



Suruhanjaya Sekuriti
Securities Commission
Malaysia



AUDIT OVERSIGHT BOARD ANNUAL INSPECTION REPORT 2023

**AUDIT OVERSIGHT BOARD
ANNUAL INSPECTION REPORT
2023**

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3 Persiaran Bukit Kiara
Bukit Kiara
50490 Kuala Lumpur
Malaysia

Tel +603 6204 8900
Fax +603 6201 1888
Website www.sc.com.my/aob

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MISSION STATEMENT

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

VISION STATEMENT

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

OUR REMIT

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

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

INTRODUCTION

BUILDING ON AUDIT QUALITY TO PROMOTE CONFIDENCE

High quality financial reporting is dependent upon the respective stakeholders in the financial reporting ecosystem carrying out their roles effectively. Among the various stakeholders, auditors play an important role in ensuring the quality and reliability of audited financial statements.

The Audit Oversight Board (AOB) is responsible to promote and develop an effective and robust audit oversight framework in Malaysia. Hence, to ensure that audit quality remains as a high priority on the stakeholders' agenda, the AOB focuses on continuous engagement with stakeholders within the ecosystem.

Directors and Audit Committees (ACs) are ultimately responsible for overseeing the governance structure of public-interest entities (PIEs) which includes the provision of reliable audited financial information to users of financial statements for informed decision-making purposes.

Information disclosed in the Annual Transparency Reports and statistics relating to Audit Quality Indicators (AQIs) can be used as a basis for discussions between ACs with their respective auditors to enhance their oversight function. For the convenience of ACs, a compilation of statistics relating to AQIs for both the Major Audit Firms and the Other Audit Firms are shared in the Appendix of this Annual Inspection Report (AIR).

Key activities performed by the AOB such as registration, inspection and enforcement ensure that audit firms (firms) and individual auditors are committed to delivering high quality independent audits.

Highlights of the outcome of the AOB's activities in 2023 include:

Monitoring and Supervision of PIEs		Stakeholder Engagements	
Inspected 15 firms on design and implementation of firm's systems of quality management in accordance with the <i>International Standard on Quality Management 1</i> (ISQM 1) in their first year of implementation	Reviewed 50 audit engagements audited by 50 individual auditors Final Inspection Reports which summarised the inspection findings were issued to the respective firms	Hosted dialogue sessions with firms, AC members and investors on corporate reporting, audit quality and corporate governance	Collaborated with accounting bodies, other regulators and standard setting bodies including contributing views on areas of concern relating to audit quality
		Published the AIR and AOB Alert Series to the ACs in promoting transparency and availability of information for various stakeholders	

The AOB's efforts continued to receive global recognition from the Asian Corporate Governance Association (ACGA). In the recent issue of the Corporate Governance (CG) Watch 2023, Malaysia ranked first out of 12 regional markets for quality of auditors and audit regulators. This positive acknowledgement of Malaysia's accounting and auditing ecosystem generates greater confidence in audited financial statements (AFS) of PIEs, which in turn, is beneficial to the capital market's growth.

MONITORING AND SUPERVISION

Section 31V(1) of Part IIIA of the *Securities Commission Malaysia Act 1993* (SCMA) mandates the AOB to conduct inspections on the auditors of PIEs to assess their degree of compliance with the relevant auditing and ethical standards as well as to assess the quality of audit reports prepared by them.

The AOB's inspection activities are important to measure the firm's performance in exercising and demonstrating high quality independent audits of PIEs and schedule funds. Inspections comprised firm and engagement level reviews. For firms that have been inspected in the past, subsequent inspections of these firms would also include a follow-up review on the implementation of the firm's remedial action plan.

HOW DOES THE AOB SELECT ENGAGEMENTS TO BE INSPECTED?

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

- Risk assessment of registered and recognised firms and individual auditors particularly on previous inspection results;
- Usage of data analytics including consideration of historical data and the use of financial models to identify adverse trigger points;
- Risk associated with individual public-listed companies (PLCs) based on market capitalisation, complexity of the PLC's structure, governance structure, nature of the industry and operating environment of the entities;
- Specific areas of industry or market concerns to address emerging trends or potential systemic issues; and
- Significant accounting, auditing or other developments during the year.

Findings identified during inspections are–

- individually critical deficiencies that may, on its own have an impact on the basis of audit opinion; or
- pervasive issues where the impact cannot be easily quantified.

At the conclusion of each inspection, these findings will be highlighted in a Final Inspection Report issued to the firms. All findings are expected to be remediated by the firms within a timeline agreed with the AOB.



Directors and their ACs are strongly encouraged to understand and discuss the common findings raised by the AOB with their auditors. This is to ensure that the risk areas specific to their entities are adequately addressed.

This AIR provides insights into the observations arising from the AOB's inspections at both firm and engagement levels in 2023, as well as several recent developments and key messages.

HOW INSPECTION MATTERS TO YOU?

The diagram below shows some examples on how the AOB's inspection and this AIR can be a beneficial reference to each stakeholder:





INSIGHTS INTO THE AUDIT PROFESSION

REGISTRATION AND RECOGNITION STATISTICS

As of 31 December 2023, there were 37 firms and 374 individual auditors registered with the AOB. During the year, one audit firm met the size criteria of a Major Audit Firm which increased the number of Major Audit Firms from eight to nine. The number of PIEs audited by Major Audit Firms increased by 4.3% while audit clients by PLC market capitalisation remained the same.

There were four foreign firms and 13 foreign individual auditors performing audits of five foreign incorporated companies listed on Bursa Malaysia.

TABLE 1

Registration and recognition of firms and individual auditors as of 31 December 2023 and 31 December 2022

	No. of audit firms		No. of individual auditors	
	2023	2022	2023	2022
Registered				
Major Audit Firms	9	8	244	229
Other Audit Firms	28	28	130	128
Total registered	37	36	374	357
Recognised				
Foreign Audit Firms [#]	4	4	13	12
Total registered and recognised	41	40	387	369

TABLE 2

PIEs and schedule funds audited by AOB-registered and AOB-recognised firms as of 31 December 2023 and 31 December 2022

	% of total no. of PIEs		% of total PLCs' capitalisation		No. of schedule funds		% of total net asset value (NAV)	
	2023	2022	2023	2022	2023	2022	2023	2022
Registered								
Major Audit Firms	77.8	73.5	95.2	95.3	1,293	1,269	98.5	98.5
Other Audit Firms	21.8	26.1	4.7	4.6	46	44	1.5	1.5
Recognised								
Foreign Audit Firms [#]	0.4	0.4	0.1	0.1	-	-	-	-
Total	100.0	100.0	100.0	100.0	1,339	1,313	100.0	100.0

Note:

[#] Foreign auditors who audit foreign incorporated companies listed on Bursa Malaysia.

BOX ARTICLE 1

ENHANCING MONITORING AND SUPERVISION OF REGISTERED AUDITORS

As part of enhancing the monitoring and supervision of AOB-registered auditors, the *Guidelines on Continuing Obligations for Registered Auditors* (Guidelines) was issued in June 2023. The Guidelines combined existing and new obligations for AOB-registered auditors.

The new requirements on Change, Resignation and Removal of Auditors were prompted by regulatory concerns associated with resignation of auditors subsequent to their appointment at the PLCs' Annual General Meeting.

Regulatory concerns include the risk posed by auditors who fail to carry out their statutory duties by resigning when faced with known or suspected financial irregularities in their audit clients. In addition, the resigning auditor (outgoing auditor) may not be transparent in communicating key audit concerns when providing professional clearance to the newly appointed auditor (incoming auditors). This situation could have an unintended effect on the audit engagement and in turn impact audit quality.

AUDITORS' OBLIGATIONS IN RELATION TO THE CHANGE, RESIGNATION AND REMOVAL OF AUDITORS

CHANGE OF AUDITOR

Before accepting the appointment as a PIE's auditor, the **incoming auditor** must:

- **seek professional clearance** from the outgoing auditor; and
- **complete the evaluation** for the **acceptance** of a new audit engagement

The **outgoing auditor** must provide a **written reply** to the incoming auditor within **14 business days** from the receipt of the request.

If consent is not provided by the **PIE audit client** for disclosing the professional reason, the **outgoing auditor** must:

- **inform** the incoming auditor of the non-consent in the **written reply**; and
- **submit** a copy of the written reply to the **AOB** concurrently

RESIGNATION AND REMOVAL OF AUDITOR

Upon giving a **notice of resignation** as a PIE auditor, the **outgoing auditor** must submit the following to the **AOB**:

- a written notification setting out;
 - a) the **specific reasons and circumstances** that gave rise to the resignation
 - b) any **key audit concerns** that relate to the PIE audit client's annual financial statements within **5 business days**; and
- a copy of the professional clearance letter

If a **registered auditor** is **removed** by a PIE audit client, the registered auditor must **notify the AOB** of such removal and the **reasons** of the removal if known to the registered auditor, within **5 business days** upon receipt of the notice of removal from the PIE audit client.

The requirements on Change, Resignation and Removal of Auditors are effective from 1 July 2024. The Guidelines are issued pursuant to Section 158 of the SCMA and non-compliance can result in actions taken against the auditors pursuant to the Act.



Any submission to the AOB in relation to the above Guidelines will be monitored for consistency with the PIE's announcement on auditors' change.

BOX ARTICLE 2

KEY AUDIT QUALITY INDICATORS: DEVELOPING AND SUPPORTING AUDIT TALENT

As in prior years, a large proportion of the audit workforce for both the Major Audit Firms and Other Audit Firms comprise non-managerial staff as shown in the table below.

Percentage of non-managerial staff in the Major Audit Firms and Other Audit Firms			
	2023	2022	2021
Major Audit Firms	80%	80%	78%
Other Audit Firms	74%	71%	72%

In view of this, the development of talent particularly the non-managerial audit staff is closely monitored by the AOB. It has been observed that both the Major Audit Firms and the Other Audit Firms have continued to invest in training to upskill their audit staff.

Average hours of training for non-managerial staff of Major Audit Firms and Other Audit Firms			
	2023	2022	2021
Major Audit Firms	79	74	78
Other Audit Firms	47	35	34

The AOB further notes that a majority of the firms’ audit staff have obtained or are currently pursuing professional qualifications.

Percentage of audit staff with professional qualification or pursuing professional qualification



Major Audit Firms: 86%

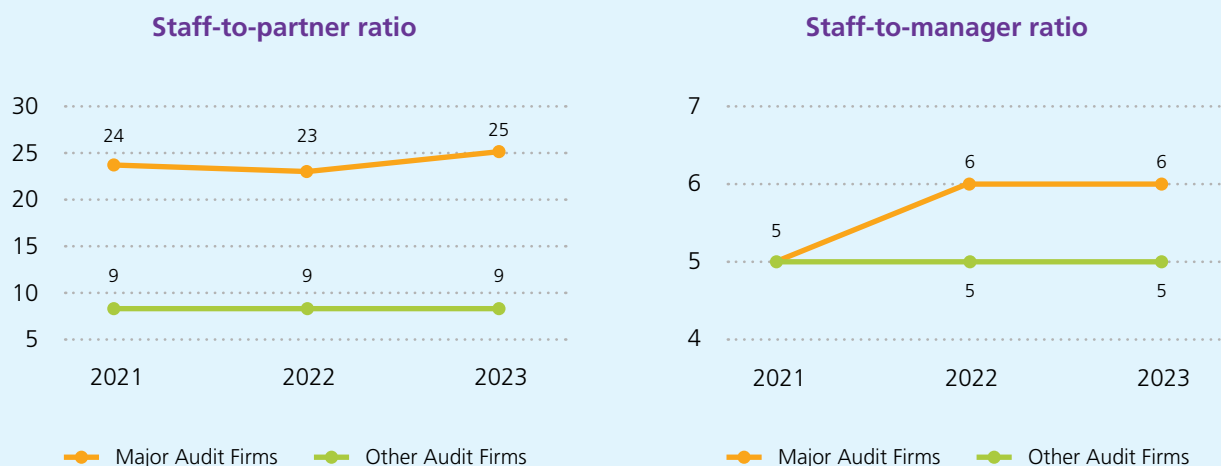


Other Audit Firms: 62%

In addition, some firms have introduced incentives to encourage their audit staff to pursue professional qualifications by sponsoring their professional examination fees or by subsidising their study fees.

As the average years of experience for non-managerial staff is about two years, there is a need for sufficient supervision of their work. In this respect, the AOB monitors the staff-to-partner ratio and staff-to-manager ratio.

STAFF-TO-PARTNER/MANAGER RATIO OF MAJOR AUDIT FIRMS AND OTHER AUDIT FIRMS

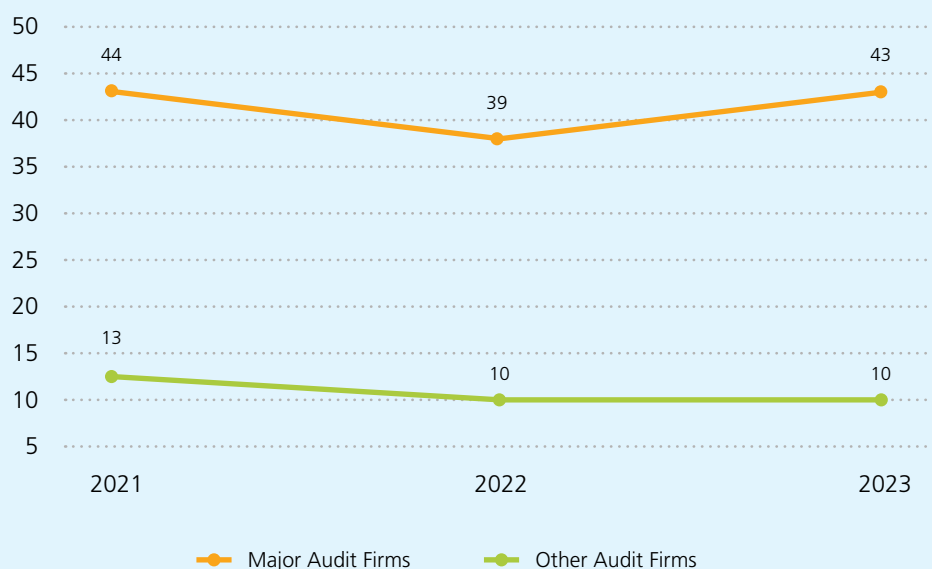


Note: A lower ratio would imply that a partner or managerial staff could accord greater attention to supervise audit engagement teams.

As shown above, the audit staff-to-partner ratio and audit staff-to-manager ratio have remained relatively stable over the last three years.

Another aspect that is also important to promote audit quality is whether there are sufficient quality control staff who provide support to the audit practice in the form of training, technical consultations, risk management and quality assurance.

Average ratios of audit staff to one quality control staff of Major Audit Firms and Other Audit Firms



Audit firms are encouraged to periodically review the headcount of their quality control functions to ensure that they remain adequate to support the audit staff in their respective firms.



KEY REMINDERS

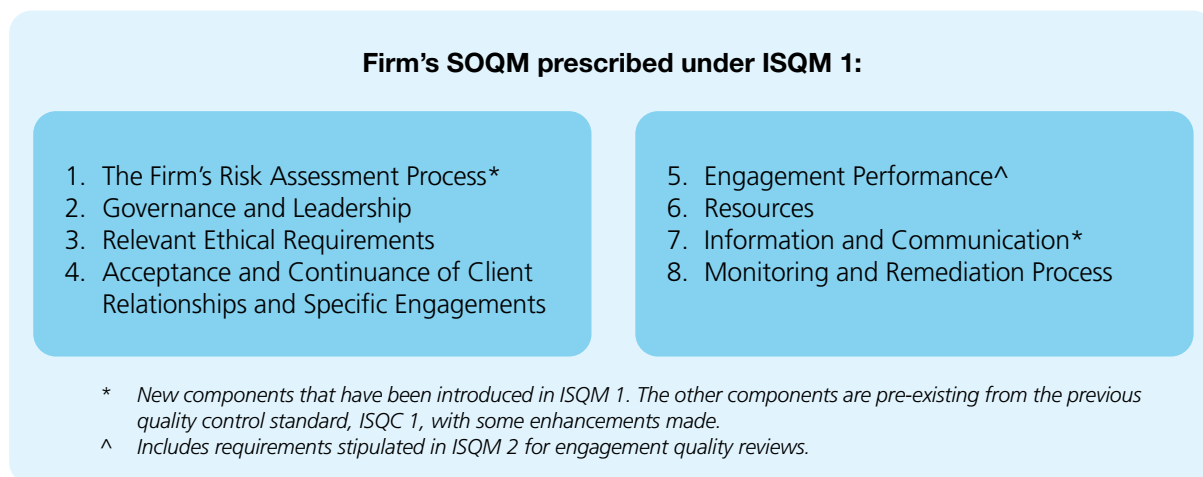
Discussions between the auditor and the AC on the audit firm's AQIs should be undertaken as they not only promote continued focus on audit quality but also serve as useful inputs for consideration during the appointment and re-appointment of auditors.



PROMOTING HIGH QUALITY AUDIT PRACTICES

FIRM LEVEL INSPECTION FINDINGS AND OBSERVATIONS

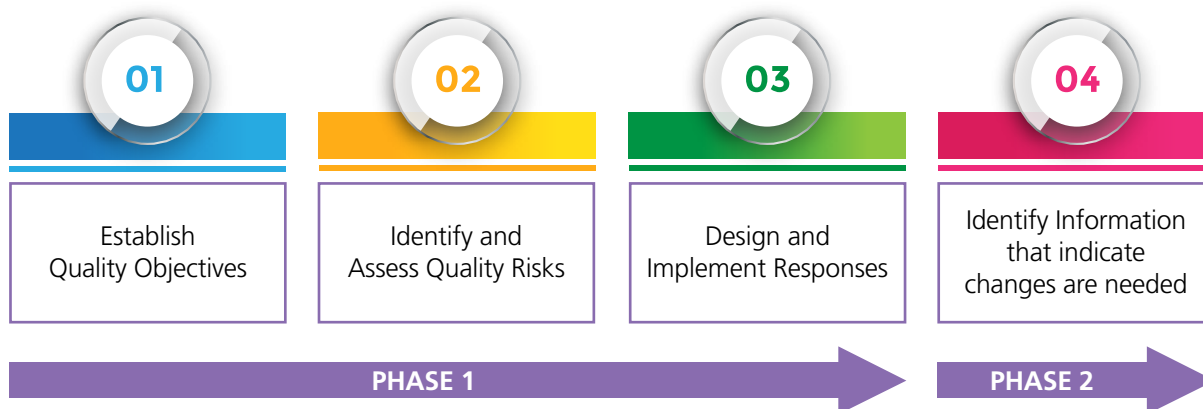
In line with the introduction of the new quality management standards namely ISQM 1 and *International Standard on Quality Management 2* (ISQM 2) that became effective on 15 December 2022, firms were required to establish a System of Quality Management (SOQM) as illustrated below:



As per ISQM 1 requirements, all firms are required to establish a risk assessment process as follows:

CHART 1

Risk Assessment Process



For the purpose of ensuring adherence of the above, the firms are assessed as follows:

- Phase I: Assessment on the firm's design and implementation of the SOQM.
- Phase II: Review on the firm's operating effectiveness of the SOQM where the firm is required to identify information that indicate changes are needed.

In 2023, the focus of firm level inspection includes the overall assessment on the firm's design and implementation of the SOQM as follows:

- Assessment on the adequacy of the firm's Quality Objectives for each ISQM 1 component.
- Identification and assessment of Quality Risks for each Quality Objective.
- Assessment on the adequacy of the firm's risk responses in addressing Quality Risks.

Nine Major Audit Firms and six Other Audit Firms were inspected in 2023. All the firms inspected have implemented SOQM. However, some shortcomings were noted as highlighted below:

Common findings identified during the inspections relating to the risk assessment process of the Major Audit Firms and Other Audit Firms in 2023

FIRM'S RISK ASSESSMENT PROCESS

The following common findings identified during the inspections relating to the risk assessment process in 2023 were noted:

- Certain mandatory quality objective(s) have been excluded from the risk assessment process.
- Certain key risks that can impede the achievement of the established quality objectives have not been identified.
- The assessment on the likelihood of a risk occurring and the effect that it may have on the achievement of a mandatory quality objective was not performed by some firms. Such assessment is necessary as it could help to determine the extent of responses required to address a particular risk.
- Certain responses that have been designed by some firms to address the identified risks were either inadequate or not fully implemented.

The quality objectives specified in ISQM 1 are required for all firms, unless clearly not applicable. Nonetheless, the non-inclusion of certain mandatory objectives from the risk assessment process was quite prevalent in the inspections of the six Other Audit Firms. There was lack of documentation to support whether there was any proper evaluation in justifying the basis of selecting only certain objectives.

The exclusion of mandatory objectives could result from the risk assessment process not being sufficiently thorough. It is advisable for firms to carefully consider risks associated with all quality objectives as prescribed by the standard. For consideration of the risks that might adversely impact the firm's quality objectives, firms are required to demonstrate the impact and likelihood of such risk based on the size, nature and complexity of the firm's structure.

In view of the above findings, firms are strongly encouraged to review their risk assessment process to ensure that it is sufficiently robust to identify and mitigate key risks that could impede the achievement of the established quality objectives.

Common findings identified during the inspection of design and implementation of ISQM 1 components of the Major Audit Firms and Other Audit Firms in 2023

DESIGN AND IMPLEMENTATION OF ISQM 1 COMPONENTS

The common findings identified during the inspection of design and implementation of ISQM 1 components in 2023 are as below.



1. Procedures for the acceptance of non-audit service engagements involving PIE audit clients

There is no requirement in the firm's procedures to obtain concurrence from those charged with governance (TCWG) prior to the firm accepting a non-audit service engagement involving PIE audit clients. This requirement is mandatory under the By-laws (on Professional Ethics, Conduct and Practice) of the Malaysian Institute of Accountants (MIA By-Laws) to promote effective oversight by TCWG on auditors' independence.

2. Policy on the rotation of audit partners

The firm's partner rotation policy did not consider relevant past roles undertaken by an audit partner prior to becoming a key audit partner when calculating the length of his or her involvement with an audit engagement. Such consideration is required under the MIA By-Laws to address familiarity threat.

3. Procedures for workload monitoring

Most firms had not established procedures to monitor staff workload such as the overtime hours incurred by audit staff.

4. Policy for the appointment of Engagement Quality Reviewers (EQR)

The cooling-off period before an engagement partner can assume the role of EQR was not defined in the firm's policy. This is a requirement under ISQM 2 to address threats to the objectivity of an EQR.

5. Policy for the retention of documentation relating to a firm's system of quality management

Certain firms did not define a retention policy for documentation relating to their system of quality management although this is a requirement under ISQM 1.

6. Procedures for communication of information externally

Certain firms had not established procedures on timely communication of information to external parties (e.g. non-compliance with ethical requirements, transparency reporting) when required by law and regulation.

MATTERS FOR CONSIDERATION DURING THE ADOPTION OF NEW ISQM 1 COMPONENTS

- Audit firms are reminded to establish a process to govern the acceptance of non-audit services involving PIE audit clients by TCWG in line with the MIA By-Laws requirement.
- As a new component in ISQM 1, processes involving the communication of information internally and externally should be designed and implemented as it is crucial for the firm to disseminate required information on a timely basis for an effective system of quality management.
- As part of the system of quality management evaluation, it is important for the firms to remediate identified deficiencies in a timely and effective manner to prevent them from recurring.

SUSTAINABILITY OF AUDIT FIRMS

Firms play an important gatekeeping role to foster trust and confidence in the capital market. Therefore, it is imperative not only for firms to deliver high quality audits but also to carry out their audit business practice sustainably in the long run. To achieve this, firms need to be financially stable to invest in human capital, technology and intellectual resources in order to operate an effective system of quality management.

Human capital investment (e.g. salary cost) is known to be a major factor for sustainability of audit practice. As shown in Table 1 below, there is a close correlation between audit fees and salary costs growth which shows a rise in salary costs of 20% had been matched by a corresponding rise in audit fee revenue of 17% in 2023.

TABLE 1

Salary costs and audit fee revenue for AOB-registered audit firms

	2021 (RM billion)	2022 (RM billion)	2023 (RM billion)	% change between 2021 and 2023
Audit fee revenue	1.29	1.36	1.51	17 %
Salary costs	0.69	0.72	0.83	20 %

As shown in Table 2, there was a spike in staff turnover rate for the AOB-registered firms in 2022 as Malaysia transitioned to the endemic phase of COVID-19 during the year. There was a concern that the replenishment of talent was not sufficiently timely to address the high staff turnover. The situation has since improved in 2023 where the average audit staff turnover rate has reduced from 31% to 25%. In addition, firms have also intensified their recruitment activities in 2023 leading to an audit headcount of 8,928 individuals.

TABLE 2

Average audit staff turnover rate and audit headcount for AOB-registered firms

	2021	2022	2023
Average audit staff turnover rate	25%	31%	25%
Audit headcount	7,920	8,038	8,928

To ensure sustainability of operations, AOB-registered firms are encouraged to:

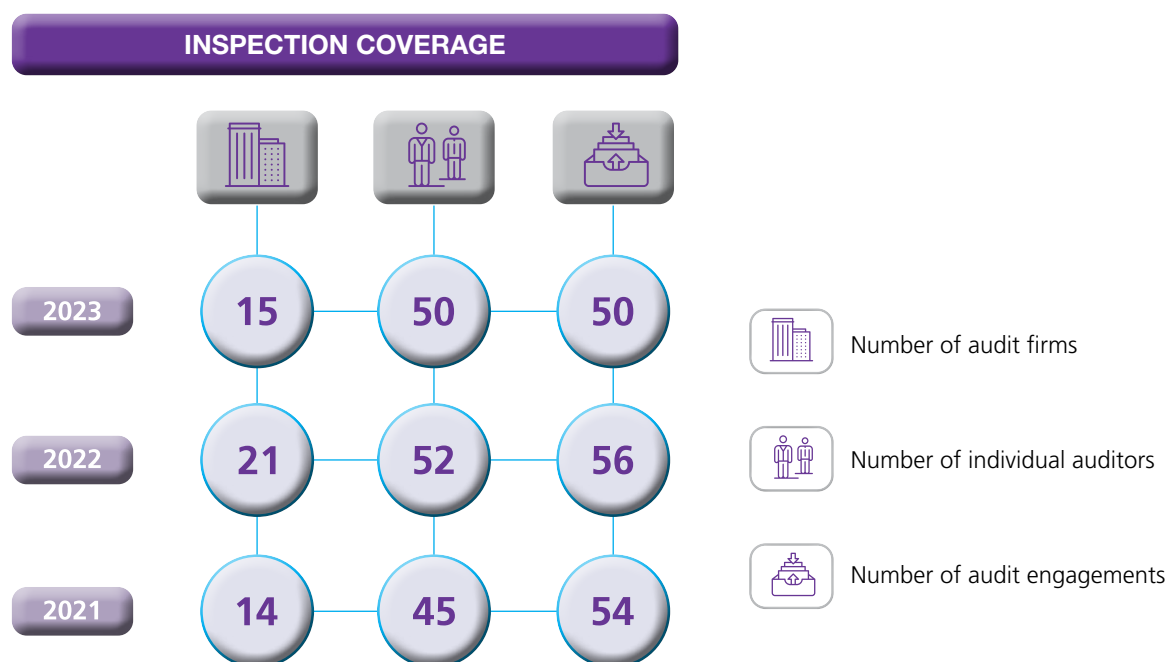
- Closely monitor their financial resilience and capacity needs as part of their risk management process to ensure that audit quality is continuously upheld.
- Right-pricing the audit fees to ensure that they commensurate with the time, effort and expertise required in the audit engagements in addition to consideration of engagement complexity and associated risks.
- Monitor audit staff workload such as reviewing overtime hours incurred by audit staff on audit engagements to identify and address potential work-life balance concerns. Heavy staff workload that is addressed in a timely manner may help retain audit staff for a longer period and alleviate pressures due to staff turnover.

In an interview exercise conducted by the AOB in 2022, a total of 47% of the interviewees indicated that they were willing to continue working with their firms if the issue of long working hours and compensation are addressed.

ENGAGEMENT LEVEL INSPECTION FINDINGS AND OBSERVATIONS

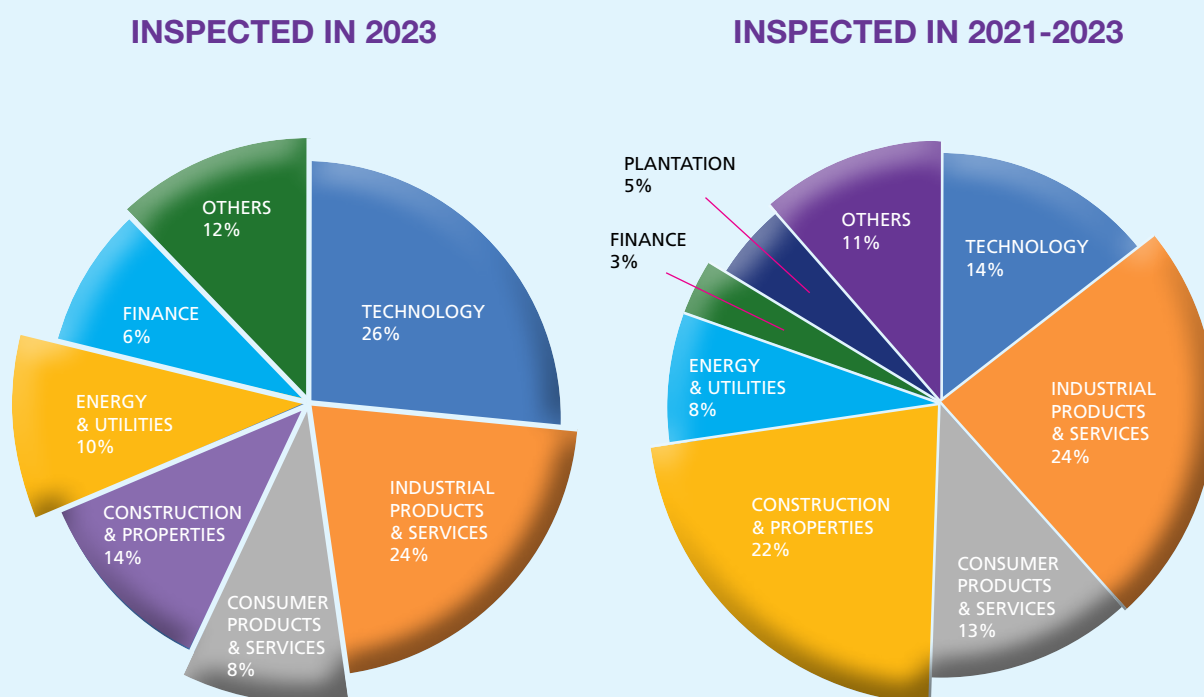
On an annual basis, the AOB conducts inspections on all firms that have more than 50 PIE audit clients with a total market capitalisation of above RM15.0 billion. These nine Major Audit Firms (2022: eight) collectively audited PLCs that represented 78% of the total number of PLCs and 95% of the total market capitalisation in Malaysia.

In 2023, 15 firms were inspected, covering 50 individual auditors and 50 audit engagements.



BOX ARTICLE 3

INDUSTRIES COVERED BY THE AOB'S INSPECTION



*Others: Telecommunications and media, transportation and logistics, and healthcare

COMMON FINDINGS ACCORDING TO INDUSTRIES INSPECTED IN 2023

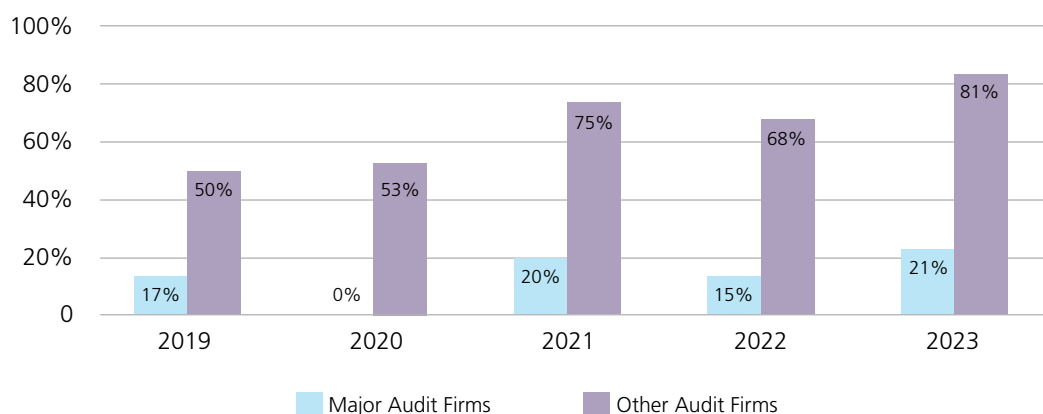
INDUSTRY	AREAS OF CONCERN
Technology	<ul style="list-style-type: none"> Assessment on key assumptions used to determine recoverable amount of software development costs. Appropriateness of non-contractual customer relationship capitalised in accordance with MFRS 138 <i>Intangible Assets</i>. Assessment of various performance obligations and allocation of transaction price in the revenue recognition in accordance with MFRS 15 <i>Revenue from Contracts with Customers</i>.
Industrial products and services	<ul style="list-style-type: none"> Assessment of cost allocations in determining the product costing for inventories. Errors in unit of measurement and the corresponding conversion during physical inventory counts.
Construction and properties	<ul style="list-style-type: none"> Assessment on the basis of collectability criterion in the revenue recognition in accordance with MFRS 15 <i>Revenue from Contracts with Customers</i>. Sufficiency of provision for liquidated ascertained damages. Assessment on valuation of land held for property development.
Energy and utilities	<ul style="list-style-type: none"> Assessment of specific terms and conditions of contracts in accordance with MFRS 15 <i>Revenue from Contracts with Customers</i>.

ENGAGEMENTS REQUIRING SIGNIFICANT IMPROVEMENTS

At the end of every inspection, the AOB assesses the severity of findings arising from each engagement review. Engagements requiring significant improvements (ERSI) are engagements in which specific remediation measures are imposed on firms and/or engagement partners; or are routed to the AOB's Enforcement, Regulation and Quality (ERQ) department.

CHART 1

Percentage of inspected ERSI



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.

In 2023, one (2022: two) AOB-registered firm met the criteria of a Major Audit Firm, which led to an increase in the number of Major Audit Firms from eight to nine (2022: from six to eight). This change is not reflected retrospectively in Chart 1.

As illustrated in Chart 1, there is an overall increasing trend of inspected ERSI for both the Major Audit Firms as well as the Other Audit Firms. Additionally, there is an increase in the gap between Major Audit Firms and other Audit Firms for percentage of inspected ERSI from 53% in 2022 to 60% in 2023.

The AOB acknowledges that firms of varying sizes face different sets of challenges, including the ability to make sufficient investments of necessary resources in supporting consistent audit quality across all engagement performances.

Compilation of AQI as disclosed in the appendix of this AIR highlighted differences in the average percentage of personnel without professional qualifications and/or MIA membership (Major Audit Firms: 14% in 2023 and Other Audit Firms: 38% in 2023) and total average hours of training provided by the firms to audit personnel (Major Audit Firms: 249 hours in 2023 and Other Audit Firms: 157 hours in 2023).

Regardless of these challenges, it is vital for firms to increase their efforts in improving the audit quality of all levels of personnel.

CHART 2

Breakdown of actions taken on inspected engagements

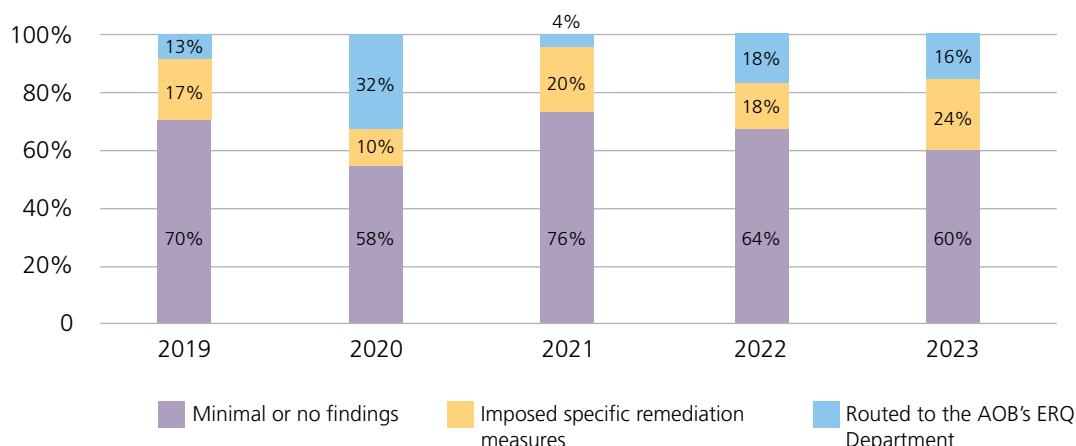


Chart 2 represents the breakdown of actions taken on inspected engagements over the last five years. As illustrated, the percentage of inspected engagements routed to the AOB's ERQ Department has fluctuated over the years. Despite a drastic decrease from 2020 to 2021 due to the inspection approach adopted during the Movement Control Order period followed by an increase in 2022, there was a slight improvement in the percentage of engagements routed to the AOB's ERQ Department from 2022 to 2023.

While this improvement is encouraging, this development is offset by a reduction in engagements with minimal findings compared to ERSI in the last three years.

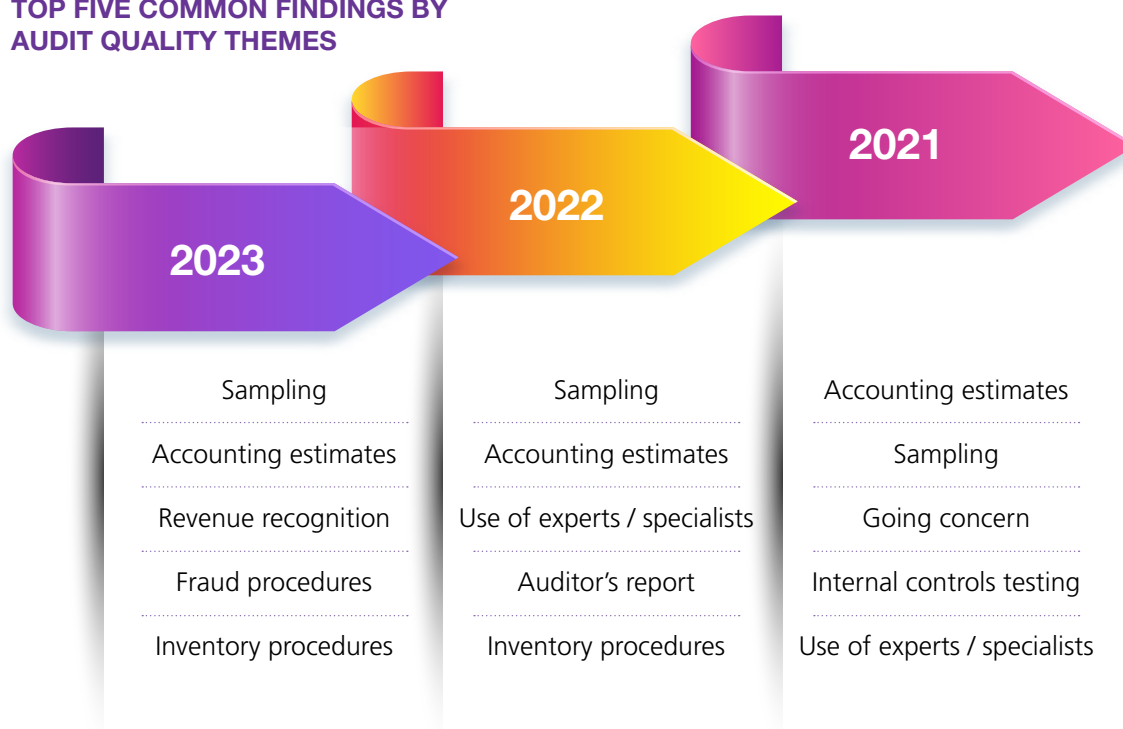
“The AOB expects greater efforts from the firms to ensure consistent performance in all PIE engagements.”

Firms must maintain an appropriate level of professional scepticism particularly in dealing with complex transactions and business arrangements during periods of economic volatility. This can be reinforced by the firms' leadership emphasising on extensive EQR involvement, particularly in addressing significant and high-risk audit matters.

COMMON FINDINGS FOR ENGAGEMENT REVIEWS

Engagement findings based on the categories of audit quality themes defined by the *International Forum of Independent Audit Regulators' (IFIAR) Survey of Inspection Results for Audit Firms* have been compiled over a three-year period as follows.

TOP FIVE COMMON FINDINGS BY AUDIT QUALITY THEMES



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

The top two common findings will be further discussed in the following section.

SAMPLING

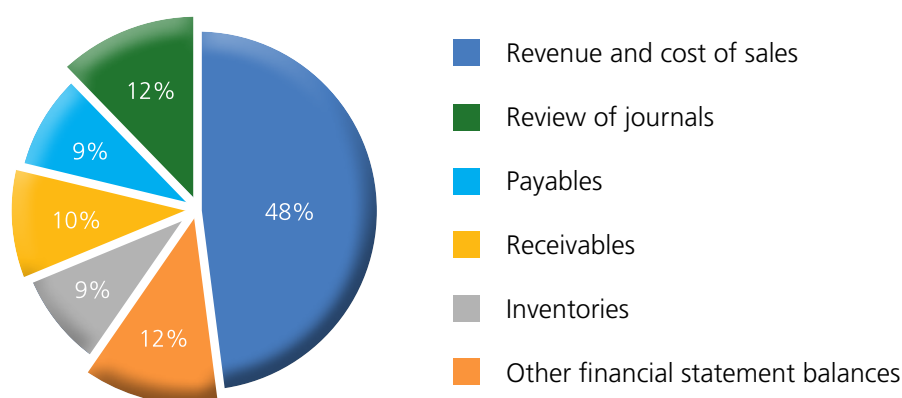
Sampling represents one of the most fundamental aspects in auditing. The continued observation on findings relating to sampling raises concerns on the effectiveness of the firm's execution of its audit procedures.

“There were instances where samples were omitted from being tested, particularly in the areas that were inappropriately perceived as low risk despite the amount being material to the financial statements. Auditors are reminded to apply additional rigour during the review process, where such errors can be avoided.”

The chart below represents the common areas with sampling findings. Significant observations were noted surrounding the areas of revenue and cost of sales encompassing procedures performed on test of controls, test of details and cut-off.

It is vital that auditors have in-depth understanding of the PIE's business to ensure appropriate procedures surrounding sampling are designed and executed.

Common Areas with Findings on Sampling

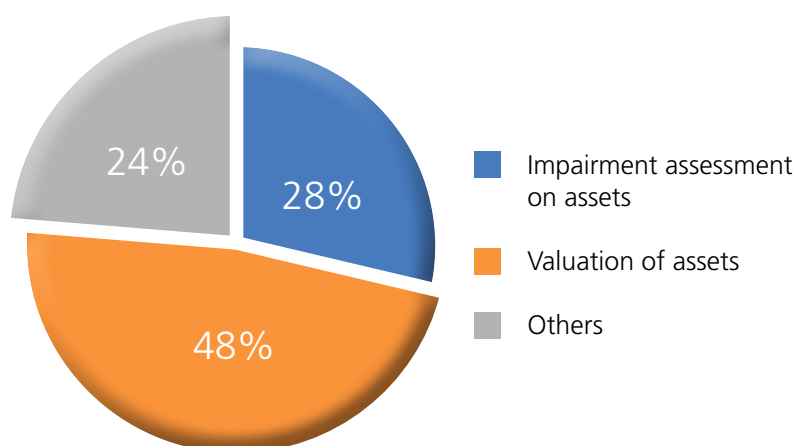


REVENUE AND COST OF SALES	
NATURE OF FINDINGS	COMMON PITFALLS
Insufficient sample selected in order to reduce sampling risk to an acceptable low level	<ul style="list-style-type: none"> Lack of clarity on the basis of sampling used for sample selection. The lead time for transactions were not considered when coming up with the sample size for cut-off testing. Inappropriate risk factor was used in the sampling calculator (i.e. placing reliance on failed internal controls).
Sample selected for testing is biased and/or not representative of the population	<ul style="list-style-type: none"> Testing was biased towards one revenue stream despite the PIE having multiple performance obligations with different controls and processes. Relying solely on the client's own documentation or listings as audit evidence, without firstly verifying the reliability of those listings.
Failure to design appropriate procedures to achieve the test objective, and/or to perform suitable alternative procedures when necessary	<ul style="list-style-type: none"> Planned audit procedures were not completed on selected samples without further explanation and investigations by the auditors. Insufficient samples tested arising from irrelevant key controls identified and relied upon.
Failure to investigate the nature and cause of any deviations to the population	<ul style="list-style-type: none"> Discrepancies in testing were limited to 'Not Applicable' without any further explanation or follow-up.

ACCOUNTING ESTIMATES

Over the years, there have been notable deficiencies across elements of accounting estimates throughout the AOB's inspections. Significant findings arising from the valuation and impairment assessment of assets remained as the top common findings across the inspected firms, particularly in addressing the valuation of goodwill on consolidation and intangible assets.

Common Areas with Findings on Accounting Estimates



The common inspection findings observed are as follows:

- Assessment on key assumptions used to determine recoverable amount
- Identification of assets with indication of impairment and the impairment assessment
- Challenging the work of an expert
- Inclusion of terminal value in cash flow projection for assets with finite useful life
- Determination of cash-generating unit (CGU) to which an asset belongs

BACK TO BASICS: DOCUMENTATION AS KEY AUDIT EVIDENCE

The AOB does not question the judgement of audit partners, but the appropriateness and sufficiency of audit evidence obtained to support an audit partner's judgement. All auditors should approach the audit of financial statements with the necessary degree of professional scepticism.

Even though firms often cite a lack of audit documentation as the reason for audit deficiencies, the underlying cause of audit findings can be attributed to a shortfall in the audit evidence obtained and retained by auditors. Auditors are expected to assess the audit evidence before placing reliance on them, failing which the auditors may not have a basis to support their opinion.

To be able to effectively evaluate and challenge the audit evidence obtained, the auditor must possess a thorough understanding of the PIE's business and the industry of which the PIE operates including certain complex and complicated business transactions and arrangements. Therefore, the understanding and cumulative knowledge obtained must be adequately recorded in the audit working papers.



ACs and auditors have to continuously work hand-in-hand in sharing cumulative knowledge of PIE's business, including but not limited to new complex business arrangements and transactions.

BACK TO BASICS: STRENGTHENING CRITICAL PROCEDURES

The AOB observed continuous significant findings on certain common key areas over the years. Firms are reminded to reassess their focus areas and continuously refine and recalibrate their efforts in addressing basic procedures that could have been easily overlooked. Examples of critical procedures to focus on are as follows.

COMMON AREA OF FINDINGS	CRITICAL PROCEDURES FOR CONSIDERATION
Sampling	<ul style="list-style-type: none"> • Understand the complexity of the PIE's business and align the intended objective of the procedures to be performed. • Perform thorough risk assessment via team brainstorming session or use of data analytic tools to identify heightened risk areas. • Design additional procedures to support pre-existing procedures for heightened risk identified. • Validate the basis and rationale of sample size and selection where each sampling unit had an equal chance to be selected, unbiased and representative of the entire population. • Evaluate the appropriateness and reliability of PIE's document used as audit evidence. • Investigate the exception noted from test performed for instance, the material differences on reconciliation, no confirmation replies and incomplete supporting documents.
Accounting estimates	<ul style="list-style-type: none"> • Ensure early planning and timely discussions with management. • Assess the risk by focusing on the key assumptions that are more significant to the PIE's business. • Challenge the extent and quality of disclosures particularly where the assumptions are highly subjective. • Encourage a culture of professional scepticism which emphasises on consultation as and when in doubt. • Use effective internal and external specialists to review complex financial models. • Analyse linkage between key inputs, historical results and other macroeconomic factors to challenge optimistic future projections. • Assess thoroughly the terms and conditions of agreements that may lead to modifications to the structure of transaction.
Revenue recognition	<ul style="list-style-type: none"> • Obtain an understanding on the PIE's controls and processes surrounding revenue recognition by performing assessment on contractual terms between customers/projects. • Verify transactions to appropriate evidence which indicates satisfaction of performance obligation rather than internally generated documents. • Assess the appropriateness and sufficiency of the PIE's disclosure in the notes to the financial statements. • Stay vigilant for red flags throughout the audit and ascertain that the entire test results meet the audit objective.
Fraud procedures	<ul style="list-style-type: none"> • Design specific procedures to address heightened risk of management override of controls in addition to the generic preexisting procedures. • Design specific procedures to understand the control and process surrounding the journal entries posting which include posting of unusual journal entries and adjustment, whether journals were appropriately supported, reviewed and authorised. • Perform surprise cash count/ surprise audit for cash intensive business. • Apply professional scepticism throughout the audit process. • Rotate audit staff and assign independent reviewers to perform periodic checks without advance notice to avoid complacency.

COMMON AREA OF FINDINGS	CRITICAL PROCEDURES FOR CONSIDERATION
Inventory Procedures	<ul style="list-style-type: none"> • Gain a comprehensive understanding of the PIE's industry which include the nature of inventories, any reliance on experts for the valuation of inventories, business model and inventory management practices. • Assess work performed by experts for valuation of inventories thoroughly if there is any involvement of expert work, including the assessment of the competency of the expert and nature, timing and extent of work performed by expert. • Assess the appropriateness and reliability of sources used as valuation of inventories for the net realisable value test of inventory.

Sufficiency of audit procedures carried out contributes to quality of audit. Therefore, firms need to ensure that robust audit procedures are performed in achieving the objective of the audit.

The AOB acknowledges the issue of lack of resources and talent retention as one of the main challenges faced by the auditing profession. Nonetheless, quality of audit work needs to be upheld, notwithstanding the limitation of talent constraint.

All members of the audit engagement team needs to play their respective roles effectively. Audit partners should actively share cumulative knowledge and experience with staff to further boost learning capabilities, ease the steep learning curve in today's increasingly complex environment and better prepare for challenges ahead.

Firms must emphasise a culture of sharing of quality review findings with all audit staff. This practice increases the level of awareness and understanding and improves the level of audit quality throughout the firm on a consistent basis.

UNCOVERING FINANCIAL INSIGHTS THROUGH DATA ANALYTICS

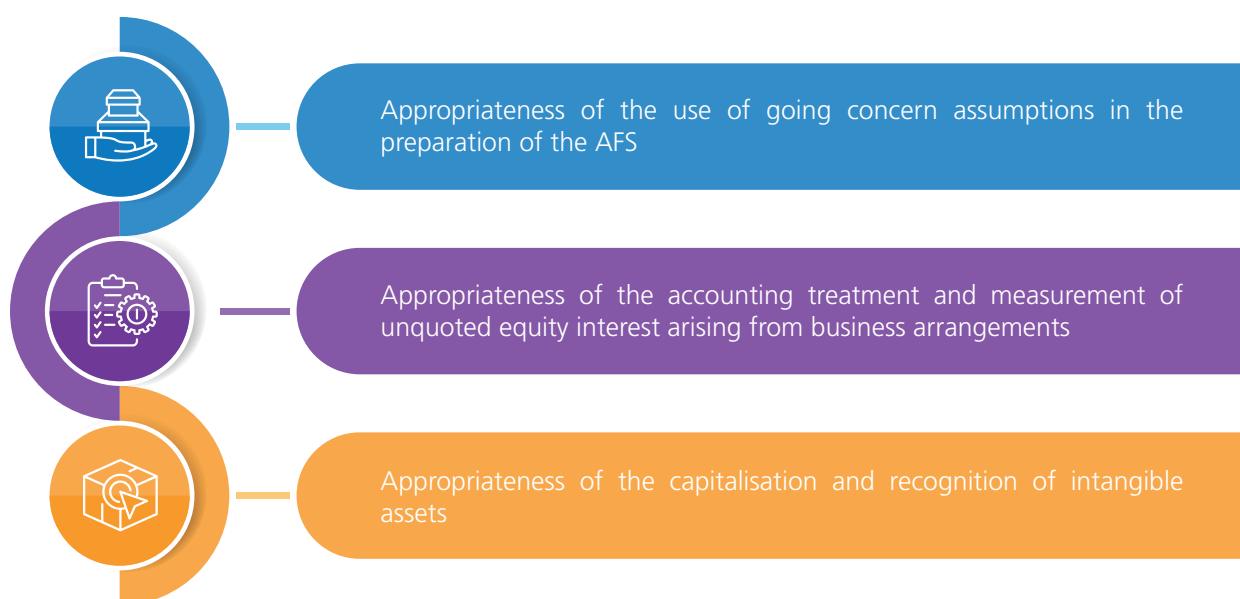
In this ever-changing landscape of auditing, the integration of data analytics in the AOB's overall inspection process has transformed its traditional inspection approach and processes.

By leveraging data analytics tools and techniques, the AOB is able to delve into PLCs' financial information, trends, and anomalies, providing an insight into potential areas of concerns which need to be appropriately addressed by the auditors.

In 2023, thematic inspections conducted based on the inputs provided by the data analytics tool resulted in the following observations in Diagram 1.

DIAGRAM 1:

Analysis of findings from data analytics



One of the findings identified from the AOB's data analytics tool is the going concern assumptions used in the preparation of AFS. The AOB is able to pinpoint various financial and non-financial data that may suggest potential doubt on the PLC's ability to continue as a going concern. Inspections are planned and tailored accordingly to review the robustness of the assessment performed by auditors in evaluating the management's own plans to support the going concern assumptions.

The following case study aims to provide some insights into the assessment and approach taken in evaluating management's going concern assessment.

CASE STUDY 1

Monetisation of assets/properties

BACKGROUND

PLC A is an investment holding company, with its core business in property development.

Due to rapidly changing economics and stiff competition in the market, growth in the PLC A's real estate segment had been sluggish. The rising cost of labour and raw material prices further aggravated PLC A's overall financial performance.

Financial performance of PLC A from FYE 2020 to FYE 2022:

	2020 RM' million	2021 RM' million	2022 RM' million
(Loss)/Profit before tax	(17.6)	(8.6)	5.4
Net current liabilities	(50.1)	(30.9)	(18.4)
Operating cash (outflows)/inflows	(3.1)	0.1	2.4
Audit opinion issued	Material uncertainty related to going concern	Material uncertainty related to going concern	Unmodified opinion

Despite having recorded a net current liabilities (NCL) position of RM18.4 million in 2022, the financial statements had been prepared on a going concern basis where Firm A expressed an unmodified audit opinion for the financial year ended (FYE) 30 June 2022.

In assessing the management's assumption, the procedures performed by Firm A primarily focused on the feasibility of management's plan to monetise its non-core assets or properties to reduce or eliminate the Group's NCL position as follows:

Monetisation of assets

Reviewed the ownership title to identify any caveats or covenants that could restrict the disposal transactions in the agreements, or any encumbrances against the properties/assets



Evaluated the feasibility and marketability of the properties or assets that PLC A plan to dispose - any active marketing and on-going negotiation with potential buyers



Performed subsequent events review - Follow up with management on the status of disposal in ensuring the action plan are aligned with the managements's plan

The assessment of management's use of going concern in the preparation of AFS was further highlighted by Firm A in its auditor's report. The completion of disposal of properties with proceeds received amounting to RM55.3 million and gain on disposal of the properties amounting to RM20.4 million were disclosed in the notes to the financial statement as a 'Subsequent Event'.



Management typically demonstrate a historical track record of raising funds for working capital i.e. restructuring or monetisation of certain assets/non-core business and negotiating repayment terms with creditors/bankers. However, leveraging on historic track records alone may not be sufficient to support the overall going concern assessment. It is imperative that auditors consider and assess the impact of other external factors that could affect the timing and probability of the expected cash flows.

During challenging economic times, the conditions that triggered the potential material uncertainties and the management's assessment to mitigate the possible effect arising from the material uncertainties can evolve over time.

Auditors are reminded to ensure that AFS provides the stakeholders with the relevant disclosure on financial and non-financial information, clearly describing how the management intends to alleviate or mitigate the possible effect arises from material uncertainties.

On the other hand, as part of the management's plan in evaluating an entity's going concern assumption, it is not unusual for PLCs to rely on financial support letters or letters of undertaking from key shareholders or related parties. Assessing the counterparties' financial capabilities to provide continuous funding is one of the common audit procedures that are often performed by auditors in concluding the appropriateness of the going concern assumption. The commitment to provide financial support or undertaking should be in written form by the counterparties to the PLC.

The case study below provides an overview of the financial commitment provided by shareholders or related parties that is integral to the management's going concern assessment in mitigating the possible effect of material uncertainties:

CASE STUDY 2

Financial support letters / Undertaking

BACKGROUND

PLC B is involved in the manufacturing and trading of healthcare related products. As at FYE 31 December 2022, the following going concern indicators were noted:



The financial statements of PLC B have been prepared on a going concern basis based on the following considerations:

- The Group had carried out a 12-month cash flow forecast and are satisfied that the entity has adequate liquidity to manage its working capital and meeting its financial obligations;
- The Group are able to draw and roll-over their current available credit facilities to fund the operations;
- The Group own unencumbered properties, of which the Group will monetise these properties when the opportunities arise; and
- The Group have obtained the continuous financial support from its key shareholder to provide the necessary financial assistance to continue the entity as a going concern.

It was highlighted that the going concern assessment by the management was mainly premised on the fundings and continuous financial support provided by its key shareholder. The financial support letter included a caveat that does not guarantee financial funding will be provided. This may be construed as not providing a constructive obligation by the key shareholder.

Despite the above, Firm B did not seek additional evidence surrounding the intent and ability of the counterparty to provide such financial support.

WHAT SHOULD AUDITORS CONSIDER?

- Consider the intent and financial capability of the counterparties providing the financial support to ensure that they are in the position to provide such support.
- Consider the enforceability of the letter and seek clarification should there be any ambiguity in the wording of the financial support letter.
- Consider obtaining other evidence such as the key shareholder's or related parties' board resolution, to support the counterparties' consent to provide financial support.
- Consider the historical track record of the fundings received from the counterparties, and perform subsequent events review to ensure such financial support had in fact, been provided subsequently.
- Consider the timing and period of support provided, the financial support letter should have at least a minimum period of 12 months from the end of the reporting period.

Audit procedures should be planned and tailored to ensure the audit of the going concern assumption has been effectively and adequately dealt with.



The auditor's responsibility is to evaluate whether sufficient appropriate audit evidence has been obtained and conclude on the appropriateness of management's use of going concern assumption in the preparation of AFS.

In circumstances where the PLCs have one or more conditions or events that triggered the potential doubts on material uncertainties, the auditors could encounter difficulties in trying to evaluate the reasonableness of the management's assumptions applied in the going concern assessment.

In such cases, the absence of a detailed going concern assessment performed by the management could potentially deter the auditor from concluding the appropriateness of the use of going concern assumption in the preparation of AFS. The AOB wishes to reiterate that it is management's responsibility to evaluate the PLC's ability to continue as a going concern and not the responsibility of auditors.

KEY AUDIT MATTERS: PITFALLS OF GENERIC DISCLOSURES

Firms must consider the most appropriate and relevant Key Audit Matters (KAMs) and move away from 'one size fits all' reporting. KAM disclosure is a reporting tool to indicate quality of audit services by auditors. Failure to highlight the appropriate risks and their subsequent audit responses may give the wrong signal to the market as users rely on this information to make informed decisions.

To prevent misrepresentation in the auditor's reports it is important that firms emphasise the importance of specific communication of KAMs tailored to the related PIEs.

Best practice to disclose KAM:

- Specific and detailed descriptions of the nature of the risks tailored to the PIE and its industry.
- Revisit significant and complex areas, particularly where considerable audit efforts were directed to address the risks.
- Conclusions as part of audit responses in addressing significant risks.

GOING CONCERN AS A KEY AUDIT MATTER

Going concern was frequently highlighted as a KAM for PIEs that have adverse financial indicators such as continued net losses and NCLs. Similar to impairment assessments, common audit responses to address this risk include–

- evaluations of management's analysis of the cash flow forecasts for the next 12 months;
- ensure that the PIEs are able to generate sufficient operating cash flows; and
- thorough assessment on the PIE's repayment obligations.



The going concern risk needs to be critically assessed and sufficiently addressed especially in 'close-call' cases as it may easily fall into a situation that of material uncertainty related to going concern.

Although there are no existing *International Standards on Auditing* (ISA) requirements to conclude on KAMs, firms are encouraged to share and disclose the rationale in concluding that the use of the going concern assumption is appropriate for greater transparency, particularly in addressing 'close-call' situations.

BOILERPLATE REPORTING

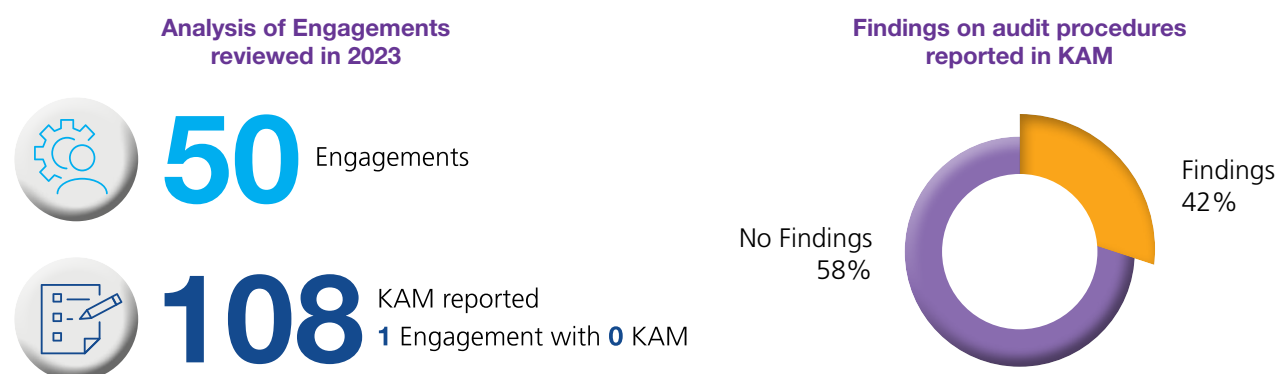
Based on the AOB's recent inspections, firms tend to use generic templates in communicating KAMs. This generic reporting diminishes the uniqueness and meaningfulness of the auditor's work, as it may not accurately capture the actual work performed to address the key areas being highlighted.

It was observed that material and significant risk areas were not being reported as KAMs, despite the significant audit effort having been carried out to address the risk areas. There were instances where the PIE entered into new and complex transactions during the year which were significant and complex but were not highlighted as a KAM.

There are concerns surrounding the use of boilerplate reporting where the information was too generic and was not adequately specific to the risk faced by the PIE. Inappropriate audit responses may not address the actual risk and could potentially mislead TCWG. Given the importance of KAMs, ACs should play an important role to obtain in-depth understanding and challenge, if necessary, the KAMs presented by auditors.

AUDIT RESPONSES

Another important element of KAMs was the audit responses in addressing the risks communicated in the audit report. The disclosure of audit procedures provides additional assurance to the users that these significant risks are properly audited and increases confidence in the auditor's report issued.

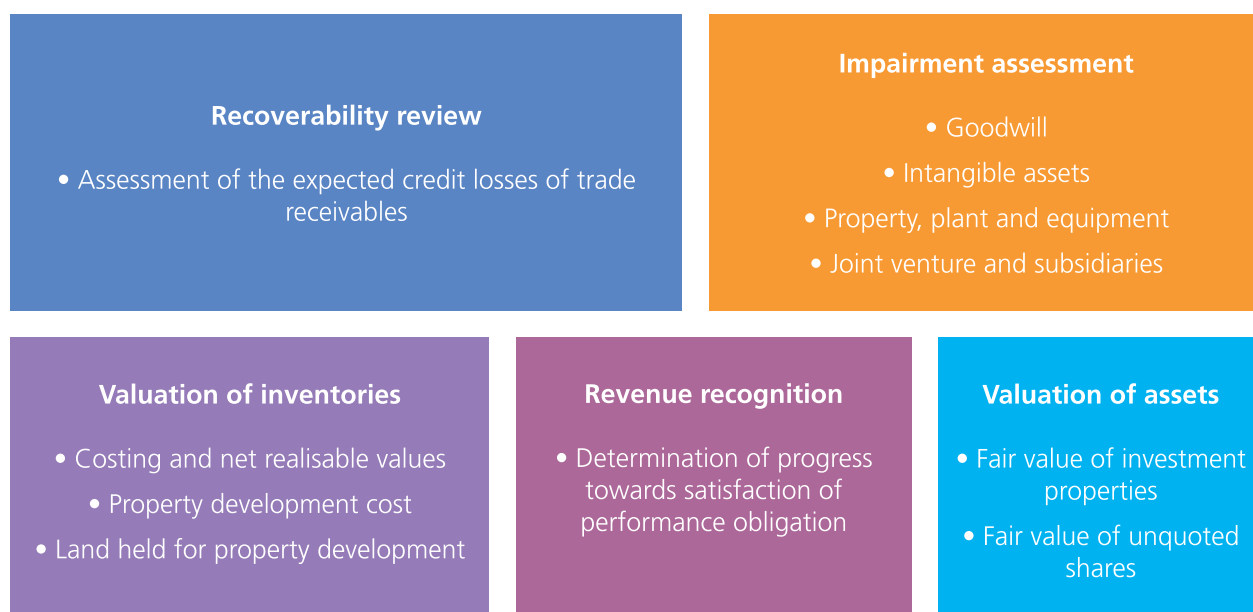


The charts above indicate that while firms may have sufficiently identified and communicated key audit areas of PIEs, the audit responses were not explicitly performed to address the risk arising from these areas. The AOB observed the findings mainly resulted from insufficient assessment on the key assumptions used by management in determining the impairment of assets and recoverability of receivables. The lack of understanding in the management's control and processes have also contributed to the findings raised by the AOB.

COMMON KAMS REPORTED FOR INSPECTED ENGAGEMENTS

Based on 50 engagements inspected in 2023, the AOB observed the commonly reported KAMs are as follows.

Analysis of Top 5 Common KAMs



REMEDIATION EFFECTIVENESS AND ROOT CAUSE ANALYSIS

REMEDIATION OF INSPECTION FINDINGS

The remediation process enables appropriate remedial actions to be taken on a timely basis to respond to identified deficiencies. A firm's remedial actions may be viewed as ineffective if there are recurring findings. Monitoring and remediation process includes:



In 2023, 14 out of 15 firms inspected by the AOB were reinspected firms. The chart below highlights a 5-year trend of reinspected firms with the number recurring findings identified.

Chart 1:

Re-inspected audit firms with recurring findings (2019 – 2023)



The recurring findings in 2023 were in the following areas:

- Assessment of the terms and conditions of contracts with regards to MFRS 15 *Revenue from Contracts with Customers*.
- Risk assessment process in assessing the risk of material misstatement and accounting estimates.
- Testing the recording/posting of interest computation to the ledger.
- Review of journal entries.
- Review of related party transactions.
- Review of KAMs.



An effective root cause analysis is important to remediate findings in a sustainable manner. Although efforts taken by firms such as training and resources reallocation seems to be a common remediation approach, these action plans might not be adequate as there are still recurring findings. Performance of a proper root cause analysis is crucial to understand the actual reason for such findings and only then an appropriate remediation can be conducted to prevent recurring findings.

COMMON ROOT CAUSES OF FINDINGS

Performing a root cause analysis is essential to investigate the root causes of identified deficiencies and to appropriately remediate them.

In addition, firms are also highly encouraged to investigate the root causes of positive outcomes to identify opportunities for further improvement and enhancement of the system of quality management.

In the AOB's inspection across firms over the years, the common root causes of findings observed by the AOB are firms falling short in the following areas:



Rigour of review by the Engagement Partner in challenging key areas of judgement and estimations and ensuring sufficiency and appropriateness of audit evidences



Rigour of assessment and challenge by the engagement team over management's estimates and judgement



Ineffective review and challenge by the EQR in key areas of judgement and estimations



Scepticism applied during the audit execution



Lack of understanding and bias interpretation of the standards and requirements



Industry / technical knowledge in the execution of the audit



Reliance on management's representation with insufficient procedures performed to corroborate the representation

The monitoring and remediation process enables proactive steps to be taken and continuous improvement of engagement quality and the system of quality management. Prompt identification of deficiencies enables timely remediation in an effective manner and contributes to a culture of continual improvement.



Audit firms to emphasise:

- Exercise of professional scepticism in audits
- Timely involvement of engagement partner and importance of an effective EQR role
- Proper assignment of EQR which takes into consideration the risk, nature and complexity of audit engagement
- Continuous communication to personnel on the importance of quality in addressing deficiencies noted and remedial actions

IMPACTFUL ENFORCEMENT OUTCOME



The primary goals of the AOB's enforcement action are to hold auditors accountable for their work and impose sanctions against those who breach the relevant laws and regulations.

The AOB is mindful that for its enforcement actions to be an effective deterrence and to mitigate the risk to the capital market, actions need to be completed in a timely manner. However, sufficient appropriate time should be given to the AOB to ensure that the enforcement processes are robust, fair and withstand challenges.

The enforcement actions have an impact on the reputation and professional lives of auditors. As such, in accordance with the principles of natural justice and due process, auditors are provided with numerous opportunities to defend their position.

Typically, information on ongoing enforcement proceedings are not shared publicly until the conclusion of the proceedings. This is to avoid any premature conclusion by any third party and unintended consequences to the auditors.



SHAPING THE FINANCIAL REPORTING ECOSYSTEM

IMPACT OF CLIMATE CHANGE ON FINANCIAL REPORTING

REPORTING ON SUSTAINABILITY AND CLIMATE CHANGE

The United Nations Environment Programme's *Corporate Sustainability Reporting Toolkit* reports that companies have been reporting on their commitments towards the development of sustainable businesses to both internal and external stakeholders since the 1960s. Its relevance gained traction in the early 1990s stemmed from increasing greenhouse gases and other environmental and societal concerns. Sustainability reporting provides a perceptive narrative to investors and other stakeholders on the impact of a company's activities on the environment, society, and the economy as well as reporting on their progress towards achieving various sustainability targets.

In addressing the increasing need and demand for standardisation in sustainability reporting to enable consistency and comparability of information, the International Sustainability Standards Board (ISSB) released its inaugural sustainability standards in June 2023, specifically:

- the *International Financial Reporting Standards (IFRS) S1 General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1); and
- *IFRS S2 Climate-related Disclosures* (IFRS S2).

These standards act as a global baseline for disclosures of sustainability-related and climate-related risks and opportunities.



In the March 2024 issue of the AOB Alert to Audit Committees and Auditors on the 'Impact of Climate-Related Risks on Financial Reporting on Public-Interest Entities', the AOB highlighted key focus areas for PIE directors and auditors in discharging their responsibilities with regards to sustainability and/or climate-related financial reporting.



[Read the AOB Alert](#)

SUSTAINABILITY ASSURANCE REPORTING

The risk of greenwashing is heightened when companies are incentivised to provide favourable and impactful disclosures. Sustainability assurance is therefore essential in ascertaining transparency and robustness of disclosures in accordance with required sustainability standards.

Benefits of sustainability reporting for companies



- Measure performance and progress towards achieving sustainability metrics and targets.
- Benchmarking or differentiating business against peers/competitors.
- Improve reputation and increase trust.
- Provide information to internal and external stakeholders to attract capital/investment.

The existing assurance standards recognised in Malaysia (at the time of writing) are the International Standard on Assurance Engagement (ISAE) 3000 and International Organization for Standardization (ISO) Standards. Based on these standards, limited or reasonable assurance can be provided by either professional accountants or non-accountant assurance practitioners. In the current market practice, sustainability report assurances are only provided on certain metrics and sustainability information deemed material and important for stakeholders, which may vary for different companies. It is crucial for the assurance process on sustainability reporting to be consistent and efficient across the market.

The International Auditing and Assurance Standards Board (IAASB) is currently developing a profession-agnostic sustainability assurance standards, the International Standards on Sustainability Assurance (ISSA) 5000 *General Requirements for Sustainability Assurance Engagements*. The ISSA 5000 is projected to be a comprehensive standard suitable for any sustainability assurance engagement.

NATIONAL SUSTAINABILITY REPORTING FRAMEWORK

The Securities Commission Malaysia (SC), with endorsement from the Ministry of Finance, has set up a national level Advisory Committee on Sustainability Reporting (ACSR). This inter-agency committee is tasked to identify the enablers that will facilitate the use of the standards issued by the ISSB, specifically the IFRS S1 and IFRS S2 in Malaysia. The ACSR's responsibilities also include identifying other supporting elements that need to be in place including a framework for assurance and capacity building, collectively constituting the National Sustainability Reporting Framework (NSRF).

The ACSR issued a consultation paper on the NSRF in February 2024 to seek public feedback on the proposed use of the sustainability disclosure standards issued by the ISSB. The consultation paper aims to understand investors' expectations, assess the reporting-readiness of preparers as well as understand the wider industry needs and challenges.

Feedback was sought from preparers in listed companies, large non-listed companies, mid-tier and small-medium enterprises as well as information users including investors, rating agencies, interested organisations and those providing assurance services. Understanding the perspectives of these stakeholders is crucial in ensuring an inclusive consultation process.

The consultation paper aims to seek feedback on the following to inform the NSRF–

- (a) the use and application of IFRS S1 and IFRS S2, including the required transition reliefs;
- (b) the approach in relation to a sustainability assurance framework; and
- (c) enablers and/or support required for (a) and (b).

“As the sustainable assurance realm is still evolving in Malaysia, Directors and assurance providers need to remain agile while keeping abreast with the developments in the sustainability space to better execute their respective roles”

Moving forward, the AOB will continue to engage with relevant stakeholders to create awareness on sustainability reporting assurance requirements and any initiatives, including capacity building, undertaken to drive adoption and successful implementation of the NSRF.

PROMOTING EFFECTIVE OVERSIGHT OF AUDITORS AND THE AUDIT PROCESS

ACs play an important role in the financial reporting process through their oversight of financial reporting and the audit process. Effective oversight by knowledgeable and independent ACs is a powerful market force to enhance audit quality. Recognising this, the AOB has made efforts to ensure that ACs are adequately informed and equipped with relevant information to effectively carry out their oversight responsibilities over auditors and the audit process.

The AOB has maintained ongoing dialogues through its Annual Conversation with ACs. The annual sessions provided valuable insights on the financial reporting ecosystem which has assisted the AOB to develop oversight activities. In 2023, the session with ACs focused on discussions on how climate-related matters are affecting the financial statements of PLCs and their impact on financials. ACs were reminded to ensure that there are adequate governance structures in place to monitor climate-related matters and engage management and auditors in a timely manner.

Over the years, the AOB has worked on developing and sharing information with ACs. The AOB continues to share the AIR with ACs and have recently embarked on providing more targeted information via the AOB Alert to ACs.

The AOB Alert which is available on the SC's website aim to provide the ACs with regular updates on the matters affecting the financial reporting and audit quality matters.

KEY TAKEAWAYS FOR ACs



Stakeholder Expectations: ACs are encouraged to acknowledge heightened stakeholder expectations on climate-related matters and strive for regular updates to the financial statements to align with evolving sustainability commitments while ensuring consistency with external information.



Comprehensive Understanding of Climate Risks: ACs should develop a robust understanding of risks. This includes acknowledging the shift to a lower-carbon global economy.



Potential Impact on Financial Statements: ACs need to be wary of the potential ripple effect of climate-related risks impact on the financial statements, such as challenges in compliance, complexities in adoption of green technologies and supply chain disruptions.



Engagement with External Auditors: ACs are encouraged to actively engage in discussions with external auditors and have a collaborative approach to enhance the credibility and reliability of disclosures on climate-related risks.

BOX ARTICLE 4

ENGAGEMENT WITH INSTITUTIONAL INVESTORS

High quality audits help to protect investors, enhance shareholders' confidence in the quality and reliability of the financial information, and enables efficient fundraising. Investors are a key player in the financial reporting ecosystem and by extension a key stakeholder for the AOB. Recognising the importance of engaging with key investor groups, the AOB participates as a member of the IFIAR's Investor and Other Stakeholders Working Group (IOSWG). Involvement in the IOSWG provides the AOB with an avenue to understand investors and other stakeholders' expectations of auditors and audit regulators.

Further to the AOB's involvement with IOSWG, the AOB organised an insightful session with members of the Institutional Investors Council on 23 November 2023. The session was attended by representatives of some of the largest institutional investors in Malaysia such as Employees' Provident Fund (EPF), Kumpulan Wang Persaraan (Diperbadankan) (KWAP), Lembaga Tabung Angkatan Tentera (LTAT) and Lembaga Tabung Haji. This engagement aimed to gain a deeper understanding of investors' perspectives on auditors and audit quality.

Investors expressed a high degree of reliance on auditors' work for their investment decisions due to limited access to internal documents. However, concerns were raised about the adequacy of KAM disclosures, especially for smaller companies which tends to be boilerplate. The importance of financial statement disclosures, such as accounting estimates like impairment, was emphasised.



Reliance on Auditors' Work: Investors expressed a high degree of reliance on auditors' work and reports, particularly since they often lack access to internal documents. Investors consider auditors' assessments crucial in their investment decision-making process.



Importance of KAM Disclosures: There were mixed opinions regarding the adequacy and usefulness of KAM disclosures in assisting investment decisions. While some investors appreciated thorough disclosures, others found them lacking, especially in smaller companies where KAMs might be overlooked.



Red Flags in Auditor Appointments: Investors flagged the appointment of smaller or inexperienced audit firms for larger companies as a potential red flag, emphasising the importance of audit firm competency and track record.



Impact of Sustainability Assurance: The discussion touched on the emerging trend of sustainability assurance. Investors recognised its importance, especially in the context of increasing global sustainability efforts, though challenges remain regarding the reliability and standardisation of sustainability assurance.

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FOCUS OF 2024

FOCUS OF 2024

The 2024 focus areas have been identified after considering overall business risks and the current operating environment.



Firm level review

In assessing compliance with ISQM, the AOB will move into Phase 2 where assessment on the operating effectiveness of firms' system of quality management will commence. Firms are reminded to ensure–

- periodic risk assessment is being carried out in making sure that the risk register remains relevant and that adequate controls are in place to address the risks;
- monitoring programme of the firms with sufficient resources allocated; and
- sufficient documentation is maintained to substantiate effective operation of the system of quality management and to facilitate monitoring reviews.



Engagement level review

Continuous improvement has been made to the AOB's inspection programme by incorporating a data-driven and risk-based approach. Beyond the usual focus on riskier engagements and significantly judgemental areas, the AOB will emphasise on–

- audit areas with recurring significant engagement findings such as accounting estimates; and
- companies in industries related to the financial sector and financial institutions.



Capacity-building initiatives

As in previous years, the AOB will continue to collaborate with the local professional body, The Malaysian Institute of Certified Public Accountants (MICPA) to develop a series of training programmes to further improve audit quality. These training programmes focus on addressing common areas of audit weaknesses noted by the AOB during its inspection of firms and auditors. In 2024, accounting estimates and valuation will be the areas of focus for capacity building.

The AOB is currently exploring new avenues to further enhance capacity building efforts via active engagement with fellow local and global regulators, professional accountancy bodies and other stakeholders.

APPENDIX

APPENDIX

AUDIT QUALITY INDICATORS STATISTICS FOR THE MAJOR AUDIT FIRMS

AQIs	2023	2022	2021
Workload of the PIE audit partner			
Average number of PIE audit clients per partner	5	5	5
Average number of entities related to PIE audit clients per partner Note: Entities related to PIE audit clients are non-PIEs within the PIE Group, which are audited by Malaysian firms. Examples include, but are not limited to, subsidiaries and associates of PIEs.	55	55	59
Average number of non-PIE audit clients per partner	97	109	118
Auditor's independence			
Average proportion of fee income derived from the:			
a) Audit practice	49%	48%	49%
b) Non-audit practice	51%	52%	51%
Average proportion of fee income derived from audit clients segregated by:			
a) Statutory audit	73%	73%	72%
b) Other assurance services	8%	8%	9%
c) Services provided by non-audit practices	19%	19%	19%
Capacity and competence of the audit practice			
Average composition of audit personnel:			
a) Audit partners	5%	5%	4%
b) Managerial staff	15%	15%	18%
c) Non-managerial staff	80%	80%	78%
Average years of audit experience of the audit personnel:	Years	Years	Years
a) Audit partners	24	23	23
b) Managerial staff	10	10	10
c) Non-managerial staff	2	2	2
Professional qualifications of the audit personnel:			
a) Average percentage of personnel with professional qualifications and/or MIA membership	21%	20%	23%
b) Average percentage of personnel who are pursuing professional qualifications and/or MIA membership	65%	65%	66%
c) Average percentage of personnel without professional qualifications and/or MIA membership	14%	15%	11%
Average staff turnover rate	24%	33%	27%
Audit engagement supervision			
Average staff-to-partner ratio	25	23	24
Average staff-to-manager ratio	6	6	5
Audit firm's investment to promote audit quality			
Average hours of training provided by the firms to audit personnel	Hours	Hours	Hours
(a) Partners	84	77	75
(b) Managerial staff	86	75	83
(c) Non-managerial staff	79	74	78
Average ratio of audit staff to one quality control staff Note: Quality control staff are involved in risk management, technical consultations, training and quality assurance functions of the firms either on full-time or part-time basis.	43	39	44

Note: The AQI statistics above are derived from information submitted by the Major Audit Firms based on their financial periods ended 2021, 2022 and 2023 respectively.

AUDIT QUALITY INDICATORS STATISTICS FOR OTHER AUDIT FIRMS

AQIs	2023	2022	2021
Workload of the PIE audit partner			
Average number of PIE audit clients per partner	3	3	3
Average number of entities related to PIE audit clients per partner Note: Entities related to PIE audit clients are non-PIEs within the PIE Group, which are audited by Malaysian firms. Examples include, but are not limited to, subsidiaries and associates of PIEs.	25	27	24
Average number of non-PIE audit clients per partner	134	146	125
Auditor's independence			
Average proportion of fee income derived from the:			
a) Audit practice	71%	70%	70%
b) Non-audit practice	29%	30%	30%
Average proportion of fee income derived from audit clients segregated by:			
a) Statutory audit	78%	78%	80%
b) Other assurance services	4%	4%	3%
c) Services provided by non-audit practices	18%	18%	17%
Capacity and competence of the audit practice			
Average composition of audit personnel:			
a) Audit partners	10%	13%	12%
b) Managerial staff	16%	16%	16%
c) Non-managerial staff	74%	71%	72%
Average years of audit experience of the audit personnel:	Years	Years	Years
a) Audit partners	22	24	24
b) Managerial staff	11	11	11
c) Non-managerial staff	2	2	2
Professional qualifications of the audit personnel:			
a) Average percentage of personnel with professional qualifications and/or MIA membership	34%	34%	35%
b) Average percentage of personnel who are pursuing professional qualifications and/or MIA membership	28%	30%	31%
c) Average percentage of personnel without professional qualifications and/or MIA membership	38%	36%	34%
Average staff turnover rate	25%	31%	24%
Audit engagement supervision			
Average staff-to-partner ratio	9	9	9
Average staff-to-manager ratio	5	5	5
Audit firm's investment to promote audit quality			
Average hours of training provided by the firms to audit personnel	Hours	Hours	Hours
(a) Partners	58	47	72
(b) Managerial staff	52	39	50
(c) Non-managerial staff	47	35	34
Average ratio of audit staff to one quality control staff Note: Quality control staff are involved in risk management, technical consultations, training and quality assurance functions of the firms either on full-time or part-time basis.	10	10	13

Note: The AQI statistics above are derived from the information submitted by the Other Audit Firms for annual periods ended 30 June 2021, 30 June 2022 and 30 June 2023 respectively.

DESCRIPTION OF THE AUDIT QUALITY INDICATORS

AUDIT QUALITY INDICATORS	DESCRIPTION
1. Workload of the PIE audit partner <ul style="list-style-type: none"> a) Average number of PIEs per partner; b) Average number of entities related to PIEs per partner; and c) Average number of non-PIEs per partner. 	<p>A partner's workload increases in tandem with the number of clients that the partner has to service. The heavier the workload, the lesser the amount of a partner would have to supervise the audit engagements.</p>
2. Auditor's independence <ul style="list-style-type: none"> a) Average proportion of fee income between audit practice and non-audit practice such as tax, corporate advisory and consulting; and b) Average proportion of fee income derived from audit clients segregated into statutory audit, other assurance services and services provided by the non-audit practice. 	<p>The multi-disciplinary model of firms has enabled these firms to provide both audit and assurance services as well as non-audit services to their audit clients.</p> <p>When the proportion of fees derived from the offering of non-audit services to audit clients is relatively higher than the audit fees, there is a risk that the provision of non-audit services by the firm to its audit clients could undermine auditors' independence.</p> <p>Further, when the proportion of fee income from the non-audit practice of the firm is relatively higher than the audit practice, this raises the concern that the firm's focus on audit quality may be overridden by their non-audit business considerations.</p>
3. Capacity and competence of the audit practice <ul style="list-style-type: none"> a) Average percentage of audit personnel with professional qualifications and who are pursuing professional qualifications; b) Average staff turnover rate for audit personnel; and c) Average years of experience of audit partners and audit staff. 	<p>These indicators would provide the ACs with an indication of the firm's ability to manage its talent pool, particularly in ensuring that the firm has sufficient and competent talent to carry out quality audits.</p> <p>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.</p> <p>As certain factors that drive these indicators are beyond the firm's control, it is also important for ACs to gain an understanding of the various mitigating actions taken by the firms to address capacity and competency issues.</p>
4. Audit engagement supervision <ul style="list-style-type: none"> a) Average staff-to-partner ratio; and b) Average staff-to-manager ratio. 	<p>These indicators provide an overview on whether the firm has sufficient partners and managerial staff to supervise less experienced audit team members.</p> <p>A lower ratio would imply that a partner or managerial staff could accord greater attention to supervise audit engagement teams.</p>

AUDIT QUALITY INDICATORS	DESCRIPTION
<p>5. Audit firm's investment to promote audit quality</p> <ul style="list-style-type: none"> a) Average hours of training provided by the audit firms to audit personnel; and b) Average ratio of audit staff to one quality control staff. 	<p>Training provided by the firm to audit personnel is important to ensure that they remain technically competent and kept up-to-date with the latest changes in accounting and auditing standards.</p> <p>In addition, audit quality is also promoted within the firm through various quality control functions comprising training, technical consultations, risk management and quality assurance.</p> <p>A higher ratio of headcount in quality control functions relative to audit personnel headcount would indicate greater firm commitment to allocate resources to support audit quality.</p>

