, telecommunication, etc.
- Relevant laws and regulations governing the industry e.g., banking or securities laws and regulations.
- Social, environmental or health and safety issues faced by the industry e.g., extensive use of foreign labour, deforestation, etc.

Nature of the entity
- Organisational structure of the entity e.g., complex group structure.
- Ownership and governance of the entity which includes major shareholders of the entity, board structure and independence of directors.
- Locations or countries of operations.
- How the entity finances its operations.

Integrity and ethical values of the client
- Identity and business reputation of the owners, key management and those charged with governance.
- Reasons for change of auditors.
- Access to communicate with predecessor auditor.
- Whether the entity is aggressively concerned with maintaining the firm's fees.
- Indication of client-imposed limitation on the scope of audit work e.g., access to the work of component auditors, financial records of associates, jointly controlled companies, etc.
- Indication that the client might be involved in money laundering or other criminal activities.

Firm's ability to perform the audit engagements
- Availability of sufficient resources to perform quality work within the agreed timeline which includes relevant audit experience in specialised industry and use of auditor's experts (IT audits, valuation).
- Fulfilment of relevant ethical requirements by the firm and engagement team, particularly on independence.

Competence and capability of the entity's finance function
- Qualifications and relevant experience of senior management.
- Whether there is any prior year adjustment in the AFS.

Review of the entity's financial performance
- Analyse the entity's financial performance by using ratios e.g., sales growth index, debt-to-equity ratio, leverage index or days sales in receivables index.
- Review of analysts' report and credit rating agency report.

AUDIT QUALITY INDICATORS

Since 2015, the AOB has embarked on an annual data gathering exercise involving the Major Audit Firms in Malaysia. This data gathering exercise, which was subsequently expanded to include the Other Audit Firms in 2020, has enabled the AOB to compile statistics relating to Audit Quality Indicators (AQIs) for both the Major Audit Firms and the Other Audit Firms.

The AOB strongly encourages ACs to consider the statistics relating to the AQIs that have been shared in Table 3 and Table 4 respectively when deciding on the appointment and reappointment of auditors.

TABLE 3
AQI statistics for the Major Audit Firms

AQIs	2022	2021
Workload of the PIE audit partner		
Average number of PIE audit clients per partner	5	5
Average number of entities related to PIE audit clients per partner Note: Entities related to PIE audit clients are non-PIEs within the PIE Group, which are audited by Malaysian audit firms. Examples include, but are not limited to, subsidiaries and associates of PIEs.	55	59
Average number of non-PIE audit clients per partner	109	118
Auditor independence		
Average proportion of fee income derived from the: a) Audit practice b) Non-audit practice	 48% 52%	 49% 51%
Average proportion of fee income derived from audit clients segregated by: a) Statutory audit b) Other assurance services c) Services provided by non-audit practices	 73% 8% 19%	 72% 9% 19%
Capacity and competence of the audit practice		
Average composition of audit personnel: a) Audit partners b) Managerial staff c) Non-managerial staff	 5% 15% 80%	 4% 18% 78%
Average years of audit experience of the audit personnel: a) Audit partners b) Managerial staff c) Non-managerial staff	Years 23 10 2	Years 23 10 2
Professional qualifications of the audit personnel: a) Average percentage of personnel with professional qualifications and/or MIA membership b) Average percentage of personnel who are pursuing professional qualifications and/or MIA membership c) Average percentage of personnel without professional qualifications and/or MIA membership	 20% 65% 15%	 23% 66% 11%
Average staff turnover rate	33%	27%

AQIs	2022	2021
Audit engagement supervision		
Average staff-to-partner ratio	23	24
Average staff-to-manager ratio	6	5
Audit firm's investment to promote audit quality		
Average hours of training provided by the firms to audit personnel (a) Partners (b) Managerial staff (c) Non-managerial staff	Hours 77 75 74	Hours 75 83 78
Average ratio of audit staff to one quality control staff Note: Quality control staff are involved in risk management, technical consultations, training and quality assurance functions of the audit firms either on full-time or part-time basis.	39	44

Note:
The AQI statistics above are derived from information submitted by the Major Audit Firms based on their fiscal periods ended 2021 and 2022 respectively. Refer to the **Appendix** for the description of the respective AQIs.

TABLE 4
AQI statistics for Other Audit Firms

AQIs	2022	2021
Workload of the PIE audit partner		
Average number of PIE audit clients per partner	3	3
Average number of entities related to PIE audit clients per partner Note: Entities related to PIE audit clients are non-PIEs within the PIE Group, which are audited by Malaysian audit firms. Examples include, but are not limited to, subsidiaries and associates of PIEs.	27	24
Average number of non-PIE audit clients per partner	146	125
Auditor independence		
Average proportion of fee income derived from the: (a) Audit practice (b) Non-audit practice	 70% 30%	 70% 30%
Average proportion of fee income derived from audit clients segregated by: (a) Statutory audit (b) Other assurance services (c) Services provided by non-audit practices	 78% 4% 18%	 80% 3% 17%

AQIs	2022	2021
Capacity and competence of the audit practice		
Average composition of audit personnel: (a) Audit partners (b) Managerial staff (c) Non-managerial staff	 13% 16% 71%	 12% 16% 72%
Average years of audit experience of the audit personnel: (a) Audit partners (b) Managerial staff (c) Non-managerial staff	Years 24 11 2	Years 24 11 2
Professional qualifications of the audit personnel: (a) Average percentage of personnel with professional qualifications and/or MIA membership (b) Average percentage of personnel who are pursuing professional qualifications and/or MIA membership (c) Average percentage of personnel without professional qualifications and/or MIA membership	 34% 30% 36%	 35% 31% 34%
Average staff turnover rate	31%	24%
Audit engagement supervision		
Average staff-to-partner ratio	9	9
Average staff-to-manager ratio	5	5
Audit firm's investment to promote audit quality		
Average hours of training provided by the firms to audit personnel (a) Partners (b) Managerial staff (c) Non-managerial staff	Hours 47 39 35	Hours 72 50 34
Average ratio of audit staff to one quality control staff Note: Quality control staff are involved in risk management, technical consultations, training and quality assurance functions of the audit firms either on full-time or part-time basis.	10	13

Note:
The AQI statistics above are derived from the information submitted by the Other Audit Firms for annual periods ended 30 June 2021 and 30 June 2022 respectively. Refer to the **Appendix** for the description of the respective AQIs.

THE AOB'S SURVEY OF AUDIT COMMITTEES ON ANNUAL TRANSPARENCY REPORTING BY THE AUDIT FIRMS

BACKGROUND

The AOB introduced a requirement for an AOB-registered audit firm to produce an *Annual Transparency Report* for firms with more than 50 PIE audit clients and a total market capitalisation of above RM10 billion for two consecutive years. This requirement was introduced to promote greater transparency and stronger accountability for audit quality among firms.

In 2021, a total of eight firms in Malaysia were required to produce an *Annual Transparency Report* as they met the reporting criteria stipulated above.

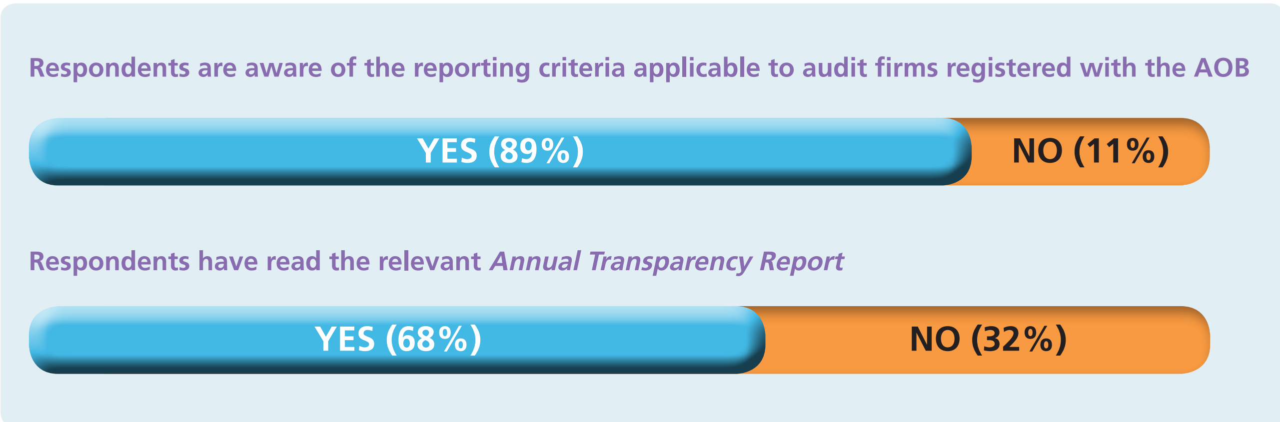
In 2022, the AOB carried out a survey involving AC members of PLCs to understand how the Annual Transparency Reports (ATRs) produced by the eight firms were used by them as well as to identify any areas for improvement. A total of 151 AC members responded to the survey. 97% of the respondents were AC members between one to three PLCs, with the remaining 3% representing between four to six PLCs.

KEY HIGHLIGHTS OF THE SURVEY

A. Report readership and usage of the Annual Transparency Reports

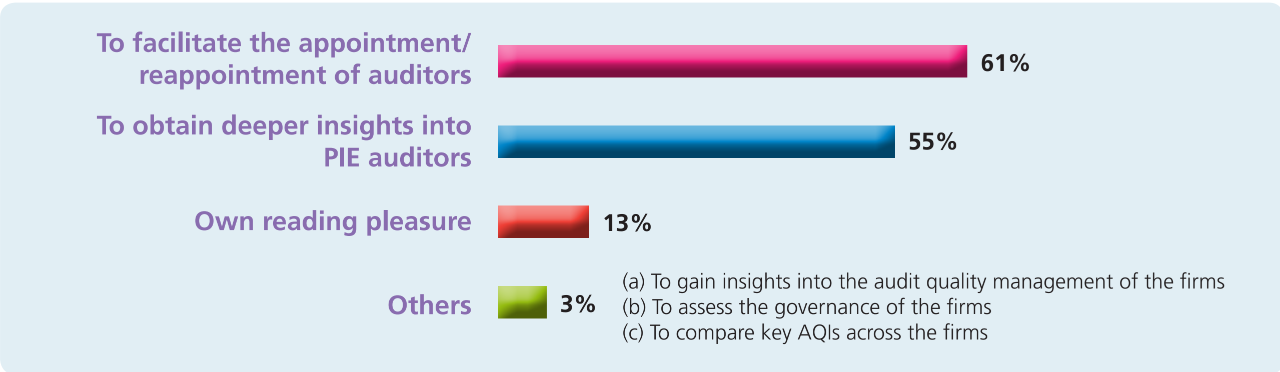
As shown in Diagram 1, most of the survey respondents are aware of the need for firms to produce an *Annual Transparency Report.* However, only 68% of the respondents have read the reports produced by the firms.

DIAGRAM 1
Respondents' awareness of the Annual Transparency Reports produced by the firms



As shown in Diagram 2, respondents who have read the ATRs have indicated that they would like to obtain a better understanding of auditors and use the information in the reports to facilitate the appointment and reappointment of auditors.

DIAGRAM 2
Respondents' purpose for reading the Annual Transparency Reports produced by the firms



In addition, 94% of the survey respondents who have read the ATRs have found the information disclosed in the reports to be useful to facilitate the selection and reappointment of the auditors of their companies. In view of this, the AOB encourages all AC members to read the ATRs.

B. Feedback on the contents of the Annual Transparency Reports

The survey respondents were asked to assess the contents of the ATRs produced by the firms by indicating their level of agreement to a set of statements on a scale of '1' being 'strongly disagree' to '5' being 'strongly agree'. The overall results of the assessment are detailed in **Table 5** below.

TABLE 5
Results of the respondents' assessment of the contents of the Annual Transparency Reports

Assessment of contents	Firms							
	A	B	C	D	E	F	G	H
1. The report has provided me with a good understanding of:								
(a) the firm's legal and governance structure	Green	Green	Green	Blue	Blue	Blue	Yellow	Blue
(b) the measures taken by the firm to uphold quality	Green	Green	Green	Green	Blue	Blue	Yellow	Yellow
(c) how the firm manages its risks	Green	Green	Green	Blue	Blue	Blue	Yellow	Yellow
2. The report is fairly presented and not oriented towards marketing or selling of services	Green	Green	Green	Green	Blue	Yellow	Yellow	Yellow
3. The explanation provided on the AQIs are sufficient	Green	Green	Green	Blue	Blue	Blue	Blue	Yellow
Total average score	Green	Green	Green	Blue	Blue	Blue	Yellow	Yellow

Green ● Ratings above 4.0 Blue ● Ratings from 3.5 to 4.0 Yellow ● Ratings below 3.5

While some firms have fared reasonably well in all areas assessed, there is room for improvement for other firms. Some respondents have also highlighted that they would like to see increased disclosures in the ATRs relating to the following areas:

- Litigations faced by the firms*;
- Any actions taken by the regulators and authorities on the firms*;
- Circumstances where there is heavy dependency on fees contributed by any audit clients of the firms*;
- Results of internal and external quality monitoring reviews and the remediation efforts to address any shortcomings identified;
- Training programmes provided by the firms including support provided to audit personnel to pursue professional qualifications;
- Profile of the firms' clients such as the number of clients by industry grouping;
- Environmental, social and governance initiatives including those relating to employees' well-being; and
- AQIs presented in the respective firms' ATRs including making references to their peers to facilitate comparison.

* Currently under the AOB's consideration to be included in the Annual Transparency reporting guidelines for audit firms.

The AOB has shared the results of the survey with the Major Audit Firms during the annual dialogue held on 8 September 2022 and with AC members from 794 PLCs during the virtual dialogue series held on 17 November 2022 and 6 December 2022.

KEY REMINDERS FOR FIRMS

- Firms are strongly encouraged to address the survey feedback from AC members, particularly on enhancing relevant disclosures to further improve the firms' reports.
- In addition, firms should provide briefings to AC members and solicit periodic feedback to ensure that the firm's report remains responsive and relevant to their needs.

KEY REMINDERS FOR AC MEMBERS

- AC members are advised to utilise the information disclosed in the ATRs and statistics relating to AQIs, to differentiate the firms based on audit quality considerations when deciding on the appointment and reappointment of auditors.
- ACs should engage with their auditors annually on aspects of their *Annual Transparency Report* to develop a good understanding of the efforts undertaken by the auditors to uphold audit quality and to discuss on any other matters of interest that may impact audit quality.

PART II:
FIRM LEVEL INSPECTION FINDINGS AND OBSERVATIONS

COMMON FINDINGS: FIRM REVIEWS

MAJOR AUDIT FIRMS

Eight Major Audit Firms were inspected in 2022 where there was no finding relating to the system of quality controls for two Major Audit Firms. The common findings identified during the inspections of the Major Audit Firms have been detailed in Table 1 below.

TABLE 1
Common findings identified during 2022 inspections of the Major Audit Firms

Common findings in 2022	Key concerns/risks	Reminders
Acceptance and continuance of client relationships and specific engagements		
Procedures for client acceptance As part of the client acceptance process, the firms require that the prospective audit engagement partner evaluate the reply from the predecessor auditor on the professional clearance sought. However, the AOB noted that certain firms did not stipulate the requirement for prospective audit engagement partners to document the outcome of their evaluation.	A prospective audit engagement partner may not have considered all relevant information, particularly responses provided by the predecessor auditor in the professional clearance letter when deciding on whether to accept a new audit engagement.	Firms should require prospective audit engagement partners to maintain sufficient documentation to evidence that a thorough evaluation has been carried out prior to the acceptance of a new audit engagement.
Monitoring		
Monitoring reviews for the audit engagements The firms have a policy where each audit engagement partner would be subject to a quality monitoring review at least once every two to three years. For certain firms, the audit engagement partners have not been selected for quality monitoring reviews within the cycle as defined by the firm's policy.	Shortcomings in the quality of audit work performed by the audit engagement teams may not be detected in a timely manner.	Firms are reminded to ensure strict adherence to its policy to safeguard audit quality including ensuring that sufficient resources have been allocated to effectively carry out the quality monitoring reviews.

OTHER AUDIT FIRMS

The AOB inspected six Other Audit Firms in 2022, where the common findings identified are detailed in Table 2 below.

TABLE 2
Common findings identified during the 2022 inspections of the Other Audit Firms

Common findings in 2022	Key concerns/risks	Reminders
Relevant ethical requirements		
Policy on the rotation of audit partners The AOB continues to observe shortcomings in the firm's policy on rotation of audit engagement partners. The MIA By-Laws requires an audit partner to be rotated out of an audit engagement once the maximum period of involvement allowed has been reached. In calculating the period of involvement, the MIA By-Laws stipulates that all relevant roles undertaken by an individual prior to becoming a key audit partner should also be considered. However, the policy on the rotation of audit partners for some firms did not take this into consideration.	The firm's policy may not fully address the threats to auditor independence due to an audit partner's long association with his audit client.	Firms should review their policies and procedures to ensure that they fully adhere to the requirements of the MIA By-Laws relating to the rotation of audit partners.
Engagement independence confirmations Firms have a policy that requires audit engagement team members to confirm their compliance with relevant independence requirements prior to the commencement of an audit engagement. Based on the inspected audit engagements, it was noted that some audit engagement team members did not confirm their independence.	The failure to monitor audit engagement team members' independence poses the risk that independence issues, if any, may not be detected and addressed in a timely manner.	The independence of the audit engagement team members is the responsibility of the audit engagement partner. Hence, audit engagement partners are reminded to ensure that the independence confirmations by audit engagement team members are timely and complete.

Common findings in 2022	Key concerns/risks	Reminders
Engagement performance		
Audit sampling methodology The audit sampling methodology for test of controls and test of details for certain firms did not fully comply with the ISA requirements.	The extent of testing performed by the auditors may not be sufficient to support the audit conclusions.	Firms are reminded to periodically review their audit methodology to ensure that they fully comply with the latest ISA requirements.
Audit consultations Certain firms did not clearly define the specific matters for which consultation is required in their policy.	Risk of difficult or contentious matters not being addressed and resolved by the audit engagement team due to lack of consultation.	Firms should establish clear policies and procedures on audit consultations and ensure that conclusions from consultations are implemented.
Monitoring		
Monitoring reviews for the firm and audit engagements The AOB noted that certain firms did not conduct monitoring reviews to evaluate the effectiveness of their systems of quality controls, including the quality of the audit engagements.	Shortcomings in a firm's system of quality controls may not be identified and rectified on a timely basis.	Firms are reminded to implement the following to strengthen their monitoring process: • Designate a partner with sufficient authority and experience to lead the monitoring activities; • Ensure that sufficient resources are committed to carry out the monitoring reviews; • Conduct root cause analysis to facilitate the identification of relevant remedial actions to address shortcomings identified; and • Monitor the effectiveness of the remedial actions.

BOX ARTICLE 1

AUDIT FIRM CULTURE

In recognising the importance of an audit firm's culture in driving behaviour of its personnel with respect to audit quality, the AOB continued with the culture assessment that was carried out in 2021.

The culture assessment in 2022 was performed through interviews involving 55 audit personnel from two Major Audit Firms and four Other Audit Firms. The interviewees were asked to rate the strength of each cultural characteristic listed in **Table 1** on a scale of '1' being 'very weak' to '5' being 'very strong'.

TABLE 1
Key cultural characteristics that should be present in the audit firms

Culture	Characteristics
Culture of quality	• Mindset within the firm that audit quality is of paramount importance and there is a sense of collective accountability for quality from the leadership all the way to the staff level.
Culture of ethical behaviour	• Audit personnel understand the need to comply with relevant ethical requirements and always carry out their work with integrity.
Culture of compliance	• Strong compliance mindset among the audit personnel with respect to the firm's policies and procedures and the firm has low tolerance for instances of non-compliance.
Culture of challenge	• Critical thinking and professional scepticism are attributes that are strongly encouraged by the firm and inherently applied by the audit engagement teams in the performance of the audits.
Culture of consultation	• Consultations by the audit engagement team members are strongly encouraged when they are faced with difficult and contentious matters, be it with the audit engagement partners or with the firm's technical department.
Culture of trust	• Strong sense of belief among the audit personnel that the firm will do the right thing in carrying out its fiduciary duties as company auditors and that any complaints and allegations raised by the firm's clients or audit personnel would be appropriately dealt with.

As shown in **Table 2** below, the firms have generally fared well in most of the areas assessed. However, there is still room for improvement, particularly for some of the Other Audit Firms, in inculcating the need for strong compliance, trust and quality culture within the firm.

TABLE 2
Results of the culture assessment based on interviews of audit personnel from two Major Audit Firms and four Other Audit Firms

Cultural Characteristic	Major Audit Firms		Other Audit Firms			
	Firm A	Firm B	Firm C	Firm D	Firm E	Firm F
Culture of quality	🟢	🔵	🔵	🔵	🔵	🟡
Culture of ethical behaviour	🔵	🔵	🟢	🟢	🔵	🔵
Culture of compliance	🔵	🟢	🔵	🔵	🔵	🟡
Culture of challenge	🔵	🔵	🔵	🔵	🔵	🔵
Culture of consultation	🟢	🟢	🔵	🔵	🟢	🔵
Culture of trust	🟢	🔵	🟢	🔵	🟡	🔵

🟢 4.5 and above 🔵 4.0 to 4.4 🟡 3.9 and below

It is imperative to note that the firm's culture may impact the quality of the audits performed. For example, the AOB's inspection of Firm F revealed numerous shortcomings in both the engagement level and firm level reviews which were consistent with their culture assessment results above.

BOX ARTICLE 2

SUSTAINABILITY OF THE AUDIT WORKFORCE

The stiff competition for accounting and auditing talent has been a perennial issue faced by the audit profession in Malaysia. It is common for firms to encounter staff turnover rates in double digits year-on-year.

As shown in Chart 1, there is an increasing trend in the turnover rate as Malaysia transitioned to the endemic phase of COVID-19 in April 2022 and with countries reopening their borders.

CHART 1
Average audit staff turnover rate from 2020 to 2022

A high staff turnover rate poses sustainability challenges to a firm as it would take time to replace the loss of experienced hires. The lack of experienced resources could affect the firm's ability to provide high-quality services. In addition, a firm would also incur higher costs as there is a need to continuously train new hires.

In 2022, the AOB conducted interviews with 65 audit staff from six Major Audit Firms who were serving their resignation notice period to obtain an understanding of the working environment in the firms and contributory factors leading to staff resignations.

The interviewees were asked to rate their level of satisfaction for each factor listed in **Table 1** on a scale of '1' being 'very poor' to '5' being 'very positive' as well as to provide some explanation to support their ratings.

TABLE 1
Results of the assessment based on interviews of audit personnel from the Major Audit Firms

No	Factors	Firms					
		A	B	C	D	E	F
1	Leadership of the firm	4.0 and above	4.0 and above	4.0 and above	4.0 and above	3.0 to 3.9	3.0 to 3.9
2	Open communication within the firm	4.0 and above	4.0 and above	4.0 and above	4.0 and above	3.0 to 3.9	3.0 to 3.9
3	Inclusiveness and diversity within the firm	4.0 and above	4.0 and above	4.0 and above	4.0 and above	4.0 and above	3.0 to 3.9
4	Teamwork and collaboration among team members	4.0 and above	4.0 and above	4.0 and above	4.0 and above	4.0 and above	3.0 to 3.9
5	Recognition and rewards	4.0 and above	4.0 and above	3.0 to 3.9	3.0 to 3.9	3.0 to 3.9	3.0 to 3.9
6	Professional development/training	4.0 and above	4.0 and above	4.0 and above	4.0 and above	4.0 and above	3.0 to 3.9
7	Work-life balance	3.0 to 3.9	3.0 to 3.9	3.0 to 3.9	Less than 3.0	Less than 3.0	Less than 3.0
8	Overall job satisfaction	4.0 and above	3.0 to 3.9	3.0 to 3.9	3.0 to 3.9	3.0 to 3.9	3.0 to 3.9

4.0 and above   3.0 to 3.9   Less than 3.0

The following are key observations arising from the interviews:

a) Most of the interviewees were satisfied with the leadership of the respective firms, the level of open communication as well as the inclusiveness and diversity within the firm.

b) Interviewees also cited that the work environment is conducive to fostering teamwork and collaboration among audit engagement team members. They further shared that the firms provide adequate and effective training which promote professional development.

c) However, the positive factors cited above have been overshadowed by the heavy workload which disrupts their work-life balance. Some interviewees opined that the remuneration received was not commensurate with the long working hours, in spite of the recent salary revisions effected by some of the firms.

d) The interviewees attributed the heavy workload faced to:
   - High staff turnover as well as the loss of experienced staff resulting in existing staff having to handle more work;
   - Delays in receiving required information from audit clients for audit reviews due to lack of competent finance personnel in their PLC clients; and
   - Tight deadlines imposed by the audit clients.

A total of 47% of the interviewees indicated that they were willing to continue working with their firms if the issue of long working hours and its compensation are addressed. Hence, the AOB strongly encourages firms to take decisive measures to address resignations due to heavy workloads faced by audit personnel. Some considerations to address heavy audit staff workload is provided in the next table.

CONSIDERATIONS TO ADDRESS HEAVY AUDIT STAFF WORKLOAD
1. Assess the severity of heavy audit staff workload in the firm • Monitor and evaluate the time spent on audit engagements as well as the overtime hours incurred by audit staff. • Conduct staff survey or interviews to obtain an understanding of their mental and physical well-being in relation to their work.
2. Set targets for the achievement of work-life balance for the audit staff • Set internal firm targets to address heavy audit staff workload. • Introduce key performance indicators for the firm's leadership and audit partners to ensure that the achievement of work-life balance among audit staff is given adequate focus.
3. Implement initiatives and monitor their effectiveness to address heavy audit staff workload • Identify the root causes that contribute to heavy audit staff workload at the firm. • Implement relevant initiatives to address the root causes identified. Some measures may include increasing audit staff headcount to allow better distribution of workload and increasing audit fees to ensure that sufficient resources could be allocated to carry out the audits. Audit engagement partners should ensure that the reporting deadlines that have been agreed with the audit clients are reasonable. Should there be delays from the audit clients in providing required information to the auditors, the deadlines should be revised accordingly. • The outcome of the implemented initiatives should be measured and revised as appropriate.

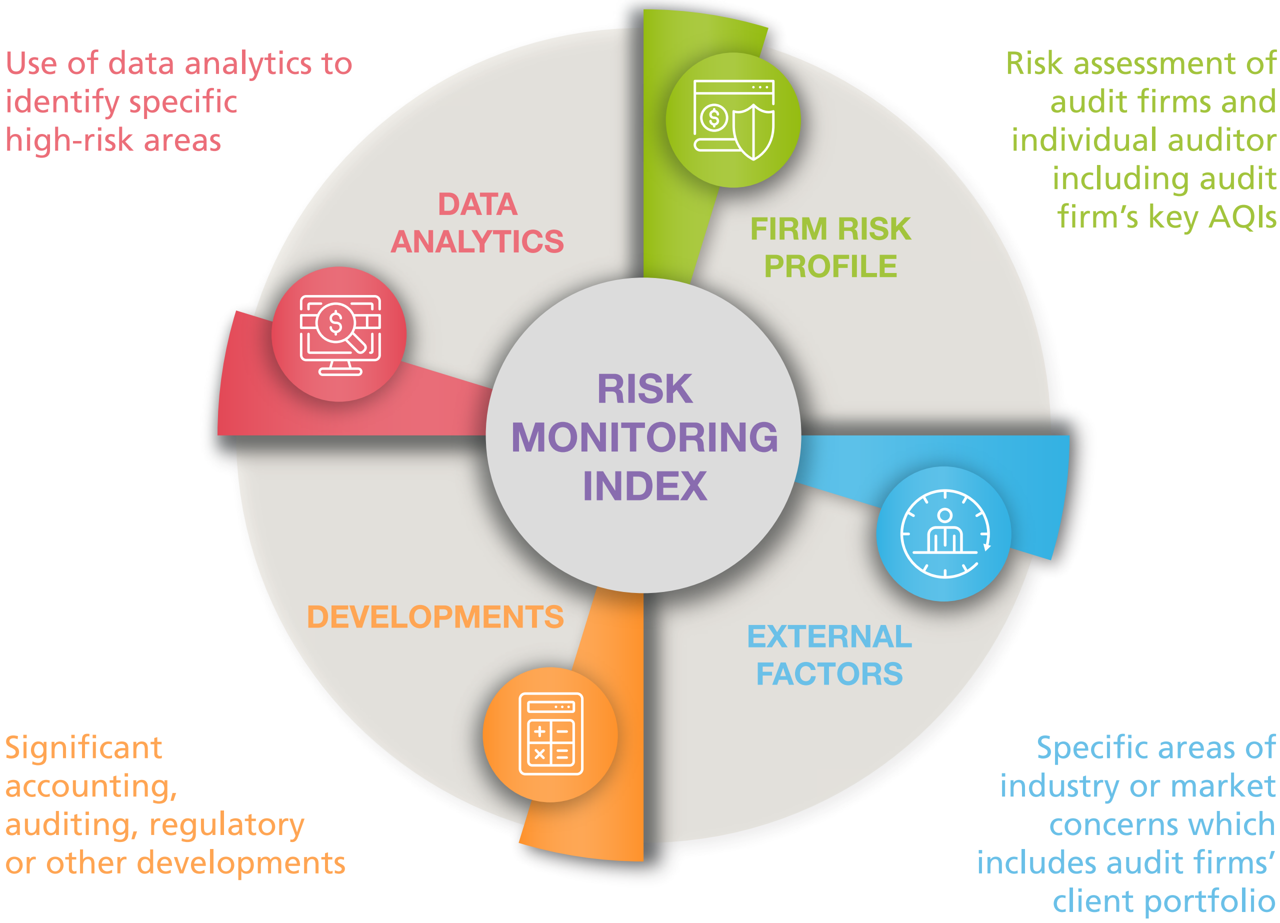
The AOB is cognisant that the issue of heavy audit staff workload is a key factor resulting in the high staff turnover, which in turn could adversely impact audit quality. For the 2023 inspection, the AOB will engage the firms to ensure that appropriate measures have been undertaken to address the issue of heavy workload faced by audit personnel.

PART III:
ENGAGEMENT LEVEL INSPECTION FINDINGS AND OBSERVATIONS

THE AOB'S RISK-BASED APPROACH

In developing and carrying out the inspection programme, the AOB adopts a risk-based approach that takes into consideration the potential impact of an audit failure to the capital market and public confidence.

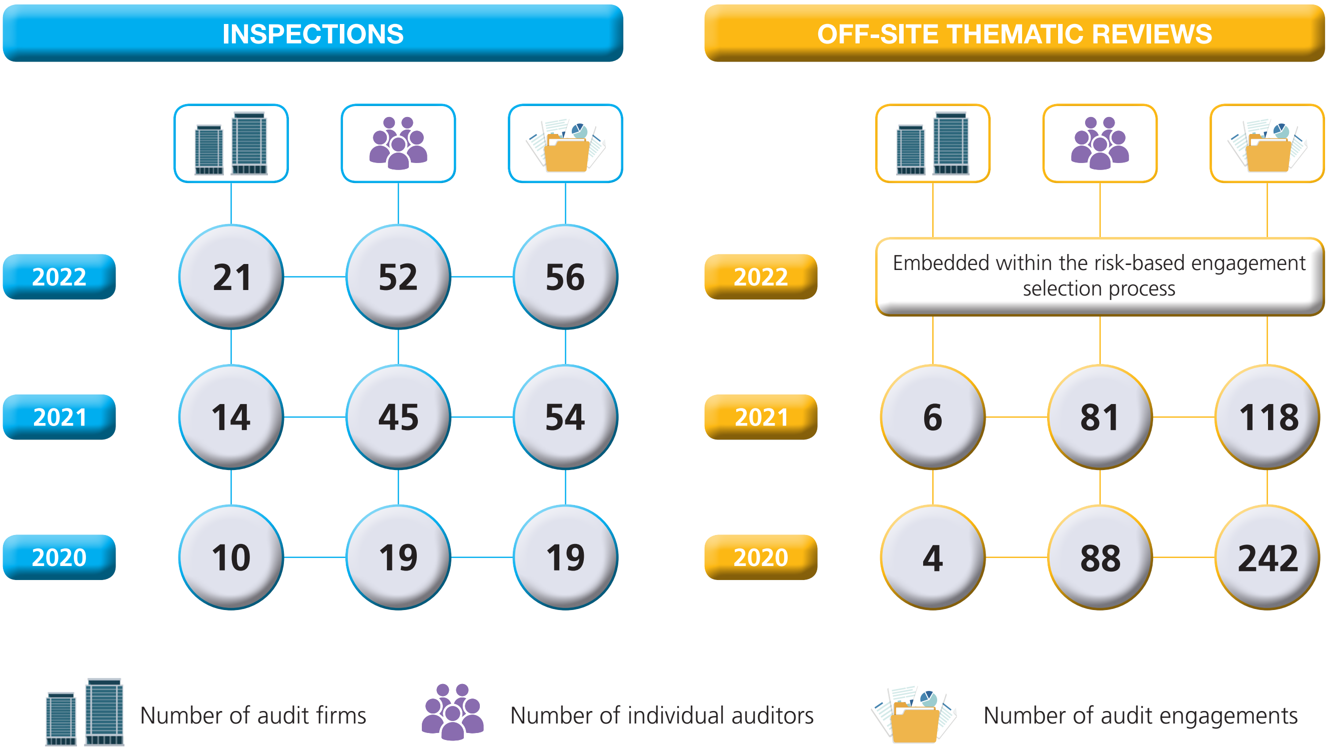
DIAGRAM 1
The AOB's Risk Monitoring Index



Further, the AOB continues to monitor other specific considerations such as financial reporting areas affected by economic trends and pressures as well as areas that present audit challenges. Elements of random selection will continue to be incorporated to retain a degree of unpredictability in the selection process.

On an annual basis, the AOB conducts inspections on all firms that have more than 50 PIE audit clients with a total market capitalisation of above RM15 billion. These eight Major Audit Firms (2021: six Major Audit Firms) collectively audited PLCs that represented 74% of the total number of PLCs and 95% of the total market capitalisation in Malaysia.

DIAGRAM 2
Inspections and off-site thematic reviews coverage



In 2022, the AOB inspected 21 firms covering 52 individual auditors on 56 audit engagements. This selection included audit engagements that were specifically selected based on financial outliers identified by the AOB's RMI.

The AOB observed that the selections of PLCs based on financial outliers identified by the AOB's RMI were predominantly centred around the PLCs audited by the Major Audit Firms. There could be various reasons driving this observation such as complexities of the PLCs, macroeconomic factors of specific industries and/or the potential evolution of business practices affecting certain PLCs.

INTEGRATION OF DATA ANALYTICS

In addition to selecting PLCs based on financial outliers, efforts were also made to integrate data analytics into the respective risk assessment of firms and individual auditors. Using the RMI, the AOB was able to better discern the risk of individual PLCs within the respective portfolio of an individual auditor based on objective observable data. PLCs with adverse financial indicators would be given greater priority in our engagement selection considerations.

RISK MONITORING INDEX

Efficiency in Monitoring
The use of data analytics enabled the AOB to increase the scope of its monitoring activities of firms and PLCs. This required upfront investment in terms of time and resources. Nonetheless, it enabled the AOB to be astute in terms of resource management to be more in line with current business risks and shorten the time taken to perform subsequent analysis.

Integration of Data Analytics
The AOB integrated data analytics into the existing selection process of PLCs particularly in distinguishing risky PLCs based on the risk assessment of firms and individual auditors. In doing so, inspection selections are based on risks identified by various data points with less reliance on individual bias.

Framework for Going Concern
The AOB managed to create a framework to identify PLCs with potential liquidity risks and tailored the inspections to review the robustness of the going concern assessment performed by the firms and indirectly, the PLCs.

Effectiveness of risk identification
The AOB improved its risk identification of firms and PLCs with a robust process to identify any potential issues and risks before they materialise or become more serious issues. As a result, the AOB was better prepared to address them by way of targeted inspections on the firms and the related PLC clients.

While the foundation of the AOB's RMI revolves around four key areas as explained in Diagram 1, the AOB also incorporates a certain degree of unpredictability in the engagement selection to ensure that other PLCs not identified by the AOB's data analytics tool would have a chance of being selected for inspection.

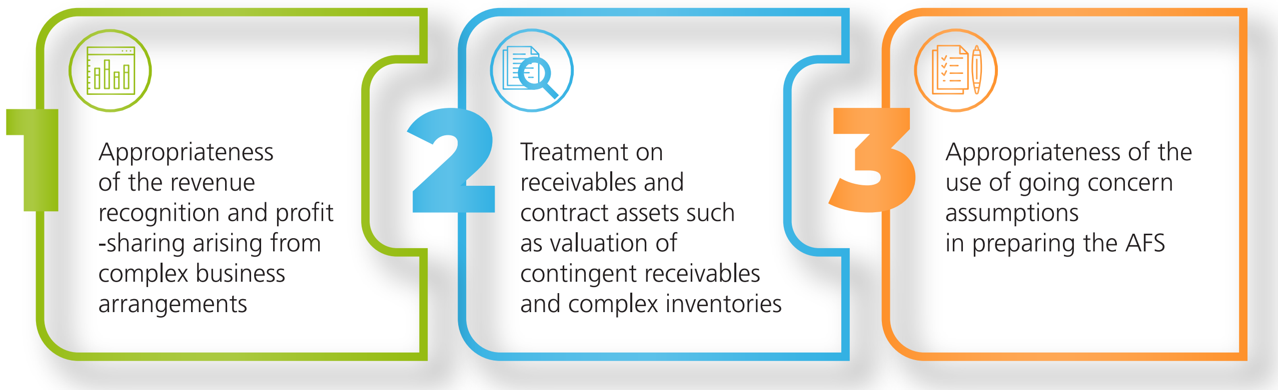
Moving forward, the AOB would continue to enhance the underlying processes within the RMI approach by incorporating latest technological developments and current industry and market risks.

OBSERVATIONS FROM THE INSPECTION USING RMI

With the use of RMI, the AOB was able to efficiently identify the specific financial statement line items that triggered various anomalies within the financial statements. This enabled the AOB to pivot and direct its focus to those areas with potential risks to the individual auditor and the PLC.

Based on inputs from the data analytics tool, the AOB planned and conducted thematic inspections resulting in the following observations:

DIAGRAM 3
Observations on complex business arrangements



While going concern remained the most critical area identified by the AOB's data analysis, the other two areas which raised concerns for the AOB as the probable root causes of the inspection findings were as follows:

- Complacency by the auditors in addressing key areas of the audit (over-reliance on legacy arrangements and prior conclusions); and
- Lack of understanding of the nature and accounting treatment as well as the risks associated with complex business arrangements and transactions.

The case study articles included in this AIR provide further insights on examples of potential complex business arrangements that should be addressed by firms.

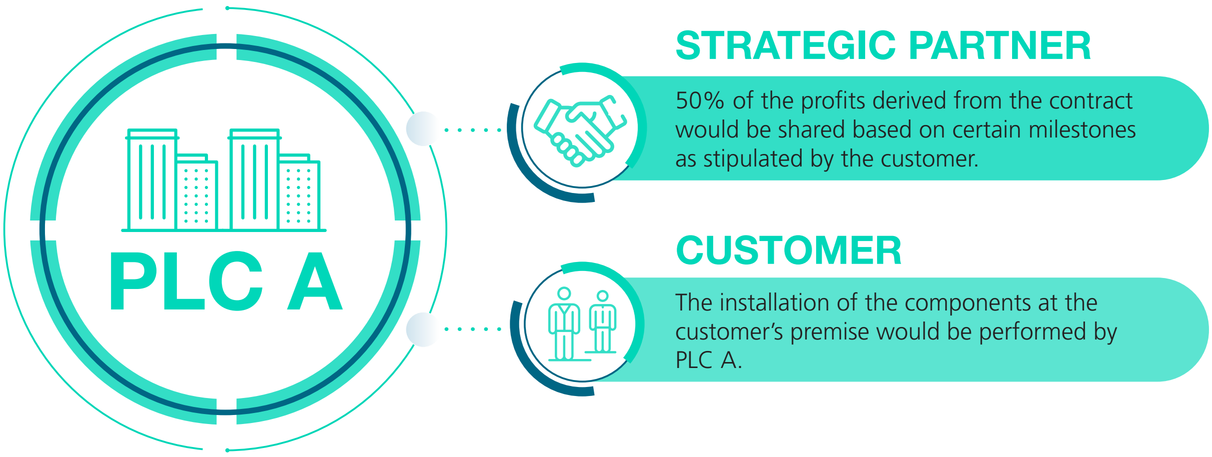
CASE STUDY 1
Appropriateness of revenue recognition and profit-sharing arising from complex business arrangements.

BACKGROUND

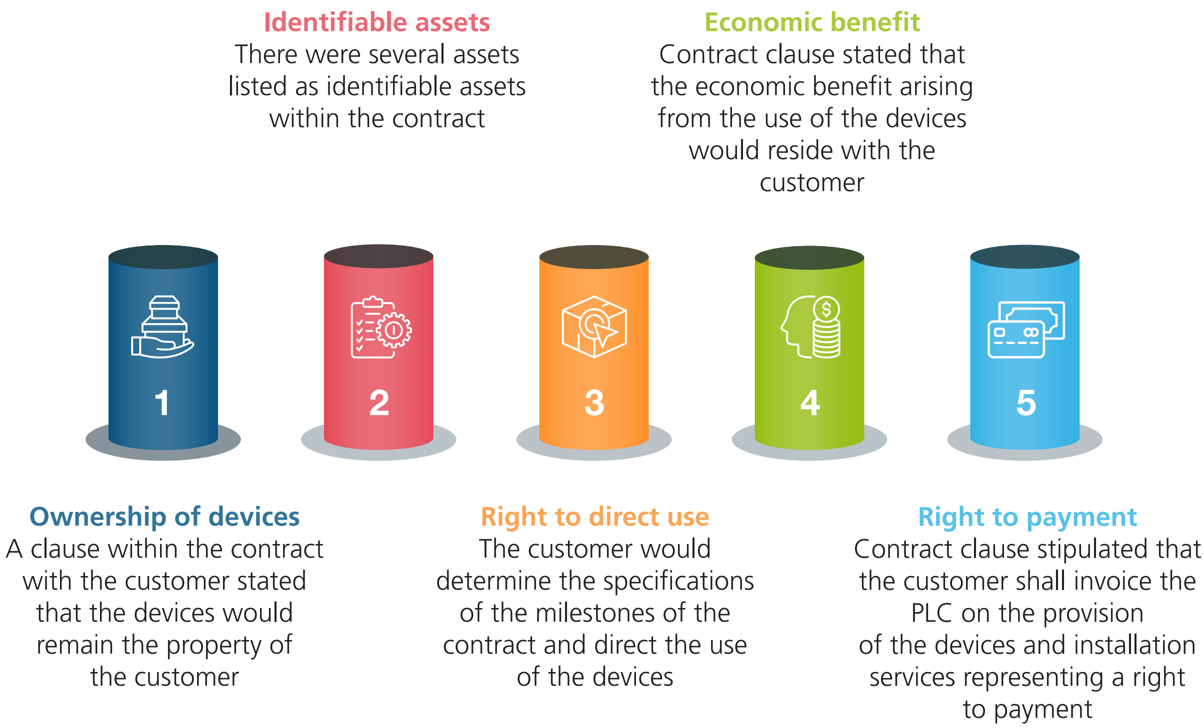
PLC A was involved in the provision of sustainable energy and healthcare services to local government entities in South Asia.

In 2021, PLC A entered into an energy performance contract with a major customer to deliver and install specialised devices. In the same year, PLC A entered into a Strategic Partnership Agreement with an external partner to collaborate in sharing technical capabilities and knowledge to develop these specialised products and install them at the customer's locations.

The overview of the business arrangements is as follows:



Based on the contract with the customer, the following salient terms and conditions were agreed and signed by all three parties:



RISK IDENTIFICATION

The revenue recognised during FYE 2022 increased by more than 100%. This was predominantly driven by PLC A's sustainable energy division upon the completion of installation work by PLC A in most locations stipulated in the contract. PLC A recognised outright revenue and associated costs during FYE 2022.

The significant increase in revenue was inconsistent with the growth in revenue of PLC A from prior years.

MATTERS TO BE CONSIDERED BY THE AUDITOR

Firm A assessed the revenue recognition in accordance with the requirements of MFRS 15 *Revenue from Contracts with Customers.* However, the firm did not consider the complexities of the business arrangements which may require them to design appropriate procedures to identify and manage the relevant risks.

AUDIT PROCEDURES PERFORMED BY FIRM A

- Assessment on MFRS 15 *Revenue from Contracts with Customers.*
- Verification of outright revenue and cost recognised in relation to the contract.
- Assessment of finance lease receivables where the relevant profit share as stipulated in the Strategic Partnership Agreement was spread over the contract duration of 10 years.

POTENTIAL ISSUES NOT ADDRESSED

Lease arrangement

The firm did not review and consider the key salient terms and conditions which indicated potential existence of lease arrangements and certain contradictory elements which indicated otherwise.

Business arrangement

The auditor relied on the legacy business arrangement of this contract in prior year and only assessed the contract based on the principles of MFRS 15 without considering the lease element.

Financing component

For receivables, the auditor assessed it as being a financing receivable. This financing component was not identified during the MFRS 15 assessment performed on the revenue.

Profit sharing

The firm failed to consider any liability to recognise the profit-sharing element between PLC A and the strategic partner.

Reliance on cumulative audit knowledge from prior years and the failure to apply adequate professional scepticism during the audit in challenging past accounting treatments may have led to deviation to the recognition of revenue and under recognition of liabilities resulting from the profit-sharing arrangement.

CASE STUDY 2

Recognition of receivable balance arising from land swap agreement.

BACKGROUND

PLC B is principally engaged in the property development and construction services with a FYE 31 December 2021. In April 2019, PLC B negotiated and entered into an agreement with Agency A to acquire parcels of land for the purpose of developing a new township.

The salient terms of the contract with Agency A are depicted as follows:

1 Agency A shall alienate three parcels of land to PLC B for a total consideration of RM370 million

2 In return, PLC B will need to surrender its own two parcels of land with a total cost of RM120 million to Agency A as part of the sales consideration.

3 In settling the remaining balance of the sales consideration, PLC B will need to fulfill certain obligations which includes:

1. To construct residential units on the land surrendered and bear all construction costs incurred. Upon completion, PLC B shall deliver the vacant possession of the completed project to Agency A.
2. To make a cash payment of RM80 million to Agency A.

RISK IDENTIFICATION

1. Pursuant to the agreement, the management of PLC B recognised the entire revenue and its corresponding receivable balance from Agency A upon surrendering the land in FYE 31 December 2019.
2. The contract further specified that Agency A is only obligated to alienate the lands to PLC B upon delivery and completion of the residential units.
3. Owing to the various movement control orders (MCO) imposed during the pandemic, the construction works were temporarily suspended in May 2020.
4. For FYE 31 December 2021, a significant receivable from Agency A was disclosed in the AFS as part of trade receivables which was outstanding for more than one year. It was disclosed that the receivable from Agency A will be settled by way of transfer of land.

WHAT SHOULD AUDITORS CONSIDER?

- Review the agreement entered with Agency A to identify the obligations arising from the terms and conditions within the agreement.
- Obtain an understanding of the agreement and the related accounting treatments. For complex accounting areas, to consider consultation with the firm's technical department from time to time.
- Ensure the agreement is reviewed on a periodic basis for any changes to the terms and conditions and if there are additional supplemental arrangements over the years.
- Assess the impairment indicators and impairment method used by the PLC's management in determining the recoverability of the receivable balance. This includes considering any external and internal factors that will affect the timing and action of the transfer of land.
- Consider the appropriateness of offsetting payment and obligations and ensure the accounting for such offsetting is properly reflected in the financial statements.

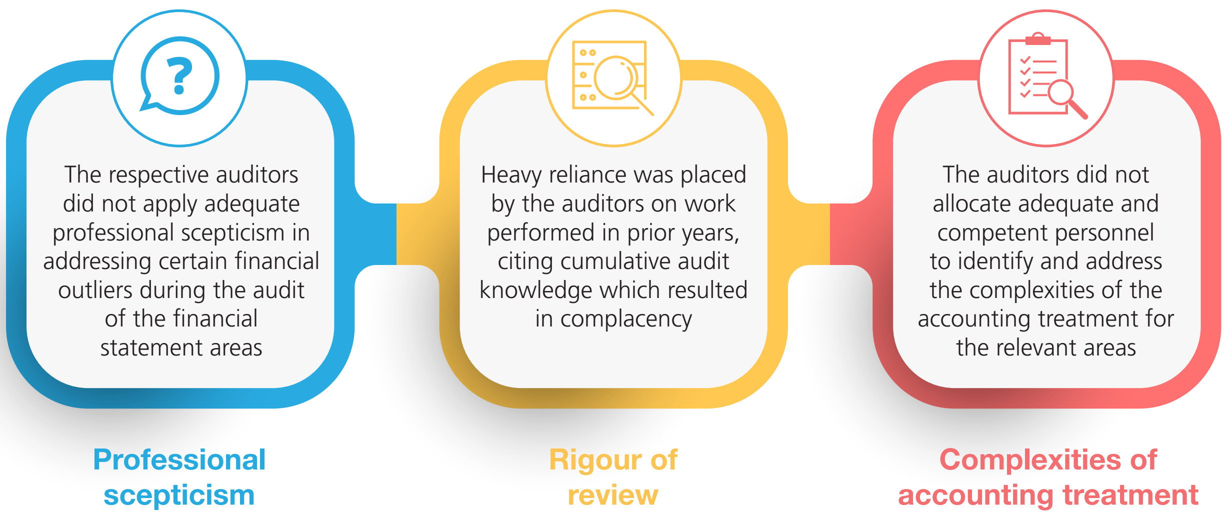
Firm B is required to obtain a thorough understanding of the business arrangements entered by PLC B in view of the various performance obligations and the respective settlement plans. Without considering the nuances of the terms and conditions stipulated within the contract, the appropriateness of the accounting treatments particularly on the basis of offsetting in deriving the receivable balance may be in question.

Should there be events or circumstances that occurred in the current year and could potentially affect the underlying transaction and progress of the development contract, the firm is required to enquire and seek further clarification from the management.

COMMON ROOT CAUSES

During the inspection, the AOB noted certain common root causes on the observations related to assessment of risk surrounding complex business arrangements as highlighted in Diagram 4 below.

DIAGRAM 4
Common root causes

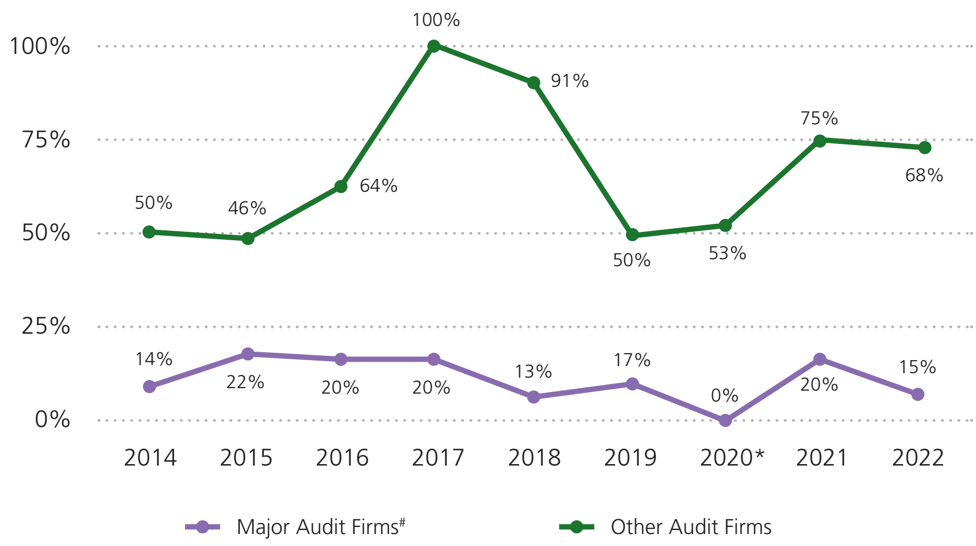


ENGAGEMENTS WITH SIGNIFICANT IMPROVEMENTS REQUIRED

At the end of every inspection, the AOB assesses the severity of findings arising from each engagement review. The AOB classifies engagements as requiring significant improvements when the engagement partners are imposed with specific remediation measures or are routed to the AOB's Enforcement, Regulation and Quality (ERQ) department.

CHART 1

Percentage of inspected engagements with significant improvements required



Note:

* The inspection results for the Major Audit Firms in 2020 may not be comparable to other years of inspections due to the hybrid approach adopted in the AOB's inspection programme arising from the various COVID-19 pandemic measures.

\# In 2022, two AOB-registered firms met the criteria of a Major Audit Firm, which led to an increase in the number of Major Audit Firms from six to eight. This change is not reflected retrospectively in Chart 1.

In 2022, 36% of the total engagements inspected required significant improvements, which was an increase from 24% in 2021. As illustrated in Chart 1, there continues to be a significant gap between the performance of Major Audit Firms and Other Audit Firms. This gap has slightly decreased from 55% in 2021 to 53% in 2022. There also seems to be a tapering down in the percentage of engagements with significant improvements required for:

- the Major Audit Firms from 20% in 2021 to 15% in 2022; and
- the Other Audit Firms from 75% in 2021 to 68% in 2022.

CHART 2
Actions taken on inspected engagements with significant improvements required

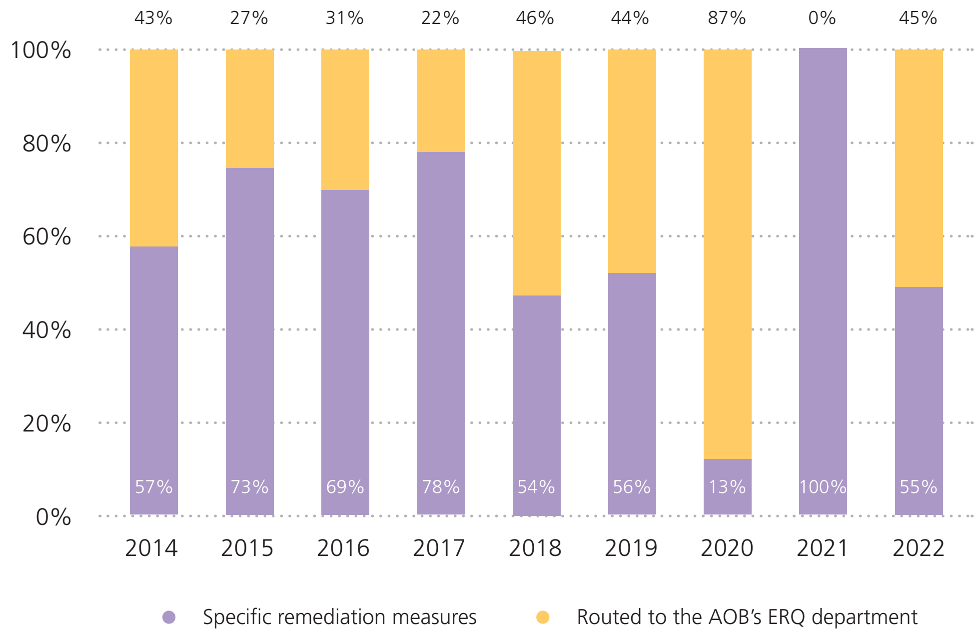


Chart 2 represents the analysis of actions imposed on inspected engagements with significant improvements required over the last nine years. As illustrated, the percentage of inspected engagements routed to the AOB's ERQ department has fluctuated over the years, with a drastic decrease from 2020 to 2021, only to experience an increase again in 2022 by 45%.

While the AOB continues to see the firms' ongoing efforts in improving audit quality, inspection findings still indicate that greater efforts are still required. Firms should always maintain the appropriate level of professional scepticism during an audit. The Engagement Quality Reviewer (EQR) also has an important role to play to ensure that the audit engagement team has appropriately addressed all significant and high-risk audit matters.

The AOB acknowledges that the issue of talent retention and balancing of partners' workload continues to be a key challenge to the firms. While efforts are taken to address the issue, firms are reminded to ensure business considerations do not override audit quality.

COMMON FINDINGS: ENGAGEMENT REVIEWS

The AOB compiles and analyses all engagement findings based on the categories of audit quality themes defined by the *International Forum of Independent Audit Regulators' (IFIAR) Survey of Inspection Results for Audit Firms.* The common findings observed from the AOB's inspection over a three-year period are illustrated in Diagram 5.

DIAGRAM 5

Top five common findings by audit quality themes

2022	2021	2020
Sampling	Accounting estimates	Sampling
Accounting estimates	Sampling	Accounting estimates
Use of experts/ specialists	Going concern	Auditor's report/ Revenue recognition
Auditor's report	Internal controls testing	Fraud procedures/ Presentation and disclosure
Inventory procedures	Use of experts/ specialists	Inventory procedures

Sampling and accounting estimates were commonly observed as the AOB's top two findings during the last three consecutive years signalling gaps in auditors' technical knowledge in applying key auditing standards. Further, inadequate understanding of the PIE's business industry has also contributed to these findings.

The top two common findings will be further discussed in the next page.

SAMPLING

ISA 530 *Audit Sampling* highlighted that the objective of the auditor in applying audit sampling is to provide a reasonable basis in drawing conclusions about the population from which the sample is selected. Therefore, an auditor must determine a sample size that is sufficient to reduce its sampling risk to an acceptably low level. Samples are to be selected in a way that each sampling unit has a chance of selection.

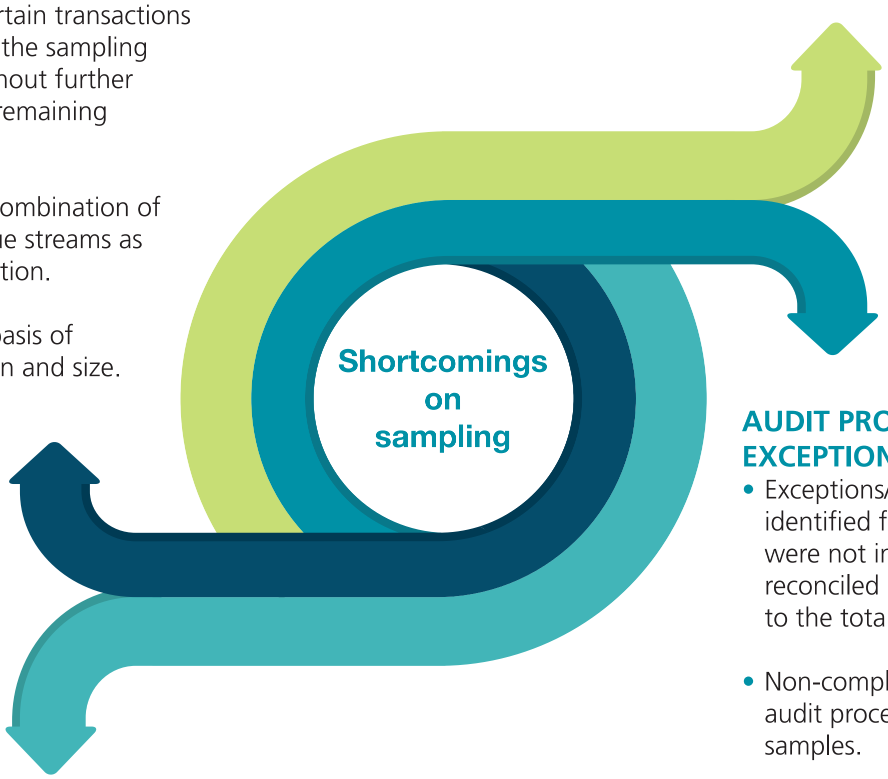
DIAGRAM 6
Common findings on sampling methodology

COMPLETENESS

- Number of samples tested were inconsistent with the sample size generated using the auditors' own sampling tool.
- Exclusion of certain transactions in determining the sampling population without further testing on the remaining population.
- Inappropriate combination of multiple revenue streams as a single population.
- Inappropriate basis of sample selection and size.

AUDIT EVIDENCE

- Inappropriate audit evidence obtained for tested samples that will not address the audit assertions.



AUDIT PROCEDURES/ EXCEPTIONS

- Exceptions/discrepancies identified from test samples were not investigated, reconciled and/or projected to the total population.
- Non-completion of planned audit procedures on selected samples.

APPLICATION OF SAMPLING METHODOLOGY

- Incorrect inputs such as lower risk factor by placing reliance on the PIE's operating effectiveness of controls.

As sampling represents one of the most fundamental aspects of auditing, it should be given due attention by engagement partners during the planning and review process. Despite firms having more robust guidance in sampling methodologies, the AOB continues to observe findings resulting from the application of audit sampling.

Auditors are required to have an in-depth understanding of the PIE's business in ensuring that audit procedures performed were appropriately designed to meet the intended objective of the test. This understanding includes consideration on whether the sampling population used is relevant, reliable and complete. Without having the right approach, samples tested may not provide sufficient appropriate audit evidence required to conclude on the audit procedures performed.

ACCOUNTING ESTIMATES

As illustrated in Diagram 7, there were notable deficiencies across elements of accounting estimates throughout the inspection in 2022.

DIAGRAM 7
Common findings on accounting estimates

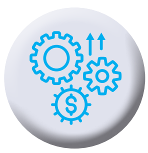
Impairment of assets
Insufficient challenge on management's assumptions used in cash flow projections in accordance with the requirements of MFRS 136 *Impairment of Assets*

Accounting estimation on project accounting
Lack of assessment on areas surrounding budgeting and provisioning

Recoverability of trade receivables
Insufficient assessment on the provision for expected credit loss, in accordance with the requirements of MFRS 9 *Financial Instruments*

Over the years, significant findings arising from impairment of assets remained in the top three common findings across the inspected firms, particularly in addressing the valuation of goodwill, deferred expenditure, right-of-use assets and investment properties.

The findings were apparent in the procedures surrounding the review of discounted cash flows in addressing impairment assessment. Among the common observations noted were as follows:



Cash Generating Units (CGU)
- No evaluation on the appropriateness of CGU determination where a number of assets were combined as a single CGU without assessing the appropriateness of doing so.
- Exclusion of carrying value of other assets from the impairment assessment.

Key Assumptions
Insufficient challenge on the projected sales and its annual growth rate used by management without consideration on the following circumstances:
- The impact of changes to the general business environment;
- Maximum operation and production capacity; and
- Aggressive and unexplained projection compared to historical results.

Sensitivity Analysis
- Sensitivity testing of the projected cash flows to verify the accuracy of disclosure was not performed.
- Where sensitivity test results in shortfall, there was no challenge on the key assumptions to support the firm's conclusion that no impairment is required.

The AOB is cognisant of challenges faced by auditors in obtaining sufficient appropriate evidence.

TABLE 1
Challenges in assessing management estimates

Challenges	
Contradictory information	• Optimistic projection of revenue growth based on management's bias despite declining trend and low demand in the market. • Reliance on global market research without considering local macroeconomics and specific business environment.
Justification on the basis of cash flow projections	• Lack of understanding of the key assumptions used such as forecasted sales volume, selling prices, cost and discount rates applied based on the prevailing economic climate.
Complexity of PIE's business structure	• Identification of synergy in determining the appropriate CGU where operations being shared across multiple components or locations. • Minimal or zero observable input for emerging business or at the initial stage of operation.
Limited data available on the impact of post COVID-19	• Rapid changes in the landscape of business industries have shaken the global demand and supply, resulting in uncertainty in the business forecast. • Limited availability of post-pandemic data in assessing management's assumptions and estimates.

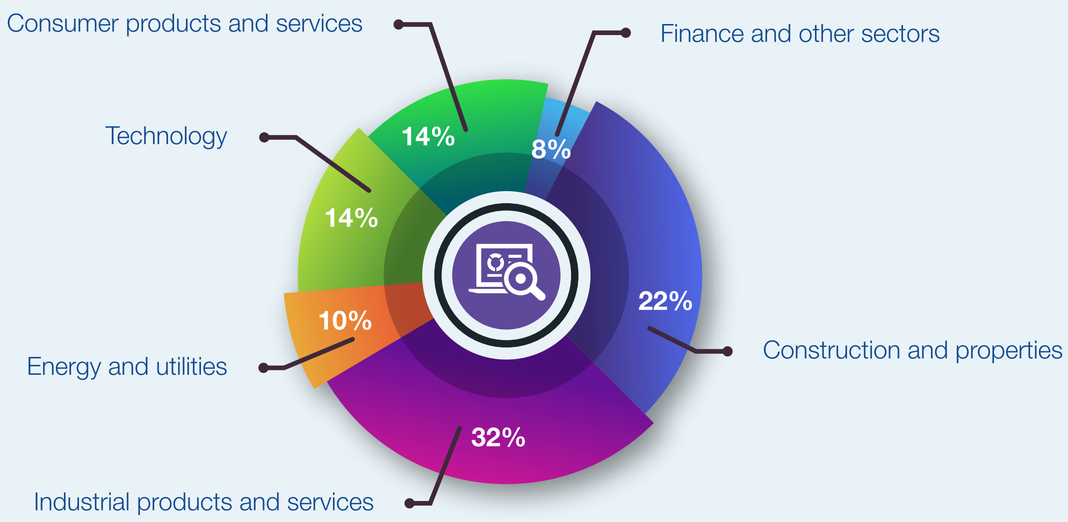
Considering the issues and challenges surrounding audit evidence to support management's key assumptions and estimates, auditors should explore other audit strategies to mitigate the risks. Other approaches worth considering are as follows:

- Effective use of internal and external specialists to review complex financial models;
- Consultations with experts and specialists;
- Challenge the extent and quality of disclosures particularly where the assumptions are highly subjective;
- Ensure early planning and timely discussions with management;
- Encourage healthy audit firm culture which emphasises on consultation and professional scepticism;
- Rigorously assess the risk by focusing on the key assumptions that are more significant to the asset; and
- Perform linkage between key inputs and historical results to challenge optimistic future projections.

BOX ARTICLE 3

COMMON FINDINGS ACCORDING TO INDUSTRIES INSPECTED

INDUSTRIES COVERED BY THE AOB'S INSPECTION IN 2022



Highlighted below are the areas of concern in relation to the above specific industries arising from the AOB's inspection in 2022:

Industry	Areas of concern
Industrial products and services	• Understanding the complex nature of inventories such as limestones and precious stones, e-waste materials and precious metals. • Assessment on work performed by management's expert in determining the valuation of inventories. • Determination on the completeness and existence of inventories during physical inventory counts.
Construction and property	• Assessment on the procedures surrounding the budgeting process. • Assessment on work performed by valuation expert in determining the valuation of inventories and investment properties. • Assessment on revenue recognition from disposals of land entered in complex business arrangements.
Technology	• Appropriateness of development expenditure capitalised in accordance with MFRS 138 *Intangible Assets.* • Assessment of various performance obligations in the revenue recognition in accordance with MFRS 15 *Revenue from Contracts with Customers.*
Consumer products and services	• Sufficiency of audit procedures performed on cash flow projections in addressing going concern and impairment assessment on property, plant and equipment.

BOX ARTICLE 4

ISA 315: INFORMATION TECHNOLOGY (IT) PERSPECTIVE

In December 2019, the International Auditing and Assurance Standards Board (IAASB) issued a revised standard for identifying and assessing the risks of material misstatement for financial audits, referred to as ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement.* The revised standard became effective for financial audits with periods beginning on or after 15 December 2021.

Among other matters, IAASB has sought to modernise the standard to keep abreast with the increased use of technology by businesses as well as recognise the use of automated tools and techniques by auditors when performing risk assessment procedures.

Diagram 1 and Diagram 2 highlight the technology-related revisions to ISA 315 and key considerations for the auditor when carrying out the risk assessment procedures during the audit.

DIAGRAM 1

ISA 315 (Revised) - Understanding of the audit client's information systems relevant to the preparation of financial statements

FOR SIGNIFICANT CLASSES OF TRANSACTIONS, ACCOUNT BALANCES AND DISCLOSURES:

- Obtain an understanding of how transactions are initiated, recorded, processed and reported in the financial statement.
- Obtain an understanding of how the information systems capture, process and disclose events and conditions other than transactions, in the financial statements.

Obtain an understanding of the **IT environment** related to the above and evaluate whether the IT systems appropriately support the preparation of the financial statements **(NEW)**

IT Applications

IT Human Resources

IT Infrastructure
- Network
- Operating systems
- Databases

IT Processes
- Management of access and changes to IT applications and IT infrastructure
- IT operations

CONSIDERATIONS FOR THE AUDITOR

Auditors should consider using automated tools and techniques such as data analytics to strengthen the risk assessment procedures during the audit. Data analytics, which allow for large volumes of data to be analysed, would allow the auditor to:
- Identify a significant class of transactions that has not been previously identified;
- Confirm his/her understanding of how transactions flow through the IT systems from initiation, processing to recording in the general ledger; and
- Identify deviations from the normal course of transactions processing that poses risks of material misstatement to a financial statement.

DIAGRAM 2

ISA 315 (Revised) - Understanding control activities relevant to the audit

Identification and evaluation of the design and implementation of controls

- Controls that address a significant risk
- Controls over journal entries
- Controls that will be relied upon to reduce substantive testing

Identification of IT applications and aspects of the IT environment relevant to the audit (NEW)

Some examples are as below:
- IT applications that store and process information relating to significant classes of transactions, account balances and disclosures.
- IT applications that support automated controls or produce reports that are relied upon by the management and the auditor.
- Other aspects of the IT environment include network, operating systems and databases supporting the use of the IT applications.

Identification of risks arising from the use of IT

Examples are as below:
- Unauthorised access to IT applications.
- Unauthorised changes made to IT programs or IT infrastructure.
- Cybersecurity threats.
- Availability of IT systems and loss of data.

Identification and evaluation of the design and implementation of relevant General IT Controls to address the identified risks above (NEW)

General IT Controls comprise processes to manage:
- Access to IT applications and IT environment.
- Changes to IT programs and IT environment.
- IT operations (e.g., backups and data recovery, management of IT incidences and job schedules).

CONSIDERATIONS FOR THE AUDITOR

1. Where the IT environment is of higher complexity, the auditor should consider engaging team members with specialised skills in IT to:
   - Identify IT applications and other aspects of the IT environment;
   - Determine the related risks arising from the use of IT; and
   - Identify relevant General IT Controls to address identified risks.

2. In evaluating the design and implementation of the relevant General IT Controls, inquiry alone is insufficient and should include the observation of the operation of the controls and inspection of relevant documents and reports.

3. When an auditor intends to place reliance on IT application controls or system-generated reports, the testing of the relevant General IT Controls alone is insufficient. The auditor should also perform testing of the specific IT application controls and other controls over system-generated reports.

GOING CONCERN: RIGOUR OF REVIEW IN UNCERTAIN TIMES

In 2022, while businesses worldwide were recovering from the effects of the COVID-19 pandemic, the global economy faced several challenges arising from the Russia-Ukraine conflict, the economic slowdown in China from the residual effects of the pandemic and intensified global inflationary pressures. Multinational companies faced prolonged supply chain imbalances and additional compliance and operational costs, affecting their financial liquidity positions.

Notwithstanding, a company does not necessarily need to be affected by macroeconomic conditions to be caught in financial distress. Poor capital management and/or business decisions could cause businesses to perform poorly, resulting in potential cash flow issues and thereby affecting the company's ability to continue to operate as a going concern.

While it is the director's responsibility to assess a PIE's ability to continue as a going concern in the preparation of financial statements, the auditors are required by ISA 570 *Going Concern* to ensure that the assumptions used were appropriate.

The AOB noted the following assumptions being commonly used by PIE directors to support their going concern assumptions:
- Unutilised banking facilities and revolving credits;
- 12-month cash flow forecast;
- Financial support by holding companies or major shareholders; and
- Proposed private placements or rights issues.

UNUTILISED BANKING FACILITIES AND REVOLVING CREDITS

The AOB observed that the most common assumption used by directors in their going concern assessment was the availability of unutilised banking facilities. The directors alternatively considered existing short-term banking facilities or revolving credits (RC). However, auditors must not assume that these short-term banking facilities can be rolled over in the next 12 months of operations without further verification.

The following is a non-exhaustive list of audit procedures that auditors may consider when assessing banking facilities and the roll-over of RCs:

AUDIT CONSIDERATIONS

- Trace existing banking facilities, both long-term and short-term, to correspondences with financial institutions;
- Obtain confirmations from financial institutions on total amount unutilised as at year-end. Cross-check this with management records to ascertain sufficiency of unutilised facilities;
- Check historical information on past RC rollovers, particularly in terms of the quantum and restrictions applied by relevant financial institutions, which could affect the continuity of existing RCs;
- Assess minimum payments required to rollover existing RCs, to be included in the cash flow forecast;
- Assess loan covenants, including potential cross-default positions and any additional covenants during the financial year for potential breaches; and
- Assess the ability to meet short-term obligations, including any reclassified long-term borrowings, which could impact future projected cash outflows and further deteriorate the net current liabilities (NCL) position.

CASH FLOW FORECAST

Cash flow forecasts are unique to the individual business depending on the nature and complexity of operations, investments and financing structure. These factors influence the robustness of the cash flow forecast which involves significant key management assumptions and estimations. The following case study provides an example of a less straightforward cash flow forecast, which requires heightened professional scepticism and detailed procedures to assess the appropriateness of the going concern assumption.

CASE STUDY 1

Going concern – cash flow forecast

PLC C primarily operates in the energy equipment and services business in Malaysia. As one of the leading industry players, it operates its business on a global scale, providing various services to National Oil Companies in countries within the Southeast Asian region.

Since the start of the COVID-19 pandemic, PLC C was severely affected as their operations had either halted or scaled down due to movement restrictions and additional health requirements imposed by the Ministry of Health (MOH) such as testing procedures, quarantine requirements and social distancing rules. These external factors had driven up costs and limited the ability of PLC C to return to normalcy in getting their earnings back to pre-pandemic levels.

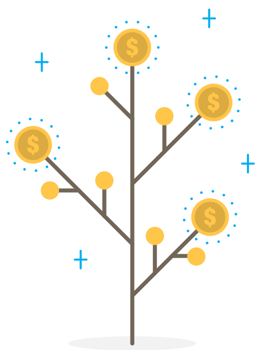
One of the key aspects of PLC C's business was its leased assets related to production vessels and tugboats. Being the most critical component of PLC C's business, these assets were leased from various global and local suppliers on a long-term basis over a period of 10-15 years. The scale of their leased assets was evident from the balance sheet where the right-of-use (ROU) assets of PLC C represented 60% of their total assets.

Historical financial performance of PLC C

Financial performance from FYE 2019 to FYE 2021

Current financial year end (FYE 2022)

During the FYE 30 September 2022, the financial performance of PLC C was as follows:



RM67 million Losses before Taxation

RM450 million Net Current Liabilities

RM345 million Negative operating cash flows

In August 2022, one of PLC C's lessors had filed a legal claim against the company for failing to settle lease liabilities amounting to RM34 million. The claimant cited PLC C's inconsistent payments of outstanding balances since the onset of the pandemic. As previously there have been no claims or legal suits filed by PLC C's lessors, this event was a clear wake up call to PLC C. Senior management decided to issue a press release announcing a review of their portfolio of leased assets, primarily focused on renegotiating the terms of payment of outstanding balances.

In a recent Annual General Meeting, the historical performance of the company coupled with the volatile business environment, particularly with the effects of inflation and the Russia-Ukraine conflict, had prompted the board of directors to raise going concern issues to its senior management.

At the conclusion of the meeting, both parties agreed to undertake the following specific measures to address the effects of the pandemic and were of the opinion that the AFS should be prepared on a going concern basis:

Preparation of cash flow forecast for FYE 2023

Renegotiation of payment terms with key lessors of their production vessel and tugboats

Financing from the state government in the form of economic grants

CONSULTATIONS ON GOING CONCERN

The AOB noted an increasing number of firms making it mandatory for engagement teams to consult on matters where there are indicators of going concern. This is despite the matter being a 'judgement call' at the audit partner's discretion in deciding to issue an unmodified audit opinion.

A consultative culture is encouraged as it is vital to mitigate the risk of an inappropriate audit opinion being rendered by the firm. Nonetheless, the AOB would like to remind firms to ensure that the technical team remains independent of the audit engagement team throughout the consultation process to enhance the credibility and objectivity of the decisions reached from the consultation.

In assessing the appropriateness of PLC C's going concern assumption, the following key points could be considered by the auditors for the FYE 2022 audit.

AUDIT CONSIDERATIONS

- Assess the cash flow forecast particularly the key assumptions used by the PIE management. It is important for the auditors to ensure the following in their review:
  - Obtain a detailed understanding of management's key assumptions;
  - Develop expectations of the assumptions based on external observable data; and
  - Test the expectations developed against management's assumptions and that these were within a reasonable threshold.
- Review the renegotiated payment terms with the key lessors to ascertain that all immediate payment obligations are discussed with these lessors and written agreements obtained on any deferment of payments;
- Obtain legal confirmation on the lawsuit by the lessor and verify that this has been adequately disclosed in the AFS; and
- Verify that sufficient financing has been obtained by PLC C and assess the likelihood of such financing being realised in the next 12 months.

PLC C's auditor performed the following audit procedures in its going concern assessment:
- Assessed the key assumptions used in the cash flow forecast for FYE 2023;
- Obtained legal confirmation on the ongoing lawsuit with the lessors; and
- Assessed the financing options of PLC C for the next 12 months.

As at the date of the auditor's report, the lease obligations due in FYE 2023 amounted to RM780 million.

Despite the uncertainty surrounding the renegotiated payment terms and payment arrangements with PLC C's key lessors, the auditor expressed an unmodified audit opinion highlighting a Key Audit Matter (KAM) in its auditor's report issued in December 2023.

Notwithstanding the above, the auditors failed to obtain sufficient appropriate evidence to support the appropriateness of PLC C's going concern assumption. Potential audit issues noted from the audit are summarised below:

POTENTIAL UNADDRESSED AUDIT ISSUES

Management's key assumptions took best case pre-COVID numbers, without considering slow market sentiment.

Reliance placed on ONE out of 20 agreements approved for staggered payment to conclude on the rest of the agreements despite it being the smallest contract.

Concluded that PLC C had no issues in paying the lessors but did not challenge the inconsistent monthly payments.

Correspondence was obtained from the management of one of the lessors, with the following limited statement:

"As the economic conditions are getting better, we look forward to resuming normal payment structure…"

As at year-end, five of 40 vessels were under maintenance and not in use. It was concluded that no repayments were required for the duration of the maintenance, but no confirmations were obtained to support this.

PART IV:
POST-INSPECTION PROCESS

REMEDIATION PROCESS

At the conclusion stage of the inspection, the AOB issues a *Final Inspection Report* to the inspected firms. Subsequently, firms are required to submit their remediation plan for the AOB's consideration which includes the following:

- Identification of relevant key areas for remediation
- Root cause analysis
- Monitor the outcome and effectiveness of the remediation plan
- Specific timeline for each action item

EFFECTIVENESS OF THE FIRMS' REMEDIAL ACTIONS TO ADDRESS INSPECTION FINDINGS

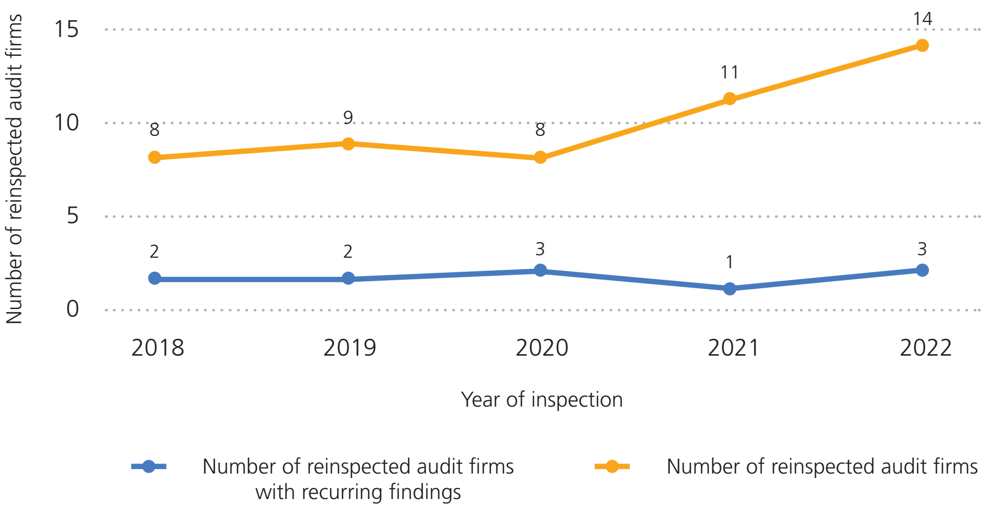
In 2022, out of 14 firms that were reinspected by the AOB, two Major Audit Firms and one Other Audit Firm had recurring inspection findings.

The recurring findings in 2022 were related to the following audit areas:

- Review of cash flow projections;
- Review of budgeted costs and budgeted revenue; and
- Review of loan covenants.

CHART 1

Reinspected firms with recurring findings (2018 – 2022)



A firm's remedial actions may be viewed as ineffective if there are recurring inspection findings after these measures have been implemented.

Remedial actions that are found to be ineffective necessitates a firm to re-perform their root cause analysis so that new or improved remedial actions can be designed to address the actual root causes of the recurring inspection findings.

KEY CONSIDERATIONS FOR THE PERFORMANCE OF AN EFFECTIVE ROOT CAUSE ANALYSIS

1. Firms should develop a methodology for the performance of root cause analysis including specifying related documentation requirements to ensure consistency of approach and proper conduct of the root cause analysis.

2. Individuals that have been identified by the firm to perform root cause analysis should be independent, competent and have sufficient authority to ensure that the analysis is free from undue influence or bias.

3. In performing the root cause analysis, relevant information should be gathered for analysis. The information may be gathered through interviews with the monitoring reviewers and audit engagement team members.

4. The individual(s) assigned with overall operational responsibility for the monitoring and remediation process should evaluate the results of the root cause analysis and ensure that appropriate remedial actions have been formulated to address them.

5. The completion of the root cause analysis should be timely so that it would not delay the implementation of relevant remedial actions to address identified deficiencies.

> *While a root cause analysis is typically focused on identified deficiencies, firms should also consider analysing the root causes of positive outcomes to identify opportunities to further enhance the system of quality management.*

ENFORCEMENT

The AOB continues to emphasise on instilling good behaviour and achieving a high level of compliance with standards and regulations among the AOB's registrants. One of the AOB's avenue to do this is via imposing enforcement actions.

In 2022, the AOB prohibited five audit partners and one firm from auditing and accepting PIEs and schedule funds as audit clients for 12 months. In addition to the prohibition, the AOB also imposed monetary penalties on the audit partners and firm totalling RM383,500.

The AOB's ERQ department observed the following failures which may lead to sanctions being imposed on the auditors:

SUFFICIENCY OF AUDIT EVIDENCE

- Non-existent, incomplete, or inadequate evidence in the assembled audit file to support the audit procedures performed, assumptions made and conclusions reached.

PROFESSIONAL SCEPTICISM

- Over-reliance on information provided by the clients without performing further audit procedures to verify reliability of information.
- Accepting clients' explanation without corroborative audit evidence.
- Failure to critically assess audit evidence for potential material misstatements.

Further, shortcomings which have gained prominence in 2022 were also related to the **effectiveness of EQR role** and **complexity of multi-location audit.** Both these areas are discussed in further detail below.

EFFECTIVENESS OF THE EQR ROLE

The EQR provides a check and balance in safeguarding audit quality and control processes through his/her independent and objective evaluation of key judgement areas and significant matters. The AOB observed that in instances resulting in enforcement actions on the EQR, the review performed by the EQR on significant risk and judgement areas were non-existent or were evidently not robust and adequately supported.

The effectiveness of an EQR review process is dependent on the competency of the reviewer, the timeliness and extent of his/her involvement in the audit engagement.

> *Under ISQM 2 Engagement Quality Reviews (ISQM 2) which took effect from 15 December 2022, the EQR shall determine that the documentation of the engagement quality review is sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the nature, timing and extent of the procedures performed by the EQR and the conclusions reached in performing the review.*

Hence, EQRs should be mindful of the requirements under ISQM 2 and ensure sufficient appropriate audit evidence to demonstrate the discharge of their duties on the audits of PIEs and schedule funds.

MULTI-LOCATION AUDIT

The AOB observed issues concerning fundamental audit procedures in multi-location audits resulted from inadequate evaluation of work performed by component auditors and over-reliance on information provided by foreign audit clients. The AOB reiterates the need for effective co-ordination and communication between the group and component auditors to ensure effective outcome from the audit.

Requirements for group audits have been laid out under ISA 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors).*

In situations where there was insufficient evidence provided by the component auditors, additional procedures should be carried out by the group auditor. Nonetheless, the group auditor should be mindful of their level of familiarity with the laws, regulations, reporting requirements and common practices in foreign jurisdictions.

A group auditor should proceed with caution and determine the right steps to mitigate the level of compliance risk when it comes to performing work in foreign jurisdictions as different countries may have different laws and regulations in place for audit arrangements.

CONCLUSION AND FUTURE OUTLOOK

DRIVING CONTINUOUS IMPROVEMENT TO AUDIT QUALITY

The audit profession has faced a number of challenges in recent years. Issues like talent shortage and attrition, cost in adopting technological advancement, and economic uncertainty have plagued the profession. Nonetheless, auditors have a duty to ensure that audit quality is not compromised.

In building high performing and sustainable practices, high-quality audits depend on individuals with the experience, independence, professional judgement, and skills. Training for staff must be effective and adequate to acquire the necessary knowledge and skill to perform audit assignments effectively. Learning and development requirements for auditors must move in tandem with the evolution of audit.

In the 2022 inspection findings, the AOB observed that the complexity of the PIE's portfolio contributed to firms' lapses in audit planning, judgement and execution of the audit. This may be due to the assumptions made in identifying potential risks and managing those risks. Consequently, the number of engagements requiring significant improvements in 2022 increased compared to 2021.

The AOB wishes to stress that some of the findings in key audit areas were significant and resulted in certain close call situations. Firms need to ensure that their audit engagement teams' thought process and intended objectives of the audit are clearly supported with documentary evidence in the audit working papers.

The dynamic landscape of business operations in various industries require heightened professional scepticism and critical thinking by auditors. Firms should be innovative in formulating measures including the need for skills in more subjective and qualitative areas as auditors learn to work with data and technological tools.

FOCUS AREAS OF 2023

In 2023, the AOB will focus on areas surrounding sustainability of audit practices, firms' system of quality management and auditing and accounting risk areas.

The AOB's engagements with auditors and key stakeholders via its AOB Conversation series and dialogues will remain a focus area. This is to ensure that auditors and ACs are adequately informed and equipped with relevant information to effectively carry out their respective roles.

The firm level review will be focusing on the design and implementation of firms' system of quality management in accordance with the requirements of ISQM 1 in view of its first year of implementation. The AOB will commence assessment on the operating effectiveness of firms' system of quality management from 2024 onwards.

The AOB will also engage firms' leadership to understand actions taken in addressing the issue of high attrition rates encountered by firms and the scarcity of individuals with relevant accounting technical skills in the existing market.

For engagement level reviews, the AOB will emphasise on audit procedures addressing the risks of material misstatement in complex and significantly judgemental areas of the financial statements, including:

- Identification and assessment of risks of material misstatement due to error or fraud.
- Audit areas with recurring significant engagement findings such as accounting estimates and going concern assessments.
- Assessment of complex accounting treatments focusing on auditors' professional due care and heightened scepticism surrounding related risk areas.
- Companies in industries related to the energy and information technology sectors.

In the spirit of continuous learning and encouraging improvements in audit quality, the AOB will share best practices of firms identified during the inspection.

APPENDIX

APPENDIX

DESCRIPTIONS OF THE AUDIT QUALITY INDICATORS

AUDIT QUALITY INDICATORS	DESCRIPTION
1. Workload of the PIE audit partner a) Average number of PIEs per partner; b) Average number of entities related to PIEs per partner; and c) Average number of non-PIEs per partner.	A partner's workload increases in tandem with the number of clients that the partner has to service. The heavier the workload, the lesser time a partner would have to supervise the audit engagements.
2. Auditor independence a) Average proportion of fee income derived from audit clients segregated into statutory audit, other assurance services and services provided by the non-audit practice; and b) Average proportion of fee income between audit practice and non-audit practice such as tax, corporate advisory and consulting.	The multi-disciplinary model of firms has enabled these firms to provide both audit and assurance services as well as non-audit services to their audit clients. When the proportion of fees derived from the offering of non-audit services to audit clients is relatively higher than the audit fees, there is a risk that the provision of non-audit services by the firm to its audit clients could undermine auditors' independence. Further, when the proportion of fee income from the non-audit practice of the firm is relatively higher than the audit practice, this raises the concern that the firm's focus on audit quality may be overridden by their non-audit business considerations.
3. Capacity and competence of the audit practice a) Average percentage of audit personnel with professional qualifications and those pursuing professional qualifications; b) Average staff turnover rate for audit personnel; and c) Average years of experience of audit partners and audit staff.	These indicators would provide ACs with an indication of the firm's ability to manage its talent pool, particularly in ensuring that the firm has sufficient and competent personnel to carry out quality audits. Talent retention continues to be a challenge faced by the audit profession due to stiff competition for accounting and auditing talents within Malaysia as well as abroad. As certain factors that drive these indicators are beyond the firm's control, it is also important for ACs to gain an understanding of the various mitigating actions taken by firms to address capacity and competency issues.
4. Audit engagement supervision a) Average staff-to-partner ratio; and b) Average staff-to-manager ratio.	These indicators provide an overview on whether the firm has sufficient partners and managerial staff to supervise less experienced audit team members. A lower ratio would imply that a partner or managerial staff could accord greater attention to supervise audit engagement teams.

AUDIT QUALITY INDICATOR	DESCRIPTION
5. Audit firm's investment to promote audit quality a) Average hours of training provided by the audit firms to audit personnel; and b) Average ratio of audit staff to one quality control staff.	Training provided by the firm to audit personnel is important to ensure that they remain technically competent and kept up-to-date with the latest developments in accounting and auditing standards. In addition, audit quality is also promoted within the firm through various quality control functions comprising training, technical consultations, risk management and quality assurance. A higher ratio of headcount in quality control functions relative to audit personnel headcount would indicate greater firm commitment to allocate resources to support audit quality.