



Suruhanjaya Sekuriti
Securities Commission
Malaysia

Audit Oversight Board

Conversation with Audit Firms

Annual Inspection Report 2021

18 August 2022 and 8 September 2022

Restricted

Audit Oversight Board

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Inspection Landscape



AOB's Observations

- Audit Firm Culture
- Valuation Experts
- Going Concern



Inspection Findings

- Firm Level Review
- Engagement Level Review
- Recurring Findings



Emerging risk



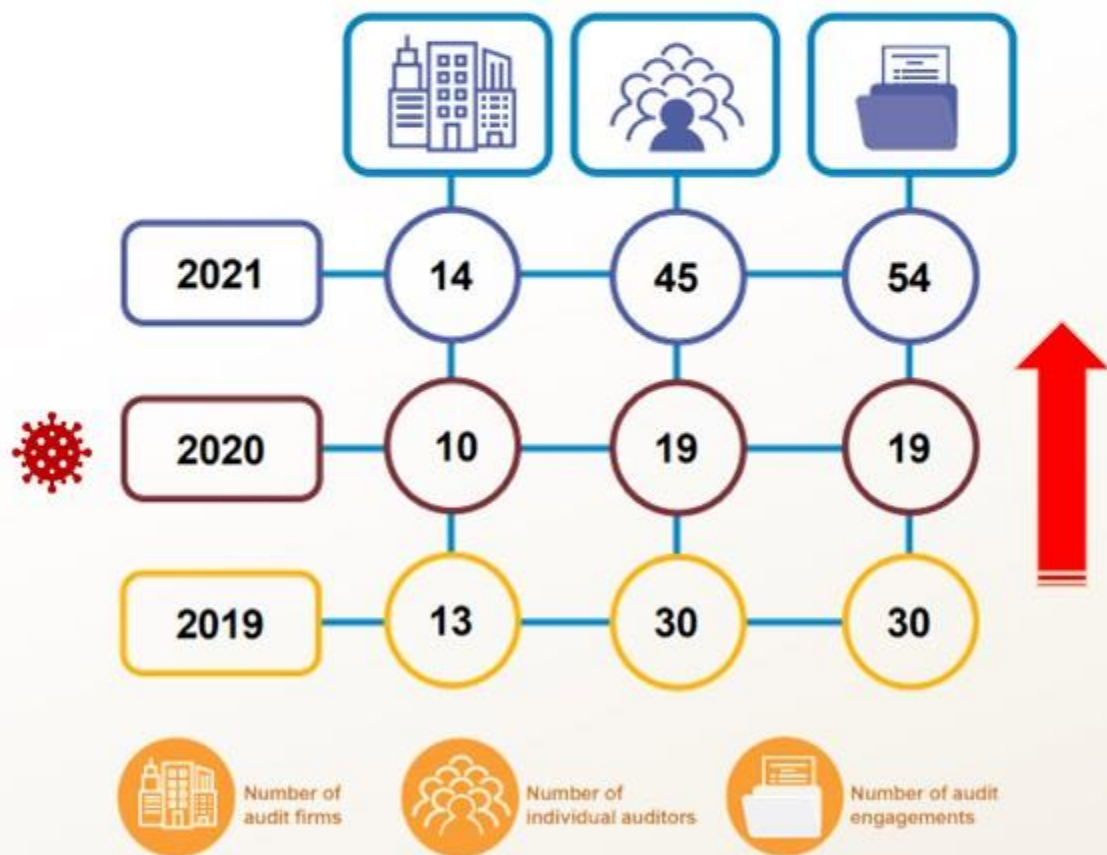
A stylized, colorful illustration of a city skyline. The buildings are rendered in various colors including blue, red, orange, yellow, and grey. They have a grid-like pattern of windows. The buildings are of different heights and are arranged in a way that creates a sense of depth. The background is a light blue gradient.

Inspection Landscape

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Inspection Landscape

INSPECTIONS



Data-driven Risk-based Inspections

- ❑ Direction of future inspections will be heavily reliant on data and AOB's risk assessment of both the audit firms and PIEs audited;
- ❑ Previous rotation cycles and lengthy periods without inspections will be reduced; and
- ❑ Audit firms will need to be vigilant and always ready for an AOB inspection.

Inspection Findings



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Firm Level Review



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Rotation of key audit partners

Audit firms did not consider all relevant roles undertaken **prior** to becoming key audit partner (MIA By-Laws)



Acceptance procedures for non-audit service clients

Audit firms accepted non-audit service engagements **before obtaining consent** from the respective audit partners



Audit Consultations

Consultations not carried out on matters affecting audit opinion, though required and audit reports signed before completion of consultation process



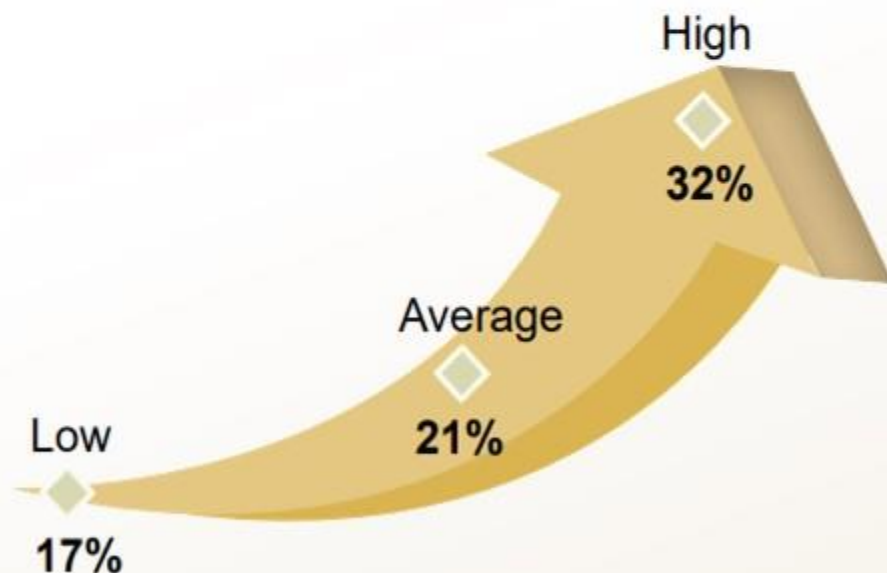
Safeguarding of assembled audit engagement files

Deficiency in controls over access and monitoring of audit engagement files to **prevent unauthorised modification** after file assembly

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Managing Staff Attrition

Staff turnover rate



Technological Transformation

- ☐ Increase adoption of digital application of digital audit platforms to bridge the gap arising from human resource constraints.
- ☐ Provide training programmes to upskill existing audit personnel on IT-related audits.
- ☐ Increase talent pool with the skills necessary to facilitate understanding and audit of automated controls, in tandem with PIEs move towards increasing reliance on technology and automated controls.
- ☐ Support the application of computer-assisted audit techniques (CAATs) and usage of data analytics tools on audit engagements

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Engagement Level Review



Accounting Estimates

- ☐ Impairment of goodwill - VIU assessment (MFRS 136);
- ☐ Recoverability of receivables & ECL assessment (MFRS 9);
- ☐ Valuation of investment properties measured at fair value (MFRS 140); and
- ☐ Valuation of ROU (MFRS 16).



Sampling

- ☐ Verification on completeness of source documents used for sample selection;
- ☐ Sufficiency and appropriateness of sample size and selection; and
- ☐ Reliability of internally-generated documents/listings used to verify samples.



Going Concern

- ☐ Reasonableness of assumptions by management;
- ☐ Appropriateness of reliance on financial support from related parties;
- ☐ Basis of conclusion for not highlighting MUGC; and
- ☐ Non-consultation with technical department.

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Recurring Findings



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**Assessment of cash flow
projections in impairment
assessments**

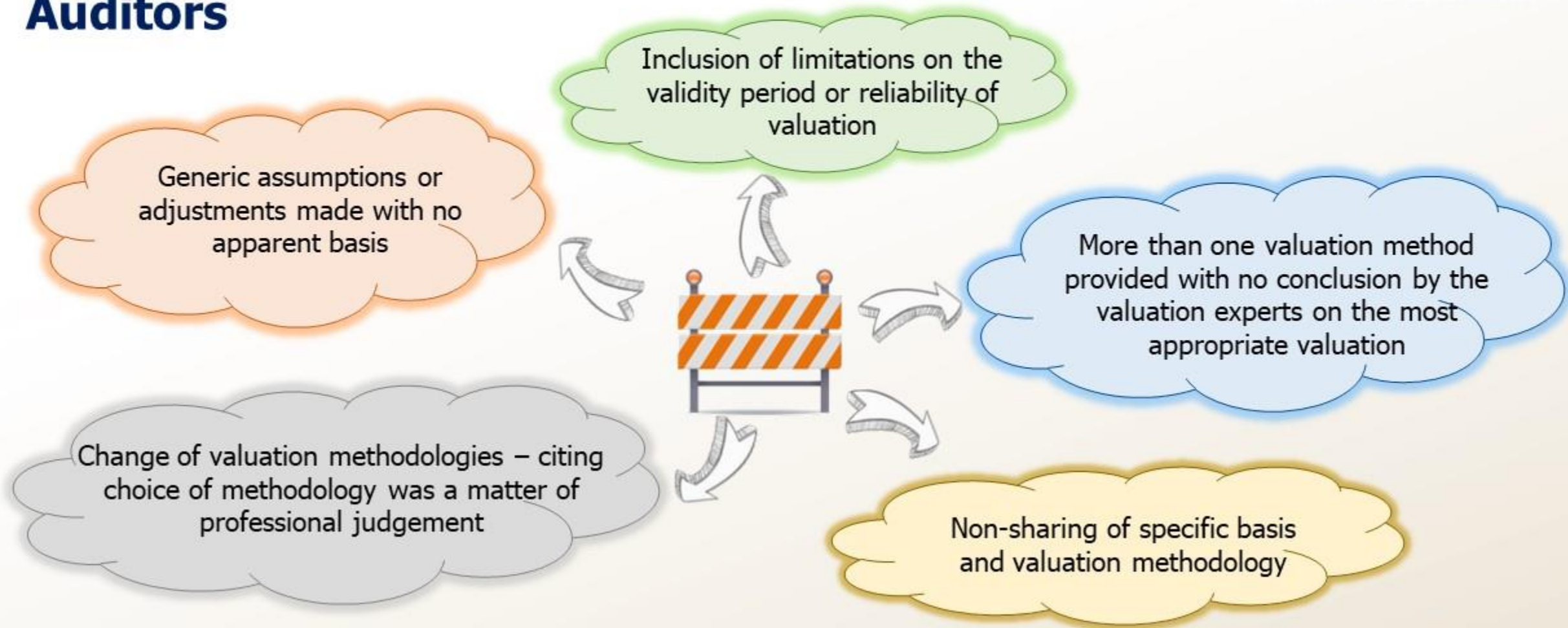
Firms should formulate **sustainable remediation plans** that are agile and dynamic to withstand changes in staff and external factors. Effective remediation action should **address the immediate concern** but is also an **ongoing effort of continuous improvement** to address upcoming risks.



Valuation
Experts

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Valuation Experts: Common Challenges Faced by Auditors



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Valuation Experts: Comparison Approach

- ☐ PIE B's investment property X is a freehold building located at Jalan Dungun, Bukit Damansara.
- ☐ Valuation Expert C was appointed to carry out the valuation of investment property X.
- ☐ The AFS for FYE 31 December 2021 disclosed: "valuation method of investment property X was changed from income method to comparison method in 2021".

Details	Comparison 1	Comparison 2	Comparison 3
Location	Jalan Damansara, Pusat Bandar Damansara	Jalan Sultan Ismail, Kuala Lumpur	Bandar Sri Damansara
Tenure	Leasehold	Freehold	Freehold
Transaction date	10 May 2018	31 July 2019	30 September 2021
Consideration	RM750 per sq. ft.	RM630 per sq. ft.	RM550 per sq. ft.
Adjustments			
Time factor	15%	-10%	-5%
Tenure	10%	-	-
Location	-	-	-

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Valuation Experts: Income Allocation Approach

- ❑ PIE D's investment property Y is a freehold building carried at fair value. As at 31 December 2021, the carrying amount was RM13.5 million.
- ❑ The AFS disclosed: "significant increase/(decrease) in estimated market value per sq. ft. in isolation would result in a significant higher/(lower) fair value of properties".
- ❑ Valuation Expert E was appointed to carry out the valuation on investment property Y. The expert adopted a net yield of 5.5% for the reversionary interest and 5.0% for term interest.
- ❑ In December 2021, Bank Bhd and Gloves Sdn Bhd indicated that the tenancy would not be renewed after expiry.

Tenants	Tenancy expiry date	Annual rental RM'000	Present value at 5.5%	Net yield of 5.5%	Reversion value RM'000	Market value RM'000
Bank Bhd	31 Jan 2022	400	0.9479	18.1818	6,900	7,200
Gloves Sdn Bhd	28 Feb 2022	250	0.8985	18.1818	4,100	4,500
Fruits Trading Bhd	31 Dec 2022	100	0.8072	18.1818	1,500	1,800
		750			12,500	13,500

Going Concern



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Going Concern Assumptions: Are They Appropriate?



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...entity's situation deteriorating...

Scenario	No significant doubts about going concern.	Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Entity determines no material uncertainties.	Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Material uncertainties about going concern remain after considering mitigating actions.	Intends to liquidate or to cease trading, or no realistic alternative but to do so.
Basis of preparation	Going concern			Alternate basis (not going concern)
Disclosure	Basis of preparation No specific disclosures.	Basis of preparation Significant judgements?	Basis of preparation Material uncertainties. Significant judgements?	Limited specific requirements

Source: IFRS Foundation educational material on application of going concern requirements

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Going Concern: Extension of Credit Facilities

- ❑ PIE G was in **NCL position** of RM20 million as at 31 December 2021. Cash flow forecast was performed by the PIE management to assess going concern.
- ❑ Revolving credit ("RC") facilities of RM30 million was **excluded** as these facilities were assessed to be rolled over in the next 12 months.
- ❑ **Unmodified opinion** was issued in the Auditor's Report dated 18 March 2022.

Available RC facilities

RC 1: RM15 million

Presumed as "evergreen" facility. Terms and conditions of the facility's agreement was not assessed.

RC 2: RM10 million

Minimum RC payment was included as part of cash flow forecast.

RC 3: RM5 million

Historical assessment on the repayment terms of the facility as evidence of continued financial support.

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Going Concern: Appropriateness of Audit Opinion

- ❑ PIE H is involved in the manufacturing and trading of palm oil and its related value-added products.
- ❑ Financial results for FYE 30 June 2021: LBT of RM60 million; NCL of RM63 million and negative operating cash flows of RM35 million.
- ❑ The auditor's report, which included a MUGC paragraph, was signed on 8 September 2021.

Management's Assessment

Roll-over of existing short-term banking facilities with utilisation of RM9 million as at 30 June 2021

New credit facility of RM15 million for working capital purposes

Funding from investment company

Financial support from major shareholder

Auditor's Evaluation

Breach of covenant which resulted in the financial institution rescinding the facilities

Negotiations were still on-going with the lenders and no formal offer extended as at audit report date

LOI dated 1 June 2021 obtained but no commitment received as at audit report date in relation to investment sum or timing of proposed investment

Major shareholder was in NCL position and incurred LBT for FYE 30 June 2021



Regulatory Initiatives

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Change of Auditors and Auditor Resignations (cont'd)



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----- GUIDELINES UNDER DEVELOPMENT -----

Regulatory concerns

Auditors resigning when faced with known or suspected financial irregularities perpetrated by their clients

Instances where the outgoing auditors are not forthcoming in communicating audit concerns to the incoming auditors



Change in auditors during annual general meeting

Outgoing auditor

- Must respond to professional clearance request from incoming auditor

Incoming auditor

- Disallowed from accepting a client unless professional clearance has been obtained

Change in auditors due to resignations

Outgoing auditor

- Must notify AOB on the reasons of resignations within 7 days from the date of resignation notice issued to the client
- Must provide the AOB with a copy of the professional clearance letter issued to the incoming auditor

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Change of Auditors and Auditor Resignations (cont'd)



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Regulatory concerns

Outgoing auditor refusing to provide the incoming auditor with access to the firm's audit working papers



Key initiatives

Engaged with the professional body to develop a technical guidance relating to granting of access to the outgoing auditor's audit working papers

To issue an alert on this matter with reference made to the technical guidance issued by the professional body

Emerging Risks



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Emerging Risks

Going concern assessment

- ☐ Cascading effect or emerging audit risk arising from the recovery phase of the pandemic – potentially affect the current operations and prospects of the PIE for e.g. sustainability of new business ventures/divestments
- ☐ Unpredictable triggering factors affecting the financial performance of the PIE to deviate from previous expectations
- ☐ Adequacy and transparency of disclosures – market and investor confidence over highly subjective and complex areas

Accounting estimates and involving significant judgements

- ☐ Critically challenge management on key judgements including the relevance of previous assumptions applied
- ☐ Early involvement of experts/specialists in assessing complex valuation measurements
- ☐ Consider external consultations if necessary

Audit firm's culture and audit quality

- ☐ Strong tone at the top & consistent reinforcement of messaging on positive culture on audit quality across all levels of personnel
- ☐ Effective compliance with ISQM 1 w.e.f. 15 December 2022 – no leeway given for inspection in 2023



Q&A
Session