Suruhanjaya Sekuriti
Securities Commission
Malaysia

Audit Oversight Board annual inspection report 2021

2021

Audit Oversight Board

ANNUAL INSPECTION REPORT

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CONTENTS

MISSION STATEMENT

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

VISION STATEMENT

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

INTRODUCTION

INTRODUCTION

The Audit Oversight Board (AOB) was established under Part IIIA of the *Securities Commission Malaysia Act 1993* (SCMA) to assist the Securities Commission Malaysia (SC) in regulating auditors of public-interest entities (PIEs) and schedule funds.

In order to assist the SC to discharge its audit oversight function, the AOB, among others, conducts inspections and monitoring programmes on registered audit firms and individual auditors of PIEs and schedule funds.

An inspection involves an assessment of:

- the degree of compliance by auditors with auditing and ethical standards applicable in Malaysia; and
- the quality of the auditor's reports relating to the audited financial statements (AFS) of PIEs and schedule funds.

The AOB may conduct inspections at:

- The Firm level (compliance with *International Standard on Quality Control 1* (ISQC 1) and ethical standards); or
- Engagement level (compliance with *International Standards on Auditing* (ISA) and other regulations); or
- An inspection of both aspects concurrently.

This allows the AOB to fulfil the entrusted mission to foster high-quality independent auditing on the financial statements of PIEs and schedule funds in Malaysia and to promote confidence in the quality and reliability of AFS of PIEs and schedule funds.

AOB HIGHLIGHTS 2021

Monitoring and supervision of PIEs

14 audit firms covering **45** partners and **54** audit engagements were inspected

11 of **14**
AOB's inspections were conducted remotely/virtually in 2021

24%
Audit engagements inspected were imposed with specific remediation measures

5 out of **6**
Major Audit Firms had a minimum of 1 engagement that required significant improvements

In addition to the AOB inspection,
118 audit engagements were reviewed via **off-site thematic reviews**

> This *AOB Annual Inspection Report* aims to provide insights into the AOB's inspection activities, existing and planned strategic initiatives in relation to improve audit quality and provide a unique understanding of the audit landscape in Malaysia.

PART I

Highlights snapshots of the current audit landscape in Malaysia. Some of the information would be beneficial to auditors and the Audit Committee members to understand how their audit firms are compared to the industry's norms, particularly those that are required to produce an *Annual Transparency Report*.

Based on the audit firms' characteristics, eight audit firms registered with the AOB met the criteria to produce an *Annual Transparency Report*. The AOB reviewed the relevant audit firms' reports and provided feedback to the audit firms to ensure that the reporting requirements stipulated by the AOB were met.

PART II & PART III

Features analysis of inspection findings and observations arising from Firm and Engagement level reviews respectively.

In 2021, the AOB embarked on a thematic review to assess the audit culture in the Major Audit Firms. Details of key cultural characteristics and results of the review are featured in Part II.

The updated risk assessment approach, inspection results and sharing on areas of common concerns including Fraud Risk Assessment and Going Concern are presented in Part III.

Part IV

Highlights the remediation progress of inspected audit firms to address the AOB's inspection findings, including a detailed analysis of recurring findings.

Remediation is a key stage of the inspection framework as it requires the affected audit firms to address concerns raised during the inspection process. As such, even though enforcement actions are imposed by the AOB against the audit firms, **remediation efforts are still required** and would be most beneficial for audit firms and auditors who wish to remain as the AOB's registrants.

The report concludes with a summary on the trends of inspection results as well as the areas that auditors (and other stakeholders) need to focus in the years ahead.

WHAT DOES THE AOB DO WITH THE FINDINGS?

FIGURE 1

THE AOB'S PROCESS ON REPORTING FINDINGS TO THE AUDIT FIRMS

1. Conclusion of inspection
2. The AOB issues *Draft Inspection Report*
3. Written responses by audit firm within timeframes prescribed by the AOB
4. Analysis of audit firm's response and presentation of findings to the AOB Board
5. The AOB Board's approval and decision
6. Issuance of *Final Inspection Report*
7. Regular reporting of remediation by audit firm within the timelime agreed with the AOB

The AOB's process upon the completion of an inspection is summarised in Figure 1. Findings presented in the *Final Inspection Report* are defined in Figure 2.

FIGURE 2

WHAT ARE THE AOB'S FINDINGS?

Firm reviews

Relates to compliance with the requirements of ISQC 1 and ethical standards

Engagement reviews

REPORT

- Relates to compliance with ISAs
- Individually critical deficiency, which may have an impact on the basis of the audit opinion
- Pervasive issue where the impact cannot be easily quantified

> “In the absence of sufficient documentation, there was no evidence that the necessary audit procedures have been carried out appropriately. In such situation, the AOB would conclude that the audit firm has failed to perform the required audit procedures.”

Although the findings highlighted by the AOB are individually critical or pervasive, these findings do not necessarily suggest that the affected PIE’s financial statements contained a material error or its internal controls in respect of financial reporting are materially weak.

All findings highlighted are expected to be remediated by the audit firms within a timeline agreed with the AOB following the issuance of the *Final Inspection Report*. Further details in relation to the remediation measures are reported in **Part IV: Remediation of Inspection Findings**.

The AOB assesses the severity of findings arising from each engagement review to determine the appropriate actions to be taken. For engagements where significant improvements are required, the AOB does not restrict actions to the individual partners involved but will also consider the need for further measures to be imposed on the audit firms, if necessary.

The following actions might be taken by the AOB depending on the results of the assessment performed (Figure 3).

FIGURE 3

ACTIONS THAT COULD BE TAKEN BY THE AOB

- Imposition of specific remediation measures to incorporate or revise the relevant audit procedures
- Refer to other SC’s line departments or sharing of findings with respective PIEs
- Enforcement action by the AOB pursuant to Section 31Z and Section 31Q of the SCMA
- Imposition of additional registration conditions and interim measures

Imposition of Specific Remediation Measures

As part of the specific remediation measures imposed, the audit firms will be required to incorporate or revise the relevant audit procedures in their audits of the PIEs for the following financial year to evaluate the areas relating to the findings raised. Audit firms will also be required to evaluate the impact of these audit procedures on the AFS for the financial year inspected. Further details in relation to the specific remediation measures imposed on the audit firms are elaborated in **Part III: Inspection Findings and Observations from Engagement Level Reviews – Engagements with Significant Improvements Required**.

ENFORCEMENT

The principle of proportionality, efficiency and achieving the desired outcome continues to be essential to the strategic enforcement approach adopted by the AOB. In determining the type of sanction that is imposed on any contravention or breach by the auditors, the AOB considers the nature and seriousness of the offences, previous regulatory records and other aggravating and mitigating factors.

Among the matters considered by the AOB in determining the appropriate sanction were the impact of the contravention on the integrity of the profession, the capital market as a whole and the impact of the breach on the stakeholders' confidence and reliability of the affected PIEs' AFS.

The AOB may impose administrative actions on auditors for various misconducts as summarised in Figure 4.

FIGURE 4

TYPES OF ACTIONS IMPOSED

Directive to comply	Section 31Z of the SCMA
Public reprimand	
Remedy the breach according to the directive of the AOB	
Undertake relevant professional education	
Assign reviewer to oversee the audit	
Prohibitions from auditing and accepting PIEs and schedule funds as audit clients	
Monetary penalties	
Revoke, withdraw, or suspend the registration or recognition of auditors	Section 31Q of the SCMA

NUMBER OF ENFORCEMENT CASES AND A RANGE OF SANCTIONS IMPOSED IN 2021

REVOCATION
1 individual auditor

REPRIMAND
1 individual auditor

PROHIBITION
1 audit firm

PENALTIES IMPOSED ON

1 audit firm

1 individual auditor

TOTAL AMOUNT OF PENALTIES IMPOSED

RM600,000

For details of the AOB's Enforcement Actions, please refer to:

(i) Read more on AOB sanctions.

(ii) Read more on AOB revocation and suspension of registration.

FREQUENTLY ASKED QUESTIONS
Auditors prohibited from auditing and/or accepting PIEs and schedule funds as its clients

1 What does a prohibition entail?

Pursuant to section 31Z(2)(f) of the SCMA, the AOB may impose prohibition on a person concerned from **accepting any PIE or schedule fund as its client or preparing reports** in relation to financial information of any PIE or schedule fund.

Pursuant to section 31Z(2)(g) of the SCMA, the AOB may impose prohibition on a person concerned from **auditing financial statements or preparing reports** in relation to financial information of a PIE or schedule fund.

The prohibition includes work carried out by a person or firm in his/its **capacity as an Auditor and/or a Reporting Accountant**.

2 How long is the prohibition period?

Pursuant to section 31Z(2)(f) of the SCMA, the prohibition from accepting any PIE or schedule fund as client may be imposed on the person concerned for a period **not exceeding 12 months**. Meanwhile, section 31Z(2)(g) of the SCMA states that the prohibition from auditing financial statements or preparing reports of a PIE or schedule fund may be imposed on the person concerned for a period **not exceeding 12 months or permanently**.

Read more on the enforcement action imposed on auditors including the period of the prohibition from https://www.sc.com.my/aob/aobs-sanctions.

3 What is the purpose of the prohibition?

The AOB imposed the prohibition based on the facts of the case, the degree of the auditors' non-compliance with the auditing and ethical standards, severity of the breach, impact to the capital market and the need to protect public interest regardless of size or affiliation.

The prohibition is primarily intended to ensure auditors have ample time to build sufficient internal capacity to enhance an audit firm's audit capability and competency to the required standard.

4 Will the prohibition affect the auditors' license under the *Companies Act 2016*?

No, the prohibition would not affect the auditors' license issued under the *Companies Act 2016* unless decided otherwise by other relevant authorities. The prohibition only prohibits auditors from auditing and/or accepting PIE or schedule fund as audit clients during the prohibition period. The prohibition does not prohibit auditors from continuing their engagements with their non-PIE or non-schedule fund audit clients.

5 If the auditor is prohibited, is the auditor still considered to be an AOB registrant?

Yes, the prohibited auditor is still registered with the AOB until the auditor applies to withdraw his/her registration with the AOB or their registration or recognition is revoked by the AOB.

6 Can a PIE or schedule fund appoint an auditor who has been sanctioned by the AOB?

The PIE or schedule fund may or may not appoint an auditor who has been sanctioned by the AOB depending on the types of sanction imposed. The PIE or schedule fund **cannot appoint an auditor** if-

- the auditor has been prohibited from accepting and/or auditing PIE or schedule fund during the prohibition period; or
- the auditor's registration with the AOB has been revoked.

7 What should a PIE or schedule fund do when the appointed auditor is prohibited from auditing and/or accepting PIE or schedule fund as its client?

The PIE or schedule fund should consider whether the continued appointment of the auditor who has been sanctioned by the AOB, would have **an impact on the entity**, in particular any legal consequences and its investor confidence on the AFS.

The PIE or schedule fund should immediately **consult with its legal counsel and engage the auditor concerned**. The PIE or schedule fund should ensure that there is no disruption to the completion of the statutory audit and that the AFS can be issued within the required time.

WHAT SHOULD DIRECTORS OF PIEs DO WITH THE AOB FINDINGS?

The oversight function is an essential part of a PIE's governance structure that is meant to ensure that reliable audited financial information is provided to users of financial statements for informed decision-making purposes.

> Directors and Audit Committees are ultimately responsible for overseeing the financial reporting process of the PIE.

Communication

Directors and Audit Committees play a key role in driving audit quality. The *AOB Annual Inspection Report* acts as a guide for the directors and/or Audit Committees to ask insightful questions to their auditors on common inspection findings that may impact their entities. This information could facilitate the Audit Committees and management to better understand the challenges faced by auditors in performing their audits.

Audit Committees should also set expectations for transparent communication lines with the auditors. This allows a platform for the auditors to highlight any complex financial reporting matters as highlighted in the *AOB Annual Inspection Report* as well as any differences in opinions with management. By obtaining a more complete picture of matters via discussions with the Audit Committees, the auditors would be able to tailor the audit procedures to adequately address the risk areas that are specific to the entities and of the Audit Committees' utmost concern.

Significant audit judgements and accounting estimates

The *AOB Annual Inspection Report* also highlights several key areas surrounding accounting estimates. The directors and/or Audit Committees could play their role in making sure that their entities have appropriate controls and processes in place to address complex accounting issues, including having appropriate accounting records to support the management's assumptions on significant key judgements and relevant appropriate accounting treatments.

The policies and processes should also be able to alert the Audit Committees and those charged with governance (TCWG) as early as possible whenever complex or highly-subjective transactions are performed. This will help facilitate the decision-making process and avoid any last-minute setbacks. Consequently, any challenges that arise from disruptions such as added costs and loss of reputation could be identified, addressed and mitigated in advance.

This would allow the auditors to evaluate the sufficiency of audit evidence to mitigate any significant audit risks by appropriately challenging management in key judgement areas.

Assessment of audit culture and audit quality

Directors and Audit Committees can significantly assist in supporting quality audits. The audit fees set should be proportionate with the work required to be performed by the auditors.

By considering the respective Audit Quality Indicators (AQIs) as disclosed in the *AOB Annual Inspection Report*, this would enable stakeholders to make better comparison between audit firms based on audit quality considerations particularly in deciding the appointment and reappointment of audit firms. Further details in relation to the AQIs are elaborated in **Part I: Insights into the Audit Profession**.

The AOB strongly encourages directors and Audit Committee members to understand and discuss the common inspection findings and firm-level AQIs shared in this report with their auditors to enhance their oversight function.

PART I:
INSIGHTS INTO THE AUDIT PROFESSION

REGISTRATION AND RECOGNITION STATISTICS

Table 1 **Registered and recognised audit firms and individual auditors as of 31 December 2020 and 31 December 2021**

	No. of audit firms		No. of individual auditors	
	2021	**2020**	**2021**	**2020**
Registered				
Major Audit Firms	6	6	198	193
Other Audit Firms	31	32	147	146
Recognised				
Foreign Audit Firms*	4	4	12	13
TOTAL	**41**	**42**	**357**	**352**

* Foreign auditors who audit foreign incorporated companies listed on Bursa Malaysia.

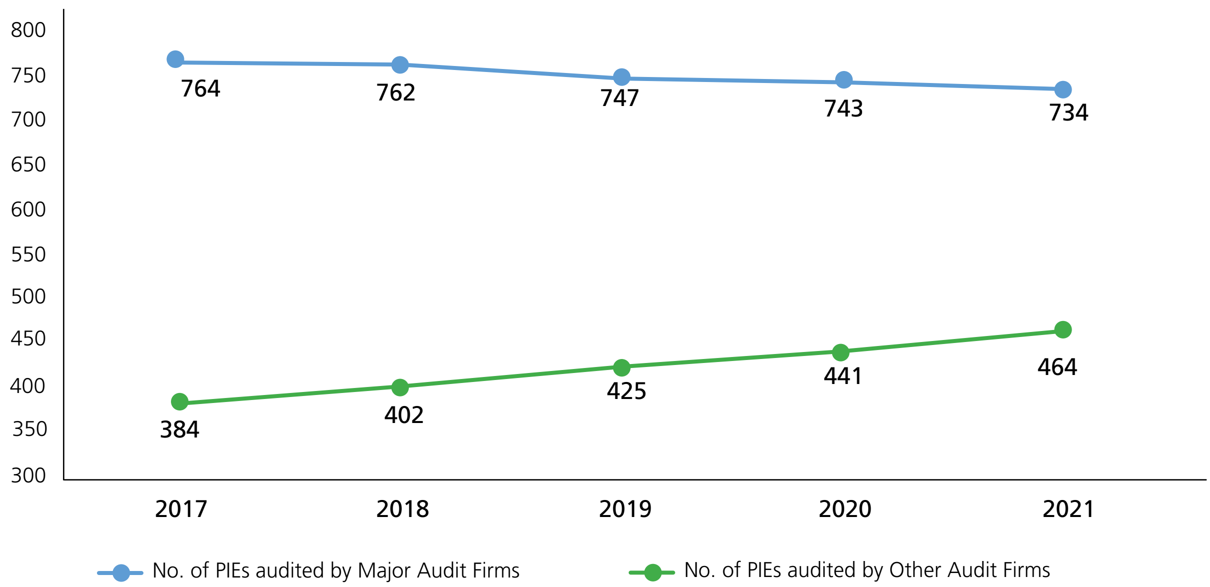
While the Major Audit Firms had a larger market share for the audits of PIEs as shown in Table 2, the Other Audit Firms continued to register a steady increase in the number of PIE audit clients over the years, as depicted in Chart 1.

Table 2 **PIEs and schedule funds audited by AOB-registered firms and AOB-recognised foreign audit firms as at 31 December 2020 and 31 December 2021**

	% of total no. of PIEs		% of total public-listed companies' (PLCs) market capitalisation		No. of schedule funds		% of total net asset value (NAV)	
	2021	2020	2021	2020	2021	2020	2021	2020
Registered								
Major Audit Firms	61.0	62.5	92.4	92.3	1,212	1,112	98.3	98.3
Other Audit Firms	38.6	37.1	7.4	7.6	43	37	1.7	1.7
Recognised								
Foreign Audit Firms*	0.4	0.4	0.2	0.1	-	-	-	-
TOTAL	**100%**	**100%**	**100%**	**100%**	**1,255**	**1,149**	**100%**	**100%**

* Foreign auditors who audit foreign incorporated companies listed on Bursa Malaysia.

Chart 1 **Number of PIEs audited by the Major and Other Audit Firms**



AUDIT QUALITY INDICATORS

The *Malaysian Code on Corporate Governance* (MCCG) encourages Audit Committees to consider the information presented in the audit firms' Annual Transparency Reports when deciding on the appointment and reappointment of the external auditors. In 2021, a total of eight audit firms in Malaysia were required to produce the Annual Transparency Reports as they had met the reporting criteria stipulated below.

REPORTING CRITERIA

Commencing from 2021, an audit firm that meets the following reporting criteria for two consecutive years is required to produce an *Annual Transparency Report*:

- 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.

Audit firms are required to disclose a set of common AQIs in their Annual Transparency Reports to facilitate comparisons between the audit firms based on audit quality considerations as detailed in Figure 1. It is important to note that each AQI should not be read in isolation as audit quality is affected by a combination of quantitative and qualitative factors.

FIGURE 1

MANDATORY AQIs TO BE REPORTED IN THE ANNUAL TRANSPARENCY REPORTS

AQI	Considerations for the Audit Committees
1. Audit partner workload* ■ Ratio of the average number of PIEs per partner; ■ Ratio of the average number of entities related to PIEs per partner; and ■ Ratio of the average number of non-PIEs per partner. * Workload of the audit partners who are involved in PIE audits.	A partner's workload increases in tandem with the number of clients that the partner has to service. The heavier the workload, the lesser amount of time the partner would have to supervise the audit engagements.

AQI	Considerations for the Audit Committees
2. Auditors' independence ■ Proportion of fee income derived from audit clients segregated into statutory audit, other assurance services and services provided by the non-audit practice; and ■ Proportion of fee income between audit practice and non-audit practice such as tax, corporate advisory and consulting.	The multi-disciplinary model of audit firms has enabled them to provide both audit and assurance services as well as non-audit services to their audit clients. When the proportion of fees derived from the offering of non-audit services to audit clients is relatively higher than the audit fees, there is a risk that the provision of non-audit services by audit firms to its audit clients could undermine auditors' independence. Further, when the proportion of fee income from the non-audit practice of an audit firm is relatively higher than the audit practice, this raises the concern that the audit firm's focus on audit quality may be overridden by their non-audit business considerations.
3. Capacity and competence of the audit practice ■ Headcount of audit personnel with professional qualifications; ■ Turnover rate for audit personnel; and ■ Average years of experience of audit partners and audit staff.	These indicators would provide the Audit Committees with an indication of the audit firm's ability to manage its talent pool particularly in ensuring that the audit firm has sufficient and competent talent to carry out quality audits. Talent retention continues to be a challenge faced by the audit profession due to stiff competition for accounting and auditing talent within Malaysia as well as abroad. As certain factors that drive these indicators are beyond the audit firms' control, it is also important for Audit Committees to gain an understanding of the various mitigating actions taken by the audit firms to address capacity and competency issues.
4. Audit engagement supervision ■ Staff to partner ratio; and ■ Staff to manager ratio.	These indicators provide an overview on whether the audit firm has sufficient partners and managerial staff to supervise less experienced audit team members. A lower ratio would imply that a partner or managerial staff could accord greater attention to supervise audit engagement teams.
5. Audit firm's investment to promote audit quality ■ Average hours of training provided by the audit firm to audit personnel; and ■ Ratio of audit staff to quality control function staff.	Training provided by the audit firm to audit personnel is important to ensure that they remain technically competent and kept up-to-date with the latest changes in accounting and auditing standards. In addition, audit quality is also promoted within the audit firm through various quality control functions comprising training, technical consultations, risk management and quality assurance. A higher ratio of headcount in quality control functions relative to audit personnel headcount would indicate greater audit firm commitment to allocate resources to support audit quality.

AQI		Considerations for the Audit Committees
6.	**Internal and external monitoring reviews** ■ Results of monitoring reviews that have been carried out by the audit firm or the audit firm's network; and ■ Results of the AOB inspections and compliance reviews by the professional bodies.	Monitoring reviews are conducted to evaluate the audit firms' compliance with quality control standards as well as to assess the quality of the audit engagements. Audit Committees should evaluate the results of the monitoring reviews disclosed in the Annual Transparency Reports and where necessary, engage the auditors to obtain further information on the shortcomings identified and the detailed efforts to remediate them.

IMPORTANT NOTE FOR AUDITORS

Audit firms should ensure that their audit engagement partners have a good understanding of the contents in the audit firm's Annual Transparency Reports so that they can provide input to their clients' Audit Committees on the following:

- The audit firm's governance structure and measures to uphold quality and manage risk; and
- The AQIs disclosed in the audit firm's *Annual Transparency Report*.

Audit engagement partners should also take the initiative to engage and provide updates to Audit Committees on the audit firm's Annual Transparency Reports and AQIs.

IMPORTANT NOTE FOR AUDIT COMMITTEES

When deciding on the appointment and reappointment of the external auditors, the Audit Committees should differentiate the auditors based on audit quality considerations by-

- comparing and evaluating the information disclosed in the respective audit firm's Annual Transparency Reports. From 2022 onwards, the respective audit firm's Annual Transparency Reports would be readily available on the audit firm's website within four months after the audit firm's fiscal year-end; and
- comparing AQI information disclosed in the audit firm's Annual Transparency Reports with those disclosed in the *AOB Annual Inspection Report.* In Figure 2, the average AQIs highlighted by the AOB are based on information reported in the audit firm's Annual Transparency Reports for fiscal periods ended 31 December 2020 to 30 June 2021.

It is worthwhile to note that the auditors would be in the best position to explain their audit firm's AQIs and efforts undertaken to address any shortcomings. Hence, the AOB hopes that the Audit Committees would engage with their auditors in meaningful discussions on the audit firm's AQIs to drive continued focus and improvements on audit quality.

FIGURE 2

AQIs REPORTED IN THE AUDIT FIRMS' ANNUAL TRANSPARENCY REPORTS FOR FISCAL PERIODS ENDED 31 DECEMBER 2020 TO 30 JUNE 2021

AUDIT PARTNER* WORKLOAD

	Low	Average	High
No. of PIEs per partner	3	4.8	7
No. of entities related to PIEs# per partner	36	54.1	82
No. of non-PIEs per partner	61	118.2	193

Note:

* * Relates to audit partners who are involved in PIE audits.
* \# Relates to non-PIEs within the PIE Group, which are audited by Malaysian audit firms. Examples include, but are not limited to, subsidiaries and associates of PIEs.

AUDITOR INDEPENDENCE

Proportion of fee income between the audit practice and non-audit practices

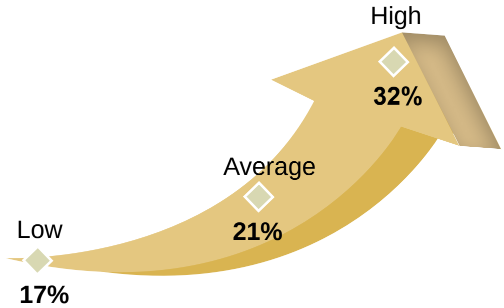
- 49% Audit practice
- 51% Non-audit practices

Proportion of fee income derived from audit clients

- 72% Statutory audit
- 8% Other assurance services
- 20% Services provided by non-audit practices

CAPACITY AND COMPETENCE OF THE AUDIT PRACTICE (ON A COLLECTIVE BASIS)

Staff turnover rate



Audit staff composition and year of audit experience

Staff role	Partner	Managerial staff	Non-managerial staff
Staff composition	4%	17%	79%
Average years of experience	23 years	10 years	3 years

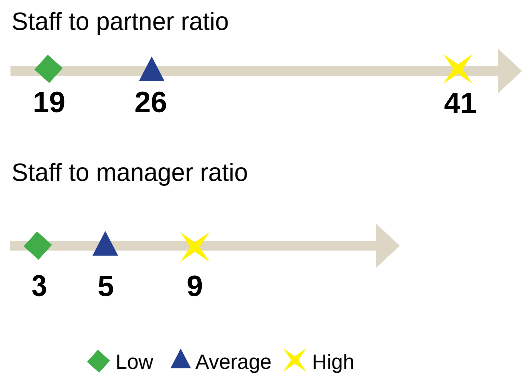
Audit staff's professional qualifications

23% With professional qualifications and / or MIA membership

64% Pursuing professional qualifications and / or MIA membership

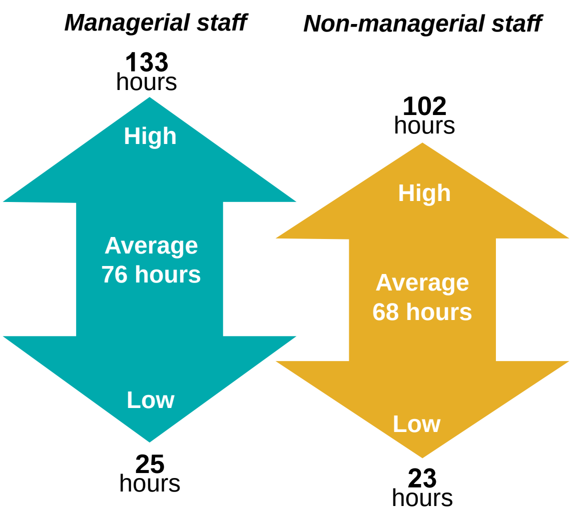
13% Without professional qualifications and / or MIA membership

AUDIT ENGAGEMENT SUPERVISION



AUDIT FIRMS' INVESTMENT TO PROMOTE AUDIT QUALITY

Average hours of training provided to audit staff



Ratio of audit staff to one quality control staff#

51

Average of one quality control staff supporting 51 audit staff

Note:

Quality control staff are staff who are involved in risk management, technical consultations, training and quality assurance functions of the audit firms.

PART II: INSPECTION FINDINGS AND OBSERVATIONS FROM FIRM LEVEL REVIEWS

In 2021, the AOB carried out inspections on six Major Audit Firms and three Other Audit Firms. It is worth noting that there was no finding relating to the system of quality controls for two Major Audit Firms.

The common findings observed in 2021 from the firm-level reviews are detailed in Table 1.

TABLE 1

COMMON INSPECTION FINDINGS IDENTIFIED FOR THE MAJOR AUDIT FIRMS AND THE OTHER AUDIT FIRMS

Common findings	Key concerns / risks	Reminders
Relevant ethical requirements		
Policy on the rotation of audit partners The MIA By-Laws requires for an audit partner to be rotated out of an audit engagement once the maximum period of involvement allowed has been reached. In calculating the period of involvement, the MIA By-Laws stipulates that all relevant roles undertaken by an individual **prior** to becoming a key audit partner should also be considered. However, the policy on the rotation of audit partners for some audit firms did not consider this.	Threats to auditor independence posed by an audit partner's long association with his audit client may not be fully addressed by the existing audit firm's policy.	Audit firms should conduct a review of their policies and procedures to ensure that they fully adhere to the requirements of the MIA By-Laws.
Acceptance and continuance of client relationships and specific engagements		
Acceptance procedures for non-audit service engagements As audit partners are ultimately responsible for ensuring auditor independence, audit firms typically have a requisite for an audit partner to provide consent before a non-audit service engagement involving the audit client is accepted. However, there were instances where some audit firms accepted non-audit service engagements before the respective audit engagement partners provided their consent.	An audit firm or its affiliated entities could inadvertently accept a non-audit service engagement that is prohibited under the MIA By-Laws.	The provision of prohibited non-audit services to an audit client is considered a serious ethical breach. The AOB would not hesitate to take stern actions that include revoking the registration of the audit firm. Hence, audit firms should closely monitor their personnel's compliance with established procedures for the acceptance of non-audit services.

Common findings	Key concerns / risks	Reminders
Engagement performance		
Audit consultations Audit firms have established policies that includes mandatory consultations on key matters affecting its audit opinions. However, the following shortcomings were noted: (a) Some audit engagement teams did not carry out consultations on matters that affected the audit opinions although consultations are required by the audit firm's policy; and (b) There were instances where the audit reports were signed-off by the audit engagement partners before the completion of the consultation process.	Risk of inappropriate audit opinion being rendered by the audit engagement team.	Audit firms should remind their audit engagement teams to carry out consultations in accordance with established policies to safeguard audit quality. In addition, audit firms should also take stern action on audit engagement teams that fail to comply with its policies and procedures.
Safeguarding assembled audit engagement files Some audit firms require the audit engagement teams to use an audit software to document their audit work and to assemble the audit engagement files upon finalisation. However, certain audit firms have not implemented sufficient access and monitoring controls to prevent unauthorised modification to the audit engagement files after file assembly.	Integrity of audit engagement files could not be assured when access to audit software functionality to modify audit engagement files are not appropriately restricted and there was a lack in monitoring by the audit firm over such access.	Audit firms should consider the following: ■ Restricting system access to prevent unauthorised modification to audit engagement files after the date of the file assembly as well as to implement monitoring over the use of such access; and ■ Should the audit engagement teams require modifications to be made after file assembly, their requests should be subject to a review and approval process with proper documentation maintained on file.

AUDIT FIRM CULTURE

Organisational culture comprises a collection of values, beliefs and norms that influence the behaviour of individuals within the organisation. Culture drives conduct and conduct is an observable outcome from culture. In their efforts to achieve sustainable audit quality, audit firms should embed the right culture within their respective organisations.

The key cultural characteristics that should be present in the audit firms are listed in Table 2.

TABLE 2

KEY CULTURAL CHARACTERISTICS THAT SHOULD BE PRESENT IN THE AUDIT FIRMS

Cultures	Characteristics
Culture of quality	▪ Leadership takes responsibility and is accountable for audit quality. The leadership sets the tone at the top through their actions and consistent communications that demonstrate commitment to audit quality. ▪ The audit firm's business strategy is subject to overriding commitment to audit quality. ▪ There is a clear assignment of responsibilities and allocation of sufficient resources that enables the effective operation of the audit firm's system of quality controls. ▪ There is a continuous focus on developing audit personnel's competence and capabilities in the audit firm. ▪ The audit firm rewards high-quality work that drives the mindset for job accountability. ▪ Audit personnel believes that the audit firm values audit quality and has a mindset to pursue job excellence.
Culture of ethical behaviour	▪ The audit firm sets a strong tone on the importance of adopting professional ethics and complying with relevant ethical requirements. This is normally demonstrated by stern actions taken by the audit firm in the event of ethical breaches. ▪ The audit firm conducts frequent communication relating to professional ethics and professional behaviour through various means such as townhall meetings, training and email reminders. ▪ Audit personnel possess the mindset to behave professionally and carry out their work with integrity, objectivity, competence and due care.
Culture of compliance	▪ The audit firm has low tolerance for instances of non-compliance with its policies and procedures. Compliance is closely monitored and any non-compliance incidents are dealt with decisively and in a timely manner. ▪ Audit personnel are fully aware of the repercussions of non-compliance with the audit firm's policies and procedures and strive to comply with them. A compliance mindset is embedded in the audit personnel.

Cultures	Characteristics
Culture of challenge	■ The audit firm encourages its audit personnel to develop critical thinking and to adopt a questioning mindset through structured training and on-the-job training as part of its efforts to promote the application of professional scepticism and sound judgement. ■ The audit partners frequently remind the audit engagement teams to critically examine the audit evidence provided by the client and to robustly challenge key judgements and estimates made by the client. ■ In addition, the audit partners provide strong support to the audit engagement teams when they are faced with difficult clients.
Culture of consultation	■ The audit firm issues frequent reminders to audit personnel on its consultation policies and procedures. ■ The audit partners and managers frequently encourage team members to consult when in doubt and when faced with difficulties during their audit assignments. The audit partners and managers are approachable and provide timely response to matters consulted. ■ The audit firm's audit personnel are comfortable to consult, both formally and informally, on matters that are difficult and contentious.
Culture of trust	■ The audit firm has established clear policies and procedures to receive complaints, investigate and take relevant actions. The audit firm has also established clear channels for complaints that include allowing audit personnel to raise anonymous complaints. ■ The audit firm's personnel strongly believe that they would not be penalised for reporting serious incidents and concerns including those involving partners and senior leadership of the audit firm. They trust that the audit firm would take the appropriate actions in dealing with any complaints raised to the audit firm. Therefore, they have no reservations in raising their complaints to the audit firm.

In 2021, the AOB conducted a culture assessment by interviewing a sample of 65 audit personnel across the Major Audit Firms. The interviewees were asked to rate the strength of each cultural characteristic listed in Table 3 on a scale of '1' being 'very weak' to '5' being 'very strong' as well as to provide some examples to support their ratings. The overall results of the culture assessment is detailed in Table 3.

While the Major Audit Firms have fared well in most of the areas assessed, some audit firms can further improve in reinforcing a positive culture within the audit firms particularly in building greater trust in the audit firm.

In 2022, a similar culture assessment would also be carried out on the Other Audit Firms as the AOB believes that the inculcation of the key cultural traits would be beneficial to audit firms of various sizes.

TABLE 3

RESULTS OF THE CULTURE ASSESSMENT BASED ON INTERVIEWS OF AUDIT PERSONNEL FROM THE MAJOR AUDIT FIRMS

Cultural Characteristic	Firm A	Firm B	Firm C	Firm D	Firm E	Firm F
Culture of quality	4.0 to 4.4	4.0 to 4.4	4.0 to 4.4	4.0 to 4.4	3.9 and below	3.9 and below
Culture of ethical behaviour	4.5 and above	4.0 to 4.4	4.0 to 4.4	4.0 to 4.4	4.0 to 4.4	4.0 to 4.4
Culture of compliance	4.5 and above	4.5 and above	4.5 and above	4.5 and above	4.0 to 4.4	4.0 to 4.4
Culture of challenge	4.0 to 4.4	4.0 to 4.4	4.0 to 4.4	4.5 and above	4.0 to 4.4	4.0 to 4.4
Culture of consultation	4.5 and above	4.5 and above	4.0 to 4.4	4.0 to 4.4	4.5 and above	4.0 to 4.4
Culture of trust	4.0 to 4.4	4.0 to 4.4	4.0 to 4.4	3.9 and below	4.0 to 4.4	3.9 and below

4.5 and above 4.0 to 4.4 3.9 and below

AUDITOR RESIGNATIONS

Under the *Companies Act 2016*, an auditor of a company may resign by giving a notice in writing to the company at its registered office. The auditor's term of office would come to an end after 21 days from the date of notice or from the date specified in the notice.

In monitoring the change in auditors' appointments, the AOB noted a considerable number of auditors of PLCs resigning after their appointment at the annual general meeting (AGM) as depicted in Table 4.

Table 4 Number of auditor resignations after AGM involving PLCs

	2018	2019	2020	2021
Number of auditor resignations after AGM	44	70	41	46

REGULATORY CONCERNS RELATING TO AUDITORS RESIGNATIONS

(a) Auditors, when faced with known or suspected financial irregularities perpetuated by their clients, chose to resign instead of carrying out their statutory obligations to whistle blow and report to relevant authorities.

(b) Incoming auditors were unaware of key audit issues that existed prior to their appointment due to the following:

- Outgoing auditors might not be forthcoming in communicating key audit issues in their professional clearance letters to the incoming auditors; and
- Outgoing auditors' refusal to extend their co-operation to the incoming auditors by providing access to their audit working papers. This lack of co-operation reduces the ability of the incoming auditors to identify key audit issues.

In view of the above concerns, the AOB is considering setting new reporting guidelines on the change in auditors and auditor resignations involving PIE audit clients after their appointment at the AGM. These requirements would enable the AOB to be informed on the reasons for auditor resignations as well as to oversee the communications between the incoming and outgoing auditors whenever there is a change in auditors for PIE audit clients after their appointment at the AGM.

The AOB engaged with the Malaysian Institute of Accountants (MIA) and the Malaysian Institute of Certified Public Accountants (MICPA) to highlight the above concerns. Arising from these engagements, MICPA intends to formulate the relevant technical guidance for the incoming auditors to access the audit working papers of the outgoing auditors.

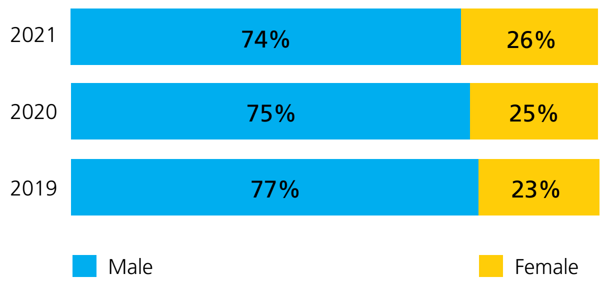
The AOB strongly encourages the outgoing auditors to share their audit working papers with the incoming auditors in the spirit of collaboration among audit professionals and a collective responsibility to promote audit quality in the financial ecosystem.

GENDER DIVERSITY IN SENIOR AND LEADERSHIP ROLES IN AUDIT FIRMS

The audit profession faces stiff competition for accounting talent from within the profession and the commercial sector both locally and abroad. The promotion of gender diversity by audit firms is therefore relevant as it can help attract, recruit and retain the best talents.

As shown in Chart 1, there is only marginal improvements in gender parity of audit partners in the last three years with slightly above a quarter of the total audit partners being female. This is despite 64% of the audit workforce comprising the female gender as of 31 December 2021. Further, there is minimal involvement of female audit partners undertaking senior and leadership roles in the audit firms.

Chart 1 Gender composition of audit partners in audit firms registered with the AOB



- None of the Major Audit Firms' managing partners or head of the audit practices are women.
- Only three out of the 37 audit firms registered with the AOB had women managing partners.

The audit profession is a demanding career where long hours, tight deadlines and heavy workload would make the profession unfavourable to working mothers, who prefer to work in professions that could offer better work-life balance or allow a certain degree of flexible work-arrangements. A combination of the above factors will narrow the talent pool and contribute to the high-attrition rate faced by the audit firms.

Hence, there is a need for audit firms to remove any impediments that prevent talented and motivated women from staying on with the audit firm and progressing into more senior and leadership roles. The AOB encourages audit firms to consider the initiatives to reduce gender disparity, as highlighted below:

INITIATIVES FOR CONSIDERATION TO REDUCE GENDER DISPARITY AT SENIOR AND LEADERSHIP LEVELS

1. **Make gender parity an organisational goal**
   - Set a strong tone at the top to reduce gender disparity; and
   - Set targets for female representation at senior and leadership levels.
2. **Implement programmes to facilitate progression of women to senior level roles in the audit firm**
   - Conduct leadership training and mentorship programme for emerging female partners and leaders; and
   - Provide equal opportunities for women to be promoted within the audit firm.
3. **Promote healthy work-life balance**
   - Allow for flexible work-arrangements for working mothers; and
   - Strengthen employee engagement to identify challenges faced and provide adequate support to improve their well-being.

BEST PRACTICES FOR THE IMPLEMENTATION OF THE NEW AND REVISED STANDARDS ON QUALITY MANAGEMENT

For the audits of financial statements with periods beginning on or after 15 December 2022, three new and revised global standards on quality management would come into effect:

International Standard on Quality Management 1 (ISQM 1)	International Standard on Quality Management 2 (ISQM 2)	International Standard on Auditing 220 (Revised) (ISA 220)
■ Replaces ISQC 1; and ■ Introduces a more proactive and targeted approach to manage quality.	■ New standard introduced to strengthen engagement quality reviews.	■ Revised standard to strengthen the key elements of quality management at the engagement level.

BEST PRACTICES FOR THE IMPLEMENTATION OF THE NEW AND REVISED STANDARDS ON QUALITY MANAGEMENT

1. Leadership taking accountability for the implementation

- Implementation of the new standards should be led by senior partners of the audit firm; and
- Set implementation milestones and closely monitor the progress.

2. Committing sufficient resources for the implementation

- Implementation roles and responsibiltities should be assigned to competent personnel with sufficient authority;
- The risk assessment process should be carried out by relevant personnel including those from other service lines who are impacted by the implementation of ISQM 1;
- Information technology (IT) systems should be utilised to strengthen information sharing, reporting and monitoring of risks and compliances; and
- Ensure undue reliance is not placed on the network, particularly for audit firms with affiliation to international networks.

3. Communication

- Changes to policies and procedures relating to the audit firm's system of quality management should be communicated in a timely manner to partners and staff through briefings, training and written communication.

4. Readiness assessment before the implementation deadline

- Conduct independent reviews to assess the effectiveness of controls in addressing identified risks; and
- Control weaknesses identified during the reviews should be appropriately addressed before the effective date of the standards.

5. Documentation

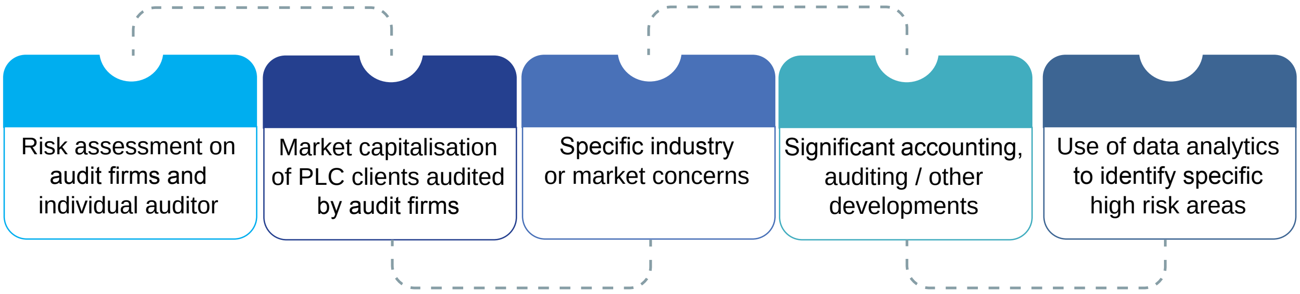
- The results of the audit firm's risk assessment process should be properly documented in a risk register;
- Policies and procedures should be documented to support effective operation of the audit firm's system of quality management; and
- Sufficient documentation should be maintained to substantiate the operation of the system of quality management and to facilitate monitoring reviews.

PART III: INSPECTION FINDINGS AND OBSERVATIONS FROM ENGAGEMENT LEVEL REVIEWS

The AOB adopts a risk-based approach in the planning and engagement selection for its inspections and monitoring programmes, taking into consideration various factors as highlighted in Figure 1.

FIGURE 1

RISK-BASED APPROACH TAKEN BY THE AOB



Risk assessments and market capitalisation

Risk assessments on the audit firms and individual auditors include various factors such as the size of the audit firm, number of registered audit partners with the AOB and the results of their internal and external monitoring reviews, market capitalisation and complexity of the audit firm's PLC clients.

The AOB also continues to monitor the audit firms' key AQIs as part of the risk assessments' process. Some of the key AQI trends includes but are not limited to the following:

- Audit partner workload;
- Capacity and competence of the audit practice; and
- Level of audit engagement supervision.

Specific industry or market concerns and significant accounting and auditing developments

The AOB considers the following external factors in its risk-based approach:

- Recent business developments;
- Market trends and economic outlook;
- Industry-specific dynamics and market concerns surrounding the capital market; and
- Current developments *vis-a-vis* accounting and auditing principles issued by the International Accounting Standards Board (IASB) and/or International Auditing and Assurance Standards Board (IAASB).

Data analytics

The introduction of data analytics (DA) formed a vital part in the AOB's annual inspection programmes in recent years. In 2021, the AOB took the opportunity to further enhance its DA-driven approach, which now takes into consideration differences in the complexity of the PIE structure, nature of the industry and operating environment of the entities.

This continuous improvement will ensure that the AOB's inspection programme is sufficiently robust in identifying key economic trends and market concerns in a timely manner. The more in-depth utilisation of DA by the AOB allows for a more focused inspection and at the same time, maximises the resources available to the AOB.

In view of the AOB's targeted and risk-based approach, inspection results on certain financial statement areas may not be representative of the position of the entire financial statements of the PIEs. 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.

In 2021, the AOB conducted inspections on 14 audit firms covering 45 individual auditors and 54 audit engagements. These included 11 inspections conducted remotely which allowed a safer inspection process while adhering to the Standard Operating Procedures (SOPs) in place throughout the COVID-19 pandemic.

The AOB worked together with the audit firms to explore various options to perform monitoring reviews and/or virtual inspections. As most of the inspections were conducted off-site, the respective audit firms inspected were required to provide the assembled audit documentation digitally via online sharing or via the provision of the audit firms' own laptops to the AOB office. All meetings were conducted virtually with full co-operation received from the relevant audit firms. Together with the usage of data analytical tools in the risk assessment and engagement selection process, the AOB will continue to embrace digital transformation to remain agile in its processes and inspection approach.

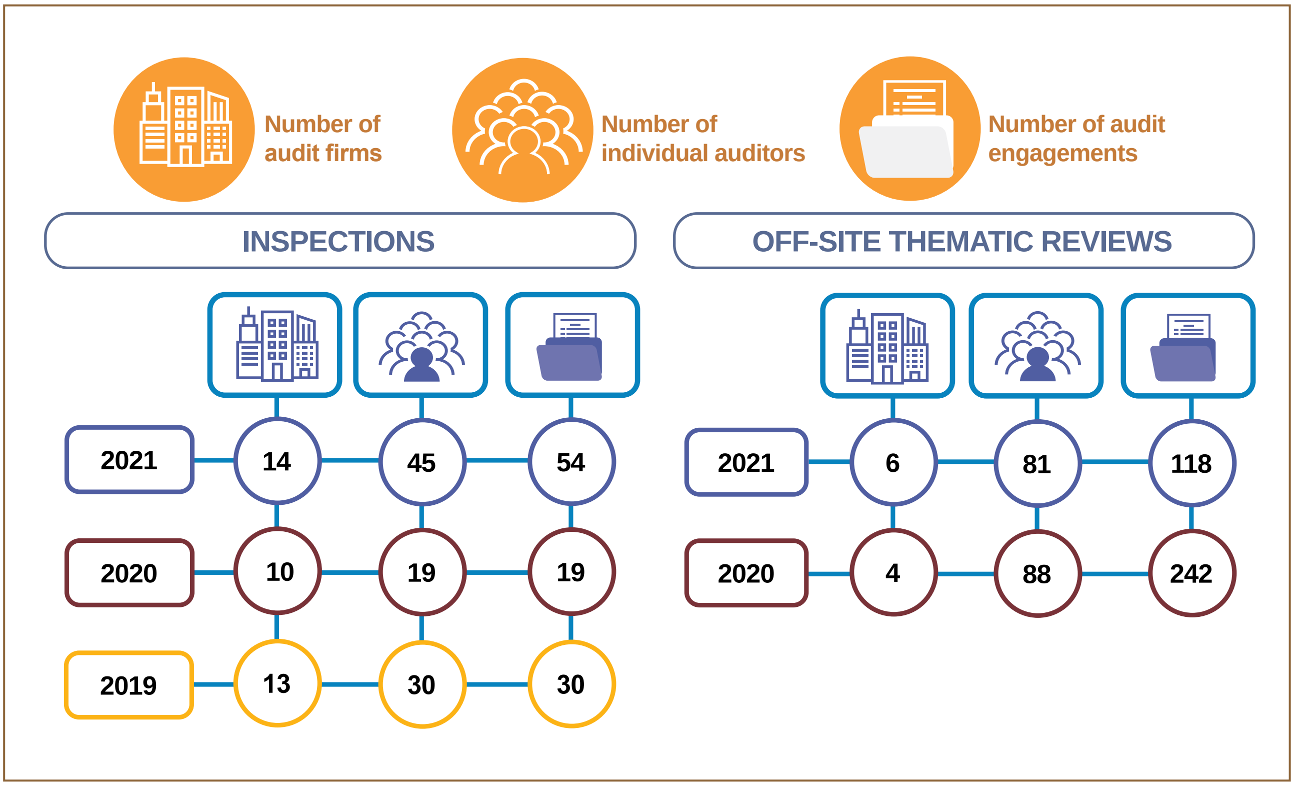
To further strengthen its monitoring process, the AOB continues to conduct off-site monitoring reviews by analysing auditors' reports and disclosures made within the Annual Reports and AFS of the respective PLCs.

Driven by specific concerns arising from the reviews, the AOB was able to funnel engagements identified as having potential risk areas to thematic inspections in 2021. Further details in relation to the data-driven off-site thematic reviews are featured in **Data Analytics Driven Off-site Thematic Reviews** section.

The enhanced approach taken by the AOB was the main driving factor that contributed to a significantly higher number of audit engagements inspected in 2021, as highlighted in Figure 2.

FIGURE 2

INSPECTIONS AND OFF-SITE THEMATIC REVIEWS COVERAGE



DATA ANALYTICS DRIVEN OFF-SITE THEMATIC REVIEWS

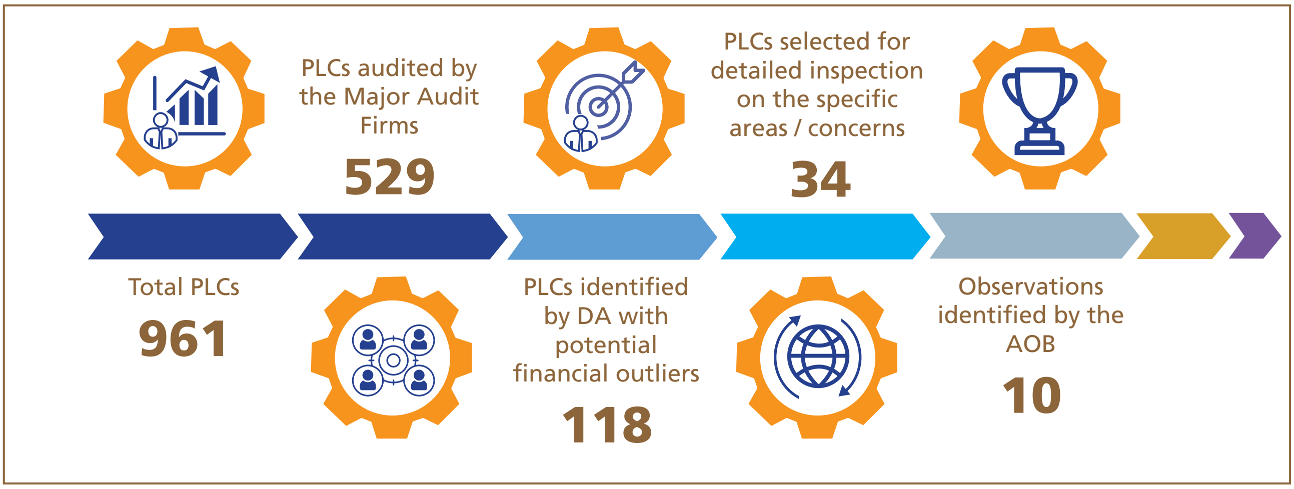
In line with the AOB's strategic goals, the AOB strengthened its risk identification process by developing its DA capabilities. This entailed an adoption of a more in-depth application of DA in its inspections and thus enabling the AOB to-

- reduce the element of subjectivity by providing objective, data-driven comparatives to the PLCs' financial status on a macro level;
- widen the AOB's scope of PLCs monitored with the introduction of basic predictive analytics into the overall assessment; and
- utilise time and resources in a more effective manner as basic work such as data compilation from Annual Reports, comparable industries and the overall market are increasingly automated.

The AOB took the opportunity to pilot the enhanced analytics-driven inspection approach by leveraging available DA tools to conduct targeted reviews on PLCs within the capital market. The approach was intended to be methodical and focused on PLCs that were audited by the Major Audit Firms (Figure 3).

FIGURE 3

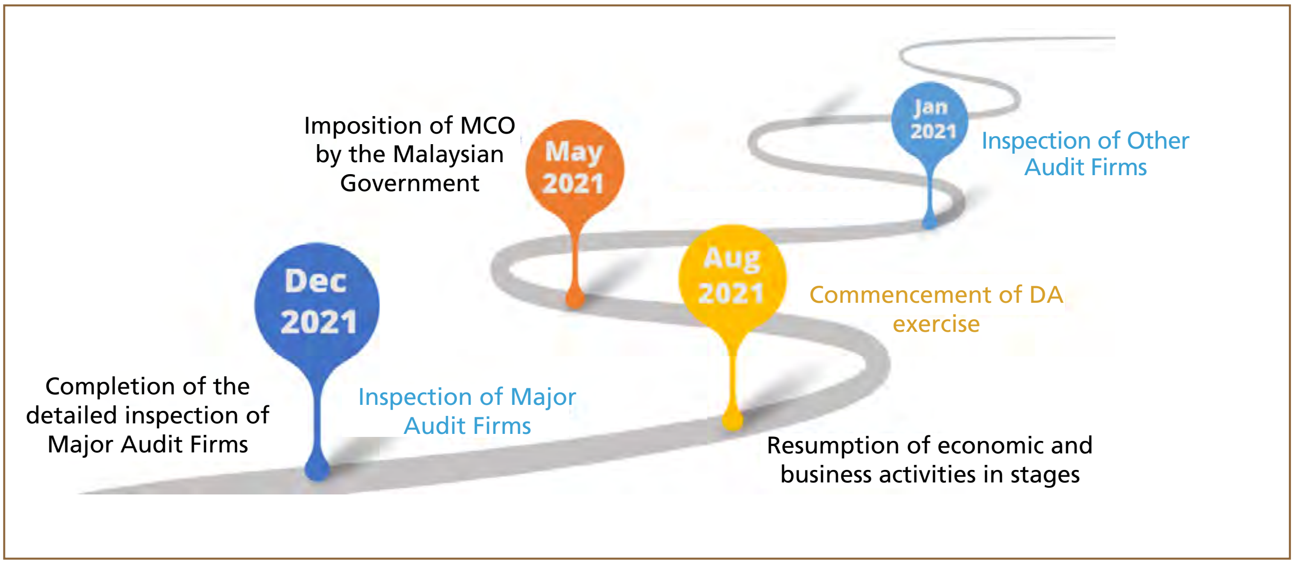
OVERVIEW OF THE ENHANCED ANALYTICS-DRIVEN INSPECTION



Out of 961 PLCs listed on Bursa Malaysia as at 31 August 2021, the AOB focused on 529 PLCs that were audited by the Major Audit Firms. The Major Audit Firms collectively audited PLCs that represented 55% of the total number of PLCs and 92% of the total market capitalisation of PLCs in Malaysia. This resulted in a close approximation of the audit firms under the AOB's purview.

Moreover, the AOB inspected certain PLCs audited by the Other Audit Firms prior to the imposition of the movement control order (MCO) in May 2021. This enabled the AOB to immediately refocus its attention on the inspections of the PLCs audited by the Major Audit Firms upon resumption of economic and business activities in August 2021, as illustrated in Figure 4.

FIGURE 4



The AOB introduced DA tools and leveraged the parameters within these tools to identify potential financial outliers within the PLCs scoped for review. The DA tools varied across a range of historical financial ratios that were key in assessing the financial health and performance of the PLCs as well as predictive ratios that were single numerical points, taking into consideration a set of existing variables/parameters.

A total of 118 PLCs were identified as being of higher risk and required further attention.

The AOB analysed these PLCs individually to further assess whether-

- the potential outliers identified were indeed outliers and whether there were clearly verifiable information to reasonably explain the potential outlier; and
- there was a reason to believe that the potential outlier identified could be a risk that had not been identified, mitigated and/or addressed by the respective auditors of the PLCs.

This assessment resulted in 34 PLCs being selected by the AOB for a detailed inspection of the audit working papers. In these cases, further assessment of the auditors' audit plan and audit procedures were inspected by the AOB to ensure that the necessary work was performed in addressing the financial outliers identified above.

Although the remaining PLCs did not have any potential financial outliers that were of any cause for concern, the AOB will continuously monitor these PLCs through other risk assessment criterion as part of our selection process. Elements of unpredictability will continue to be incorporated in the selection process to ensure that any concerns not identified by DA would have a chance of being selected for inspection.

FIGURE 5

NUMBER OF PLCs IDENTIFIED BY DATA ANALYTICS AS POTENTIAL OUTLIERS AND SUBSEQUENTLY INSPECTED BY THE AOB

	Number of PLCs	
	Potential outliers identified by DA	Shortlisted for detailed inspection
Going Concern	51	11
Receivables	31	9
Non-Current Assets	16	7
Other Financial Statement Line Items	12	3
Revenue	8	4

The inspections conducted on 34 PLCs resulted in the following observations, among others:

- Insufficient audit procedures were performed to conclude the appropriateness of the going concern assumption used in the preparation of the PIE Group's financial statements;
- Insufficient audit procedures were performed to verify key inputs and assumptions used in the impairment of non-currrent assets and net realisable value assessment of inventories; and
- Insufficient audit procedures were performed to verify the accuracy and occurrence of revenue.

In year 2022, the AOB has further established DA as the way forward in conducting our inspections. As such, the primary focus would be to integrate DA into the wider risk assessment process in relation to the annual inspection plan. A brief overview of what the future would entail is illustrated in Figure 6.

The AOB, in conjunction with other line departments within the SC, is committed to enhance our DA capabilities, where a comprehensive DA tool would enable the AOB to widen its resources and provide the AOB with a more efficient, effective and holistic approach for future inspections.

FIGURE 6

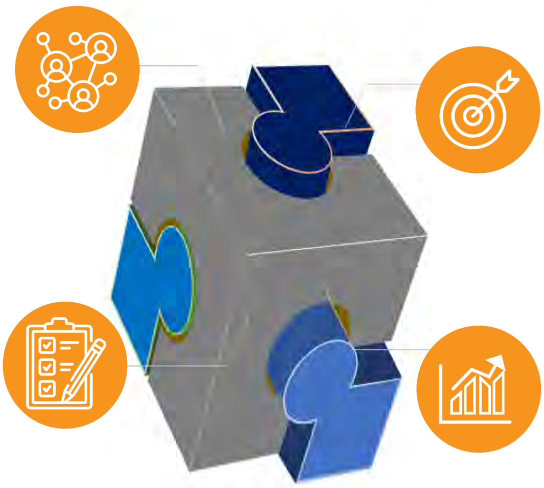
THE FOCUS OF THE AOB'S FUTURE INSPECTION

Increase in engagements

Potential increase in the number of engagements selected for inspection with specific focus on certain Financial Statement Line Items

Risk idenfitication

Focus would be on the respective engagement's risk identification process in accordance with ISA 315 (Revised) *Identifying & Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*



Market outliers

Engagements selected to include PLCs based on risk to the market and outliers identified from our DA

Going Concern

Going concern would be a focus area of the AOB to ensure going concern assessments performed by the auditors are sound following the effects of the pandemic

ENGAGEMENTS WITH SIGNIFICANT IMPROVEMENTS REQUIRED

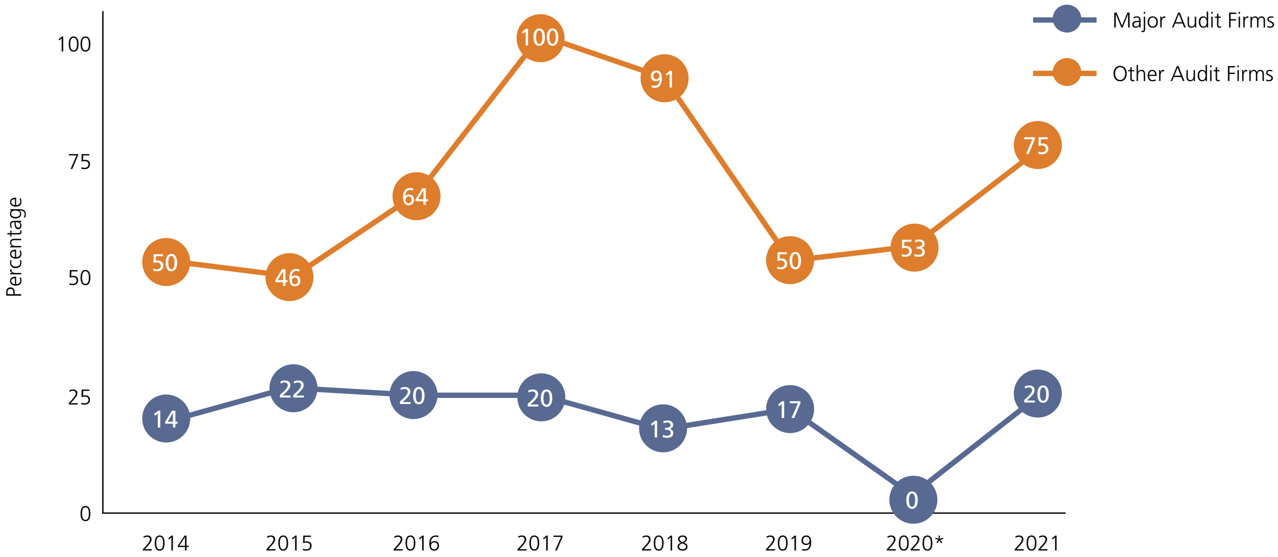
At the end of every inspection, the AOB assesses the severity of findings arising from each engagement review. In the event that the engagement partners are imposed with specific remediation measures or are routed to the AOB's Enforcement, Regulation and Quality (ERQ) department, the AOB classifies the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

For 2021, 24% of the total engagements inspected required significant improvements. As illustrated in Chart 1, the Other Audit Firms recorded a 22% increase in the number of engagements requiring significant improvements. There continues to be a significant gap between the performance of the Major Audit Firms and the Other Audit Firms at 55% in 2021.

As previously reported in the *Annual Inspection Report 2020*, the AOB adopted a hybrid approach in 2020 where selected audit firms were subjected to inspection while the remaining audit firms were subjected to off-site monitoring and thematic reviews based on the risk assessment and review of historical performance. In 2021, the AOB complemented its off-site thematic reviews with targeted/risk-based data-driven inspections remotely. Therefore, the results for the Major Audit Firms for 2020 may not be comparable to the other years of inspection (same as chart below). Chart 1 illustrates that 20% of the engagements inspected for the Major Audit Firms in 2021 required significant improvements. There were no significant improvements as the performance was consistent with previous years prior to 2020.

Chart 1

Percentage of inspected engagements with significant improvements required



Note

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

Although there were no engagements that were routed to the AOB's ERQ department (Chart 2), an overall increase in engagements requiring specific remediation measures in 2021 was still a concern to the AOB. Specific remediation measures were imposed on the engagement partners as the AOB observed that there were concerns surrounding areas involving accounting estimates and professional judgement, including fair value measurements and going concern assessments. Understandably, these key areas require significant level of professional scepticism and technical expertise in relevant accounting and auditing standards, thereby further improvements are needed.

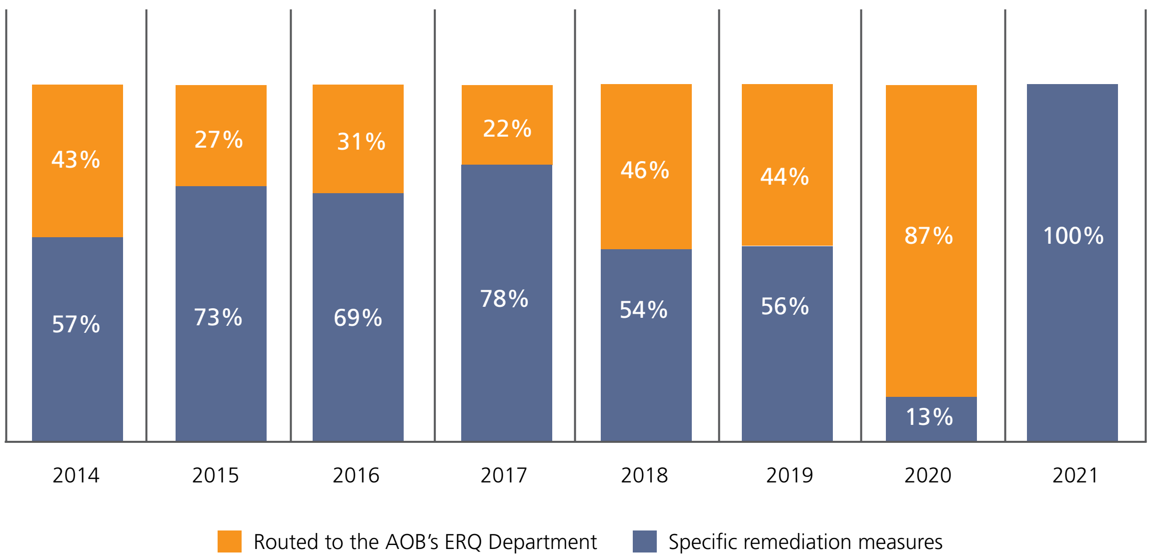
As part of the remediation process, engagement partners were required to demonstrate initiatives to improve their technical capabilities. Some of the potential actions to be imposed on the individual engagement partner in addressing the gap in industry and/or technical knowledge included the following:

- The requirement for the engagement partner to attend specific approved training programme to address relevant ISA requirements identified from the inspection findings; and
- The condition for the engagement partner to be subjected to an internal quality review where the outcome of the review is to be reported to the AOB within a specified timeframe.

In addition to the above, the involvement of audit firms may be required to immediately address the findings or rectify any potential errors to the financial statements. In these instances, specific remediation measures were imposed on the audit firms themselves in addition to those imposed on the engagement partners.

This further signified the need for audit firms to have a strong internal quality monitoring programme and to review their existing approach in ensuring that the audit personnel are well equipped and updated with the latest accounting and auditing knowledge.

Chart 2 **Actions taken on inspected engagements with significant improvements required**



In addition, the AOB observed inconsistencies in the inspection results within each inspected audit firm. Therefore, the audit firms are advised to critically review their approach to AQIs and resource management which include the following:

- Improving the ratio of audit staff for every quality control function personnel which allows dedicated resources to support audit quality;
- Balanced composition of the audit team members to ensure sufficient and adequate supervision by the managers and/or partners throughout the audit; and
- Understanding the training needs of different levels of audit staff.

This is to ensure a consistently high standard of quality are applied in executing the audit across all audit engagements within the audit firm.

SPECIFIC REMEDIATION MEASURES IMPOSED ON AUDIT FIRMS

In addition to the imposition of specific remediation measures on individual engagement partners, specific remediation measures were also imposed on audit firms where inspection findings were severe and/or pervasive. Examples of the specific measures imposed on audit firms are as follows:

- Requirement to demonstrate the audit firm's efforts to increase the competency and professional scepticism of its audit staff, including the engagement partners and Engagement Quality Control Review (EQCR) partners, in areas involving heightened risk as identified in the *Final Inspection Report*;
- Obligation to reperform specific audit procedures to address the AOB's inspection findings and/or to immediately rectify any potential impact on the financial statements of the financial year(s) in question;
- Subject the audit firm to undergo an internal quality review by the audit firm's regional and/or global network;
- Directive to conduct an internal quality review on all engagement partners that audit PIEs and schedule funds within the audit firm; and
- Conduct a review on the effectiveness of the audit firm's leadership particularly in promoting the right partners' behaviour such as placing emphasis on audit quality and establishing an effective governance structure to uphold audit quality.

The outcome of the specific measures imposed are required to be reported to the AOB within a specified timeframe.

COMMON FINDINGS FOR ENGAGEMENT REVIEWS

As discussed in the previous section, in addition to analysing the severity of findings arising from each engagement review, the AOB compiles and analyses all engagement findings based on the categories of audit quality theme defined by the *International Forum of Independent Audit Regulators' (IFIAR) Survey of Inspection Results for Audit Firms*. The common findings observed from the AOB's inspection over a three-year period are illustrated in Figure 7.

FIGURE 7

TOP FIVE COMMON FINDINGS BY AUDIT QUALITY THEMES[1]

2021	2020	2019
Accounting estimates	Sampling	Sampling
Sampling	Accounting estimates	Accounting estimates
Going concern	Auditor's report / Revenue recognition	Auditor's report
Internal controls testing	Fraud procedures / Presentation and disclosure	Fraud procedures
Use of experts / specialists	Inventory procedures	Group audits

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

ACCOUNTING ESTIMATES

For the last three consecutive years, accounting estimates (including fair value measurements) has ranked second in the list of common inspection findings arising from the AOB's engagement reviews. However, in 2021, a significantly higher number of inspection findings surrounding this audit area was noted.

The AOB noted that the findings involving accounting estimates were prevalent among the Major Audit Firms as compared to Other Audit Firms given the complexity of its clients. As accounting estimates are relatively subjective (involving complex calculations and requiring professional judgement), it is important that the auditors apply an appropriate level of technical knowledge in understanding the relevant accounting and auditing standards. This was not adequately addressed by the audit firms, as noted during the inspection.

In 2021, the findings in relation to accounting estimates were mainly related to the valuation of assets as follows:

- Impairment assessment of goodwill, particularly in relation to the review of management's value in use assessment, in accordance with the requirements of MFRS 136 *Impairment of Assets*;
- Recoverability of trade receivables, including provision for expected credit loss, in accordance with the requirements of MFRS 9 *Financial Instruments*;
- Valuation of investment properties measured at fair value in accordance with the requirements of MFRS 140 *Investment Property*, particularly with regards to the reliance placed on asking prices rather than transacted prices when assessing for potential impairment; and
- Valuation of right-of-use assets in accordance with the requirements of MFRS 16 *Leases*.

Other areas in which findings in relation to accounting estimates were noted are as follows:

- Property development costs;
- Property, plant and equipment; and
- Contract assets and liabilities.

Given the current challenging environment, audit firms should apply greater professional scepticism when performing their audits particularly when significant judgement is involved. By promoting a 'Culture of Challenge' within the audit engagement team, it would improve the awareness among the audit team members and reduce any complacency in challenging the management's assumptions.

Audit firms are required to effectively tailor their audit procedures rather than place unwarranted reliance on management's representation without considering the volatility of market trends and its impact on business outlook.

SAMPLING

For the last three consecutive years, findings in relation to sampling remained in the top three common inspection findings. These findings were more common across Other Audit Firms as compared to Major Audit Firms.

Similar to previous years, the AOB observed that certain firms were still using monetary thresholds to select samples, particularly in relation to the review of journals.

There were also instances where unwarranted reliance were placed on the operating effectiveness of test of controls performed in determining the sample size for substantive testing purposes. This resulted in inappropriate sample size and selection where sampling risks may not have been adequately addressed by the audit firm.

The findings in relation to sampling that recurred in 2021, included the following observations:

- Not verifying the completeness of source documents used for sample selection;
- Not assessing the basis and rationale for sample size and sample selection in the assembled audit working papers to justify that each sampling unit had an equal chance of selection and that sampling risk had been reduced to an acceptably low level; and
- Verifying samples to internally-generated documents and listing without proper evaluation of the reliability and appropriateness of these documents prior to accepting them as audit evidence.

The consistent recurrence of these observations have raised concerns on the effectiveness of the audit procedures designed by the audit firms in dealing with audit sampling. The audit firms are reminded to identify the underlying root causes of the continued recurrence of the findings to ensure no such recurrence in future audits.

CAPACITY-BUILDING INITIATIVES TO ADDRESS COMMON AREAS OF AUDIT WEAKNESSES

The AOB in collaboration with MICPA had developed a series of training programmes for the AOB-registered audit firms with less than 10 partners. These training programmes were subsidised as part of the AOB's continued capacity-building efforts to improve audit quality in Small and Medium Practices.

The training programmes focused on addressing common areas of audit weaknesses noted by the AOB during its inspection of audit firms and auditors particularly in areas involving accounting estimates and audit sampling.

A total of 975 individual auditors and audit firms' staff benefitted from these training programmes.

GOING CONCERN

Going concern emerged as one of the common findings for the first time since the AOB published its *Annual Inspection Report* in 2017. The pandemic has given rise to entities facing potential financial distress with concerns over their financial liquidity. Cognisant that the situation needed to be addressed as early as possible, the AOB focused on data analytics-driven efforts to identify PLCs that were at risk of financial distress. In 2021, these efforts were focused on the larger PLCs audited by the Major Audit Firms.

Although the findings in this area were only prevalent across the Major Audit Firms, all auditors are reminded to remain vigilant regardless of the size and structure of their audit firm as well as their respective PIE clients.

In the majority of the engagements inspected in 2021, the AOB observed that the PLCs showed potential financial distress by recording either-

- operating losses;
- net current liabilities positions; and/or
- negative net operating cash flows.

Despite having at least one or a combination of these indicators present in the AFS, they were not clearly addressed by the respective PLCs and the auditors alike.

Complex matters such as key inputs in estimations and cash flow forecasts require in-depth assessment by the auditors. Any 'close-call' judgement or potential modification of audit opinion would typically require an internal consultation. However, the AOB noted that there were instances where this was not considered although such matters were the requirements outlined in the audit firm's own policies.

In relation to the above, the AOB observed the following common findings:

- Insufficient assessment on the appropriateness and reasonableness of managements' key assumptions used in the cash flow forecasts;
- Insufficient assessment on the appropriateness of relying on financial support obtained by related parties, particularly whether the related parties have the financial ability to provide such support;
- Insufficient assessment to support the auditor's conclusions of not highlighting a Material Uncertainty related to Going Concern in the auditor's report or including 'Going Concern' as a key audit matter; and
- Non-compliance with the audit firm's own policies and procedures which required consultation with the audit firm's technical department involving matters related to Going Concern particularly where indicators exist.

Further details are highlighted in the **Going Concern** section.

COMMON ROOT CAUSES

The main root causes of the shortfalls in relation to accounting estimates, audit sampling and going concern appeared to be:

- **A lack of involvement from the engagement partner** (and to an extent the EQCR partner) to adequately drive the audit by identifying and communicating key risk areas and following up with a thorough review of these areas;
- **A lack of professional scepticism** combined with a reluctance or inability to adequately challenge the PLC's representations, estimates and/or judgements;
- **A degree of complacency** that things will continue to be the same as prior years without taking into account the internal/external developments and how it might impact the auditors' clients;
- **Adequacy of disclosures** or reluctance in disclosing such matters by the PLCs; and
- **Gaps in the engagement team's technical knowledge** in relation to the requirements of the accounting and auditing standards.

The need of having the right infrastructure, supervision and technical competence are important to support audit quality. The AOB encourages all audit firms to continuously assess the underlying root causes for the inspection findings to ensure that appropriate measures can be taken to improve audit quality.

“The engagement partners hold the utmost responsibility to cultivate professional scepticism among audit team members, particularly in auditing significant audit matters. Serious efforts should be taken to maintain and further improve the technical competencies of all audit staff regardless of level. This is to ensure that their technical accounting and auditing knowledge is up-to-date with the most recent developments.”

COMMON MISCONCEPTIONS OF INTERNAL CONTROLS TESTING

ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* refers to internal controls as the policies, processes, tasks, behaviours and other aspects of an organisation to ensure the following:

1. Efficient conduct of business;
2. Safeguarding of assets;
3. Prevention and detection of fraud and other unlawful acts;
4. Completeness and accuracy of financial records; and
5. Timely preparation of financial statements.

The existence of proper internal controls would allow for the preparation of financial statements that are free from material misstatements, whether due to fraud or error. A detailed understanding of the entity and its operating environment, including the testing of the entity's internal controls, is vital in identifying and mitigating any key risk.

A sound internal control environment would provide some assurance that the financial transactions are complete, accurate and valid. Therefore, this would offer a degree of comfort over the reliability of the information that are provided to the auditors should the auditors establish that the PIE's controls and processes were designed and operating effectively. Given the complexity, size and business environments of entities, it will be beneficial for audit firms to adopt a controls-reliance strategy in obtaining sufficient appropriate audit evidence.

However, the AOB observed the following common misconceptions when audit firms adopted the controls-reliance approach in carrying out their audit of the financial statements (Cases 1-4).

CASE 1

Controls need only be tested once during each financial year. The same controls are in place and deemed effective throughout the financial period.

What went wrong?

Continuous reliance was placed on the controls which were tested during the interim period. Subsequent to the interim period, additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the entity's monitoring of controls.

What should auditors consider?

Where reliance is placed on the operating effectiveness of controls during an interim period, the auditor shall obtain audit evidence of any significant changes to those controls subsequent to the interim period and determine whether additional audit evidence should be obtained for the remaining period obtained for the remaining period. Subsequent to the interim period, additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the entity's monitoring of controls.

CASE 2

Failure of key controls means that operating effectiveness failed and a fully substantive approach should resolve the matter.

What went wrong?

No alternative controls were identified to mitigate the failure of key controls. The key controls that were incorrectly identified resulted in numerous exceptions. Switching the audit strategy to a non-reliance of control strategies would not address the control failures identified during the audit.

What should auditors consider?

ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* requires the auditor to communicate deficiencies identified in internal controls to TCWG and management.

Where significant weaknesses are identified, the auditor should assess the impact of these failures on the overall audit approach. Even if the auditors may subsequently rely on a substantive approach to obtain audit evidence, weaknesses surrounding the PIE's controls and processes can still be a cause for concern which should be highlighted to TCWG.

Further, ineffective internal controls, management bias or lack of segregation of duties would lead to the risk of material misstatements and increase the risk of fraud. These weaknesses can be easily taken advantage of by the PIE for fraudulent purposes which would consequently have detrimental effects on the PIE. Audit firms are reminded to maintain professional scepticism in the circumstances where material misstatements due to fraud may exist particularly in addressing the requirements of ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.*

CASE 3

If controls have operated effectively in the past, then no test of controls is required even if there are changes to the controls.

What went wrong?

In view of restrictions in movements as a result of the COVID-19 pandemic, management represented that there were changes in controls to accommodate the new standard operating procedures applied by the PIE. As the changes in the controls and processes were 'temporary', no test of controls was performed. It was concluded that reliance was placed on the tests performed in the previous audit.

What should auditors consider?

Auditors should not be complacent as such 'temporary' circumstances are not limited to the pandemic alone, and their PIE clients could also be experiencing other changes in business environment driven by personnel changes, restructuring exercises, technological advancements and other factors made by their PIE clients. Auditors are still required to test the effectiveness of these 'temporary' controls particularly if the controls form part of the auditor's assurance strategy.

In any case, should auditors intend to rely on the operating effectiveness of internal controls documented in the prior years' working papers, auditors should still obtain the necessary evidence to confirm that there were no significant changes in those controls that may occur subsequent to the previous audits. This can be done by performing inquiries combined with observation or inspection to confirm the understanding of those controls.

CASE 4

Same controls and processes were applied to all transactions within the same business cycle.

What went wrong?

A three-way match of comparing the purchase orders, goods receipt notes and suppliers' invoices was identified by the auditors to be one of the key controls before approving the payments of supplier invoices.

In performing the test of controls surrounding the purchase cycle, the engagement team indicated that the above control identified was not applicable for five samples selected where the audit procedures performed was limited to the following documentation in the assembled audit working paper:

> *"Payments were made earlier than the date of goods received as the supplier requires the Company to make payments in advance. No further testing is necessary. Controls are not applicable."*

There was no documented evidence on the assessment of management controls and processes in relation to the advance payments. The general controls were applied across as a one-size-fits-all without considering the specific processes for different types of business arrangements and transactions within the entity.

What should auditors consider?

Within each business cycle, there could potentially be different controls to cater to different business arrangements. Hence, a deeper understanding of various processes within the business cycle needs to be assessed and documented to ensure that the right controls were identified and appropriately tested, where applicable.

Other common misconceptions on internal controls

- Highly trusted employees or executives are not required to adhere to internal controls;
- Internal controls are just process checklists that bogs down the transaction process, and hence not applicable to PIE senior management; and
- Internal controls are the responsibility of internal auditors and only revolves around operational function without having any material financial impact.

RELIANCE ON INFORMATION TECHNOLOGY CONTROLS FOR FINANCIAL AUDITS

Audit clients are increasingly dependent on IT to drive business growth and to support their business operations including financial reporting. In the performance of a financial audit, ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* requires that auditors identify the relevant risks arising from the use of IT by their audit clients and to evaluate the effectiveness of relevant controls that addresses these risks.

Table 1 provides examples of matters that should be considered by the auditors when assessing the IT risks faced by the audit clients.

TABLE 1

RISKS ARISING FROM THE USE OF INFORMATION TECHNOLOGY BY AUDIT CLIENTS

Considerations impacting the IT environment	Considerations impacting the IT systems
1. Implementation of new IT systems or major programme changes that are significant to the business and financial reporting; 2. System disruptions that can affect business operations; 3. Security of the IT infrastructure to safeguard data integrity against cyber threats and unauthorised system access; 4. Service delivery issues that may be posed by third-party IT service providers; and 5. Risks from the adoption of emerging technologies by the client such as cloud computing and big data and complex technologies such as artificial intelligence and machine learning.	1. Completeness, accuracy and validity of data within the IT systems; 2. Accuracy of system processing of transactions; 3. Reliability of interface between multiple IT systems; and 4. Reliability of system-generated reports.

During the inspections, the AOB observed that the Major Audit Firms have internal IT specialists that were engaged to assist in audit engagements. On the other hand, the Other Audit Firms tend to perform their audits around IT systems due to lack of IT expertise.

Below are details of some of the common IT inspection findings:

1. The auditors did not sufficiently consider the relevant risks arising from the use of IT by the audit client. Consequently, the relevant general IT and application controls have not been identified for testing to address the risk of material misstatements at the assertion level for significant classes of transactions and account balances.

2. The auditors did not carry out sufficient testing of IT General Controls (ITGC) although the audit strategy was to-
   - rely on the operating effectiveness of ITGC; or
   - rely on ITGC to support the continuing effectiveness of application controls.

3. The auditor has placed reliance on application controls and system-generated reports without performing relevant testing to-
   - determine whether the application controls are operating effectively; and
   - determine whether the information in the report is complete and accurate.

The root causes to the inspection findings stemmed from the lack of IT specialists' involvement on certain audit engagements involving clients that rely heavily on IT or due to the auditors' lack of understanding of risks arising from the use of IT by their audit clients.

Hence, audit firms should consider the following initiatives to strengthen the IT capabilities of the audit engagement teams:

A. Upskilling of financial auditors

Training should be provided to financial auditors to enable them to carry out basic evaluation of ITGC and perform testing of application controls for clients with less complex IT environment. It is also beneficial to equip financial auditors with skills in data analytics so that they can effectively carry out the relevant data analysis using data analytics tools.

B. Inclusion of IT specialists within the audit engagement team

Consider the need for specialists' involvement such as IT auditors and data analysts in the following circumstances:

- Where the IT environment or the key IT systems in use by the audit client is complex;
- Clients' businesses involve highly automated and paperless processing of transactions; and
- Need for reliance on the operating effectiveness of ITGC and application controls.

C. Support the application of computer-assisted audit techniques (CAATs) and usage of data analytics tools on audit engagements

The application of CAATs is particularly useful as it enables audit work to be performed on large volumes of data involving recalculations, reperformance, reconciliations or testing of system-generated reports.

In addition, auditors could also leverage data analytics tools and techniques to-

- obtain a better understanding of the business and the flow of transactions through IT systems;
- perform risk assessment procedures;
- perform testing of journal entries; and
- perform analytical procedures.

As CAATs and data analytics tools allow work to be performed on the entire population of data, a higher level of assurance could be obtained. Therefore, audit firms should invest in these tools and support their usage to assist in their audits.

ACCOUNTING ESTIMATES: VALUATION EXPERTS AND ASSESSMENT OF VALUATION REPORTS

ISA 500 *Audit Evidence* requires auditors to-

- evaluate the competence, capabilities and objectivity of the valuation expert;
- obtain an understanding of the work of the valuation expert; and
- evaluate the appropriateness of the valuation expert's work as audit evidence.

However, in relying on the valuation reports prepared by the valuation expert, there was a lack of understanding of the relevant accounting and auditing standards by the auditors.

The key inputs used in deriving the fair value computation such as valuation methods, significant assumptions and data used by the valuation expert are usually complex in nature with a high degree of subjectivity and estimation. Auditors tend to accept the valuation provided by these valuation experts without obtaining further understanding on the approach and the appropriateness of the underlying assumptions or adjustments applied by the valuation experts to the key variables in deriving the final asset value.

Based on the AOB's inspection, observations on common challenges faced by the auditors when auditing the work of valuation experts as presented in Figure 8.

FIGURE 8

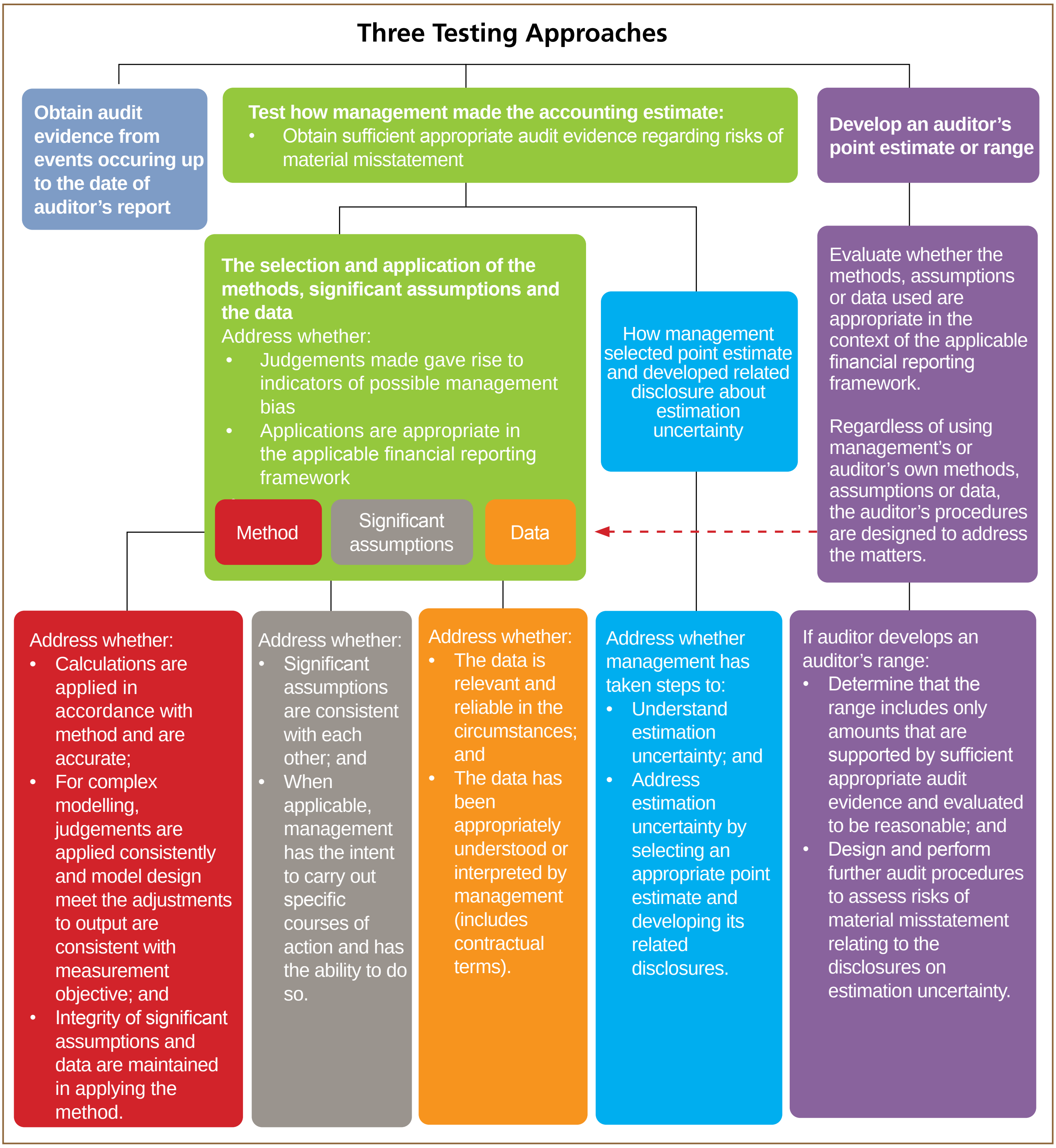
COMMON CHALLENGES FACED BY THE AUDITORS WHEN AUDITING THE WORK OF VALUATION EXPERTS

- Generic assumptions or adjustments made with no apparent basis
- Inclusion of limitations on the validity period or reliability of valuation
- More than one valuation method provided with no conclusion by the valuation experts on the most appropriate valuation
- Change of valuation methodologies – citing choice of methodology was a matter of professional judgement
- Non-sharing of specific basis and valuation methodology

ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures* requires the auditor to include one or more of the Three Testing Approaches as shown in Figure 9 in response to the risk assessment of accounting estimates at the assertion level.

FIGURE 9

THREE TESTING APPROACHES AS PER ISA 540 (REVISED) AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES



Source: IAASB ISA 540 (Revised) Implementation Support: Flowchart 2: ISA 540 (Revised) Three Testing Approaches.

CASE STUDY 1 – COMPARISON APPROACH

PLC A's investment property X:

- Freehold building located at Jalan Dungun, Bukit Damansara; and
- Disclosed in AFS financial year ended (FYE) 31 December 2021 that, 'valuation method of investment property X was changed from income method to comparison method in 2021'.

PLC A appointed Valuation Expert B to carry out valuation on the investment property X.

Details	Comparison 1	Comparison 2	Comparison 3
Location	Jalan Damansuria, Pusat Bandar Damansara	Jalan Sultan Ismail, Kuala Lumpur	Bandar Sri Damansara
Tenure	Leasehold	Freehold	Freehold
Transaction date	10 May 2018	31 July 2019	30 September 2021
Consideration (RM/sq. ft)	750	630	550
Adjustments			
Time factor	15%	-10%	-5%
Tenure	10%	-	-
Location	-	-	-

In assessing the fair value of investment property as at 31 December 2021, Audit Firm C did not challenge the key inputs used in Valuation Expert B's report and did not consider the following:

- Evaluation of the competency, capabilities and objectivity of Valuation Expert B;
- Basis and rationale of Valuation Expert B's change in valuation method from income method to comparison method in 2021;
- Assessment if there were any significant changes between the date which the valuation was performed by Valuation Expert B on 31 October 2021 and the date of financial year-end on 31 December 2021;
- Relevance of the comparable properties used in the valuation report, particularly where one of the comparable property was located further from the valued property, in 'Bandar Sri Damansara';
- Latest transaction dates were in 2018 and 2019, which were not the most recent transactions; and
- Reasonableness of the 'Adjustments' taken up by Valuation Expert B in determining the fair value of the investment property:

Factor	Adjustment
'Time factor'	15% to -10% adjustment based on year of transaction
'Tenure'	10% upward adjustment applied to Comparison 1 due to it being a 'Leasehold' building
'Location'	No adjustment applied to Comparison 2 and 3 despite it being located at 'Jalan Sultan Ismail' and 'Bandar Sri Damansara'

CASE STUDY 2 – INCOME ALLOCATION APPROACH (INVESTMENT METHOD)

PLC B's investment property Y:

- Freehold building carried at fair value;
- Carrying amount as at FYE 31 December 2021 is RM13.5 million; and
- It was disclosed in the AFS that, 'significant increase/(decrease) in estimated market value per square foot in isolation, would result in a significant higher/(lower) fair value of properties'.

PLC B appointed Valuation Expert C to carry out valuation on the investment property Y. Three tenants occupy all five floors of the building as at the reporting date.

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

Excerpt from valuation report dated 30 September 2021:

'For the purpose of this valuation exercise, we have adopted a net yield of 5.5% for the reversionary interest. For the term interest, we have adopted a net yield of 5.0% in our valuation'.

In December 2021, tenants 'Bank Bhd' and 'Gloves Sdn Bhd' have indicated to PLC B that the tenancy would not be renewed after the expiry of the current tenancy agreements.

In assessing the fair value of investment property as at 31 December 2021, Audit Firm D did not challenge the key inputs used in Valuation Expert C's report and did not consider the following:

- Assessment of the competency, capabilities and objectivity of the Valuation Expert C;
- Verification of the information within the respective tenancy agreements, where annual rental income from 'Bank Bhd' as stated in the agreement was RM250,000 instead of RM400,000 indicated by the Valuation Expert C in the valuation report;
- Appropriateness of using the value derived using the Investment Method as the market value of investment property Y;
- Reasonableness of using two different 'net yield' of 5.5% and 5.0% to determine the 'reversionary' and 'term' interest by Valuation Expert C;
- Impact of the non-renewal of the tenancy agreements with 'Bank Bhd' and 'Gloves Sdn Bhd' in the assessment of the overall occupancy rate of investment property Y; and
- Sensitivity analysis of the fair value measurement on changes to the key inputs, particularly in verifying the disclosure in the AFS.

FRAUD RISK ASSESSMENT

In recent years, there has been constant debate on the expectation gap of auditors being fraud detectors in auditing financial statements. While the primary responsibility for the prevention and detection of fraud lies on the shoulders of management with appropriate oversight by TCWG, it is crucial that auditors properly plan and perform sufficient audit procedures to address potential material misstatements due to fraud to obtain reasonable assurance that the financial statements are free from material misstatements.

In cases where the auditors identified or suspected a fraud, auditors shall communicate these matter to the appropriate level of management and to TCWG on a timely basis. If the two-way communication is inadequate (i.e. failure to co-operate and/or no action from TCWG), the auditors may take appropriate action in arriving at the audit opinion and consider escalating the matter to the relevant authorities.

FIGURE 10

FRAUD ASSESSMENT

AUDITORS' OBLIGATION: IDENTIFIED/SUSPECTED MATERIAL MISSTATEMENTS DUE TO FRAUD

- Understand the nature of the business including the controls and processes surrounding the entity to ensure that the transactions were held within the normal course of business.
- Incorporate elements of unpredictability in performing audit testing.
- Heighten professional scepticism including critical assessment of contradictory audit evidence when evaluating responses to inquiries obtained from management, reliability of documents, unusual transactions, unexpected relationships identified and/or complex business arrangements.
- Obtain sufficient appropriate audit evidence through designing and implementing appropriate responses including evidence by third parties.
- Heighten supervision and review by experienced audit team members in complex audit areas.

COMMUNICATION BY THE AUDITORS

- Considerations of factors such as the likelihood of collusion and the nature and magnitude of the suspected fraud are required in determining the appropriate level of management to report such matters.
- Due to the nature and sensitivity of fraud, the auditors may consider it necessary to report such matters in writing.
- The AOB also emphasises the importance of documenting the auditor's responses to the fraud risk factors and to consider internal consultation (within the audit firm or the audit network firm) particularly where complex considerations and professional opinion are required.
- If the auditor has doubts about the integrity or honesty of management or TCWG, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action.

Communicate to appropriate level of management

Communicate to appropriate authorities outside the entity

APPROPRIATE LEVEL OF MANAGEMENT

Auditors are required to communicate fraud related matters to TCWG. **Timely communication** is essential to ensure effective solution in addressing the matters.

Once the auditors communicate information that indicates the existence of potential fraud, TCWG should discharge its duties to implement the appropriate corrective measures. These includes the following actions:

To be **alert** to any potential instances of fraud and keep an open line of communication with internal and/or external reporting parties

Establish **a proper corporate governance structure** to define clear roles and responsibilities

Emphasise and set the tone from the top on the **repercussions of committing fraud** within the Company

Consider appointing **external experts** to investigate if necessary

APPROPRIATE AUTHORITIES OUTSIDE THE ENTITY

If the two-way communication between the auditors and TCWG were not adequate and the situation cannot be resolved, the auditor may take the following actions:

- Attempt to investigate and determine **additional audit procedures** that are necessary to resolve the matter. Consider any other **alternative procedures** to establish various ways to obtain supporting evidence
- **Modify the auditor's opinion** on the basis of a limitation of scope
- Obtain **legal advice** about the consequences of different courses of action
- **Withdraw** from the engagement, where withdrawal is possible under applicable laws or regulations
- **Communicate with higher authority** in the governance structure that is outside the entity

Under Section 320 of the *Capital Market and Services Act* (CMSA), the auditors of the PLC may report the following breaches to the relevant authorities:

- Any breach OR non-performance of the securities laws → **Report to the SC**

- Any breach OR non-performance of the rules of the Exchange
- Any case that adversely affects, to a material extent, the financial position of the PLC

→ **Report to the SC and the Exchange**

No auditor shall be liable to be sued in any court for any report submitted by the auditor in good faith and in the intended performance of any duty imposed on the auditor under Section 320 of the CMSA.

SECTION 320 CMSA

Section 320 of CMSA states:

> *"If an auditor, in the course of the performance of his duties as an auditor of a listed corporation, is of the **professional opinion** that there has been a breach or non-performance of any requirement or provision of the securities laws, a breach of any of the rules of the stock exchange or any matter which **may adversely affect to a material extent the financial position of the listed corporation**, the auditor shall immediately submit a written report on the matter."*

What happens next?

Auditors	Company
▪ Provide full co-operation to the SC and/or the Exchange; and ▪ Provide information that is factual, clear and not misleading.	▪ Honest and open during the engagement with regulators; ▪ No misrepresentation of facts and information; ▪ Report any wrongdoings to the appropriate authorities; and ▪ Legal protection is offered to whistle-blowers under the CMSA and the *Whistleblower Protection Act 2010.*

CASE STUDY: CIRCUMSTANCES TO REPORT UNDER SECTION 320 OF THE CMSA

PIE A is an online merchant where the principal business activities include provision of payment services and online trading services. PIE A transacted in multinational business transactions where the revenue from online businesses were deposited in various overseas accounts and contributed to 80% of total group revenue. In verifying the relevant assertions in relation to the cash and bank balances as at year-end, particularly the balances in the overseas accounts, Firm Z performed the following audit procedures:

Audit procedures performed	In obtaining the confirmation of significant bank balances held in overseas account, the auditor relied on the contact information of financial institutions provided by management. The contact details were addressed to related parties of the PIE.
What should have been considered?	The auditor should consider to perform the following audit procedures: ▪ Obtain the confirmation directly from the banks or financial institutions where the accounts were held; ▪ Verify the address provided by the management to ensure the integrity and authenticity of the location of the said banks/financial institutions; and/or ▪ Any other **alternative procedures** to establish various ways to obtain supporting corroborative evidence. In the event that external confirmation was not obtained, the auditor should consider alternative procedures including but not limited to performing visits and interviews of third-party personnel to verify the existence, accuracy, completeness and rights and obligations of the bank balances.
Consideration to report under Section 320	If the reply confirmed an amount that is materially different from the bank balance recorded in the books, the auditor should obtain clarification from management and communicate the matter to TCWG. The auditor should use **professional judgement** to assess the situation and consider reporting the matter under Section 320 of the CMSA. The following are examples of red flags that the auditor might encounter during the course of their audit work: ▪ Evidence of possible fraud where auditor has doubts about the integrity or honesty of management or TCWG; ▪ Contradictory evidence to management's representation; ▪ No other corroborative evidence to support the existence of bank balances; and ▪ Where all procedures to obtain evidence have been exhausted and material differences remain unreconciled.

GOING CONCERN

The underlying responsibility and fundamental assumption which is required to be assessed by the directors and management is whether the financial statements were prepared on a going concern basis. While this assumption has always been inherently overshadowed by the need to exercise substantial judgement, the complexity has been amplified due to the rapidly progressing business environment.

In January 2021, the IFRS Foundation issued an educational material highlighting the importance of robust disclosures in the financial statements particularly where the evaluation was no longer a binary decision. The educational material reiterates that while taking into account significant uncertainties and mitigating considerations for financial statements that are prepared on a going concern basis, it is important that the effectiveness and feasibility of these judgements are disclosed. This would enable the users of the financial statements to have complete information to make informed decisions regarding the entity.

Consequently, in accordance with ISA 570 *Going Concern,* the auditors are required 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, including the sufficiency of the disclosures in the AFS.

FIGURE 11

APPLYING THE REQUIREMENTS IN INTERNATIONAL ACCOUNTING STANDARD 1

...entity situation deteriorating...

	1	2	3	4
Scenario	No significant doubts about going concern.	Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Entity determines no material uncertainties.	Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Material uncertainties about going concern remain after considering mitigating actions.	Intends to liquidate or to cease trading, or no realistic alternative but to do so.
Basis of preparation	Going concern			Alternate basis (not going concern)
Disclosure	Basis of preparation No specific disclosures.	Basis of preparation Significant judgements?	Basis of preparation Material uncertainties. Significant judgements?	Limited specific requirements

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

The following case studies illustrates the significance and importance of including relevant going concern disclosures in the AFS.

SCENARIO 1 Lack of disclosures despite existence of heightened risks to the going concern assumption

PLC C is primarily involved in the manufacturing of consumer products for the Malaysian market. The following indicators of going concern were noted as at FYE 31 March 2021.

1. **Fourth year of consecutive losses before tax of RM140 million**
2. **Deteriorating net current liabilities position of RM70 million**
3. **Net operating cash outflows of RM80 million**
4. **Default on loan repayment on 1 April 2021 of RM15 million**

Despite the indicators identified above, the financial statements of PLC C continue to be prepared on a going concern basis. The following were disclosed in the basis of preparation in the financial statements of PLC C:

> The financial statements are prepared on the going concern basis. However, during the financial year ended 31 March 2021, the Group incurred a net loss of RM140 million, and as at that date, the Group's current liabilities exceeded its current assets by RM70 million and has not complied with the repayment terms of its bank borrowings as disclosed in Note 33.
>
> The ability of the Group to continue as a going concern and meet its obligations is therefore dependent on the continued support and indulgence from its lenders and the achievement of future profitable operations.

In the auditor's report dated 23 May 2021, the auditors expressed an **unmodified audit opinion** on the financial statements of PLC C for the FYE 31 March 2021.

However, despite considering the following mitigating factors in the going concern assessment by the auditors, the following factors were not disclosed in the financial statements.

- Indulgence for loan repayments for 12 months, received on 3 May 2021
- Approved undrawn credit facilities of RM250 million
- Appointment of two new suppliers for raw materials with cheaper cost per unit in April 2021
- Renewal of contracts with four major customers with guaranteed minimum order quantities

The mitigating circumstances and feasibility of these plans, which were supported by written evidence were in fact **evaluated by the auditors** as part of the audit, although these were **not disclosed in the financial statements.**

SCENARIO 2

Appropriateness of the audit opinion

PLC D is involved in the manufacturing and trading of palm oil and its related value-added products with a FYE 30 June 2021. The business operations of PLC D were concentrated in Asia particularly within Malaysia.

In preparing the financial statements based on the going concern assumption, the following were disclosed in the basis of preparation of the financial statements of PLC D:

> The financial statements of the Group have been prepared on the historical basis and on the assumption that the Group and the Company will continue as a going concern.
>
> The Group incurred a loss before tax of RM60 million with negative operating cash flows of RM35 million during the year ended 30 June 2021 and, as of that date, the Group's current liabilities exceeded their current assets by RM63 million. The deterioration in the financial standing of the Group during the current financial year was mainly due to the ongoing economic condition that caused the Group's difficulties in obtaining financing. These events and conditions cast a significant doubt on the Group's ability to continue as a going concern.
>
> Nevertheless, the Group prepared the financial statements by applying the going concern assumption in consideration of the plans/activities as follows:
>
> (a) The Group will obtain continuous support from its lenders to roll over its existing short-term banking facilities with a total limit of RM11 million. As at 30 June 2021, drawdowns of these existing approved facilities amounted to RM9 million;
>
> (b) The Group is in the process of negotiating for a credit facility of RM15 million from a financial institution for working capital purposes, and expects to obtain the facility once it fulfils certain conditions;
>
> (c) The Group is in the process of negotiating with an investment company to secure funding of a substantial amount to provide support to the Group; and
>
> (d) The Group has continued financial support from its major shareholder to meet the shortfall in working capital requirements. As at 30 June 2021, advances due to this major shareholder amounted to RM20 million. The major shareholder has indicated that they will continue to support the Group by providing the necessary financial assistance and will not recall the advances made to the Group to the extent that may affect the ability of the Group to continue as a going concern.

In view of the uncertainties surrounding the viability and quantum relating to the factors highlighted above, the auditor after considering views from an internal consultation, included a **material uncertainty relating to going concern paragraph** in the auditor's report dated 8 September 2021.

SCENARIO 2 Appropriateness of the audit opinion (Continued)

However, the following gaps were noted upon further scrutiny of the audit evidence obtained by the auditors in relation to the above mitigating factors considered by the management:

Rollover of existing short-term banking facilities with utilisation of RM9 million as at 30 June 2021	Compliance with the loan facilities covenants were not evaluated by the auditors, where a breach of financial ratio was not evaluated. Consequently, on 1 September 2021, the financial institution rescinded the facilities in view of the breach.
New credit facility of RM15 million for working capital purposes	As at 8 September 2021, negotiations were still ongoing with the lenders with no formal offer extended to-date.
Funding from investment company	While a letter of intent dated 1 June 2021 was sighted by the auditors, there was no commitment received as at 8 September 2021 in relation to the investment sum or timing of the proposed investment.
Financial support from major shareholder	A copy of the signed letter of financial support was reviewed by the auditors as part of their audit procedures performed. The major shareholder was also audited by the same audit firm. However, there was no evaluation over the major shareholder's ability to provide the support, particularly where the major shareholder was in a net current liability position and incurred losses before tax for the FYE 30 June 2021.

SCENARIO 2

Appropriateness of the audit opinion (Continued)

In addition to the events and conditions highlighted above, the following was also noted as part of the evaluation of audit work performed by the auditors of a significant component.

The operations of the subsidiary were suspended since 20 June 2021 due to the ongoing litigation with the landowners affecting access to the subsidiary's factory. The external counsel has advised that the recommencement of operations is dependent on the settlement litigation, including the claims for damages estimated at RM30 million. The outcome of the litigation remains uncertain as at 8 September 2021, where no liabilities were recognised or disclosed by the subsidiary to date.

The material uncertainty over the recommencement of the significant component's operations and potential additional liability was not considered or disclosed in the basis of preparation as detailed above. Similarly, the impact of these events on PLC D's ability to continue as a going concern were not assessed.

Notwithstanding the appropriateness of the audit opinion rendered on the financial statements in view of the matters highlighted above, the disclosures, particularly the feasibility of these mitigating actions, would have provided a different picture to the situation at the time.

Further, disclosure of **complete and accurate information** in the financial statements would have alerted users of the AFS to the potential bias exercised by management in their conclusion over the going concern assumption. This would further empower the users of the financial information to exercise their judgement based on their individual risk appetite and assessment.

The case studies above highlight the importance of adequate disclosures to accurately inform the users of the AFS on the factors considered in the preparation and finalisation of financial information made available to the capital market.

While the underlying financial information may or may not be ultimately erroneous, significant ambiguity and lack of proper disclosures could have had negative implications on the PLCs and the auditors.

Although the auditors are reminded of the importance in exercising professional scepticism in evaluating the entity's application of going concern basis in preparing the financial statements, **directors and management** of the entities should be cognisant that they are **ultimately responsible over the assessment and relevant disclosures made in the financial statements**.

WHAT DID WE LEARN FROM THE COVID-19 PANDEMIC?

With every challenge lies opportunities for advancements by adjusting, developing and finding alternative ways to overcome obstacles. As we move into year 2022 by reflecting on the last two years hampered by the global pandemic, the AOB was encouraged to observe the developments and consequential benefits to the players and key stakeholders of the capital market. This section discusses the efforts undertaken by audit firms in overcoming the challenges brought about by the pandemic to ensure sustainability of business and continued relevance in the capital market.

Increasing reliance on technology

Remote working arrangements during the pandemic emphasised the necessity of timely technological adoption where in the past, this could have previously been deemed as a complementary option. Audit firms equipped with audit software (be it customised or off-the-shelf) were better positioned to manage the transition with minimal disruptions to their operations. As previously reported in the *Annual Inspection Report 2020*, 81% of the AOB registrants were already utilising audit softwares in the audit engagements of most, if not all of their respective PIE audit clients.

In 2021, through engagements with the audit firms, the AOB observed further positive efforts taken by the audit firms to adopt technology. Efforts by the audit firms included continued investments in hardware and software upgrades, transitions from shared folders into audit software tools for file assembly purposes and centralised servers with remote access granted to audit personnel. The shift and adoption of these audit softwares have fortified the consistency in application of audit firms' methodologies, particularly where remote working reduced the ability for on-the-job guidance and training within the audit team. Nonetheless, audit firms are reminded to ensure that audit softwares are continuously updated with the latest accounting and auditing standards.

With the increase in reliance placed on technology, the risks associated with threats of cyber security breaches as well as data integrity and confidentiality were heightened. The proactive detection and management of these security threats should be a concerted effort and should not be left with the audit firm's IT department alone.

The following are some of the best practices adopted in the market to ensure that firms are better protected from the above threats:

- Ensuring software and systems are up to date – arranging for regular system patching and updates so that there are no windows of opportunity for hackers to exploit the audit firm's system when vulnerabilities are identified;
- Enforcing multi-factor authentication or a secured virtual private network connections whenever accessing the audit firm's IT network or servers;
- Disallowing sharing of confidential data over social media or messaging applications;
- Use of encryptions when emailing sensitive information or documents;
- Enforcing periodical off-site backup of data to ensure seamless restoration of information in the event of system or server failures; and
- Fostering awareness among all audit firm personnel on the importance of cyber security and to be mindful of the various ways such breaches or loss of data could occur. This could be achieved via ad-hoc tests and/or regular trainings.

Virtual/off-site audits

Movement restrictions during the pandemic necessitated the development of alternative and supplementary audit procedures to address the additional risks noted. The AOB observed audit firms adopting virtual audits, making full use of video teleconferencing applications for inventory count observations, asset sightings, vouching work, multi-location audits as well as engagements with the management, management experts and TCWG. Some PIE clients further provided the audit firms with restricted access to their systems to facilitate the audit process.

This further signalled the audit firm's preference and transition to the future of audit, which may include virtual and/or a hybrid of virtual-physical audit. The audit firms have claimed that the use of these virtual tools has lifted geographical boundaries, save time and resources and enabled audits to be performed virtually anywhere around the world.

However, this may not be entirely true!

The existing shortcomings of IT infrastructure locally and abroad could still hamper virtual audit initiatives, especially for entities located in remote areas with limited internet connectivity. This in particular applies to multi-location audits, where component auditors in countries with strict regulations in relation to sharing of documents or information over the internet may experience difficulties in accessing information. Virtual audits would not be suitable under these circumstances and may adversely affect the sufficiency of audit evidence obtained on the audit performed.

The performance of audit requires the exercise of professional judgement and professional scepticism. Concerns have been raised over the ability of the audit firms to effectively discharge their role in virtual audits, potentially compromising audit quality.

The following are some of the best practices observed as part of virtual audits performed.

- Additional guidance for virtual audits and/or alternative audit procedures to ensure that these would address the requirements of relevant accounting and auditing standards.
- Increased depth of reviews or supervision for junior level staff, who may be technologically savvy but may not be well-versed with the application of the audit firm's methodology without direct supervision.
- Increased professional scepticism, particularly in the area of management override of controls and reliability of information and/or transactional documents provided by entities.
- Additional reliance on the work performed by 'personnel on the ground' like internal auditors or other audit firms who are physically located in remote locations.
- Considering modification of audit opinion in circumstances where sufficient audit evidence was not obtained to conclude on the audit.

Similar to the audit firms, PIEs have increased their reliance on information technology, particularly during the pandemic, to facilitate their remote working arrangements. Accordingly, a gradual transition from manual controls to automated controls were observed. The discussions in this section could therefore be relevant to the PLCs being audited.

TCWGs are reminded to ensure the move towards technological-intensive operations are not hampered by management override of controls or other technological-related fraudulent activities such as cyber fraud. The competency of management function to be updated with technological developments should be assessed on a periodical basis.

Human resources

The audit profession has historically been known for its heavy reliance on human resources, from the staff performing audit fieldwork up to those involved in quality reviews. An ongoing challenge faced by audit firms worldwide is staff retention. Audit as a profession is increasingly being used as stepping stone before embarking into a career in the finance industry or moving to neighbouring countries for attractive employment packages.

A long-term solution is necessary!

With the move towards higher reliance on technology and adoption of virtual audits, audit firms have attempted to address the higher attrition rate by upskilling their talent pool and actively promoting innovation in the audit process. In tandem with the PIEs move towards increasing reliance on technology and automated controls, the audit firms may need to consider updating their pool of resources with the skills necessary to facilitate the understanding and audit of these automated controls. Audit firms have also explored opportunities to invest in their IT infrastructure to bridge the gap in attrition.

The following best practices can be considered in addressing issues associated with higher attrition rates in audit firms.

Providing training programmes to upskill existing audit personnel on IT-related audits

Allowing flexibility in working arrangements rather than a rigid implementation of 100% physical attendance in office or clients' premises

Organising periodical retreats or team-building activities to encourage healthy working relationships at the work place

Implementing a mentorship programme to identify and monitor emotional or mental health issues among audit personnel

An area in which the AOB has not seen significant improvements in recent years has been in the sufficiency of disclosures in the AFS as well as the auditors' reports in relation to the impact of the COVID-19 pandemic. Despite the pandemic being considered a significant event, the AOB continues to observe boilerplate disclosures in relation to the impact of the pandemic to the operations and financial results of the PLCs. **There were also little to no meaningful disclosures on how the pandemic affected the audit processes** and therefore the alternative audit evidence obtained, particularly where **key audit matters that were highlighted did not significantly differ to the ones raised before the pandemic.** If the pandemic has taught us anything, enhancing the robustness of existing audit reporting processes should be a priority for the audit firms moving forward. This is even more so as the audit report is a communication tool between the auditors and other key stakeholders of the PLCs being audited. This would further complement the efforts undertaken in other areas of the audit as described above.

PART IV: REMEDIATION OF INSPECTION FINDINGS

REMEDIATION PROCESS

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

- Identification of relevant key areas for remediation
- Root cause analysis
- Performance measures for remediation with a focus on the outcome and effectiveness of the remediation plan
- Specific timeline for each action item

In this regard, audit firms may request for a meeting to be held with the AOB to discuss their remediation plan before submission, if required.

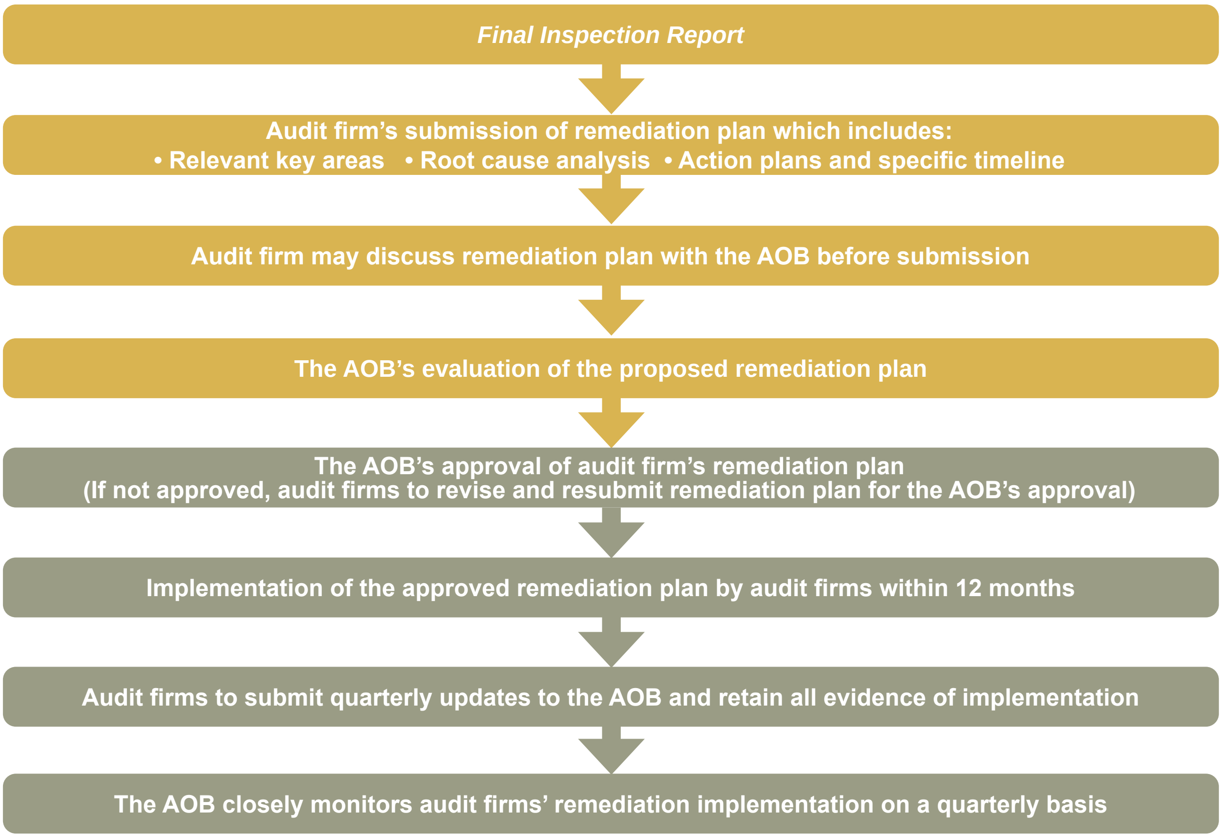
Upon approval of the remediation plan by the AOB, audit firms are required to implement the said action plan in accordance with the proposed timeline within the next 12 months. Subsequently, audit firms are required to submit quarterly updates to the AOB and retain all relevant documentation as evidence to support the completion of the remedial actions taken. The AOB would closely monitor the audit firms' implementation of their remedial action plan on a quarterly basis.

In addition to the above remediation, in cases where severe findings were identified, the AOB may impose specific remediation measures on the audit firm and/or individual partners to rectify matters raised in the *Final Inspection Report* which includes, among others, reperformance of audit procedures for areas of significant deficiencies, training and internal quality review. Audit firms are required to execute the specific measures and report the results to the AOB within the stipulated time imposed by the AOB from the date of the *Final Inspection Report*.

Remediation is based on the degree of deficiencies noted and the AOB acknowledges that there is no generic prescription to minimise the risks relating to audit quality. Remediation plans would differ from one audit firm to another in accordance with the audit firm's structure and size. However, it is vital that the remediation plan is holistic, relevant and sustainable to ensure areas affecting audit quality are rectified immediately.

> "The AOB views remediation very seriously and may publish the audit firm's *Final Inspection Report* pursuant to Section 31V(7) of the SCMA should the audit firm and/or the individual auditors named in the *Final Inspection Report* fail to take all relevant remedial measures as agreed with the AOB."

Chart 1 **Remediation process**



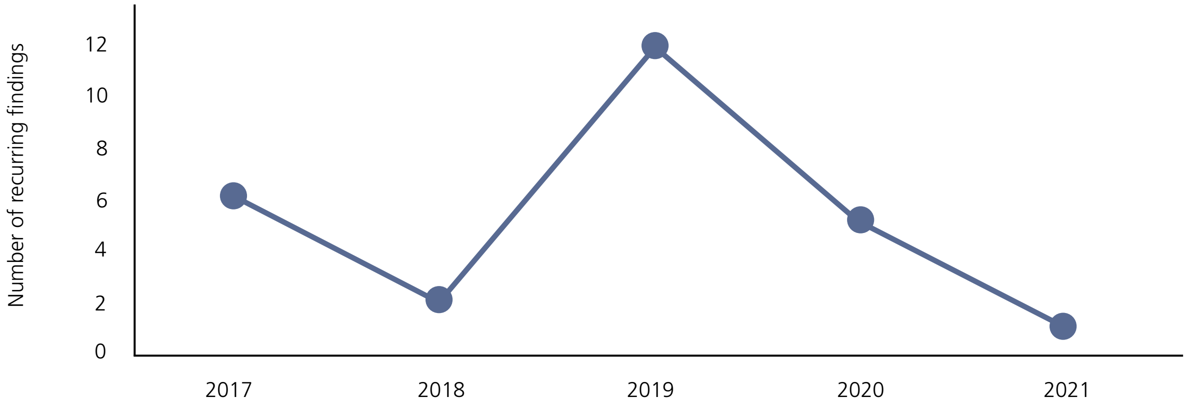
RECURRING FINDINGS

Recurring findings arising from the reinspection of audit firms is one of the key indicators to assess the effectiveness of the remediation measures in place. In 2021, all of the audit firms selected for inspection by the AOB were previously inspected. Nonetheless, only one recurring finding was observed relating to the inspection of an Other Audit Firm as follows:

- **Assessment of cash flow projections in relation to impairment assessment**

While this finding may not recur frequently, audit firms should immediately carry out a targeted and rigorous remediation plan to address the underlying root cause to avoid continuous recurrence of the finding.

Chart 2 **Recurring findings by year (2017 – 2021)**



There is a downward trend in the number of recurring findings for reinspected audit firms as illustrated in Chart 2 which may indicate the audit firms' commitment in implementing adequate remediation plans particularly through the following:

- Audit firm's robust and rigorous internal monitoring reviews; and
- Active sharing of the audit firm's internal monitoring review findings and the AOB's inspection findings to serve as a reminder and preventive mechanism.

CONCLUSION AND OUTLOOK

Overall, the results of the AOB's inspection in 2021 revealed that the number of findings for engagement reviews have reduced. It is encouraging to highlight that there has been a downward trend in recurring findings for reinspected audit firms for the past two consecutive years. This reflects the reinspected audit firms' positive efforts towards improving and sustaining those improvements.

Nonetheless, with the increasing complexity of PIE audits and the nature of business environments of the PIEs, the AOB urges audit firms to continue being vigilant and not become complacent.

Audit firms are reminded to reassess past remediation efforts particularly to gauge the degree of effectiveness of these past remediation actions for continuous improvement.

On the other hand, the number of engagements requiring significant improvement for Other Audit Firms are trending upwards. Immediate measures are required to be implemented to ensure swift improvement particularly in adhering to relevant accounting and auditing standards and tightening of gaps in basic and fundamental areas. Adequate and continuous training for audit personnel at various roles are extremely important as these are essential building blocks for high-quality audits.

The AOB is mindful of challenges faced by the auditors in performing audits during the pandemic. However, the quality of audit should not be compromised in this unpredictable business environment. On top of the existing risks such as going concern, valuation of non-financial assets and accounting estimates, auditors are reminded to heighten their alertness to other risks resulting from the challenging business environment such as fraud risks, related-party transactions and management override of controls.

A partner-driven approach to assessing these (and any other arising) risks combined with significant rigour in the review process is vital to ensure that audit firms are well placed to face the challenges that lie ahead.

The AOB will continue to carry out engagements with audit firms and other stakeholders to further promote efforts to enhance audit quality.

MOVING FORWARD: ADDRESSING HEIGHTENED RISKS ARISING FROM KEY AUDIT AREAS

Going Concern and Accounting Estimates continue to be the focus area for the AOB's inspection in year 2022 particularly due to the ever-changing economic and business environment. Furthermore, both areas remained as top engagement review findings requiring further improvement in recent inspections conducted by the AOB.

Going Concern Assessment

- Identify any cascading effect or emerging audit risk resulting from the recovery phase of the pandemic which may potentially affect the current operation and prospects of the PIE.
- Consider unpredictable triggering factors that may result in the financial performance of the PIE to deviate from previous expectations.
- Engage with Audit Committees to ensure that their PIEs include adequate disclosures to ensure market and investor confidence particularly in ensuring transparency of information over highly subjective and complex areas.

Accounting Estimates and Areas Involving Significant Judgements

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

Risk Assessment

- Continue to be vigilant on current business developments, economic trends and market concerns surrounding the capital market. To incorporate a greater level of professional scepticism through all stages of the audit.
- Determine any potential modifications that can be adopted in enhancing audit quality through the implementation of digital platforms.
- Strong communication from audit firms' leadership to all levels of personnel on the timely and sufficient involvement of partners. This is to facilitate early risk identification and assessment during the audit planning stage.

MOVING FORWARD: STRENGTHENING FINANCIAL RESILIENCE AND AUDIT CULTURE

Resilience of Audit Practices

In 2021, the AOB observed a visible rise in cases of legal disputes between the auditors and their clients. Should an audit firm's Professional Indemnity Insurance (PII) be insufficient, the financial resilience of the firm may be adversely impacted by the legal costs involved. Hence, in 2022, the AOB has embarked on an exercise to collate information on the PII maintained by the AOB registered audit firms to facilitate the monitoring of this development. Audit firms are strongly reminded to evaluate the sufficiency of their PII coverage annually in accordance with their risk management process.

Audit Firm's Culture and Audit Quality

Audit culture is critical in building a conducive audit ecosystem. Despite the importance of investing in the right systems and processes, it is vital for the audit firm's leadership to promote a positive culture on audit quality. This could be achieved by setting a strong tone at the top with consistent reinforcement of messaging across all levels of personnel. Therefore, the AOB will monitor the progress of continuous improvements to be undertaken by the audit firms in upholding the system of quality management.

Audit Committee members are reminded to obtain a copy of the *Annual Transparency Report* from their respective auditors who have met the required reporting criterion. Plans are in place by the AOB to gather feedback from Audit Committees and other key stakeholders in the capital market to further improve the existing framework.

In addition, under firm-level inspections, the AOB will continue to review the measures taken by the relevant audit firms in preparing for the implementation of ISQM 1, which will become effective after 15 December 2022. The AOB will not give any leeway should the audit firms fail to comply with the requirements of ISQM 1 in its inspections beginning in 2023.

Technological Transformation

The AOB noted that there is an increase in the adoption of digital application of digital audit platforms by Other Audit Firms. This adoption will be beneficial, especially where efficient use of technology can help bridge the gap arising from human resource constraints. However, the audit firms are reminded to be mindful of the completeness and integrity of assembled audit files, particularly during the initial implementation of their chosen audit software. Enhancements to the audit firm's methodology and corresponding training sessions will provide more clarity and consistency in the application of audit software and allowing for a smooth transition from the traditional approach previously applied by the audit firm. The AOB believes that technological adoption and adaptation is no longer a 'nice to have' option for auditors but has become a necessity to enable auditors to continue to operate in a future that is expected to become increasingly challenging.

CONSIDERATIONS FOR AUDIT COMMITTEES

In ensuring effective communication with auditors, the following are some suggested questions for the consideration of Audit Committees:

CONSIDERATION OF APPOINTMENT AND REAPPOINTMENT OF AUDITORS

- Does the appointment of auditors take into consideration factors in relation to audit quality, including technical competence, industry knowledge and resources workload and capacity?
- Does the audit firm's culture focus on audit quality? Were there sufficient supervision and monitoring reviews to ensure auditors are appropriately held accountable for overall audit quality?
- When recommendations made by management to change the auditors, were there any indications of unusual circumstances that could compromise the PIE's financials?

AREAS OF SIGNIFICANT JUDGEMENTS AND ESTIMATES

- Does the auditor demonstrate a sufficient understanding of the business, the industry and environment in which the PIE operates, risk areas, and key issues relevant to the financial report?
- What was the auditor's plan to respond to significant risk areas and how has the auditor ensured that audit procedures performed to address these areas were well executed?
- Was there any assessment conducted by the management to periodically review the effectiveness of the PIE's internal control systems?
- In view of the dynamic of the economic and market conditions, has the Audit Committee executed its oversight roles more diligently in questioning specific significant risk areas and challenging the key judgements and assumptions presented by management?

COMPETENCY OF THE PIE'S FINANCE FUNCTION

- Do directors and Audit Committees have appropriate adequate resources to support their responsibilities to oversee the processes within the finance function and internal controls over financial reporting?
- Do directors and the Audit Committees challenge the auditor, including professional scepticism applied by the auditors in judgement areas such as accounting estimates and accounting policies?
- What formal training and development programmes are in place to keep the entities' finance personnel up to date with the latest or new accounting standards?
- What was the indication given by the PIE management towards approaching technological advancement/improvements for the PIE? Has the PIE's finance function considered adopting the latest technologies in their processes and has the PIE equipped themselves with the right infrastructure, systems, and competent resources to drive a new digital process? If not, why?

OTHERS

ACRONYMS AND ABBREVIATIONS

AFS	audited financial statements
AOB	Audit Oversight Board
AQI	Audit Quality Indicator
CAATs	computer-assisted audit techniques
CMSA	*Capital Market and Service Act 2007*
DA	data analytics
EQCR	Engagement Quality Control Review
IASB	International Accounting Standards Board
IAASB	International Auditing and Assurance Standards Board
IFIAR	International Forum of Independent Audit Regulators
ISA	*International Standards on Auditing*
ISQC	*International Standard on Quality Control*
ISQM	*International Standard on Quality Management*
IT	information technology
ITGC	IT General Controls
MCCG	*Malaysian Code on Corporate Governance*
MCO	movement control order
MIA	Malaysian Institute of Accountants
MIA By-Laws	*By-Laws (On Professional Ethics, Conduct and Practice) of the Malaysian Institute of Accountants*
MICPA	The Malaysian Institute of Certified Public Accountants
MFRS	*Malaysian Financial Reporting Standards*
NAV	net asset value
PIE	public-interest entity
PLC	public-listed company
SC	Securities Commission Malaysia
SCMA	*Securities Commission Malaysia Act 1993*
SOP	standard operating procedures
TCWG	those charged with governance

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.
Exchange	Bursa Malaysia.
Major Audit Firms	Audit firms with more than 10 partners and audit more than 50 PIE audit clients with a total market capitalisation of above RM25 billion.
movement control order	The movement control order imposed by the Malaysian Government in March 2020 and the subsequent measures restricting movements.
Other Audit Firms	Audit firms other than Major Audit Firms.
Public-interest entity	Entity specified in Part 1 of Schedule 1 of the SCMA:

(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 the 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; (q) any other person as the Minister may prescribe by order published 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.