Suruhanjaya Sekuriti
Securities Commission
Malaysia

audit oversight board annual inspection report 2020

Audit
Oversight
Board

ANNUAL INSPECTION REPORT 2020

Address
No. 3 Persiaran Bukit Kiara
Bukit Kiara
50490 Kuala Lumpur
Malaysia

Telephone
+603 6204 8900

Website
http://www.sc.com.my/aob

Fax
+603 6201 1888

The cut-off date for the data included in this report was 31 December 2020.

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.

CONTENTS

INTRODUCTION

INTRODUCTION

The Audit Oversight Board (AOB) was established under Part IIIA of the *Securities Commission Malaysia Act 1993* (SCMA) to regulate auditors of public-interest entities (PIEs) and schedule funds for and on behalf of the Securities Commission Malaysia (SC). The AOB also exercises oversight over any person who prepares a report relating to financial information of PIEs and schedule funds, in relation to capital market activities.

The AOB conducts inspections on registered audit firms and individual auditors of PIEs and schedule funds on a regular basis. Inspections involve an assessment of the degree of compliance by auditors with auditing and ethical standards applicable in Malaysia as well as the quality of the auditor's reports relating to the audited financial statements (AFS) of PIEs and schedule funds.

On 11 March 2020, the World Health Organisation (WHO) declared the outbreak of COVID-19 as a global pandemic. To contain the spread of the virus, a Movement Control Order (MCO) was imposed by the Government of Malaysia on 18 March 2020, which was followed by the implementation of varying degrees of movement restrictions to-date in Malaysia. The disruptions and uncertainties brought about by the pandemic necessitated the AOB to adapt and adjust its inspection programme, enabling it to accommodate the new normal. The AOB's regular inspection programme was complemented by a Monitoring and Thematic Review in relation to the impact of COVID-19, with particular attention given to areas such as going concern, impairment of assets and disclosures in the AFS.

This annual inspection report provides insights into the observations arising from the AOB's inspections at both firm and engagement levels in 2020. It also highlights the AOB's observations on the impact of the COVID-19 pandemic on the financial position and performance of public-listed companies (PLCs), the disclosures in the AFS of PLCs as well as the related auditor's report. Key areas of concern in an audit for the directors' and Audit Committees' attention are outlined in this report as well.

Part 1 of this report covers the highlights of the current audit landscape in Malaysia relating to the audits of PIEs and schedule funds. As in the previous years, the AOB continued its annual data gathering exercise for audit firms registered with the AOB to develop more objective insights into the respective firms' commitment towards audit quality. Observations on the common trends of audit quality indicators for the Largest 8 Audit Firms are included in **Part 1** of this report. The Largest 8 Audit Firms collectively audited PLCs that represented 71.4% of the total number of PLCs in Malaysia and 96.9% of the total market capitalisation of Bursa Malaysia and hence can be taken to be a close approximation of the audit firms under the AOB's purview.

Parts 2 and **3** set out an analysis of the AOB's inspection results at firm and engagement levels. The AOB's approach to inspections and assessment on the quality of audits are presented to assist the understanding and interpretation of these findings. The observations arising from the thematic reviews on the rotation of key audit partners and impact of COVID-19 on the AFS of PIEs and the related auditor's reports are also summarised in these two parts.

Part 4 covers the remediation progress of inspected audit firms to address the AOB's inspection findings, including analysis of recurring findings. The report concludes with a summary of the trends of inspection results as well as the areas that auditors need to focus on in the year ahead particularly in a time of continuing economic uncertainties.

WHAT THE AOB DOES WITH FINDINGS

Using a risk-based approach in our inspections, the AOB's considerations in selecting audit firms and auditors for inspection include the following:

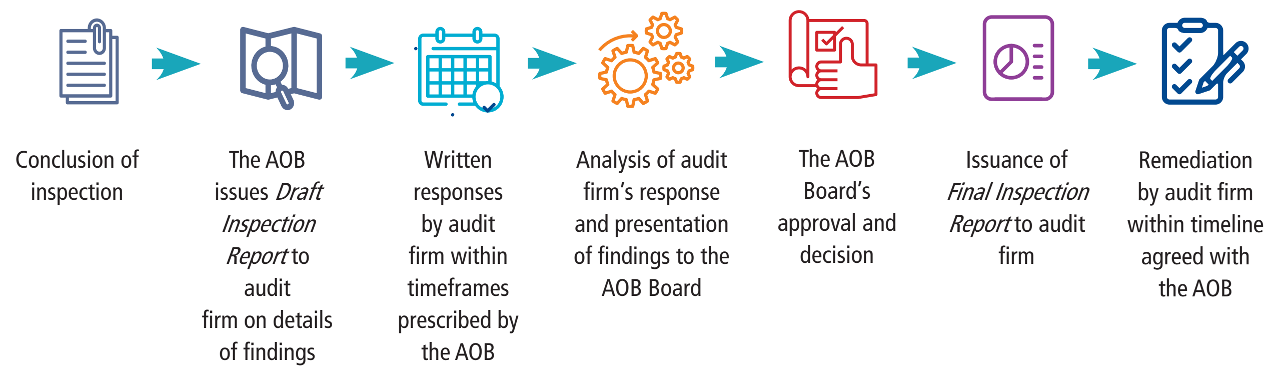
- The AOB's risk assessment of registered and recognised audit firms;
- Market capitalisation of PLC clients audited by audit firms;
- Specific areas of industry or market concerns; and
- Significant accounting, auditing or other developments during the year.

Given the AOB's targeted and risk-based approach, inspection results do not represent the entire audit engagements selected for inspection and the entire population of audit firms registered and recognised by the AOB. Inspection reports should not be taken as an assurance that the quality control of the audit firm inspected, its audits or its audit clients' financial statements are free from any deficiencies not specifically raised by the AOB.

The AOB's process upon the completion of an inspection is summarised in Diagram 1. An inspected audit firm is issued with a *Final Inspection Report*, which summarises all the findings arising from the inspection. The definitions of a finding from both firm and engagement reviews are depicted in Diagram 2.

DIAGRAM 1

THE AOB'S PROCESS AFTER COMPLETION OF INSPECTION



Source: AOB

DIAGRAM 2

DEFINITION OF A FINDING

WHAT IS A FINDING?

FIRM REVIEWS

Relates to compliance with the requirements of the *International Standard on Quality Control 1* (ISQC 1)

ENGAGEMENT REVIEWS

- **Relates to compliance** with *International Standards on Auditing* (ISA)
- **Individually critical deficiency**, which may have an impact on the basis of audit opinion
- **Pervasive issue** where the impact cannot be easily quantified

Findings do not necessarily suggest that the affected PIE's financial statements contain a material accounting error or its controls in respect of financial reporting are weak

Source: AOB

For engagements where significant improvements are required, actions can be taken on both audit firms and individual partners involved. In this regard, the AOB assesses whether findings relate to a lack of audit procedures, a potential material accounting error, or a combination of the two. The results of the AOB's assessment might require the following actions to be taken (Diagram 3).

DIAGRAM 3

ACTIONS THAT COULD BE TAKEN BY THE AOB

1	IMPOSITION OF SPECIFIC REMEDIATION MEASURES	Audit firms are required to incorporate or revise the relevant audit procedures in their audits of the PIEs for the ensuing financial year to evaluate the areas relating to the findings raised. Audit firms are also required to evaluate the impact of these audit procedures to the audited financial statements for the financial year inspected.
2	REFERRALS	The related PIEs are referred to the SC's Corporate Surveillance Department for further action to be taken on the PIEs, where relevant.
3	SHARING OF FINDINGS WITH PIES	As provided under Section 31ZD(3) of the SCMA, the AOB may share its findings with PIEs relating to inspected audit engagements. The AOB has exercised this power on several occasions. Depending on the severity of the concerns arising from the AOB's inspection, it will not hesitate to continue doing so when the need arises.
4	ENFORCEMENT	Inspection findings are referred to the AOB's Enforcement, Regulation and Quality Assurance (ERQ) Department for further evaluation and review. Subsequently, where it has been determined that there are breaches of laws and regulations, the AOB may take enforcement actions against the audit firms and individual auditors, which can range from issuing public reprimands to revoking the registration of audit firms and its individual auditors.
5	IMPOSITION OF ADDITIONAL REGISTRATION CONDITIONS AND INTERIM MEASURES	Depending on the severity and pervasiveness of the findings, while enforcement proceedings are ongoing, additional registration conditions could be imposed on audit firms and individual auditors as interim measures to safeguard audit quality and to protect public interest.

Source: AOB

WHAT SHOULD DIRECTORS OF PUBLIC-INTEREST ENTITIES DO WITH FINDINGS?

Directors and Audit Committees are ultimately responsible for overseeing the PIEs' financial reporting process to ensure that reliable audited financial information is provided to users of financial statements for informed decision-making purposes. Audit Committees in particular have an essential role to promote improvements in audit quality given their oversight of the audit process of their companies.

As the COVID-19 pandemic continues to raise challenges and compel companies to operate in an uncertain economic environment, good governance and effective oversight become increasingly important. Directors and Audit Committees have to be vigilant on an expanding range of issues and risks, including those relating to complexities of financial reporting caused by COVID-19. Continuous engagements with their auditors are essential to deal with these issues and to discuss the continuing impact of COVID-19, particularly at the earliest possible stage of the financial reporting and auditing process.

One of such issues is the area of going concern. In January 2021, the International Financial Reporting Standards (IFRS) Foundation issued an educational material to support the consistent application of going concern requirements in IFRS standards. It emphasises the importance of going concern disclosures particularly in the current economic environment, as summarised in Diagram 4.

Making accounting estimates and developing assumptions may also prove to be more challenging in an uncertain environment. The assumptions should be derived from a thorough and well-governed process with appropriate oversight from the Audit Committees and the board of directors. This would enable PIEs to react quickly and provide appropriate evidence and bases for these estimates in response to swift changes in the current operating environment.

In 2020, the AOB continued to distribute the *AOB Annual Inspection Report* to all PLCs. The sharing of common inspection findings in this report should provide sufficient information to facilitate the communication and engagement between the directors and/or the Audit Committees and their auditors. The AOB strongly encourages directors and Audit Committees to understand and discuss the findings and firm-level statistics shared in the report with their respective auditors. This is to ensure that the risk areas specific to their entities are adequately addressed and enables them to gauge the audit firms' commitment and approach to audit quality.

DIAGRAM 4

IFRS FOUNDATION EDUCATIONAL MATERIAL ON APPLICATION OF GOING CONCERN REQUIREMENTS

In reaching the conclusion that the going concern assumptions used in preparing the financial statements are appropriate, directors and Audit Committees must ensure that significant judgements made to reach that conclusion are sufficiently disclosed in both of the following circumstances:

- Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate, with no Material Uncertainty Related to Going Concern (MUGC); and
- Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. However, MUGC remains after considering mitigating actions.

It is important for users of financial statements to receive complete information about these significant judgements that are exercised in arriving at the management's conclusion.

PART

01 INSIGHTS INTO THE AUDIT PROFESSION

PART 01 INSIGHTS INTO THE AUDIT PROFESSION

REGISTRATION AND RECOGNITION STATISTICS

TABLE 1

Registered and recognised auditors as at 31 December 2019 and 31 December 2020

	No. of audit firms		No. of individual auditors	
	2020	2019	2020	2019
Registered				
Major Audit Firms	6	6	193	182
Other Audit Firms	32	33	146	143
Recognised				
Foreign Audit Firms	4	4	13	12
TOTAL	**42**	**43**	**352**	**337**

Source: AOB

In 2020, the Major Audit Firms continue to hold a larger market share for the audits of PIEs as shown in Table 2. Notwithstanding, the level of competition among the Major Audit Firms and the Other Audit Firms remains healthy where the number of PIEs audited by the Other Audit Firms continues to increase year on year as shown in Chart 1.

TABLE 2

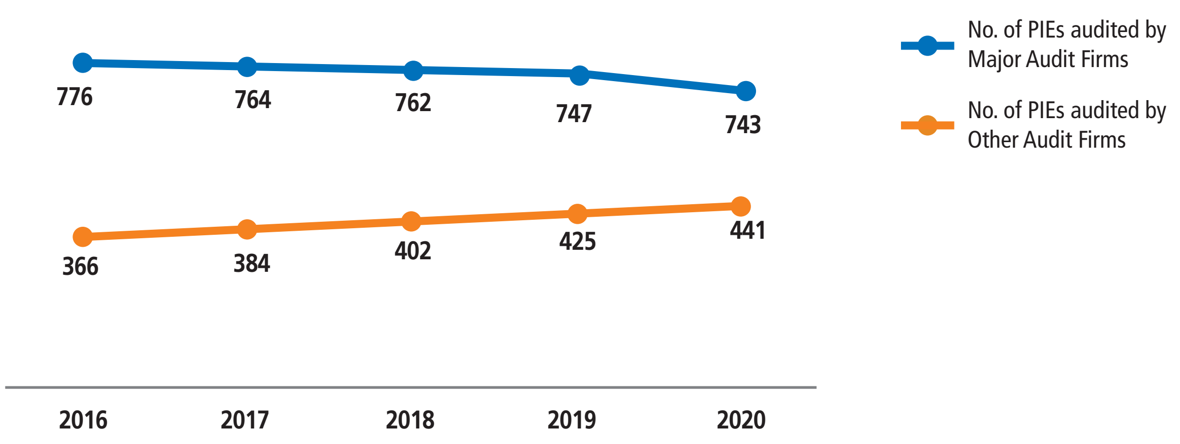
PIEs and schedule funds audited by AOB-registered firms and AOB-recognised foreign audit firms as at 31 December 2019 and 2020

	% of total no. of PIEs		% of total PLC's market capitalisation		No. of schedule funds		% of total net asset value (NAV)	
	2020	2019	2020	2019	2020	2019	2020	2019
Registered								
Major Audit Firms	62.49	63.36	92.37	94.50	1,112	1,063	98.3	98.2
Other Audit Firms	37.09	36.05	7.59	5.44	37	37	1.7	1.8
Recognised								
Foreign Audit Firms	0.42	0.59	0.04	0.06	-	-	-	-
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**1,149**	**1,100**	**100.0**	**100.0**

Source: AOB

CHART 1

Number of PIEs audited by Major and Other Audit Firms



Source: AOB

TREND ANALYSIS OF INDICATORS THAT MAY CONTRIBUTE TO AUDIT QUALITY

The trend analysis of indicators that may contribute to audit quality based on data collected from the Largest 8 Audit Firms in Malaysia are outlined below:

AUDIT PARTNER CAPACITY

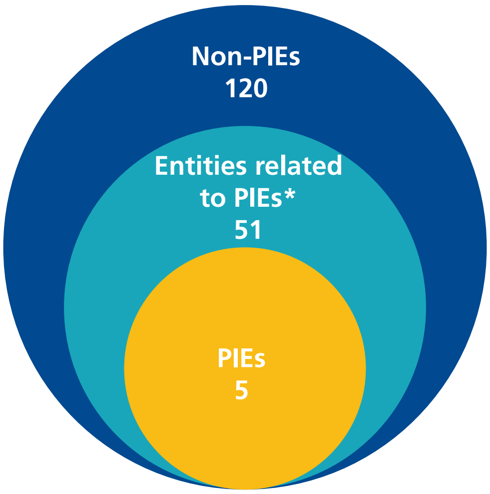
The capacity of an audit partner is impacted by the amount of workload that the partner has to manage. In addition to supervising audit engagements, an audit partner may also be required to undertake other roles in the firm relating to administration, quality management and business development.

Audit firms typically monitor an audit partner's client workload based on the number of audit clients under the partner's supervision and the collective size of the audit fees derived from his/her audit clients. An audit partner's client portfolio should be periodically reviewed to ensure that the partner is able to commit sufficient time to supervise his/her audit engagements.

Diagram 1 and Diagram 2 below depict the average workload of an audit partner.

DIAGRAM 1

AVERAGE NUMBER OF CLIENTS PER AOB-REGISTERED AUDIT ENGAGEMENT PARTNER

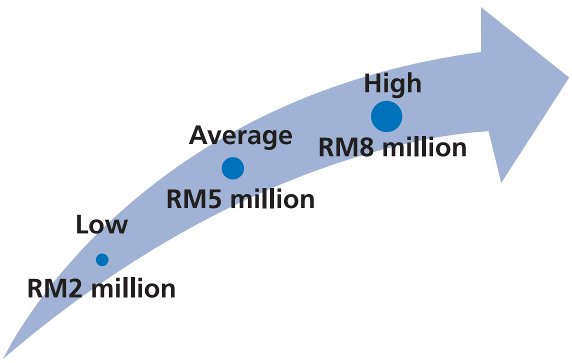


Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

**Relates to non-PIEs within the PIE Group, which are audited by Malaysian audit firms. Examples include, but are not limited to subsidiaries, associates and joint ventures of PIEs.*

DIAGRAM 2

AVERAGE AUDIT CLIENT PORTFOLIO FEES PER PARTNER



Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

Note: The average audit client portfolio fees of audit partners in the Largest 8 Audit Firms in Malaysia are derived from fees due to provision of audit and other assurance services to PIE and non-PIE audit clients.

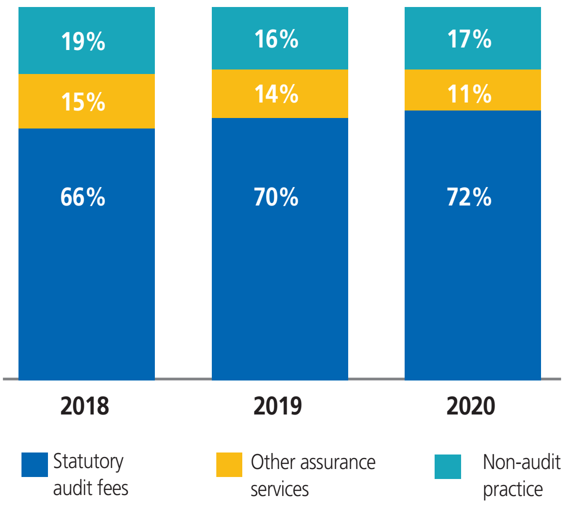
AUDITOR INDEPENDENCE

The multidisciplinary model of audit firms has enabled 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 is relatively higher than the audit fees, there is a risk that the provision of non-audit services by audit firms to its audit clients could undermine auditors' independence.

As depicted in Chart 2, the fee income from audit services continue to be a major contributor to the combined fee income derived from the firm's PIE audit clients. In addition, the composition of fees from the audit practice relative to fees derived from non-audit practice has remained fairly constant over the last three years as shown in Chart 3.

CHART 2

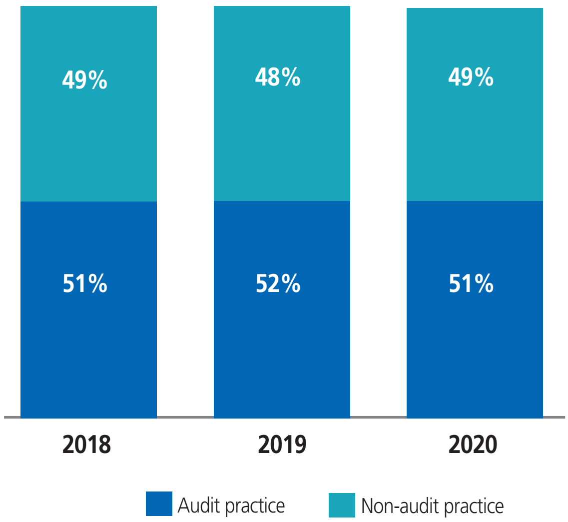
Composition of fee income between statutory audit, other assurance services and services provided by the non-audit practice of the Largest 8 Audit Firms to PIE audit clients



Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

CHART 3

Collective composition of fee income between audit practice and non-audit practice of the Largest 8 Audit Firms



Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

CAPACITY AND COMPETENCE OF THE AUDIT PRACTICE

For a quality audit to be carried out, the availability of sufficient and competent human resources is critical. As such, this is an area that requires close attention of the audit firms.

Indicators such as the headcount of the audit practice and staff turnover rates may provide a good overview on a firm's ability to manage the size of their talent pool.

Typically, audit firms face high staff turnover as an audit firm is viewed as a good place to start one's career and a good stepping stone to the commercial sector.

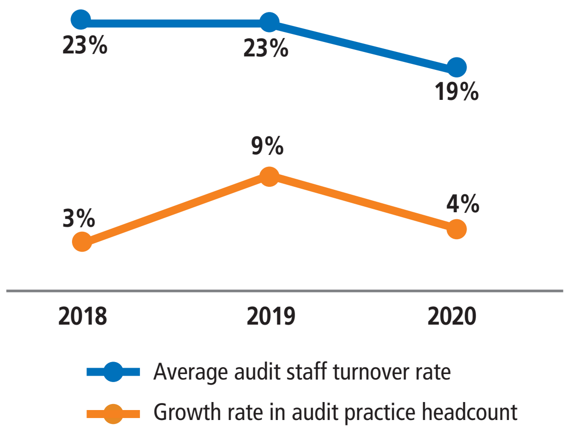
In 2020, there was a marked improvement in the average turnover rate which fell to 19%. In line with this positive development, there was a corresponding reduction in the headcount growth from the previous year.

The composition of audit personnel with professional qualifications and the average years of audit experience is a reflection on the competency of the talent pool of an audit firm.

A majority of the audit workforce typically comprise audit seniors and audit juniors (Table 3). These staff are supervised by the managerial level staff, whom largely have professional qualifications.

CHART 4

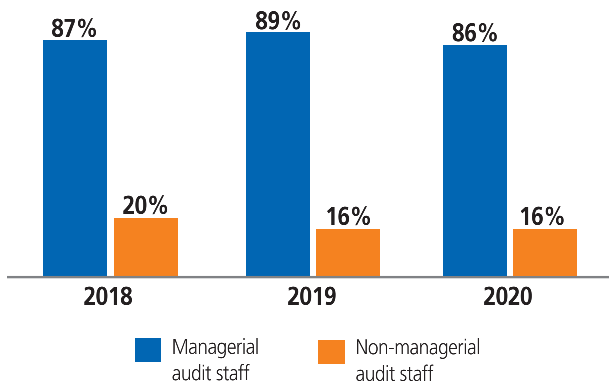
Average audit staff turnover rate and growth rates in the headcount of the audit practice



Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

CHART 5

Percentage of audit personnel with professional qualifications



Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

TABLE 3

Audit practice staff by level to total headcount and average years of experience

Staff Level	Partner	Director	Senior Manager	Manager	Audit Senior Staff	Audit Junior Staff
Staff Composition	3%	2%	4%	9%	29%	53%
Years of Experience	21.8	16.6	11.2	7.2	3.9	1.5

Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

FIRMS' INVESTMENT TO UPHOLD AUDIT QUALITY

A majority of the audit personnel of the Largest 8 Audit Firms comprise mainly non-managerial audit staff with average years of experience between 1.5 and 3.9 years. To ensure that the firms' audit personnel are technically competent, audit firms conduct structured training on auditing and accounting topics.

DIAGRAM 3

AVERAGE NUMBER OF TRAINING HOURS CONDUCTED BY THE LARGEST 8 AUDIT FIRMS IN 2020

PARTNER	67
DIRECTOR	66
SENIOR MANAGER	88
MANAGER	96
ASSISTANT MANAGER	85
AUDIT STAFF	123

Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

Note: The Malaysian Institute of Accountants (MIA) prescribes that all professional accountants are required to complete at least 120 hours of Continuing Professional Education (CPE) for every rolling three-calendar-year period, of which 60 CPE credit hours should be structured and at least 20 CPE credit hours of such structured learning should be obtained each calendar year.

Other investments by the firms to uphold audit quality include the establishment of various quality control functions within the firms comprising training, technical consultations, risk management, quality assurance and monitoring.

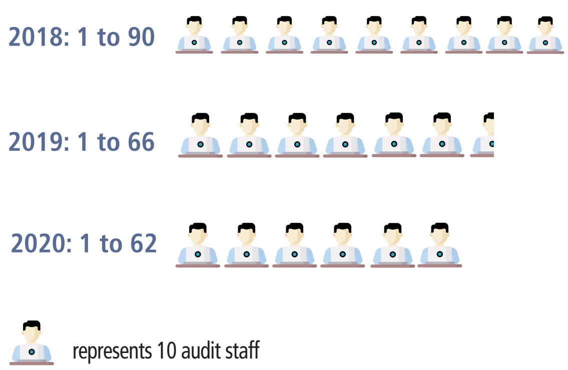
A higher ratio of headcount in quality control functions relative to audit personnel headcount would indicate greater firm commitment to dedicate resources to support audit quality.

In 2020, the ratio of headcount in quality control functions to headcount in audit practice continues to show a positive trend.

DIAGRAM 4

AVERAGE STAFF TO QUALITY CONTROL HEADCOUNT

Ratio of quality control staff to audit staff



Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

AUDIT ENGAGEMENT SUPERVISION

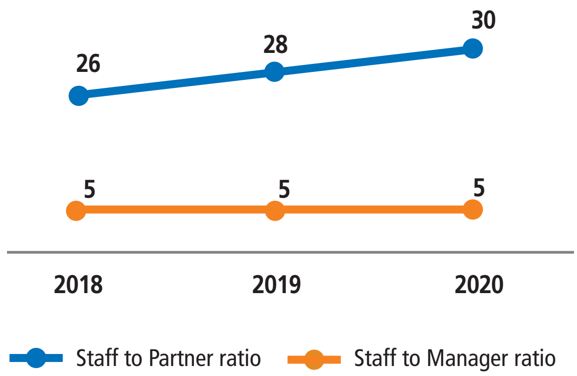
While an audit partner is primarily responsible for the overall conduct of an audit, audit partner receives support from managerial staff comprising audit directors and managers in the review and supervision of audit engagements.

The Staff to Partner and Staff to Manager ratios indicate the capacity of partners and managerial staff to supervise less experienced audit team members. A lower ratio would indicate that a partner or managerial staff could accord greater attention to supervise an audit engagement team.

While the average Staff to Partner ratio has increased over the last three years, the Staff to Manager ratio has remained constant.

CHART 6

Average Staff to Partner and Staff to Manager ratios



Source: AOB Analysis – Largest 8 Audit Firms in Malaysia

MONITORING FOR AUDIT QUALITY

Firms are required to implement a monitoring process to provide them with reasonable assurance that their systems of quality controls are adequate and operating effectively. The types of monitoring that have been implemented by the Largest 8 Audit Firms are illustrated below.

Types of reviews	Description of reviews	Number of firms
Firm reviews	Firm reviews are carried out to evaluate compliance with the requirements of ISQC1 and compliance with firm-wide policies and procedures.	8
Cold reviews for audit engagements	Reviews that are carried out to identify shortcomings in the audit work **after the issuance of an audit report**.	8
Hot reviews for audit engagements*	Reviews that are carried out to identify shortcomings in the audit work prior to the issuance of an audit report. Typically, identified shortcomings are rectified **before the audit report is issued** to the audit client.	4
Financial statements reviews*	Reviews that are carried out to identify shortcomings in the financial statements disclosures.	3

* Hot reviews and financial statements reviews for audit engagements are not specifically required under ISQC1. However, these reviews, particularly those that are carried out based on specific audit risk considerations may be beneficial to adequately address or mitigate against known risks.

ENGAGEMENT LEVEL TREND ANALYSIS

The AOB continued its engagement level trend analysis involving audit engagements that have been inspected to identify correlations between trends and audit quality. This analysis is based on data collated from engagements with satisfactory inspection results from the year 2017 to 2020.

4

PIE WORKLOAD OF THE AUDIT PARTNER

An engagement partner had **less than four PIE audit clients** with the **same financial year-end.**

5

EXPERIENCE OF THE ENGAGEMENT QUALITY CONTROL REVIEW (EQCR) PARTNER

An EQCR had at least **five years** of experience in the role of audit engagement partner of PIEs.

40-90

TRAINING AND DEVELOPMENT

On average, the team members attended **40 to 90 hours** of training during the year.

>15%

PARTNERS' AND MANAGERS' COLLECTIVE INVOLVEMENT

Partners' and managers' collective time spent on the audit engagements was **above 15%** of total engagement hours.

IMPORTANT NOTE TO PIE DIRECTORS AND OTHER STAKEHOLDERS

The analysis on the current trends relating to indicators that could contribute to the overall audit quality shared in this report is not exhaustive and is not intended to set performance benchmarks. Furthermore, the indicators should not be read in isolation as the level of audit quality can be impacted by a combination of other quantitative and qualitative factors.

The AOB hopes that the sharing of these indicators would provide a good foundation that encourages more meaningful discussions among stakeholders on audit quality matters to drive continued focus and improvements in the financial reporting ecosystem.

PART 02 INSPECTION FINDINGS AND OBSERVATIONS FROM FIRM LEVEL REVIEWS

PART 02 INSPECTION FINDINGS AND OBSERVATIONS FROM FIRM LEVEL REVIEWS

MAJOR AUDIT FIRMS

With the onset of the COVID-19 pandemic in 2020 and the resulting standard operating procedures that included travel restrictions imposed by the government, audit firms faced unprecedented challenges to their operations including the ability to meet regulatory deadlines for the issuance of AFS. This is particularly so for the Major Audit Firms who collectively audit around 63% of the total number of PIEs as of 31 December 2020.

In 2020, four Major Audit Firms were subjected to an offsite monitoring programme that included follow-ups on remediation actions taken to address past AOB inspection findings, evaluation of the firms' internal monitoring review results and thematic reviews on specific areas of concern arising from the impact of COVID-19 to the AFS and related auditor's reports.

Further details on the monitoring and thematic reviews are presented under Part 3 of this report.

The AOB inspected one Major Audit Firm in 2020 where there were no major shortcomings noted in the systems of quality controls of the firm. Due to the MCO, a planned inspection of another Major Audit Firm in 2020 was rescheduled to early 2021.

OTHER AUDIT FIRMS

The AOB conducted inspections on five Other Audit Firms in 2020, of which four of the inspections were conducted offsite due to the need to comply with strict standard operating procedures and to minimise physical meetings.

The common findings observed from the inspections are listed in Table 1.

TABLE 1

Common findings identified by the AOB during the 2020 inspections of the Other Audit Firms

Common findings in 2020	Key concerns / risks	Reminders
LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM		
For certain firms, the remuneration of the audit partners is determined solely based on their share of the firms' profits. There are no financial implications to a partner's remuneration in the event of failure to uphold audit quality.	Insufficient incentives in place to drive the right behaviour and practices among the partners in order to safeguard audit quality.	The remuneration of an audit partner should take into account his/her performance on the job that includes maintaining high quality audits. The results of the firm's monitoring reviews on audit engagements can form the basis of evaluating the performance of an audit partner with respect to audit quality.

TABLE 1

Common findings identified by the AOB during the 2020 inspections of the Other Audit Firms *(Continue)*

Common findings in 2020	Key concerns / risks	Reminders
ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS		
Prior to the acceptance of a new audit engagement, an audit firm should ensure that the firm and the prospective engagement team are independent of the prospective audit client. However, for certain audit firms, the evaluation of auditor independence was inadequate as it did not include enquiries with relevant personnel of the firm to identify all potential threats to independence.	Failure to identify potential threats to independence and to appropriately address these threats prior to the acceptance of a new audit client or new audit engagement can result in non-compliance with the requirements of the MIA By-Laws and ISQC1.	Firms are reminded to enhance the acceptance process for both audit and non-audit service engagements in order to ensure compliance with relevant ethical standards. The AOB will not hesitate to take stern actions such as imposing prohibitions or revoking a firm's registration with the AOB for serious non-compliances.
Some audit firms did not establish procedures that would require the prospective engagement team to obtain consent from the audit partner before accepting non-audit service engagements involving audit clients of the firm.	Audit partners who are ultimately responsible for ensuring auditor independence may not be aware of all relevant circumstances that can pose threats to independence.	
HUMAN RESOURCES		
Some audit personnel were not provided with training on accounting standards that would be relevant for the audit of a PIE.	Audit quality could be compromised if the audit work are carried out by audit engagement team members who are not conversant with the latest accounting standards.	Audit firms should pay close attention to the training needs of their audit personnel so that they remain competent and are able to deliver high quality audits. This is particularly important in view that audit firms typically face high staff turnover and the audit workforce mainly comprise less experienced staff.
ENGAGEMENT PERFORMANCE		
Some firms who have outsourced the destruction of audit engagement files at the end of the retention period to external parties did not make arrangements for the representatives from the firms to observe the file destruction process.	The confidentiality of audit engagement documentation could be compromised by the external party.	Firms are reminded of their obligations to safeguard confidentiality of information acquired during the audit at all times in accordance with the requirements of the MIA By-Laws.

TABLE 1

Common findings identified by the AOB during the 2020 inspections of the Other Audit Firms *(Continue)*

Common findings in 2020	Key concerns / risks	Reminders
MONITORING		
Some firms have not established a structured monitoring programme to evaluate the effectiveness of their systems of quality controls.	In the absence of a robust monitoring process, weaknesses in a firm's system of quality controls could not be identified and rectified on a timely basis.	The following are some recommendations to strengthen the effectiveness of a firm's monitoring programme to minimise occurrences of audit quality failures: • Designate a partner with sufficient authority and experience to lead the monitoring function; • Ensure that sufficient resources are committed to carry out annual monitoring reviews; • Conduct root cause analysis to identify relevant remedial actions to address identified shortcomings; and • Monitor the effectiveness of the remedial actions that have been undertaken.

AUDIT FIRMS' ACCOUNTABILITY TO SAFEGUARD AUDITOR INDEPENDENCE

The trust and confidence of the stakeholders over the reliability and credibility of the financial statements of a company hinges on the perception that the work carried out by the auditors is free from bias, undue influence and conflict of interests.

In recognising the importance of auditor independence, the AOB would like to remind audit firms on the following:

a. Continuous compliance with recognised ethical standards in Malaysia, which is the MIA By-Laws on Professional Ethics, Conduct and Practice (MIA By-Laws), is one of the conditions for an audit firm to remain registered with the AOB. Failure to adhere to this condition would result in stern enforcement actions to be taken that may culminate in the revocation of a firm's registration with the AOB;

b. While an audit firm may have established policies and procedures to address matters relating to auditor independence, it is also important that ongoing monitoring reviews are carried out to ensure that the firm's personnel adhere strictly to its policies and procedures;

c. If there are breaches of auditor independence involving the provision of a prohibited non-audit service by the firm's audit partner to a PIE audit client, the AOB would hold both the audit firm and the audit partner concerned accountable notwithstanding that the service was rendered by the partner under an entity not registered with the AOB. It is therefore important that relevant measures are undertaken by the audit firm to mitigate such occurrence; and

d. Audit firms should be mindful that independence in appearance is equally as important as independence in mind. Therefore, an audit firm should avoid being subject to circumstances where a reasonable and informed third party would likely conclude that the auditor's independence is impaired although the perceived threats to independence did not materialise as trust and confidence in the auditor could still be impaired nevertheless.

IMPORTANT NOTE TO AUDIT COMMITTEES

Under the recently revised *Malaysian Code on Corporate Governance* (MCCG) as at 28 April 2021, the following requirements have been introduced to strengthen auditor independence:

- Audit Committees are required to implement a policy that requires a former partner of the external audit firm of the listed company to observe a cooling-off period of at least three years before being appointed as a member of the Audit Committee. This applies to all former partners of the audit firm and the affiliated firms such as those providing advisory, tax and consulting services; and
- Audit Committees are required to approve non-audit services before such services are rendered by the external auditors and their affiliates while taking into account the nature and extent of the non-audit services and the appropriateness of the level of fees.

CONSIDERATIONS FOR THE ROTATION OF KEY AUDIT PARTNERS ON AUDIT ENGAGEMENTS

Paragraph R540.10 of the MIA By-Laws stipulates that when evaluating the threats posed by an individual's long association with an audit client, the audit firm should take into consideration the roles undertaken and the length of an individual's association with an audit engagement (time-on period) **prior** to becoming a key audit partner.

Although the maximum time-on period permissible is seven years, Paragraph 540.10 A1 of the MIA By-Laws stipulates that an audit firm may find it necessary to rotate a key audit partner after he/she has served for a shorter period on an audit engagement.

The AOB observed that the partner rotation policies adopted by audit firms to address the requirements of the above MIA By-Laws varies from firm to firm as summarised below:

a **Role of an individual prior to becoming a key audit partner**

The role at which point audit firms start to consider to calculate the time-on period for an individual on an audit engagement prior to becoming a key audit partner ranges from audit senior manager to audit executive directors.

b **Time-on period permissible after taking into consideration the prior roles undertaken by an individual on an audit engagement prior to becoming a key audit partner**

The maximum time-on period allowed for the combined roles undertaken prior and after an individual has become a key audit partner ranges between seven and 12 years.

Audit firms are reminded to ensure that relevant policies and procedures are put in place to address the requirements of paragraphs R540.10 and R540.10 A1 of the MIA By-Laws.

THE IMPERATIVE USE OF AUDIT SOFTWARE ON AUDIT ENGAGEMENTS

The rapid pace of technological advancements has been a key driver for innovations that have benefited many businesses. Likewise, for the audit profession, some benefits may be derived from the adoption of technology to drive the achievement of effective and quality audits. One such technological adoption by audit firms involves the use of audit software on audit engagements that leverages the internet. For the Major Audit Firms, the audit software used are developed by their respective global networks while the audit software used by some Other Audit Firms are typically purchased off the shelf with or without customisation.

There are multiple benefits that could be derived from the use of audit software on audit engagements, as follows:

a **Drive consistency in engagement performance**

Audit software typically incorporates standardised audit work programmes, templates and workflows that are aligned with a firm's audit methodology. When applied across audit engagements, the audit software could help drive consistency in the performance of the audit through standardisation of audit approach and documentation requirements.

b **Facilitate timely engagement supervision and review**

Audit software allows paperless audits where all audit work documentation including audit evidence can be retained in the system. When an audit engagement team member uses the audit software to document his/her work, this piece of work can be accessed by other team members via the internet. This enables an engagement to be supervised remotely and reviews to be carried out as and when required. Concurrent audits across multiple locations or at a location distant from the office would no longer pose a hindrance for timely reviews of audit work.

c **Facilitate better project management**

Some audit software provides the functionality to plan and monitor outstanding tasks and deadlines throughout the various stages of the audit from audit planning, execution to completion. Such capabilities would enable the audit engagement partner and manager to exercise stronger oversight over the progress of an audit assignment.

d **Enhance safeguards over the confidentiality, safe custody, integrity, accessibility and retrievability of audit engagement documentation**

Access to audit software would require a valid user account and password that is typically granted to audit engagement team members only. This mechanism enables the confidentiality and integrity of audit engagement documentation to be protected. Upon completion of an audit, the audit software would enable the electronic audit engagement files to be archived to prevent any unauthorised modifications to be made after finalisation. When the work papers and audit evidence are stored electronically, this will not only save physical storage space but also lead to ease of retrievability should the need arise.

THE IMPERATIVE USE OF AUDIT SOFTWARE ON AUDIT ENGAGEMENTS *(Continue)*

e Facilitate monitoring over the quality of engagement performance

Audit firms are required to conduct annual engagement reviews to monitor audit quality. For the Major Audit Firms, the reviewers are typically assigned by their global network and are not based in Malaysia. With the onset of the COVID-19 pandemic and travel restrictions imposed, these firms were able to carry out engagement reviews remotely through the use of audit software. Hence, the COVID-19 pandemic did not result in major disruptions to their monitoring review process.

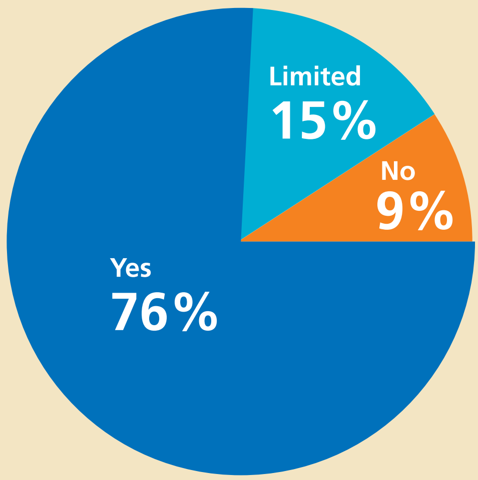
While the COVID-19 pandemic posed various challenges to the work of the auditors, audit firms that have embraced technology are in a better position to manage these challenges. For instance, audit staff who have been provided with laptops equipped with audit software were able to continue to work from home during the MCO period and the work performed was supervised and reviewed remotely by the audit engagement partner and manager. Through the internet, audit personnel could continue to gain remote access to the firm's systems and resources to support their work as well as to conduct meetings with other engagement team members and their clients through web conferencing facilities.

In 2020, the AOB conducted a survey on the utilisation of audit software by the audit firms registered with the AOB. As shown in Chart 1, the survey revealed that 76% of the respondents are currently using audit software when performing audits of all their PIEs while another 15% of the respondents are using audit software on the audits of selected PIEs and subsidiaries of PIEs.

With the numerous benefits that technology could offer, audit firms that have yet to fully embrace the adoption of technology, including the use of audit software, should do so in their pursuit to achieve sustainable audit quality.

CHART 1

Utilisation of audit software in PIE Audits



Source: AOB Analysis

NEW AND REVISED STANDARDS ON QUALITY MANAGEMENT

In September 2020, the International Auditing and Assurance Standards Board (IAASB) approved three new and revised standards relating to quality management for implementation by 15 December 2022. These standards were intended to set the foundation for high quality audit.

New and Revised Standards on Quality Management	Key Highlights
International Standard on Quality Management 1 (ISQM 1) ■ Quality management for audit firms that perform audits or reviews of financial statements, or other assurance or related services engagements	ISQM 1, which will replace ISQC1, seeks to further strengthen the robustness of the audit firm's systems of quality controls through the following: ▶ introducing a more proactive and targeted approach to managing quality; ▶ increasing the audit firm's leadership responsibilities and accountability as well as improving governance; ▶ introducing more rigorous monitoring of systems of quality controls and added focus on effective remediation of deficiencies; and ▶ modernising the standard to cater to an evolving and complex environment that includes addressing the impact of technology, networks and use of external service providers.
International Standard on Quality Management 2 (ISQM 2) ■ Engagement Quality Reviews (EQR)	ISQM 2 seeks to enhance the effectiveness of EQR by addressing, among other areas, the following: ▶ criteria for the selection of engagements to be subjected to an EQR; ▶ appointment and eligibility of engagement quality reviewers; ▶ the nature, timing and extent of the EQR; and ▶ documentation requirements for EQR.
ISA 220 (Revised) ■ Quality management for an audit of financial statements	This standard seeks to enhance linkages between quality management at the firm level and engagement level as well as strengthen the role and responsibilities of an audit engagement partner for managing quality throughout the audit engagement.

Audit firms are advised to familiarise themselves with the requirements of the latest standards and to take the necessary steps to fully implement these standards by the due date of 15 December 2022. From 2023 onwards, the AOB will be conducting firm inspections based on the new standards.

ANNUAL TRANSPARENCY REPORTING FOR AUDIT FIRMS

The Annual Transparency Reporting for audit firms was introduced by the AOB in 2019 to promote greater transparency and stronger accountability for audit quality among audit firms. However, in light of the COVID-19 pandemic, the AOB has deferred the implementation of the Annual Transparency Reporting from 2020 to 2021.

REPORTING REQUIREMENTS

Commencing from 2021, audit firms registered with the AOB that meet the following criteria at the end of the calendar year, for two consecutive years, are required to produce an *Annual Transparency Report* based on the audit firm's fiscal year-end:

- Audit firms with more than 50 PIE audit clients; and
- The total market capitalisation of the audit firm's PIE clients is above RM10 billion.

As part of a two-phase implementation approach in 2021, the audit firms that meet the above criteria are required to share their Annual Transparency Reports with the Audit Committees of their PIE audit clients. In subsequent years, these audit firms are required to publish their Annual Transparency Reports on their websites within four months after the respective audit firm's fiscal year-end.

For the other AOB-registered audit firms that do not meet the criteria for reporting, voluntary adoption of Annual Transparency Reporting is encouraged.

In order to facilitate comparability across audit firms, the minimum information that should be disclosed in the audit firms' Annual Transparency Reports has been mandated as below:

Legal and governance structure	Measures undertaken by the audit firms to uphold audit quality and manage risks	Information on the audit firm's measurement of indicators for audit quality (AQI)
▶ Legal and ownership structure ▶ Governance and leadership structure ▶ Network and structural arrangements ▶ Disclosure on partners with substantial equity in the partnership ▶ Disclosure on family relationship between partners undertaking leadership role or holding substantial equity in the partnership with other partners of the audit firm	▶ Firm's systems of quality controls ▶ Accountability framework for partners ▶ Compliance monitoring ▶ Risk management process	▶ Comprises 15 AQIs to be disclosed relating to: • Audit partner workload • Auditor independence • Capacity and competence of the firm • Audit engagement supervision • Firm's investments to uphold quality • Monitoring reviews on quality

IMPORTANT NOTE TO AUDIT COMMITTEES

Under the recently revised MCCG, Audit Committees are required to:

- Establish criteria to guide decisions on the appointment and reappointment of the external auditor. The criteria should include an assessment of the competence, audit quality and resource capacity of the external auditor in relation to the audit. The assessment should consider information presented in the *Annual Transparency Report* of the audit firm; and

- If the audit firm is not required to issue an *Annual Transparency Report*, the Audit Committee is encouraged to engage the audit firm on matters typically covered in an *Annual Transparency Report* including the audit firm's governance and leadership structure as well as measures undertaken by the firm to uphold audit quality and manage risk.

PART

03

INSPECTION FINDINGS AND OBSERVATIONS FROM ENGAGEMENT LEVEL REVIEWS

PART 03 INSPECTION FINDINGS AND OBSERVATIONS FROM ENGAGEMENT LEVEL REVIEWS

The impact of the COVID-19 pandemic and the MCO was felt by most businesses and professions, including the audit profession. The movement controls imposed by the authorities resulted in audit teams having no or limited access to their respective clients' books and records, which slowed down the progress of audit engagements. Auditors were confronted with difficulties in executing or completing their audits within the initially planned audit timeline. In many cases, auditors had to work from home and audits had to be performed remotely. While many audit firms took the effort to ensure that the right technological infrastructure was in place, the challenge was in ensuring the sufficiency, appropriateness and reliability of audit evidence obtained under circumstances brought about by the pandemic.

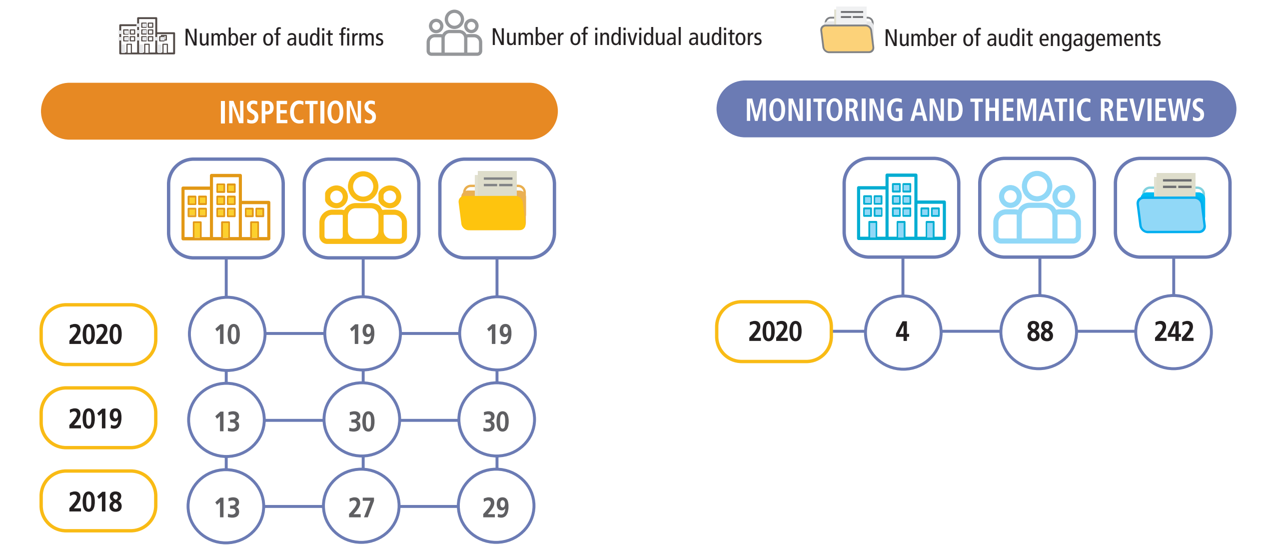
With the above complications faced by the auditors, it became more important for the AOB to ensure the delivery of high quality audits and continuous compliance with auditing standards and regulations. The AOB too was faced with challenges of working under strict standard operating procedures, with temporary suspension of physical meetings and reduction in time to complete the planned inspection programme. The need to be agile and flexible was never more apparent. With the onset of the MCO, all inspections were deferred and recommenced in July 2020 to allow auditors to focus on delivering high quality audits. During and after the MCO, the AOB adapted its inspection approach to:

- Increase the utilisation of data analytics to facilitate offsite monitoring of PLCs and their respective auditors; and
- Incorporate thematic reviews in relation to the impact of COVID-19 and MCO to the AFS and auditor's reports.

Although the 2020 inspection coverage of audit firms and audit engagements of 10 and 19 respectively have reduced as compared to the previous years, this was supplemented with the monitoring and thematic reviews where a further four audit firms and 242 audit engagements were scoped in. This hybrid approach covered audit firms that collectively audited PLCs and schedule funds representing approximately 96.4% of the total market capitalisation of PLCs, 96.0% of the total NAV of schedule funds and over 72.6% of the total number of PIEs.

DIAGRAM 1

2020 INSPECTION, MONITORING AND THEMATIC REVIEW COVERAGE



Source: AOB

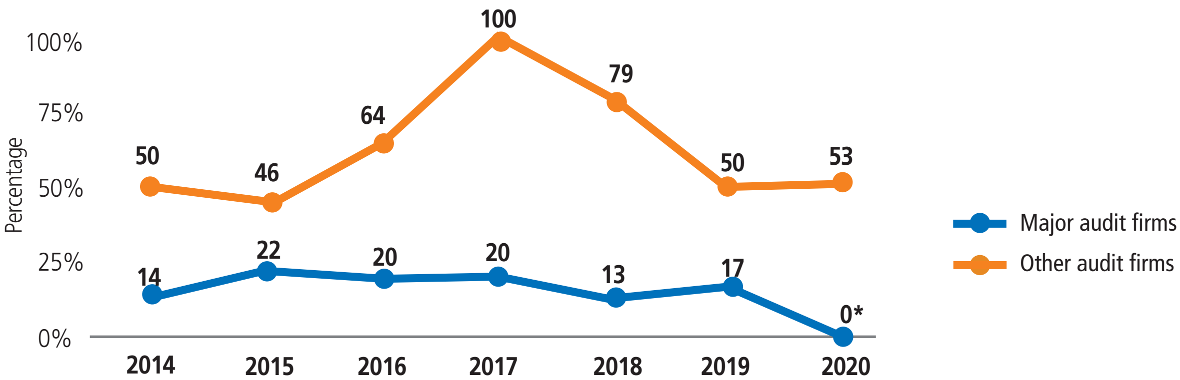
ENGAGEMENTS WITH SIGNIFICANT IMPROVEMENTS REQUIRED

At the end of every inspection, the AOB assesses the severity of findings arising from each engagement review. Engagements with significant improvements required are those where the engagement partners are either imposed with specific remediation measures or routed to the AOB's ERQ Department.

As illustrated in Chart 1, there continues to be a significant gap between the performance of the Other Audit Firms and the Major Audit Firms, which has further widened in the year 2020 with a slight increase of 3% in the inspected engagements requiring significant improvements for the Other Audit Firms and a notable decrease for the Major Audit Firms with no inspected engagements requiring significant improvements.

CHART 1

Percentage of inspected engagements with significant improvements required



Source: AOB

* The inspection results for the Major Audit Firms in 2020 may not be comparable to prior years due to the hybrid approach adopted in the AOB's inspection programme.

Although the 3% increase in 2020 for the Other Audit Firms appears to be minimal when compared against the decreasing trend over the last three years from 100% in 2017 to 50% in 2019, there were more inspected engagements routed to the AOB's ERQ Department in 2020 (88%) (2019: 44%). This indicates more severe findings arising from the engagement reviews for the Other Audit Firms.

> **"The AOB treats all registered audit firms, regardless of sizes and network affiliations, in the same manner when it comes to compliance with the accounting and auditing standards."**

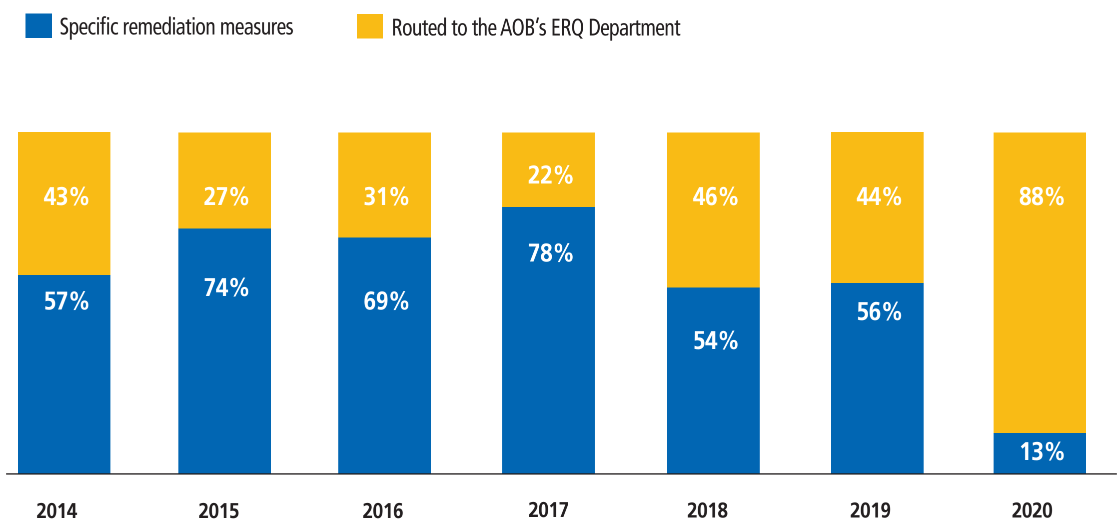
The Major Audit Firms are usually subjected to annual regular inspections. However, as highlighted above, the AOB adopted a hybrid approach in 2020 where selected audit firms were subjected to inspections while the remaining audit firms were subjected to offsite monitoring and thematic reviews based on historical performance. This approach resulted in a reduced sample of inspected engagements for Major Audit Firms. Therefore, it is worth noting that the results for the Major Audit Firms for 2020 (as illustrated in Chart 1) may not necessarily be directly comparable to that of prior years. Further details and observations arising from the offsite monitoring and thematic reviews are featured in the **thematic reviews section**.

Chart 2 represents the analysis of actions taken on inspected engagements with significant improvements required over the last seven years. As illustrated, the percentage of inspected engagements routed to the AOB's ERQ Department has fluctuated between 2014 and 2018, with a negligible decrease in 2019 and a drastic increase in 2020.

The significant increase in engagements routed to the AOB's ERQ Department in 2020 is a concern to the AOB. The AOB observed that the audits of these engagements were mainly weak in basic auditing procedures and areas involving accounting estimates and professional judgement. Furthermore, there appears to be a lack of understanding of the requirements of relevant accounting standards and the ISA as well as a lack of professional scepticism. These further signify the need for audit firms to have a strong internal quality monitoring programme and to review their existing approach with regards to training as well as management of resources with the ultimate objective of improving audit quality.

CHART 2

Actions taken on all inspected engagements with significant improvements required



Source: AOB

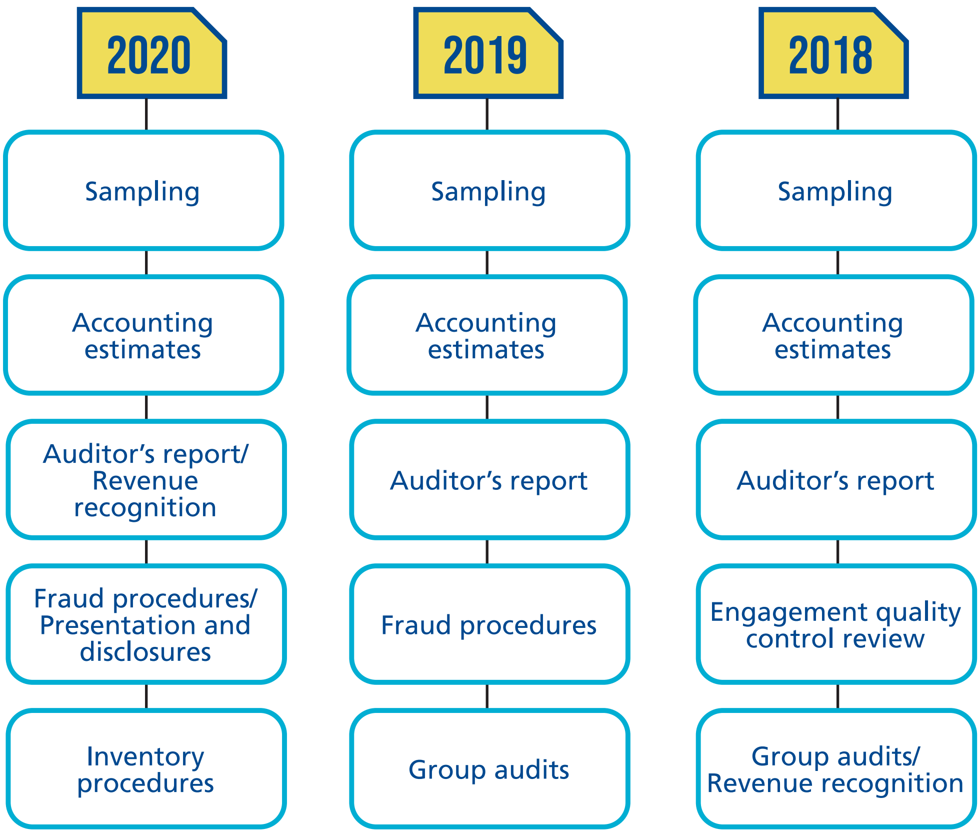
Given the challenges arising from the COVID-19 pandemic and MCO restrictions faced by the accounting and audit sectors, the AOB would like to remind all audit firms on the importance of being vigilant in ensuring that audit quality is not compromised in the pursuit of meeting unreasonable deadlines set by the management of PIEs.

COMMON FINDINGS FOR ENGAGEMENT REVIEWS

In addition to analysing the severity of findings arising from each engagement review as discussed in the previous section, the AOB compiles and analyses all engagement findings based on the categorisation of audit quality theme defined by the *International Forum of Independent Audit Regulators' (IFIAR) Survey of Inspection Results for Audit Firms*. Common findings observed from the AOB's inspections over a three-year period are illustrated in Diagram 2.

DIAGRAM 2

TOP FIVE COMMON FINDINGS BY AUDIT QUALITY THEME[1]



Source: AOB

[1] The categorisation of common findings is consistent with the *IFIAR Survey of Inspection Results for Audit Firms*.

SAMPLING

For three years in a row, sampling has topped the list of common findings arising from the AOB's engagement reviews. Despite being the most basic and fundamental audit technique, audit firms continue to stumble in this area.

The AOB observed that certain audit firms are still using monetary thresholds to select samples. In many cases, the auditors stopped short after achieving a certain level of coverage and did not perform further audit procedures on the remaining untested population, which could be material.

In addition to the above, the common findings for sampling include the following:

- Not verifying the completeness of the population used for sample selection;
- No basis and rationale for sample size and selection to justify that each sampling unit had an equal chance of selection and that the sampling risk had been reduced to an acceptably low level;
- Verifying samples to client's own documentation and listing without prior evaluation of the reliability and appropriateness of these documents as audit evidence; and
- Not investigating exceptions noted from the test performed e.g. material differences on reconciliation, no confirmation replies and incomplete supporting documents.

ACCOUNTING ESTIMATES

Another common finding is accounting estimates, including fair value measurements. Similar to sampling, it remains at the top of the list of common findings for three consecutive years.

The AOB observed that the common pitfalls for accounting estimates are usually in the areas related to property development costs, contract costs and valuation of assets. Certain audit firms lacked professional scepticism and depth in challenging management's assumptions, particularly where conflicting evidences were noted.

Furthermore, where reliance was placed on the work performed by valuation experts, audit firms tend to accept the valuation provided by these experts without obtaining further understanding on the approach used by these experts and the appropriateness of the underlying assumptions or adjustments applied to the key variables in deriving the final asset value.

The AOB also observed an increase in the common findings relating to impairment of financial assets, particularly in relation to the provision for expected credit loss in accordance with the requirements of *Malaysian Financial Reporting Standard (MFRS) 9 Financial Instruments*.

AUDITOR'S REPORT AND REVENUE RECOGNITION

The AOB continued to observe findings in relation to independent auditor's report, particularly in relation to Key Audit Matters (KAM). Findings were mainly in relation to the determination of KAM from the matters previously communicated to those charged with governance (TCWG).

The AOB also noted findings where the audit procedures disclosed in the auditor's report to address the relevant KAMs were actually not performed. These findings were common for the Other Audit Firms.

As for revenue recognition, this was one of the top common findings in 2018 and has resurfaced in 2020. The findings in 2020 were mainly in relation to the evaluation of revenue recognition in accordance with the requirements of MFRS 15 *Revenue from Contracts with Customers,* which include the following:

- Not obtaining an understanding on management's controls and processes over revenue recognition;
- No audit procedures performed to assess the impact from different contractual terms between customers/projects;
- Verification of revenue transactions to invoices instead of evidence indicating completion of performance obligation; and
- Not assessing the appropriateness and sufficiency of disclosures in the notes to the financial statements.

COMMON ROOT CAUSES

The above common findings in sampling, accounting estimates, auditor's report and revenue recognition stemmed from the following common root causes:

1. **Professional scepticism**
   There appears to be an absence or lack of professional scepticism among auditors in executing the audit, particularly in assessing the reliability of documents, responses to inquiries and other information obtained from management or TCWG throughout the audit. In reviewing the work of their audit team members, senior auditors need to be vigilant of any red flags noted from the performance of audit procedures and ascertain that these red flags have been addressed in accordance with the requirements of ISA.

2. **Technical competencies**
   The above common findings were mostly caused by insufficient understanding or appreciation for the requirements of ISA and relevant accounting standards. Notwithstanding that the implementation of MFRS 9 *Financial Instruments* and MFRS 15 *Revenue from Contracts with Customers* are relatively new, this should not be an excuse for the auditors to be nonchalant in addressing these areas. Instead, efforts should be taken to continuously maintain and further improve the technical competencies of all audit staff to ensure that they are kept abreast of changes and improvements in accounting standards and ISAs.

COVID-19 THEMATIC AND OFFSITE MONITORING REVIEW

As the pandemic and movement controls continue to cause adverse economic consequences and disrupt business activities across the country and the world, impact on businesses' profitability, liquidity and financial reporting were inevitable. Due to the challenges in financial reporting, Bursa Malaysia revised the financial reporting timeline (Diagram 3) for PLCs with Financial Year-Ends (FYE) between 31 December 2019 and 31 March 2020 to ease the burden of complying with the Listing Requirements.

Similar reliefs were also accorded by the SC. As highlighted in the earlier section, all inspections were deferred during the MCO to ease the challenges faced by the audit firms and to facilitate revised planning of audits that take into account new norms.

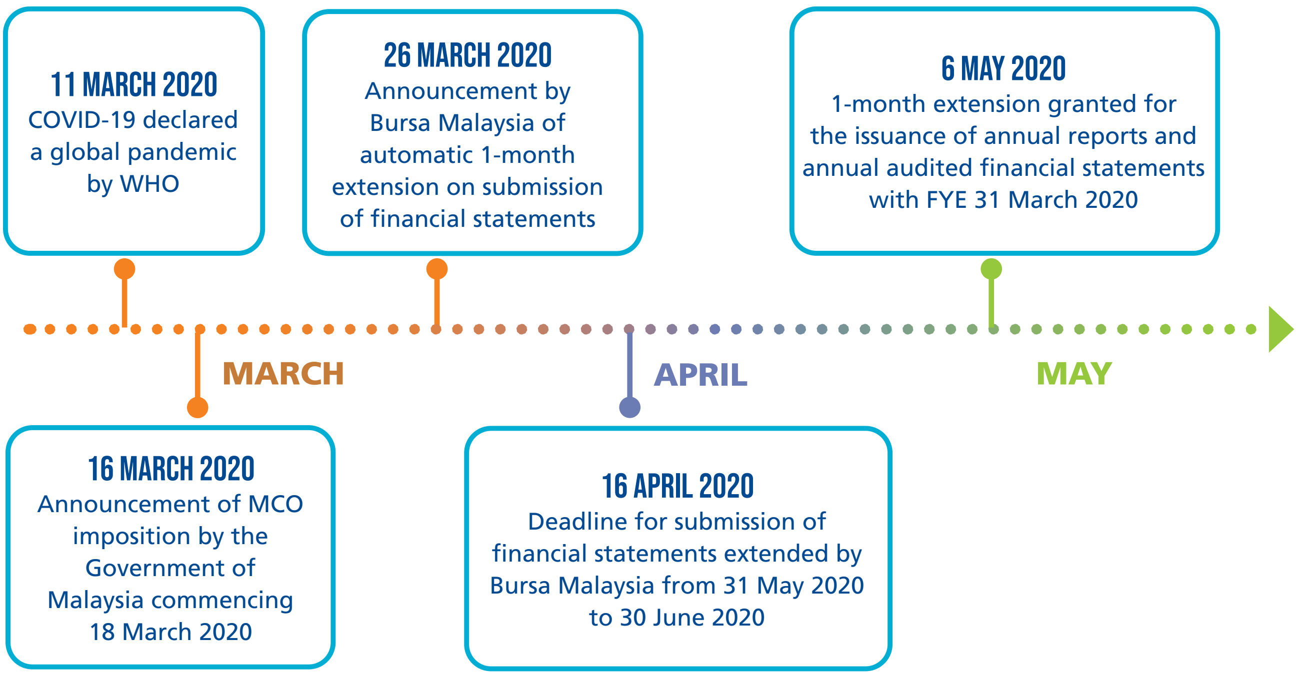
During this period, the AOB commenced offsite monitoring where the AOB analysed the impact of COVID-19 and the MCO on the financial position and performance of PLCs, disclosures in the AFS of PLCs as well as the related auditor's reports.

The following two-pronged approach was employed by the AOB in analysing the auditor's reports and disclosures made within Annual Reports (AR) and AFS of PLCs:

- An **offsite monitoring** of AR and AFS of PLCs with particular attention in analysing specific disclosures made relating to the MCO announcement and COVID-19, taking into account subsequent announcements and quarter results; and
- **Thematic reviews** on the audit procedures performed by auditors to address the heightened risks in relation to the assessment of impairment, going concern and the determination of KAM.

DIAGRAM 3

REVISED MALAYSIAN FINANCIAL REPORTING TIMELINE



Source: AOB

COVID-19 Offsite Monitoring

(A) Analysis of Audit Opinion

In assessing the impact of COVID-19 and MCO on the audit opinions issued by the auditors, the analysis in Diagram 4 was summarised from the auditor's reports of AFS for PLCs with FYE between 31 December 2019 and 31 March 2020.

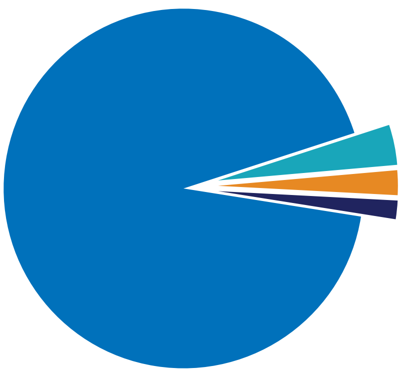
Initial predictions that COVID-19 and the MCO would have a substantial adverse impact on the audit opinions issued by the auditors of PLCs were premature, particularly for PLCs with FYE between 31 December 2019 and 31 March 2020. This is further corroborated as only **12 unmodified audit opinions with MUGC or Emphasis of Matter (EOM) relating to the impact of COVID-19** were issued as illustrated in Diagram 4.

However, uncertainties over the scale of the pandemic and its continuing impact to the Malaysian economy have increased the public scrutiny over the auditors' assessment on the PLCs' ability to continue as going concern as well as other potential significant financial impact. It is widely known that COVID-19 and the MCO adversely impacted certain industries on a larger scale than others. The following two case studies illustrate a non-exhaustive list of observable circumstances and indicators surrounding an **unmodified audit opinion provided by the auditors expressing MUGC in the auditor's report.** The case studies however do not represent an all-inclusive list of circumstances and conclusions that can be arrived at based on similar fact patterns of PLCs.

DIAGRAM 4

ANALYSIS OF AUDIT OPINIONS EXPRESSED ON AFS OF PLCS WITH FYE BETWEEN 31 DECEMBER 2019 AND 31 MARCH 2020

635 PLCs



588	UNMODIFIED OPINION	Includes those with KAM highlighting impact of COVID-19
23	MUGC	**11 PLCs** highlighted impact of COVID-19 to the performance of the Company
14	MODIFIED OPINION	None was in relation to basis of modification of audit opinions due to the impact of COVID-19
10	EMPHASIS OF MATTER	**1 PLC** highlighted impact of COVID-19 to the performance of the company

Source: AOB

CASE STUDY 1

Audit Opinion – MUGC (Financial)

PLC A primarily operates in the tourism industry in Malaysia. It owns and manages several prestigious hotels in Peninsular Malaysia. The travel and border restrictions implemented by the Government of Malaysia in line with the imposition of the MCO on 18 March 2020 led to a significant drop in demand for domestic and international travel and tourism, adversely impacting PLC A's financial performance and cash flows for the FYE 31 March 2020:

RM131 million – Loss Before Taxation

RM83 million – Net Current Liability

RM50 million – Negative Operating Cash Flows

↓30% – Decline in Revenue

In May 2020, to further compound the decline in financial results, PLC A decided to permanently cease the operations of two hotel establishments located in the Klang Valley. The hotel establishments were key assets and revenue generators for the PLC over the last few years. The decision was made in lieu of their deteriorating financial results and to aid their immediate operating cash flow requirements as a planned private placement to generate additional working capital was indefinitely deferred by the subscriber, due to the MCO.

Cognisant of the urgent requirement for operating cash flows, PLC A had negotiated and received an extension from Bank A to the repayment terms for borrowings with balance outstanding of RM75.0 million. PLC A also requested for a moratorium for the repayment of outstanding balances to some of their key suppliers. Taking into account the key indicators as described above, the auditors of PLC A performed the following audit procedures to assess the PLC's ability to continue as going concern:

- Challenged key assumptions, judgements and disclosures relating to PLC A's projected cash flows with specific focus on the PLC's ability to meet working capital and debt obligations within the next 12 months. It was noted that despite the requests for moratorium to the key suppliers, only one had been granted; and
- Evaluated the loan covenants and terms of the loan extension to determine potential breaches or cross breaches, if any.

Based on the conclusion from the performance of the relevant audit procedures, particularly where material uncertainties still exist over the moratorium on balances payable to key suppliers, the auditors expressed an unmodified audit opinion highlighting MUGC in its auditor's report.

CASE STUDY 2

Audit Opinion – MUGC (Financial and Non-Financial)

PLC B is involved in the manufacturing and trading of biomass oils and its related value-added products with a FYE 31 December 2019. The business operations of PLC B were concentrated in Asia particularly within Malaysia and Country X, as follows:

The pandemic had adversely affected the financial performance and position of PLC B as reported in their Quarter 4 2019 results announcement, as demand for their products had significantly declined. PLC B was in a net current liability position of RM7.9 million and incurred losses of RM42.9 million during the reporting period.

As a consequence of the pandemic, PLC B entered into a sale and purchase agreement with a buyer to sell one of their plantation estates. The consideration of this sale was intended to help PLC B repay the principal amount of one of their bank borrowings which was due as at the financial year-end. Furthermore, due to the high concentration of customers located in Country X which was badly affected by the pandemic, PLC B recorded impairment of trade receivables which contributed to their losses during the year.

The management of PLC B disclosed that specific measures were being taken to address the effects of COVID-19 and the MCO and concluded that the preparation of the financial statements on a going concern basis was appropriate.

In assessing the appropriateness of PLC B's going concern assumption in the preparation of the financial statements, the auditors of PLC B challenged the following key assumptions applied in the cash flow projections prepared by the management:

- Evaluation of the availability of financial and other resources, including human resources and raw materials given the closure of borders and other constraints;
- Compliance with financial and non-financial bank borrowing covenants;
- Determination of impact and feasibility of the specific measures taken by management and appropriate disclosures of such impact within the AFS; and
- Liquidity assumptions, particularly expected cash inflows from customers who may be facing similar financial constraints.

Based on the initial assessment performed by the auditors of PLC B in consultation with the audit firm's technical department, the auditors considered a modification to the opinion in view that there was insufficient audit evidence to support the management's use of going concern assumption particularly in relation to PLC B's compliance with the various bank borrowing covenants in place and the certainty of expected cash inflows from customers. However, as information subsequently became available, mainly over the financial and non-financial aspects of PLC B's operations, the auditors expressed an unmodified opinion highlighting MUGC, taking into account the continued material uncertainties surrounding the judgement areas highlighted above.

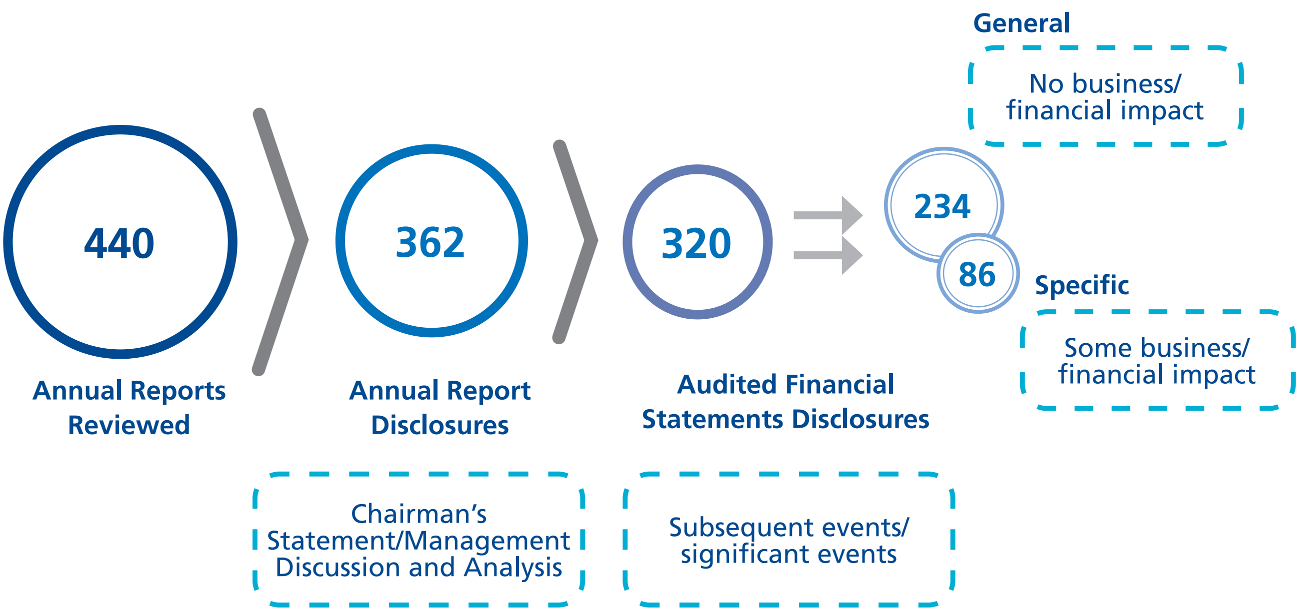
(B) Analysis of COVID-19/MCO Disclosures

One of the key areas of the AOB's review was in relation to **disclosures made by PLCs on the impact of COVID-19 and MCO** in their AR and AFS. The AOB analysed a sample of 440 ARs and AFS with FYE between 31 December 2019 and 31 March 2020.

Diagram 5 illustrates that from the review of 440 PLCs' ARs, 362 PLCs disclosed the impact of COVID-19 and MCO within their respective Chairman's Statement and Management Discussion and Analysis sections of the AR. We also noted that 320 PLCs disclosed the impact of MCO and COVID-19 within their AFS, where a vast majority of these disclosures were **generic in nature** without mention of any specific impact to their business operations and financial position. This was largely attributed to the high degree of uncertainty and judgement required to assess both financial and non-financial impact arising from COVID-19 during the reporting period.

DIAGRAM 5

ANALYSIS OF DISCLOSURES RELATING TO COVID-19 AND MCO



Source: AOB

The following two case studies provide examples of the significance of **specific disclosures** in relation to COVID-19 and MCO that would provide stakeholders with a more transparent view of the financial position and performance of the PLCs.

CASE STUDY 3 Disclosures – Impairment

PLC C is an investment holding entity where the principal activities of its subsidiaries are in the manufacturing of premix concrete products. For the FYE 29 February 2020, 80% of PLC C's revenue were contributed by a wholly-owned subsidiary, Subsidiary C, where its operations were fully based in Country X. As part of the acquisition of Subsidiary C, goodwill amounting to RM15 million was recognised by PLC C for the excess of consideration paid over the net assets acquired.

Annual Report

Management Discussion and Analysis

1. Financial impact of COVID-19 particularly in relation to significant decline in revenue derived from Country X.

2. Disclosed a forward-looking statement to detail the broad impact of the pandemic on the industry as well as the Group on the following areas:

   - Supply chain disruptions particularly on continued deferment on delivery of products;
   - Gradual resumption of operations upon implementation of the Conditional MCO (i.e. easing of certain restrictions); and
   - Increase workforce to ensure deferred projects are fulfilled in the coming months.

Audited Financial Statements

Goodwill & Investment in subsidiaries

Impairment loss of RM8 million for goodwill and RM9 million for investment in subsidiaries as **forecasted revenue** was expected to decrease by 20%.

Significant Events

Due to the impact of COVID-19, the recoverable amounts for goodwill and investment in subsidiaries were estimated to be even lower than the respective original recoverable amounts. Accordingly, impairment losses of RM8 million and RM9 million were made which would otherwise have been NIL and RM2 million respectively. The key assumptions were disclosed in the notes to the AFS.

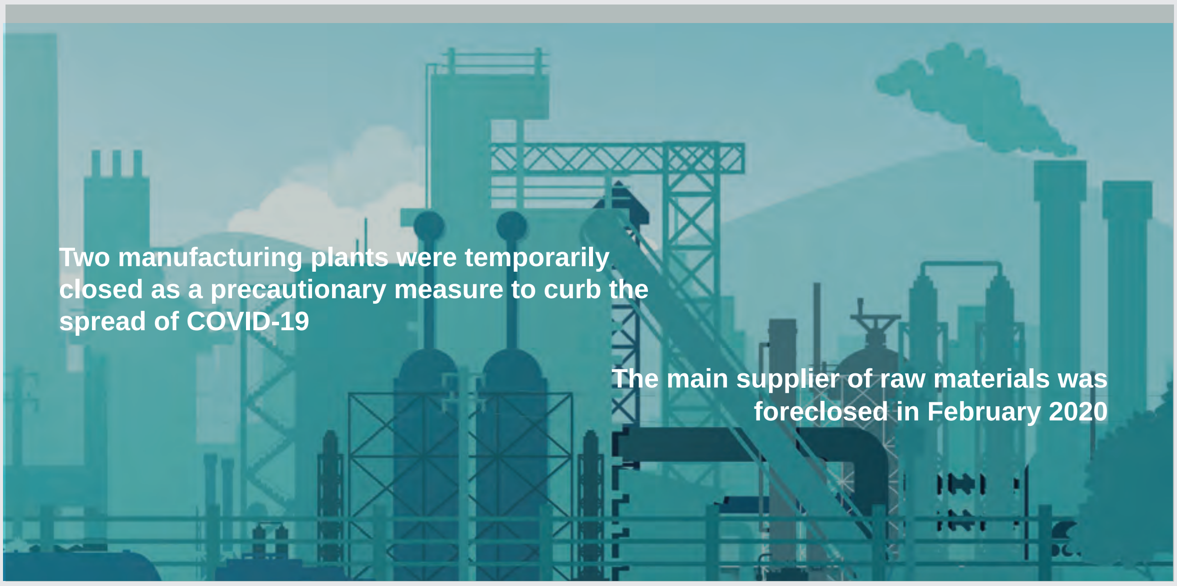
In the auditor's report signed in June 2020, the auditors of PLC C also communicated the valuation of goodwill and investment in subsidiaries as KAM with particular attention given to the impact of COVID-19 on these assets.

CASE STUDY 4

Disclosures - Going Concern and Impairment Assessment

PLC D is primarily involved in the manufacturing of consumer products for the Malaysian market. For the FYE 31 December 2019, PLC D incurred loss before tax of RM140 million, representing the third consecutive year of loss-making. Furthermore, PLC D was in a net current liability position of RM179 million as at FYE 31 December 2019, with net operating cash outflows of RM50 million.

The following subsequent events were disclosed in the AFS:



The financial statements of the PLC were prepared on a going concern basis. In the auditor's report dated 23 May 2020, the auditors expressed an **unmodified audit opinion** on the financial statements of the PLC for the FYE 31 December 2019. From the disclosures in the AFS, it was not apparent how the PLC addressed the impact of the temporary closure of the manufacturing plants and the foreclosure of the main supplier on the going concern assumption applied.

However, it was noted that the following mitigating factors were assessed by the auditors in their going concern assessment of PLC D:

Undrawn credit facilities of RM550 million

To support the working capital requirements of the PLC Group

Sourced from alternative suppliers

Contracted at lower cost per unit resulting in higher profit margin per unit sold

Relocated main equipment in plant

To enable production capacity to be maintained upon closure during MCO

!

Case Study 4 above highlights the importance of adequate disclosures to accurately enlighten and inform the users of the AFS as to the factors considered in the preparation and finalisation of these financial information. While the underlying financial information might not be ultimately erroneous, significant ambiguity and lack of proper disclosures could have had negative implications on the PLCs.

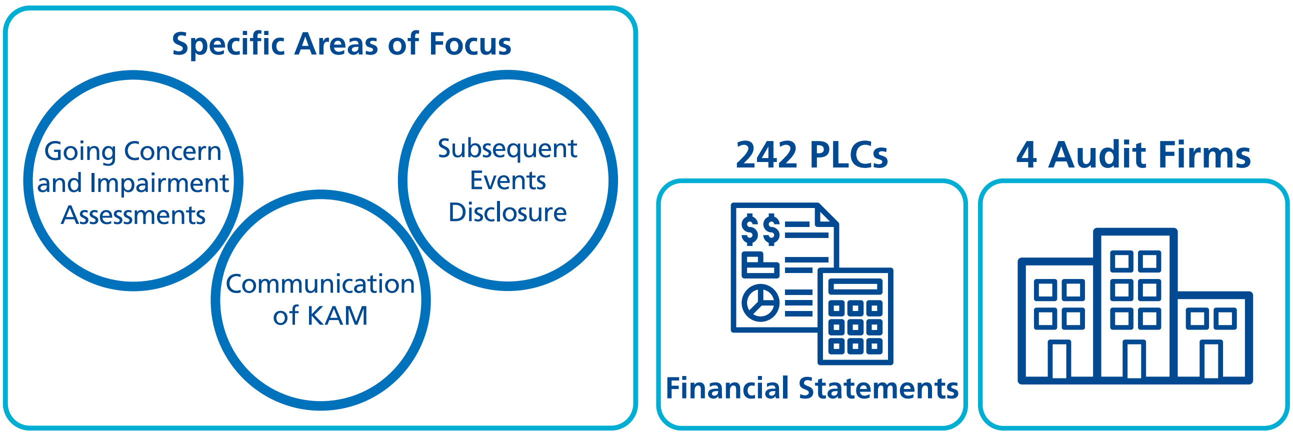
COVID-19 Thematic Review

To provide a holistic view of the impact of COVID-19 and MCO on PLCs, the AOB performed a thematic review that further scrutinised additional areas relating to **going concern** and **impairment assessments**, **subsequent events disclosure** and **communication of KAM by the auditors**.

Diagram 6 highlights the broad scope as determined by the AOB with regards to the thematic review performed. From a population of 242 PLCs that were scoped, the AOB identified 35 PLCs based on the financial position and performance of the PLCs, including the disclosures made within the AFS. The analysis took into account subsequent announcements by the PLCs, including quarter results where available. The 35 PLCs were identified for greater scrutiny on the audit procedures performed in the specific areas of focus.

DIAGRAM 6

SCOPE OF THEMATIC REVIEW



Source: AOB

DIAGRAM 7

OBSERVATIONS OF THEMATIC REVIEWS ON 35 PLCS

Source: AOB

The observations with regards to the above 35 PLCs were discussed with the respective auditors and audit firms. From the 35 PLCs, the AOB further selected eight PLCs for a special inspection of audit working papers. In these cases, further assessments of the auditors' audit procedures were required to verify the sufficiency and appropriateness of the audit procedures with regards to COVID-19 and its impact on the going concern assumption and impairment assessment.

From the thematic reviews on the AFS of 242 PLCs with FYE between 31 December 2019 to 31 March 2020, the AOB noted that the impact of COVID-19 and MCO were mitigated in many PLCs as these PLCs were in a net current asset position and/or recorded profit before tax with positive operating cash flows. As for the PLCs with no apparent mitigations, further engagements with the relevant auditors and audit firms as well as review of audit working papers revealed the following general observations in relation to audit of accounting estimates, going concern assessment and disclosures:

i. **Inadequate challenge of the assumptions used by the management in cash flow projections used for impairment assessment**

ii. **Inadequate disclosures relating to the appropriateness of the going concern assumption**

   This particularly relates to disclosures on significant judgements that were exercised in arriving at the management's conclusion that the going concern basis was appropriate, including disclosures on management's plans that mitigate the effect of the events or conditions that may cast significant doubt on the going concern assumption. In this regard, auditors should challenge the management to ensure improved application of the disclosure requirements relating to going concern.

iii. **Boilerplate disclosures relating to subsequent/significant events, with no disclosures on specific impact of COVID-19 and MCO to the AFS**

Despite the above observations and the long-standing uncertainties surrounding COVID-19 and its effects to the Malaysian financial reporting landscape, the AOB also observed several positive initiatives adopted by the audit firms to adjust and adapt to the new normal as well as to identify and assess the effects of COVID-19 on PLCs (Diagram 8).

DIAGRAM 8

AUDIT INITIATIVES IN THE FACE OF COVID-19

Audit Initiatives in the face of COVID-19

- Pre-emptive measures including early engagements with management and TCWG over potential impact on the audit and to the financial statements of the PLCs arising from COVID-19.
- Mobilisation of further investments in technology and adoption of sound business continuity plan by audit firms, ensuring seamless transition to virtual/ offsite audits.
- Enhancements to existing working papers to induce heightened scepticism and targeted assessments on the effects of COVID-19 and the MCO, particularly in relation to subsequent events disclosures, going concern and impairment assessments.
- Development of comprehensive guidance on handling these unprecedented risks and ensuring two-way communication between the technical department of the audit firm and audit teams to assist them in assessing the impact of COVID-19 and the MCO to the audit opinions issued.

MOVING FORWARD

The uncertainties surrounding the COVID-19 pandemic and movement restrictions are expected to continue to be a key risk to business operations and financial reporting of the PLCs. Hence, audit firms are reminded to pay specific attention particularly in relation to the following areas:

KEY AUDIT MATTERS

To assess if there are any significant economic, regulatory, industry or other developments arising from the COVID-19 pandemic which would constitute a significant event or transaction during the period and require the auditor's utmost attention and whether such circumstances would need to be disclosed as KAM in the auditor's report.

GOING CONCERN

To be cautious and highly sceptical when scrutinising areas involving going concern and assessing potential indicators of asset impairment. Focus should not only be the future revenue streams of the PLCs but also external inputs which are equally important in assessing the ability of a PLC to continue to operate.

DISCLOSURES

To determine whether disclosures in ARs and AFS relating to effects of the COVID-19 pandemic on the current operations and future prospects of the PIE are sufficient to keep the users of the financial statements informed.

MULTI-LOCATION AUDITS

As group auditors, to plan and ensure that sufficient appropriate audit evidence have been obtained in view of possible impediment in accessing required financial information of significant components identified.

GOING CONCERN

Going concern assessments have always been a complex matter to address, particularly where significant judgements and estimations are applied. This complexity is amplified with the onset of the COVID-19 pandemic which has caused the financial position of many organisations to deteriorate. With no end in sight to the pandemic in the shorter term, there would be more uncertainties affecting future plans and cash flow projections.

Based on the results of the regular inspection as well as the COVID-19 Monitoring and Thematic Review, the AOB continues to observe findings relating to going concern assessments.

It is the responsibility of the PIE management to assess the PIE's ability to continue as a going concern when preparing financial statements. IFRS Foundation has published a *"Going concern – A Focus on Disclosure"* educational material to support PIEs to consistently apply the going concern requirements in accordance with the financial reporting standards.

ISA 570 *Going Concern* requires auditors to obtain sufficient appropriate audit evidence on the appropriateness of the management's use of the going concern basis of accounting in the preparation of the financial statements. Based on the audit evidence obtained, auditors are required to conclude whether a material uncertainty exists regarding the entity's ability to continue as a going concern.

Common findings and observations from the AOB's inspections as well as thematic reviews in relation to the auditor's assessment of going concern are summarised in Diagram 9 and illustrated in the subsequent case studies.

DIAGRAM 9

COMMON FINDINGS RELATING TO GOING CONCERN ASSESSMENT

Insufficient audit procedures performed to evaluate the appropriateness of the management's going concern assumption applied in the preparation of the financial statements in relation to:

- Accepting management's representations without obtaining sufficient evidence to support such representations; and
- Assessing whether there were adequate disclosures made in the AFS in relation to the material uncertainties surrounding the going concern assumption, and whether a modification to the audit opinion should be considered.

Insufficient audit procedures performed to assess the cash flow projections, which were used in the evaluation of the going concern assumption particularly in relation to:

- Reliability of underlying data; and
- Reasonableness of assumptions used by the management.

CASE STUDY 1

Going Concern Assessment

PLC E specialises in the manufacturing and sale of wooden furniture for the domestic market. The historical financial performances of PLC E are illustrated below:

2019

- Loss Before Tax: RM43.2 million
- Net Current Liabilities: RM14.0 million
- Net Cash Outflows from Operations: RM3.7 million

2018

- Loss Before Tax: RM19.6 million
- Net Current Liabilities: RM5.6 million
- Net Cash Outflows from Operations: RM2.3 million

2017

- Loss Before Tax: RM0.7 million
- Net Current Assets: RM1.0 million
- Net Cash Outflows from Operations: RM0.3 million

GOING CONCERN INDICATORS FOR PLC E FOR FYE 2019

- Net current liabilities position
- Negative operating cash flows
- Consecutive operating losses incurred
- Significant reliance on short-term borrowings
- Cancellation of contract from a key customer
- Loss of Key Management Personnel

CASE STUDY 1

Going Concern Assessment *(Continue)*

In view of the going concern indicators summarised above, the management performed an assessment of PLC E's ability to continue as a going concern.

Firm W subsequently evaluated the management's assessment, the assumptions used in the assessment as well as the feasibility of the management's plans for future action in the current circumstances as illustrated below:

MANAGEMENT'S ASSESSMENT	AUDITOR'S EVALUATION
Proposed issuance of redeemable convertible unsecured loan stocks (RCULS) subsequent to year-end	Yet to be approved by the Board and released to be published as at the date of the auditor's report
Negotiation with Bank A to refinance its existing term loan	No evidence to support management's representation on the status of negotiation
Utilisation of remaining unutilised Revolving Credit (RC) facility granted by Bank B	Unutilised RC insufficient to cover the PLC's net current liabilities position
Financial support from its lenders and major shareholders	No letter of financial support obtained
Potential candidates to replace the loss of Key Management Personnel will turnaround the PLC	Assessment performed based on qualitative factors which could not be corroborated
New project in the pipeline for a major subsidiary will improve the financial position of the PLC	Cash flow projections were not prepared by the management to support the assumption

Based on Firm W's evaluation of the management's going concern assessment, the management's conclusion on the ability to continue as a going concern would no longer be appropriate.

Subsequently, Firm W is required to evaluate whether sufficient appropriate audit evidence has been obtained to conclude whether a material uncertainty exists which may cast significant doubt on PLC E's ability to continue as a going concern. Furthermore, Firm W will need to determine whether adequate disclosures about these events or conditions were sufficiently addressed in the financial statements.

CASE STUDY 2

Going Concern Assessment

PLC F is a palm oil company operating palm oil plantations and oil mills as well as trading of palm oil products. As at FYE 31 December 2019, PLC F was in a net current liabilities position and recorded negative operating cash flows. The PLC has continuously recorded losses since the prior years.

The management of PLC F concluded that there was no going concern issue based on the cash flow projections prepared as illustrated below:

Net Cash Flow Projections for FYE 2020	Quarter 1 RM' million	Quarter 2 RM' million	Quarter 3 RM' million	Quarter 4 RM' million	Total RM' million
Plantation Sector	1.5	1.6	1.7	1.8	6.6
Oil & Mill Manufacturing Sector	0.9	1.0	1.1	1.2	4.2
Total Operating Cash Flows	**2.4**	**2.6**	**2.8**	**3.0**	**10.8**

Upon assessing the cash flow projections, Firm X concurred with PLC F and concluded that there was no going concern issue in view of the future positive operating cash flows to be generated by the company.

However, the key assumptions used in the cash flow projections were not sufficiently challenged, particularly in ensuring that the key assumptions were reasonable, supportable and reliable. Hence, Firm X's initial conclusion that there was no going concern issue would no longer be applicable.

CASE STUDY 2

Going Concern Assessment *(Continue)*

POTENTIAL ISSUES NOT ADDRESSED

- Revenue projected based on a 5-year historical average where there were significant fluctuations due to disposal of plantation lands in prior years
- Estimates of future cash flows limited to *"Operating cash flow"* in totality basis without any detailed breakdown of assessment
- Impairment of plant and machineries due to flood resulting in a lower production capacity
- Latest interim financial statements show a significant decline in the company's operations

WHAT SHOULD AUDITORS DO?

- Challenge the management's assumptions used in the cash flow projections
- Evaluate the reasonableness of data source/inputs used in the cash flow projections
- Assess the reliability of source documents provided by the management

Changes in assumptions could potentially result in a deficit in the cash flow projections, hence impacting the conclusion of the going concern assessment

PROPERTY DEVELOPMENT

The audit of property development PIEs was a focus of the AOB's inspections during the year, given the higher degree of subjectivity and estimation required from PIE management in preparing and accounting for property development projects.

In this regard, it is important for auditors to firstly gain an understanding of management's controls and processes in preparing project budgets including verification of the various components applied in these budgets. Professional scepticism and judgement also need to be applied in addressing:

- **Unusual costs**, budgeted or incurred, that do not appear to be consistent with the auditor's understanding of the nature of the project. This task is commonly delegated to less experienced members of the audit team who might not be capable of detecting anomalies when performing their work. It is therefore even more important that there is heightened supervision and review in these areas by more experienced team members.
- **Complex business arrangements** in joint development, particularly those involving related parties.
- **Limited external documents** to support management's basis and assumptions. In these circumstances, there were instances where the audit team had to rely solely on information produced by the entity as well as management's representation in verifying the budgeted and actual costs incurred. It is important for the audit team to perform further testing on the reliability and accuracy of the information obtained before placing any reliance.
- **Unusual business relationship** between various parties with transactions that may be outside the normal course of business or appear to be uncommon. There were instances where significant contra transactions occurred subsequent to the financial year-end involving a contractor and various third-party buyers. The audit team is required to obtain an understanding of the controls and processes involving these business arrangements and perform a fraud risk assessment in line with the requirements of ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.*

Common findings observed from the AOB's inspections in relation to the audit of PIEs in the property development industry are as follows:

DIAGRAM 10

COMMON FINDINGS RELATING TO THE AUDIT OF PROPERTY DEVELOPMENT

Review of budgeted costs

Insufficient audit procedures were performed to verify the revision of the budgeted costs where:

- Work performed was limited to an analytical review on the variances noted during the year;
- Work performed was limited to comparing to prior year's total budget without consideration of actual costs incurred to-date;
- Budgeted costs for new projects were based on provisional basis and only assessed via inquiry with management; and
- Verification of variation order was not performed

Review of actual costs

Insufficient audit procedures were performed to verify the completeness and cut-off of the actual costs incurred.

No audit procedure was performed to assess the appropriateness of the capitalisation of show house and sales and marketing related costs.

Insufficient audit procedures were performed to assess the appropriateness of the inputs used in the percentage of completion computation particularly the inclusion/exclusion of other costs in both actual and budgeted costs.

Review of actual and budgeted revenue

For budgeted revenue, insufficient audit procedures were performed to verify variation orders included in the revised contract sum.

For actual revenue, insufficient audit procedures were performed:

- To verify the actual units sold during the financial year;
- To assess the appropriateness of recognising revenue at gross instead of net of discounts;
- To assess the reliability of "*Sales Report*" and "*Discount listings*" which were used to verify the actual units sold during the year; and
- To assess for cancellation of sales subsequent to the financial year-end.

Assessment of PIE controls and processes

Insufficient audit procedures were performed to obtain the required understanding of the management's controls and processes over:

- Revenue recognition in accordance with MFRS 15 *Revenue from Contracts with Customers;*
- Budgeting process; and
- Cancellation of sales during the year and subsequent to the financial year-end.

Review of EOT, LAD and DLP

In view of evidence of delay in the completion of the project, no audit procedure was performed to assess for any relevant extension of time (EOT) and any potential liquidated ascertained damages (LAD) to be provided for.

Insufficient audit procedures were performed in assessing the appropriateness and reasonableness of the provision for defect liabilities period (DLP).

Other findings

Insufficient audit procedures were performed to obtain the required understanding over the term of business arrangements:

- Non-cash "*Contra Arrangements*" with contractors; and
- Purchase of land held for property development involving related parties.

Insufficient audit procedures were performed to assess capitalised costs for a project which "*has been put on hold since 2017*" for impairment.

CASE STUDY 1

Review of Budgeted Costs

PLC G was involved in a mixed development project consisting of two towers, which included serviced apartments and offices. The budgeted revenue for the project was RM220 million.

In performing a review of budgeted costs where the individual components of the budget exceeded the materiality set for the audit engagement, the audit procedure performed by Firm Y was limited to comparing to prior year's budget without consideration of actual costs to date.

Further details on the breakdown of the total budgeted costs and total actual costs incurred to date as well as the relevant findings raised are illustrated below:

Direct Construction Costs	Budgeted Costs (RM' million)	Actual Costs Incurred (RM' million)	Variance (RM' million)
Preliminary expenses	26.1	26.0	0.1
Main building works	75.9	86.2	(10.3)
Architectural works	53.4	47.0	6.4
Mechanical & electrical works	24.5	19.3	5.2
Common cost	16.4	-	16.4
Others	10.6	-	10.6
Total Construction Cost	206.9	178.5	28.4
Contingency	8.3	-	8.3
Total	**215.2**	**178.5**	**36.7**

In reviewing the total budgeted costs, Firm Y did not identify the cost overrun for the cost of main building works, particularly where the audit procedures performed were limited to comparing to previous year's budget without consideration of actual costs incurred to-date. Furthermore, the contingency costs of RM8.3 million was insufficient to cover the cost overrun. As there was no revision made to the initial budgeted costs, the completeness of budgeted costs was not assessed.

If the budgeted cost was revised to RM225.5 million, there would be potential foreseeable losses of RM5.5 million that would not have been identified and accounted for.

Other than the insufficiency of testing for any potential cost overrun as highlighted above, the following findings were also noted from Firm Y's audit:

AOB's Identified Findings

- No audit procedure was performed to understand the management's controls and processes on budgeting process.
- No audit procedure was performed to challenge the basis of contingency estimated at 4% of total construction costs.
- No audit procedure was performed to challenge the basis of common costs such as podium area, link bridges and roof top garden.

CASE STUDY 2

Review of Budgeted and Actual Costs

PLC H was a property development company involved in the development of four projects in Kuala Lumpur.

In performing a review of budgeted costs and actual costs incurred to date for ongoing projects, Firm Z performed the following procedures as illustrated below:

Project Cost	Project A RM' million	Project B RM' million	Project C RM' million	Project D RM' million
Total cost incurred to date	188	125	26	12
Total budgeted cost	202	174	130	90

TESTING OF COST INCURRED TO DATE

- Tested the design and implementation of management's annual budgeting process and concluded that the control was effective
- Agreed brought forward balances to prior year's working papers
- Verified cost incurred to-date to current year's external supporting documents

TESTING OF BUDGETED CONTRACT COST

- For projects awarded in prior years, agreed total budgeted contract costs to prior year's working papers
- For projects awarded in the current year, relied on management's controls and agreed total budgeted costs to Financial Year 2020 management "provisional" budget

However, the following considerations were not addressed by Firm Z in ensuring the completeness of the total budgeted contract costs and the accuracy of management's budgeting process:

AUDITOR'S CONSIDERATIONS

Were the actual costs incurred checked against the budgeted total cost?

- Any material negative variance?
- Any potential cost overrun/under recognised for the respective significant components of the budget?

Any testing of the significant components used in management's total budgeted contract costs to independent source document?

- Budgeted material costs agreed to the contractors' quotations?
- Assessment for appropriateness of the budgeted labour costs?
- Assessment of reasonableness of contingency costs budgeted for projects?

Any changes in the circumstances in the current year, which would warrant necessary revision to the budgeted cost to ensure that all costs have been reasonably budgeted for?

- Additional costs may be required due to supply chain disruptions for construction materials and shortfall of skilled labour force during MCO.
- These extra expenditures which were not initially budgeted for may have tipped smaller margin projects into foreseeable losses position.

Any review of project correspondences and communications to corroborate discussions with management on the process of changes made to estimated costs to complete, project margins and timelines?

CASE STUDY 3

Review of EOT and LAD

In reviewing the EOT and provision for LAD for ongoing projects in PLC H for the FYE 31 December 2020, the following observations were noted:

Project Status	Project A	Project B	Project C	Project D
Percentage of completion	93.0%	71.8%	20.0%	13.3%
Estimated completion date	9 November 2020	20 March 2021	10 September 2021	–

AUDITOR'S ASSESSMENT

Project A
There was EOT until 31 January 2021 which was after the financial year-end. Therefore, no LAD indicator noted.

Project B
The estimated completion date was after the financial year-end. Therefore, no EOT required.

Project C
Despite the project was currently being put on hold, the estimated completion date was after the financial year-end. Therefore, no EOT required.

Project D
As discussed with the management, no LAD issue was noted.

CONSIDERATIONS?

Any post balance sheet review to assess whether project updates after financial year-end but before the audit report date had implications on the assessment of LADs?

Any assessment on the status of the project - whether impairment is necessary?

Any procedures performed to verify management's representation?

The auditor's report was dated on 25 April 2021. In view that the date of the EOT and the estimated completion date for Project A and Project B were subsequent to the financial year-end but before the date of the auditor's report, Firm Z should perform further assessment based on information available prior to signing the auditor's report, to evaluate and challenge the appropriateness of the conclusion on the exposure of delay in the respective projects.

Firm Z should also assess the status of Project C and the circumstances which caused the project to be put on hold to ascertain if any impairment would be required.

PART 04 REMEDIATION OF INSPECTION FINDINGS

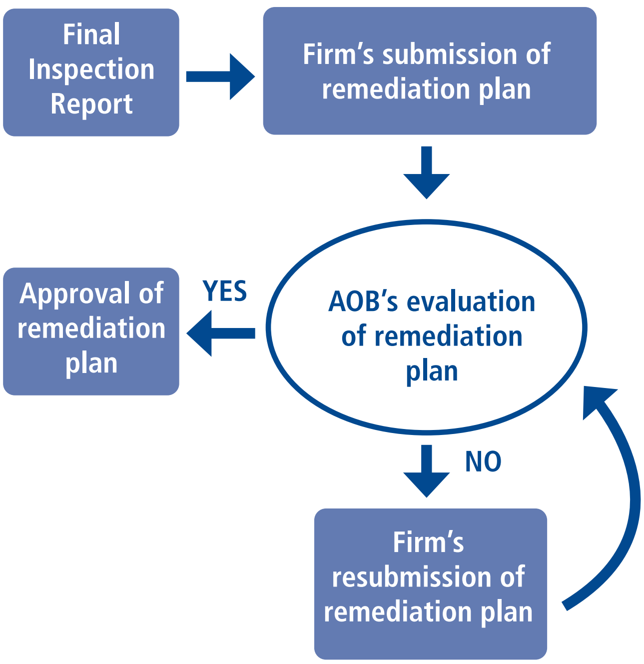
PART 04 REMEDIATION OF INSPECTION FINDINGS

REMEDIATION PROCESS

Subsequent to an inspection, audit firms are required to submit its remediation plan detailing its proposed measures to address the findings raised in the *Final Inspection Report*. The remediation plan framework usually includes the audit firm's identification of root causes and performance measures for remediation, which focuses on the outcome and effectiveness of the remediation plan.

CHART 1

Remediation plan process



Source: AOB

"The AOB observed that certain remediation plans were merely boilerplate and did not sufficiently address the identified root cause. This was particularly apparent for audit firms that were subjected to annual reinspection. There were instances where remediation plans were repeated from prior years and were found to be ineffective in tackling the underlying root cause, resulting in a series of recurring findings. The AOB also observed that firms were eager to treat the immediate symptomatic deficiencies but did not further explore the reasons behind the identified deficiencies. Such approach would only address the issues on the surface level but would not address the actual root causes and as such, the issue will inevitably reoccur in a few years and in some cases be even more significant."

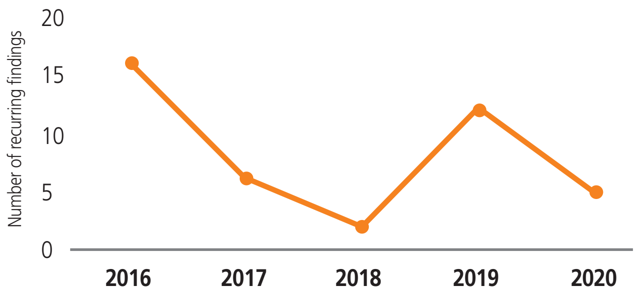
Among the common shortcomings in remediation plans observed were non-specific training programmes, general documentation with no proper guidelines and no specific achievable timeline, which did not adequately resolve the underlying root cause. Consequently, audit firms are required to submit revisions to the relevant areas or even to the extent of resubmitting a new and completely revised plan. The resubmission can vary up to multiple times before the AOB provides a written approval to the audit firms to proceed with the implementation of the said plan.

In cases where severe findings were identified, the AOB may specify measures to be taken and imposed on the audit firms and/or individual partners.

RECURRING FINDINGS

CHART 2

Recurring findings by year (2016 – 2020)



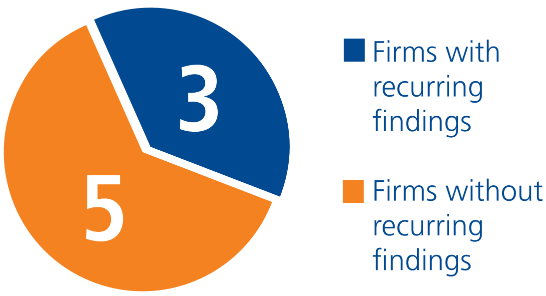
Source: AOB

One of the key ways to measure the effectiveness of remediation measures is via the number of recurring findings raised in subsequent inspections. The AOB reinspected eight audit firms in 2020. Five recurring findings were observed, all of which were in relation to three reinspected Other Audit Firms.

It is encouraging to observe a downward trend in the number of recurring findings for reinspected audit firms as depicted in Chart 2. Despite the spike in 2019, the reinspected audit firms showed significant improvements in 2020, indicating the audit firms' commitment for continuous improvement and successful firm-wide communication in ensuring consistent audit quality delivery. Notwithstanding this positive observation, audit firms are reminded not to be complacent in addressing issues that might easily recur.

CHART 3

Number of reinspected firms with recurring findings



Source: AOB

In analysing areas of recurring findings (Diagram 1), those relating to third-party confirmations have been consistently observed by the AOB over the years. It remains the top recurring finding for both Major and Other Audit Firms in the past years and mainly pertains to alternative audit procedures performed in response to non-reply of confirmations. The recurring finding on multi-location audit highlights the audit firm's lack of understanding in evaluating the work of component auditors.

While findings on goodwill assessment and review of budgets in property development may not recur frequently, more targeted and rigorous remediation plans should still be carried out to address the underlying root causes and avoid continuous recurrence.

DIAGRAM 1

AREAS OF RECURRING FINDINGS

Third-party confirmation

Multi-location audit

Goodwill assessment

Review of budgeted cost and foreseeable losses

Source: AOB

Firms should formulate sustainable remediation plans that are agile and dynamic to withstand changes in staff composition and accounting/auditing standards. This includes modifications of actions to address recurring deficiencies.

CONCLUSION AND FUTURE OUTLOOK

CONCLUSION AND FUTURE OUTLOOK

Despite the disruptions and uncertainty brought about by the COVID-19 pandemic during the year, the AOB continues to provide oversight over the quality of AFS via an adapted inspection programme.

The AOB observed a notable increase in the percentage of inspected engagements routed to the ERQ Department for Other Audit Firms. The findings raised for these audit firms included those relating to basic auditing procedures and accounting estimates as well as the exercise of professional judgement. This highlights the importance of investing in the right level of training and resources so that the competencies required to achieve an acceptable level of audit quality are in place. A similar theme of observation was noted from the monitoring and thematic reviews where there were concerns on the adequacy of challenge on estimates and disclosures relating to the appropriateness of the going concern assumption.

As the pandemic continues to cause uncertainty, heightened diligence and professional scepticism are required in dealing with accounting estimates and other areas of an audit. The full impact of COVID-19 will only be seen in AFS with FYE 2020. Auditors should be placing greater emphasis on the following key areas:

DIAGRAM 1

AUDITORS' KEY AREAS OF FOCUS DUE TO THE IMPACT OF COVID-19

RISK ASSESSMENT

- Revise risk assessments and modify responses as well as audit procedures, based on audit evidence or new information obtained.
- Continuously communicate with TCWG to assess for any emerging risk areas. Auditors should gain an understanding of TCWG's areas of concern and incorporate these into the auditors' risk assessment.

GOING CONCERN

- Challenge the status quo by critically challenging that assumptions made by the PIE remain appropriate.
- Ensure adequate disclosures are made by the PIE, including those on significant judgement exercised in arriving at the conclusion on going concern.

ACCOUNTING ESTIMATES

- Ensure estimates are based on assumptions consistent with the expectations of business performance and the operating environment at the reporting date.
- Robust and timely challenge of the PIE's projected cash flows and other key assumptions that are used and incorporated into valuation models and impairment tests.

FRAUD RISK

- Increase emphasis related to fraud, including greater focus on the PIE's fraud risk management.
- Remain alert to management bias and events and conditions that increase the risk of fraud, given the heightened motive of fraudulent activities amid the uncertainties and volatile market conditions.
- Consider providing training and updates on fraud and areas of potential fraud to create awareness and a heightened degree of scepticism when performing audits.

The pandemic has also caused audit firms to increasingly leverage technology. Audit firms that have invested in technology in the past reaped benefits in being able to adapt quickly with minimal disruption. While the AOB encourages audit firms to continuously invest in technology, they should:

- Be wary of being blindly over-reliant on technology. Auditors should be certain that evidence obtained via the use of technology can be relied upon for purposes of the audit;
- Be mindful of auditors' legal and professional responsibilities with regards to safeguarding the confidentiality of client data; and
- Include cyber security as an integral part of the investment.

Audit firms should also be cognisant that it is all too easy for their partners and personnel to use personal email accounts, social media and centralised messaging platforms to share information when performing audits. Use of such technological tools, while highly convenient, should be restricted for audit purposes as these tools might not offer the same level of precautions as the audit firms' tools.

Overall, the year 2020 has proven that auditors need to be more agile in adapting to rapid changes in the environment. The audit challenges faced in 2020 will continue well into 2021. It is expected that audit procedures will continue to be modified and innovative measures adopted to respond to changes. However, auditors should never lose sight of the core objectives of an audit and should ensure that audit quality is not compromised at all times.

In addition, under firm level inspections, the AOB will have a preliminary review of measures taken by the relevant audit firms in preparing for ISQM 1 which becomes effective after 15 December 2022.

ACRONYMS & ABBREVIATIONS AND DEFINITIONS

ACRONYMS & ABBREVIATIONS

AFS	audited financial statement
AOB	Audit Oversight Board
AQI	indicators for audit quality
AR	annual report
CMSA	*Capital Markets and Services Act 2007*
CPE	Continuing Professional Education
DLP	defect liabilities period
EOT	extension of time
EQCR	engagement quality control reviewer
EQR	Engagement Quality Reviews
ERQ	AOB's Enforcement, Regulation and Quality Assurance
FYE	financial year-end
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
ISA	*International Standards on Auditing*
ISQC	*International Standard on Quality Control*
ISQM	*International Standard on Quality Management*
KAM	Key Audit Matters
LAD	liquidated ascertained damages
MCCG	*Malaysian Code on Corporate Governance*
MCO	movement control order
MFRS	*Malaysian Financial Reporting Standards*
MIA	Malaysian Institute of Accountants
MUGC	Material Uncertainty Related to Going Concern
NAV	net asset value
PIE	public-interest entity
PLC	public-listed company
SC	Securities Commission Malaysia
SCMA	*Securities Commission Malaysia Act 1993*
TCWG	those charged with governance
WHO	World Health Organisation

DEFINITIONS

Auditor	An individual auditor or audit firm who is registered or recognised under section 31O of the SCMA as a registered auditor or recognised auditor of a PIE or schedule fund.
Big-Four Audit Firms	Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers.
Largest 8 Audit Firms	Largest 8 audit firms based on their PLC audit clients' market capitalisation in Malaysia.
Major Audit Firms	Audit firms with more than 10 partners and audit more than 50 PIE clients with a total market capitalisation of above RM30 billion.
Other Audit Firms	Audit firms other than Major Audit Firms.
Other Audit Partners	Partners who are not playing the role of engagement partner or EQCR but who will make key decisions or judgements on significant matters with respect to the audit of the financial statements on which the firm will express an opinion.
Public-interest entity	Entity specified in Part 1 of Schedule 1 of the SCMA as:

(a) a PLC or a corporation listed on the stock exchange;
(b) a bank licensed under the *Financial Services Act 2013*;
(c) an insurer licensed under the *Financial Services Act 2013*;
(d) a takaful operator licensed under the *Islamic Financial Services Act 2013*;
(e) an Islamic bank licensed under the *Islamic Financial Services Act 2013*;
(f) a person prescribed as a prescribed financial institution under section 212 of the *Financial Services Act 2013* or a person prescribed as a prescribed Islamic financial institution under section 223 of the *Islamic Financial Services Act 2013*;
(g) a developmental financial institution prescribed under the *Development Financial Institutions Act 2002*;
(h) a holder of the Capital Markets Services Licence for the carrying on of the regulated activities of dealing in securities, dealing in derivatives or fund management;
(i) an exchange holding company approved under the securities laws;
(j) an exchange approved under the securities laws;
(k) a central depository approved under the securities laws;

	(l) a clearing house approved under securities laws; (m) a self-regulatory organisation recognised under the securities laws; (n) a private retirement scheme administrator approved under the securities laws; (o) a trade repository approved under the securities laws; (p) the Capital Market Compensation Fund Corporation; and (q) any other person as the minister may prescribe by order publisehed in the *Gazette*.
Schedule fund	Fund specified in Part 2 of Schedule 1 of the SCMA: (a) a private retirement scheme approved by the SC under the CMSA; (b) a unit trust scheme approved, authorised or recognised by the SC under the CMSA; (c) any other capital market funds as may be specified by the SC.