MALAYSIAN INSTITUTE
OF ACCOUNTANTS

The Audit Profession in Malaysia 2018

September 2018

About the Malaysian Institute of Accountants

Established under the Accountants Act 1967, MIA is the national accountancy body that regulates, develops, supports and enhances the integrity, status and interests of the profession in Malaysia. MIA accords the Chartered Accountant Malaysia or C.A. (M) designation to a professional in accountancy, business and finance with a recognised qualification and relevant work experience.

Working closely alongside businesses, MIA connects its membership to an unmatched range of information resources, events, professional development and networking opportunities. Presently, there are more than 35,500 members making their strides in businesses across all industries in Malaysia and around the world.

MIA's international outlook and connections are reflected in its membership of regional and international professional organisations such as the ASEAN Federation of Accountants (AFA), and the International Federation of Accountants (IFAC).

Purpose

To regulate and develop the accountancy profession to support economic growth and nation building

Vision

To be a globally recognised Professional Accountancy Organisation (PAO) in regulating and developing the profession for nation building

Values

Integrity, Mutual Respect & Teamwork, Professionalism, Accountability, Commitment, Trust, Sustainability

Strategic Objectives

1. Develop and enhance the competency of accountancy professionals to stay relevant to business and market demand
2. Nurture professional values and ethics of members to uphold a strong accountancy profession
3. Regulate and develop the practice of the accountancy profession consistent with global standards and best practices
4. Promote the value proposition of accountancy profession and continuously uplift global recognition

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Message

from Salihin Abang, President, Malaysian Institute of Accountants

On behalf of the Institute and the Council, I am delighted to pen a few words for the MIA Practice Review Report. The Practice Review is a key tool to help the Institute in assessing and strengthening the quality of our public practitioners, particularly the small and medium practitioners. Through the Practice Review, the Institute is able to drive capacity and competency building for public practitioners who are an important segment of our membership. This in turn helps the Institute to discharge and balance our dual roles of developing and regulating the profession to protect the public interest and raise the reputation of the Malaysian accountancy profession, and henceforth supports our purpose of nation building.

The Institute would like to thank all the key people, teams and stakeholders that contributed to this important report: the Practice Review Committee, the Small and Medium Practices Committee, the Public Practice Committee, our fellow regulators and professional accountancy organisations, the MIA management team and staff, our members in public practice and all our stakeholders.

Over the years, the Institute has been steadfast in our commitment to serve members in the audit profession through continuous education and strategic development initiatives such as the MIA SMP Roadmap 2015-2020, and the establishment of the dedicated MIA SMP Department. It is our hope that this Practice Review Report will be a complementary and useful tool in strengthening audit quality and furthering our quest to develop ethical and competent accountants who safeguard the public interest and uphold the profession's reputation.

Foreword

from Huang Shze Jiun, Chairman of Practice Review Committee

The increased emphasis on reliable financial reporting leads to greater scrutiny on the quality and reliability of auditing services. Never has the demand for capable accountants and auditors of impeccable integrity been higher or the risks greater. It is no exaggeration to say that the entire audit profession is on trial, hence it is imperative for the audit profession to return to its roots of competence, integrity and objectivity. Every profession is concerned about the quality of its services, and the public accounting profession in Malaysia is no exception. In order to ensure that the audits in Malaysia are conducted to a high level of quality, MIA established its Practice Review programme pursuant to the Council's Statement on Practice Review issued in 2002. This is to ensure that all members in public practice comply with all applicable professional standards, and legal and regulatory requirements in the performance of their audit work.

Practice review is important to establish a level playing field for all audit practitioners and thereby addresses one of the major underlying issues causing the low fees and high staff turnover among audit firms in Malaysia.

The process of practice review is set out in such a manner so as to be free from bias and enables all parties in the practice review process to carry out their duty without fear or favour. Practice review is not meant to be punitive, but neither can it be wholly educationally driven in order to achieve its objective.

However, this does not mean that the Institute has not actively worked to improve the audit quality of firms in Malaysia.

In order to build and promote awareness of these initiatives, this report has taken the stand of presenting a more holistic view by working with both the Small and Medium Practice Committee and Public Practice Committee in the preparation of this report and I wish to thank the Chairmen and members of both Committees for their generous contribution to this report, as well as the profession at large.

The aim is that in reading this report, practitioners will not only be made aware of the Practice Review process and common findings, but also the initiatives available to them to proactively improve their audit quality. In line with this, practitioners are reminded that explanations are no substitute for proper documentary evidence as the view taken is that if it is not documented, it is not done.

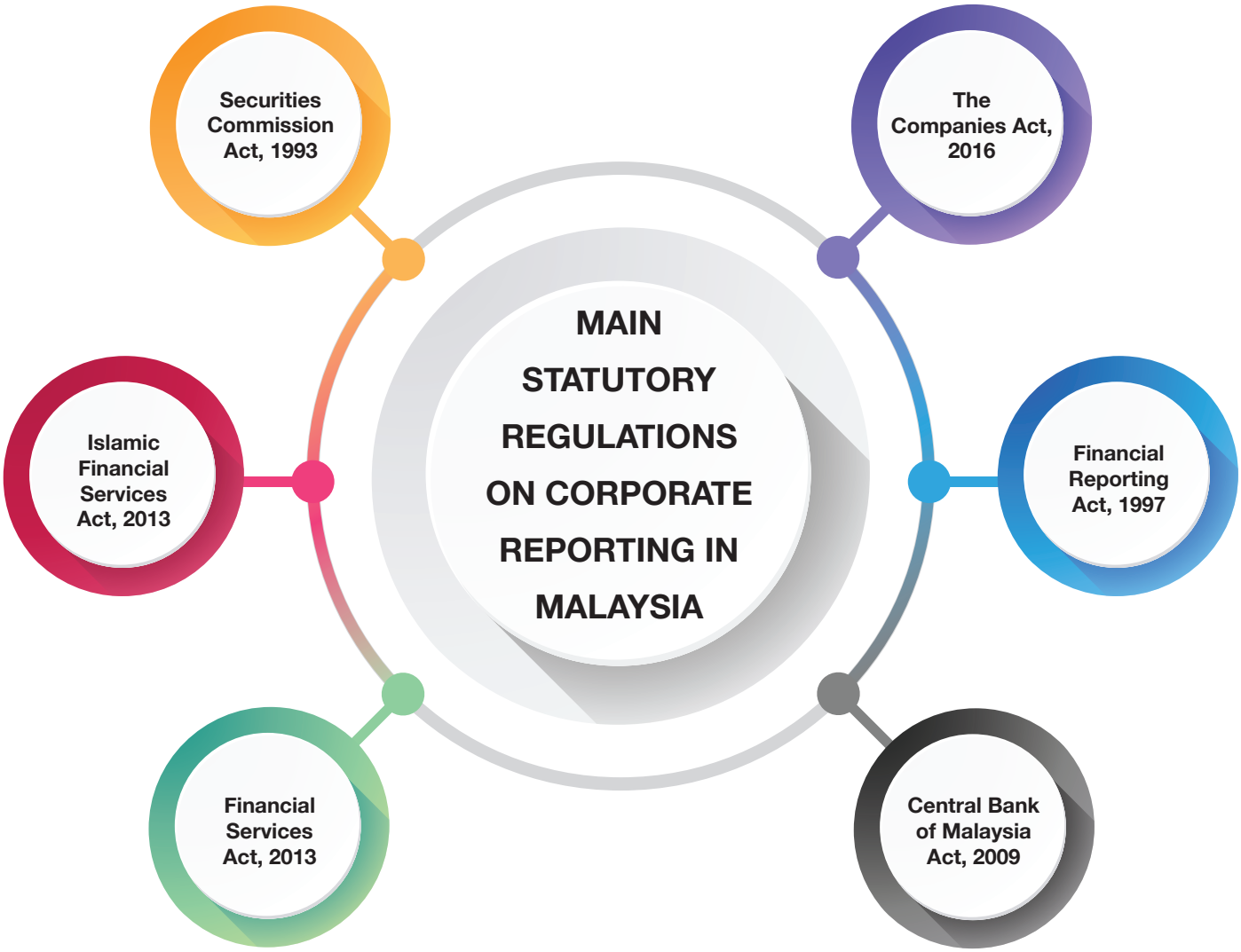
The targeted outcome from the above is for all audit firms to have a strong reputation for their competence, integrity, objectivity, coupled with a heightened understanding of the value of audit. Audit firms should understand that each and every one of them contributes to the profession's hard-earned reputation.

We belong to a proud profession with an on-going commitment to quality and a long history of continuous improvements. Therefore, each and every one of us is responsible for the public's reliance on the audit services provided and maintaining the relevance of the profession's work in the market place. We must bear in mind the Malay proverb *"Jangan kerana nila setitik, rosak susu sebelanga".*

In closing, I wish to thank the members of the Practice Review Committee for contributing their valuable time and expertise as well as the members of the Practice Review Department throughout the country for their unceasing dedication and commitment. While what we do is oftentimes a difficult task, however, it is an essential one. It is our duty to hold the line and defend the integrity of the profession.

1.0
The Audit Profession In Malaysia

1.1 Overview of the Regulatory Framework Governing the Preparation and Audit of Financial Statements



- The Companies Act 2016 (CA 2016) governs the incorporation of companies and sets requirements for companies to prepare financial statements and have them audited.

- The Act requires companies incorporated under the Act to have their financial statements audited in accordance with the Malaysian Approved Standards on Quality Control, Auditing, Review, Other Assurance and Related Services issued by the Auditing and Assurance Standard Board (AASB) of the Malaysian Institute of Accountants (MIA).

- Financial statements of companies under the law administrated by the Securities Commission of Malaysia, Bank Negara Malaysia and Suruhanjaya Syarikat Malaysia are required to be prepared in accordance with the approved accounting standards issued by the Malaysian Accounting Standards Board (MASB).

The Malaysian accounting and auditing profession is fairly mature with Malaysian accounting and auditing standards which are in line with international standards.

2010	2011	2012	2015	2018
The clarified International Standards on Auditing (ISAs) have been adopted in full and became effective for periods beginning on or after 1 January 2010, and the adopted International Standard on Quality Control (ISQC 1) became effective on 1 January 2010	The MIA-issued By-Laws on Professional Ethics, Conduct, and Practice are substantially based on the IFAC Code of Ethics for Professional Accountants and became effective on 1 January 2011	Convergence with International Financial Reporting Standards (IFRS) in 2012 *(except Property Development and Agriculture Industries)*	Malaysian Private Entities Reporting Standard (MPERS) became effective on 1 January 2015.	Full convergence with IFRS

1.2 Audit Quality Assurance Mechanisms in Malaysia

1. WHO can be appointed as an Auditor for a company?

- A person who has been approved under Section 263 of the Companies Act, 2016 as an approved company auditor; and
- Whose approval has not been revoked

2. WHO regulates the Audit Profession?

- Malaysian Institute of Accountants (MIA)
- Audit Oversight Board (AOB)
- Suruhanjaya Syarikat Malaysia (SSM)

3. WHAT is MIA's role?

Under Section 550 of the MIA By-laws (On Professional Ethics, Conduct and Practices), MIA is responsible for surveillance and enforcement of audit firms registered with MIA, through its Practice Review Framework. The Institute reports that its programme complies with the best practices outlined in Statements of Membership Obligations (SMO 1) and that it has adopted and published quality control standards requiring firms to implement a system of quality control in line with the ISQC 1. This framework is mandatory for all members of MIA.

4. WHAT is AOB's Role?

Under Part IIIA of the Securities Commission Act 1993 (SCA 1993), the AOB is responsible for conducting Quality Assurance (QA) reviews of audit firms that are registered with the AOB and audit PIEs. The AOB undertakes inspections, and takes action including sanctions, against audit firms and registered auditors for non-compliance with relevant auditing and ethical standards.

> **"Although the Audit Oversight Board (AOB) is entrusted to regulate auditors of public interest entities (PIEs), MIA is still empowered to carry out a practice review when the need arises."**

5. WHAT is SSM's Role?

The Corporate Accounts Monitoring Section of SSM is responsible for registration of audit firms, monitoring of changes in audit firms and approved company auditors, and monitoring the resignation and removal of auditors. SSM imposes sanctions on companies, directors and their auditors.

2 Broad Segments in Malaysia's Corporate Financial Reporting and Financial Statement Audits

PIE AUDIT

The AOB was established under Part IIIA of the Securities Commission Act Malaysia 1993 ("SCA") which came into force on 1 April 2010 to promote and develop an effective audit oversight framework and to promote confidence in the quality and reliability of audited financial statements in Malaysia. The AOB's mission is to oversee the auditors of public-interest entities (PIEs) and to protect the interests of investors by promoting confidence in the quality and reliability of audited financial statements of PIEs.

PIEs refer to those entities that are currently specified under Part 1 of Schedule 1 of the SCA.

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Part IIIA of the SCA provides that the AOB, in assisting the SC in discharging its audit oversight functions is responsible to-

- implement policies and programmes in ensuring an effective audit oversight system in Malaysia;
- register auditors of PIEs;
- direct the MIA to establish or adopt, or by way of both, the auditing and ethical standards to be applied by registered auditors;
- conduct inspections and monitor programmes on registered auditors to assess the degree of compliance with auditing and ethical standards; and
- conduct inquiries and impose appropriate sanctions against registered auditors who fail to comply with auditing and ethical standards.

NON PIE AUDIT

Prior to 31 January 2017, all public and private companies in Malaysia had a mandatory statutory audit requirement regardless of their size, ownership structure or whether they were operating actively. Small and medium practices serve the largest number of clients while partnerships with more than 10 partners have a larger economic footprint.

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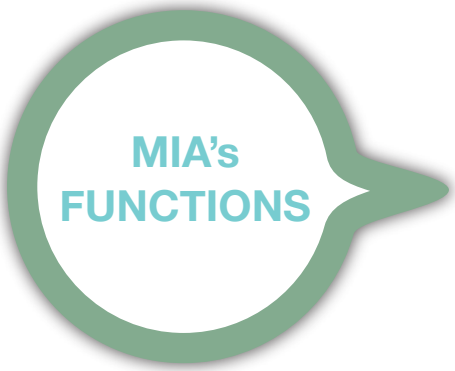
Effective from 31 January 2017, the Companies Act 2016 empowers the Registrar to exempt companies from performing a statutory audit. On 4 August 2017, the Registrar issued Practice Directive 3/2017 specifying the types of companies which qualify for audit exemption.

3 Types of Private Companies that Qualify for Audit Exemption, according to Practice Directive 3/2017

Category of private companies qualifying for audit exemption*	Incorporation date	Audit Exemption on financial statements with annual periods commencing on or after
Dormant	On or after 31 January 2017	31 January 2017
	On or before 30 January 2017	1 September 2017
Zero-revenue Companies	----	1 January 2018
Threshold-qualified Companies	----	1 July 2018

2.0
Balancing MIA's Dual Role



- To determine the qualifications of persons for admission as members;
- To provide for the training and education by the Institute or any other body, of persons practising or intending to practise the profession of accountancy;
- To regulate the practice of the profession of accountancy in Malaysia;
- To approve the MIA Qualifying Examination (QE) and to regulate and supervise the conduct of that Examination;
- To promote, in any manner it thinks fit, the interests of the accountancy profession in Malaysia;
- To render pecuniary or other assistance to members or their dependents as it thinks fit with a view to protecting or promoting the welfare of members; and
- Generally, to do such acts as it thinks fit for the purpose of achieving any of the aforesaid objectives.

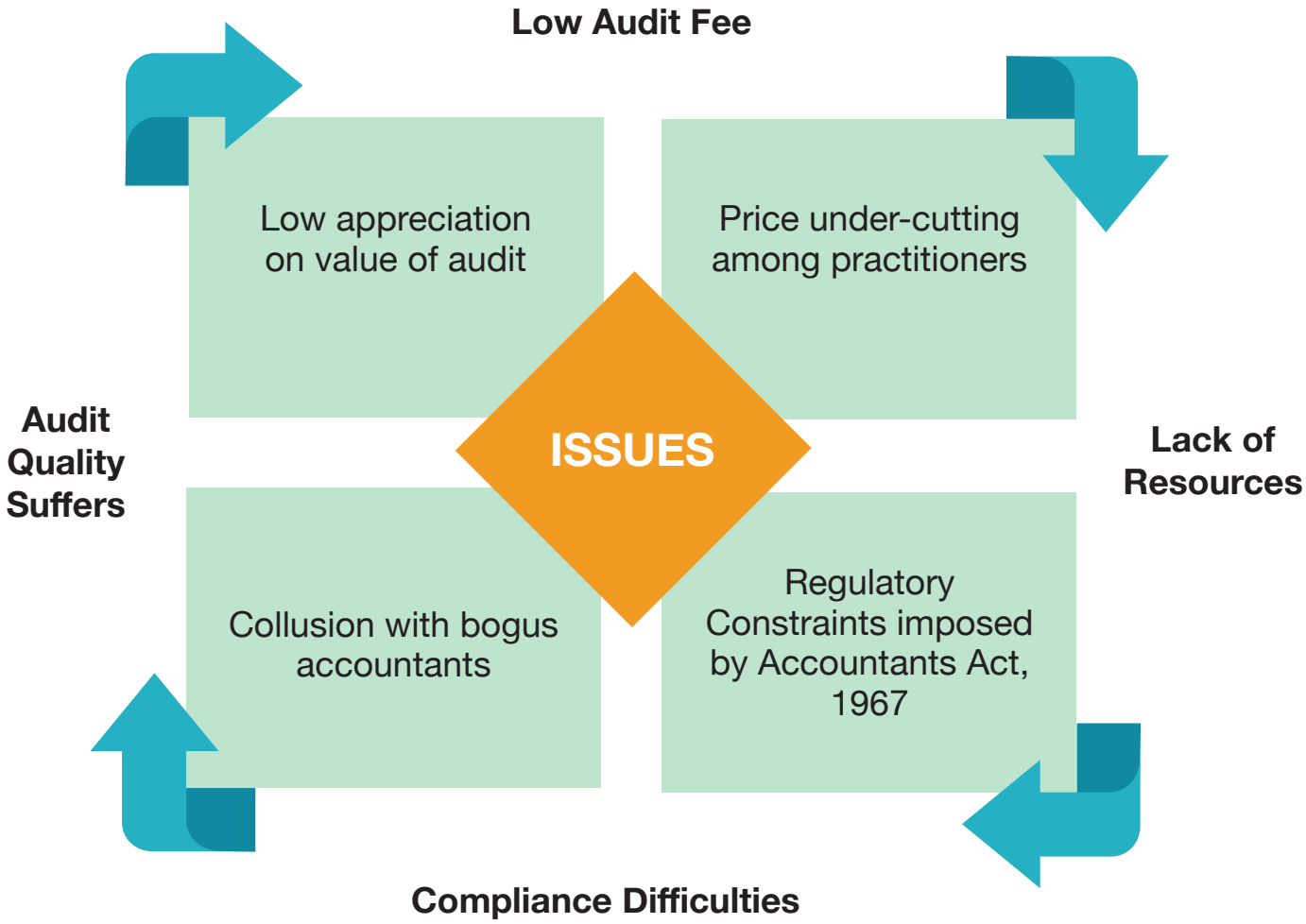
"The Accountants Act 1967 stipulates that no person shall practice or declare themselves as either a Chartered Accountant or licensed accountant unless registered with MIA."

MIA confers the Chartered Accountant qualification and membership with the Institute is mandatory for individuals who wish to practice in Malaysia.

3.0 Challenges Faced By SMPs In Malaysia

Audit services are a significant aspect of service delivery in the accounting profession. Small and Medium Practices (SMPs) in Malaysia generally face difficulty in meeting the increasing regulatory requirements due to the challenge in maintaining the right level of fees to sustain an acceptable level of quality service.

The current challenges faced by SMPs in Malaysia can be summarised as follow:



LOW AUDIT FEES

Anecdotal evidence suggests that, generally, audit fees charged in Malaysia are low as compared with other ASEAN countries. This reflects the price-competitive environment in which the audit profession operates and the relatively low salaries paid to accounting professionals in Malaysia. It is not uncommon for decisions on hiring auditors to be based primarily on audit fees. Over time, this practice may have a significant impact on audit quality and potentially damage the reputation of the Malaysian audit profession.

LACK OF RESOURCES

Audit firms face the challenge of staff retention due to high demand for accountants in other sectors and countries.

While student numbers are growing for accountancy and public practice continues to hire graduates, the profession nevertheless faces significant challenges in keeping graduates on the audit path long enough for them to develop a sustainable career in audit.

Within the accounting profession, the audit sub-profession is impacted the most from the present accounting 'talent crunch'. The majority of professional accountants choose to develop their careers in non-public practice.

AUDIT QUALITY SUFFERS

As suggested by evidence collected by MIA with respect to non-public interest entity auditors' compliance with auditing standards, many practitioners struggle to comply with the increasingly complex and prescriptive audit standards and ISQC 1.

COMPLIANCE DIFFICULTIES

The current landscape for public practice is dominated by a broad base of 1,332 sole proprietorships and partnerships of 2 partners (comprising about 90.4% of total audit firms). By and large, these firms lack resources and are unable to meet the requirements of professional standards and regulations.

On top of that, the statutory audit industry in Malaysia will have to rely heavily on an aging workforce. Due to slowing growth in the number of new audit firms being set up, there is a tremendous gap between the number of audit firms in the marketplace and the number of companies that require audit services.

If the underlying issues are not addressed, low audit fees can set off a potentially vicious cycle of lack of resources and poor audit quality.

Table 3: Underlying issues that have contributed to low audit fee

UNDERLYING ISSUES	REMEDIAL INITIATIVES BY MIA
Low appreciation of value of audit Most audit clients, especially those falling into the SME category, fail to appreciate the different roles played by an external auditor versus an accountant. Auditors have to frequently deal with delayed management accounts and poorly maintained accounting records and are expected to assist auditees resolve their accounting issues. Consequently, practising members face tight timelines to complete their audits.	This is partly handled via Public Practice Committee and Small and Medium Practice Committee's on-going initiative to educate the public on the value of audit.
Low fee which does not commensurate with effort and risk Price undercutting among practitioners increases the challenges in the practice landscape. Over time this practice will potentially lead to lower-quality audits.	In consideration of the Competition Act (CA) 2010, the MIA decided to withdraw *Recommended Practice Guide (RPG) 7: A Guide to Charging for Professional Assurance Services*, in order to uphold the spirit of the CA 2010 and not breach any of its provisions. There is an on-going initiative under SMP Committee to educate members on sustainable audit practice and value-pricing.
Collusion with bogus accountants There are members of MIA who collude with unqualified individuals to provide audit and assurance services. These members are at risk of having their audit licenses revoked.	
Regulatory constraints imposed by Accountants Act, 1967 Currently the Accountants Act 1967 does not provide MIA with purview over non-MIA members that provide accounting related services, whether statutory or otherwise, and MIA is unable to enforce against such actions that are not in the best interest of the public.	The Institute proposes to undertake a review of the Accountants Act 1967, with the overarching goal of supporting high-quality audits within the framework of free and open market competition.

PRACTICE REVIEW, SURVEILLANCE AND ENFORCEMENT DIVISION, MIA

4.0 Overview of Practice Review Programme (PRP) and Statistics

4.1 The Practice Review Programme (PRP)

The Practice Review Department (PRD) understands that the challenges facing the audit profession are both complex and numerous, which could exert great pressure on audit firms to keep pace with the developments in auditing standards and regulations as well as attract and retain clients. However, the PRD wishes to highlight that the PRP and its process is a surveillance programme designed to meet the regulatory objectives of the Accountants Act, 1967.

The Practice Review Programme

- Entrusted under Section 550: Quality Assurance and Practice Review of the By-Laws of MIA. PRP is a process where the standards and procedures of members' audit practice are assessed to ensure that they are in compliance with professional standards, legal and regulatory requirements.
- As MIA is an IFAC member, the PRP is a mandatory requirement that forms the substance of the Statements of Membership Obligations (SMOs), in particular SMO 1 on the requirement to conduct practice review of its member firms.

The Objectives of PRP Are 3-Pronged

- To confirm members' obligation to maintain, apply and observe the standards promulgated by the Institute;
- To undertake the regulatory role as provided under the Accountants Act 1967, as well as to align with some of the latest international developments; and
- To enhance the confidence of the business community in our members' standard of professional work.

"The PRP does not set new standards. Rather, PRP reviews the compliance to existing professional and regulatory standards that auditors, regardless of the size of their firm, are expected to comply with."

New Practice Review Framework

- Over the years, MIA has continued to monitor, review and refine its strategies in light of the developments and circumstances that affect its surveillance programmes and consider improvements and enhancement as appropriate. In 2016/2017, MIA revised the existing Practice Review Framework so as to expedite the process of instituting remedial actions and enable tougher sanctions against recalcitrant practitioners.

  (Note: For details on the old practice review framework, members can refer to the Practice Review Report 2009 - 2013 issued in February 2014).

  MIA believes that the new practice review framework, which was effective from 1st July 2017, is necessary, and the reforms will make the practice review processes more effective while reinforcing the need for our practitioners to uphold a high level of audit quality.

"The new Practice Review Framework is a pro-active measure and incorporates forward-looking features which ensure direct and timely communications with individual firms and identify opportunities to enhance the relevance, efficiency and effectiveness of our standard setting process."

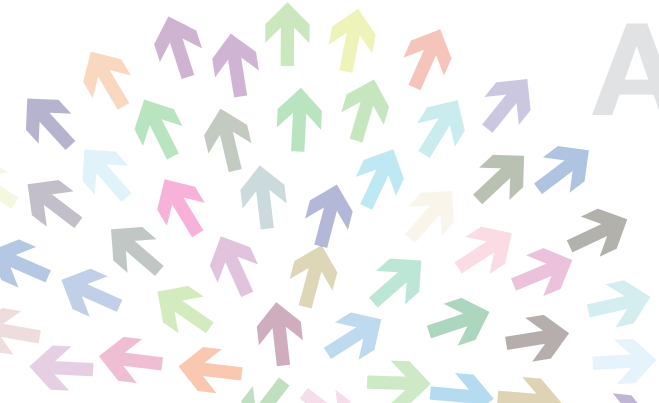
5 Objectives

- Corrective not punitive measures;
- To position practice review as a prime driver of audit quality for our profession in Malaysia;
- To work with practitioners and audit firms to meet realistic goals of compliance with applicable professional standards, legal and regulatory requirements in their work;
- To bring about an effective and impactful regime that is aimed at reducing the failure rate to 30% of Type 3 firms over a three-year period ending FY2019/2020 and subsequently to 10% thereafter; and
- To demonstrate our ability to regulate our audit firms effectively and stay relevant.

6 Main Changes

- The follow-up review for Type 3 firms will be dropped. Monitoring review will be conducted on audit firms rated as Type 3.
- A well-structured Remedial Action Plan (RAP) shall be drawn up by the Type 3 firms for PRC approval prior to implementation of the RAP.
- Practitioners of Type 3 firms are compelled to attend remedial audit workshops organised by MIA. Their attendance is compulsory and shall be closely monitored.
- A Type 4 rating has been introduced.
- Proposal to enhance the sanctions for failure of PRP (Refer to 4.3 Enforcement Actions for details).
- No fees shall be charged to the audit firms for practice review visits. However, all incidental charges and expenses incurred in relation to the review shall be charged to the firm being reviewed.

Forging A New Path...



1 Firm Selection Approach

- MIA uses a risk-based approach for selection of audit firms for practice review, which has been streamlined under the New Practice Review Framework, to select firms based on a risk profiling system using information extracted from the Annual Return submitted by Audit Firms.

- Audit firms may also be selected for review based on referrals from other regulatory bodies in Malaysia or other committees of the Institute.

- The identity of the audit firm is kept confidential at all times from all parties who are not directly involved in the practice review of the firm, including the PRC and staff of the Institute.

"Accordingly, a practice review report should not be understood to provide any assurance that the firm's audits, or the audit firm's clients' financial statements, are free of any deficiencies not specifically described in the practice review report.

2 Scopes of Review

- Firm level Inspections - Practice Review inspects the audit firm's system of quality control (firm-level inspections) to ensure that they are in compliance with the requirements of ISQC 1.

- Engagement Inspections - Practice Review's approach in performing inspections of individual engagements comprises detailed engagement inspections of audit firms to assess whether the audit work is conducted in compliance with relevant professional standards. For practical reasons, not all partners of an audit firm that have been selected for practice review will be reviewed individually with regards to the current audit engagement files.

- However, in most circumstances, the sample of files selected for practice review should be reflective of the firms' overall operations and size.

Also, the practice review reports are not intended to serve as balanced report cards or overall rating tools."

4 Types of Ratings

At the conclusion of the practice review, a reviewer is required to table a report to the PRC.

Before the deliberation of the report, the reviewer will delete any reference to audit firm's identity to preserve confidentiality.

The PRC shall determine a rating for the report in the following manner, taking into consideration the practice review report and the audit firm's comments.

TYPE 1

The firm complies with ISQC 1 and applicable professional standards, legal and regulatory requirements. No breach of mandatory auditing standards noted.
It signifies a comfortable pass and no further action is required.

TYPE 2

Minimal, nonpervasive weaknesses are noted in compliance with ISQC 1 and mandatory auditing standards. Weaknesses are noted in some engagement files but not in others. It requires a written assurance and commitment from audit firms that remedial action and improvement shall be implemented.

TYPE 3

Where it considers that the audit firm has some severe weaknesses which were pervasive in complying with applicable professional standards, legal and regulatory requirements during the course of carrying out the engagement in which the work was performed, and evidence obtained thereon was inadequate and/or inappropriate. Thus, the basis needed to form the opinions was not adequately supported. This requires the audit firm to submit a RAP to rectify all areas of weakness.

Monitoring review on the implementation of the approved RAP will be imposed on the audit firms within the specific time period as prescribed in the MIA By-Laws.

TYPE 4

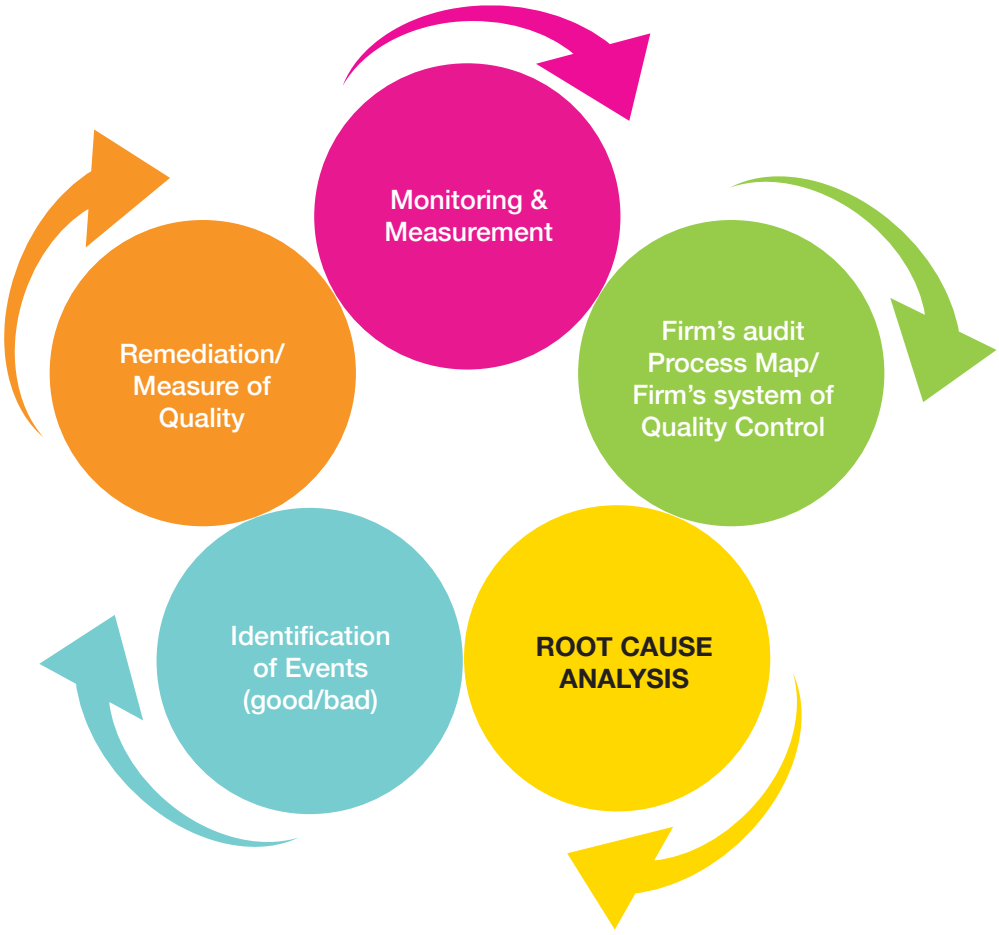
A situation where an audit firm has commited an offence or a breach against the laws and regulations of the country and MIA's regulations or the basis needed to form the opinions expressed on the engagement reviewed was not supported for reasons as stipulated in the MIA By-Laws.

If the firm is rated as Type 4, a complaint shall be lodged with the Registrar.

Formulating an Effective Action Plan for Type 3 Rating

The revised Practice Review Framework involves the identification and analysis of internal and external factors that influence how auditors fulfil their responsibilities.

- Instead of merely resolving the symptoms, the success of the RAP hinges on each firm's understanding of firm-wide problems underlying the deficiencies identified during the practice review. What firms need to do is to understand, at a very fundamental level, what is hindering the realisation of an effective system of quality control.
- Performing a Root Cause Analysis (RCA) is thus imperative to ensure that firms are able to formulate remedial plans that are targeted to address the relevant underlying deficiencies in the practice.
- Therein lies the need for audit firms to undertake an in-depth analysis of their firms to identify root causes that may result in the detraction of audit quality. Practice Review considers RCA to be part of a continuous audit quality improvement process, which includes other elements, namely remediation, monitoring and measurement.



What is An Effective Root Cause Analysis (RCA) ?

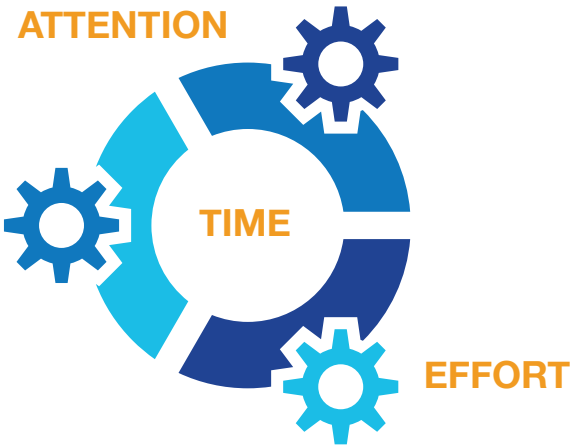
- Does not seek to establish a blame culture
- Challenges superficial answers about why things went wrong
- Identifies root cause linked directly to one or more review findings
- Avoids temptation of settling on a cursory “quick fix” answer which does not address more difficult underlying issues
- Identifies root causes with clear responsibilities and a feeling of ownership of the associated action plan remedy
- Remedies root cause and enhances preventive measures so as to avoid future recurrence

WHAT's NEXT ?

- Remediation measures and timelines would also be agreed with the audit firm with a focus on safeguarding and enhancing audit quality.

- A monitoring review on the implementation of the approved RAP will be imposed on audit firms within specific time periods prescribed in the MIA By-Laws.

- Practitioners must recognise that the remedial process is not a one-off exercise to satisfy the requirements of the PRP but an on-going, continuous project in the interest of elevating the audit quality of the firm.



- It is crucial to commence the remedial process early, maybe even after the discussion of the deficiencies with the PRD at the Practice Review's closing meeting.

- Firms should devote considerable attention, time and effort to analyse the deficiencies identified during the practice review exercise and identify the root causes underlying the failure of the quality control system.

- Where the monitoring review shows that the audit firm failed to effectively remedy their weaknesses to uphold audit quality and standards, the PRC shall lodge a complaint with the Registrar.

> **You Can Sit and Complain about Something, or you can Go and Fix it.**
>
> ***Winston Churchill***

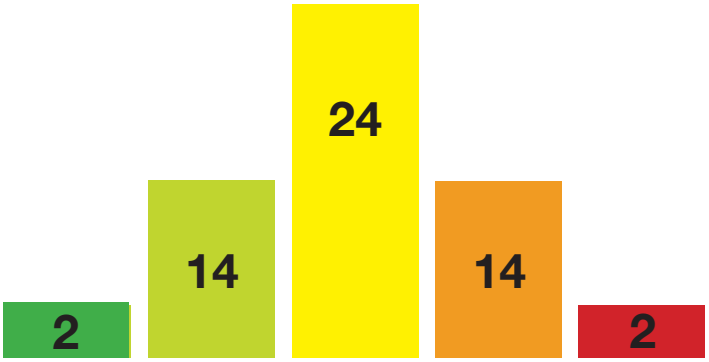
4.2 PRD's Reviewing Performance for 2017/2018

- For 2017/2018, the PRD had conducted a total of 66 reviews and finalised 56 reports as at 30 June 2018.
- The PRD had received 44 Remedial Action Plans (RAPs) submitted by audit firms, of which 28 RAPs had been approved by the PRC.
- As at 30 June 2018, the monitoring review of these firms' RAPs is still ongoing.
- Based on preliminary feedback from the firms, the RAP process allows firms to be more focused on identifying the shortcomings which need to be addressed.
- The PRD will release summary information on its most recent round of monitoring in the near future.

66
Reviews conducted

56
Reports finalised

28
RAPs approved



Type 1 (Pass) - 3.6%

Type 2 (Marginal Pass) - 25.0%

Type 3 (Unsatisfactory - Follow up/RAP required) - 42.8%

Type 3 (Unsatisfactory - Referred for Disciplinary Action) - 25.0%

Type 4 (Failure - Referred Disciplinary Action) - 3.6%

Note:

(i) The 56 reports finalised by the PRD during the year encompass reviews under both the transitional provision of the old and new frameworks.

(ii) Type 3 encompasses reviews under both the transitional provisions of the old framework and the new framework.

(iii) The firms selected for Practice Review generally exclude firms registered with the AOB that carries out PIE audits.

"The above statistics represent high-risk firms selected based on a risk-based approach and are NOT representative of the audit profession as a whole. The selection of firms assessed as higher risk would naturally result in the selection of firms that are more likely to have difficulties passing the Practice Review process."

"A 'client is king' mentality cannot be present and must at all times be subservient to an auditor's core tenet of professional scepticism."

- 2017 was a year full of reform for the PRD with the introduction of a new framework to enhance the effectiveness of the practice review process.

- In the 4th Quarter of 2017/2018, the PRD had just commenced the review of RAPs submitted by the audit firms that were rated as Type 3. While it is too early to comment on the results of the monitoring reviews of the RAPs, preliminary indicators are positive as we have seen most firms taking their responsibility very seriously and working closely with our practice reviewers to get insights into various types of remedial efforts that would address the issues identified.

- The PRD will continue to refine its approach to regulate the audit profession, especially the method by which it inspects audit, to determine the problems that auditors need to fix. We foresee achieving this in 2018/2019.

- One of the key quantitative indicators used in the risk-based selection of firms is the ratio of clients to employees and partners.

- It is not surprising that firms which are insufficiently staffed are more likely to fail the practice review process. Therefore, firms need to be cognisant of their capacity to undertake and accept audit engagements, not just in terms of sufficiency of staff but also partner capacity. Partners need to remember that while the work can be delegated, responsibility cannot.

- In terms of qualitative considerations, the leadership element of ISQC 1 is one of the most critical for audit quality.

- Firms which are more likely to pass are firms where the tone from the top is one which continuously emphasises audit quality and is uncompromising in its professionalism. A 'client is king' mentality cannot be present and must at all times be subservient to an auditor's core tenet of professional scepticism.

TOP 5* ISA Weaknesses 2017/2018

1. ISA 230 Audit Documentation
2. ISA 500 Audit Evidence
3. ISA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
4. ISA 530 Audit Sampling
5. ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

*** based on the frequencies in the application of individual ISAs during the audit file reviews for FY 2017/2018.**

4.3 Enforcement Actions

- An effective enforcement process plays an integral role in audit quality.

- In addition to the Practice Review Programme (PRP) as one of the core components under the surveillance division, MIA has an enforcement division. If the PRC believes that a serious violation in relation to Practice Review matters has occurred, a complaint shall be lodged to the Investigation Committee (IC) through the Registrar.

- Where the IC finds that there are sufficient grounds for disciplinary proceedings to be taken in respect of the complaint made, it is the duty of the Chairman of the IC to refer the complaint to the Disciplinary Committee (DC).

"MIA currently publishes the names of auditors who were found guilty by DC for audit deficiencies found during the Practice Review inspections..."

- After due inquiry has been made by the DC, if it is found that any member of the Institute is guilty of unprofessional conduct, the DC shall have the power to impose one or any combination of disciplinary punishments as stipulated in the MIA (Disciplinary) (No.2) Rules 2002.

"In total, as at 30 June 2018, there were 91 cases referred by the PRD of which 38 cases were found guilty and 10 cases dismissed by the DC, 43 cases are still pending disciplinary proceedings/ investigation."

Disciplinary Punishment under the provision of MIA (Disciplinary) (No.2) Rules 2002

(a) the name of the member to be removed from the register and he shall cease to be a member of MIA;

(b) suspend the member for a period of not exceeding three (3) years;

(c) order the practising certificate of the member to be cancelled;

(d) impose upon the member a fine not exceeding five (5) thousand ringgit;

(e) order the member to be admonished, censured or reprimanded;

(f) order the member to pay MIA such sum it deems fit and reasonable in respect of costs and expenses of an incidental to any disciplinary hearing before the DC and any investigation conducted by the Investigation Committee; or

(g) order the member to attend a course of instruction approved by the DC for a period of time to be determined by the DC.

4.3 Enforcement Actions

- MIA has always faced criticism for the paltry fines it metes out when compared with other international regulators, as these have little deterrent effect in the effort to improve audit quality and maintain public and market confidence in the profession.

- To ensure auditors in Malaysia continue to hold themselves to high audit quality standards, **MIA proposes to increase the level of fines/penalties on audit firms that fail the Practice Review Programme from the existing RM5,000 to RM50,000 to stamp out weak practices in the audit market.**

- It is also recommended that the MIA issue stricter non-financial penalties, such as withholding its support for the renewal of audit license or temporarily suspending membership for a period ranging from 6 months to a maximum of 3 years.

- The proposed measures will further safeguard the public interest and ensure continued market confidence in the audit profession. They will help to level the playing field for the clear majority of audit firms who are steadfast in their commitment to audit quality.

- At the MIA, we hold accountants and auditors in high regard and consider them to be key partners in our stakeholder protection efforts.

- At the same time, however, we must also hold those who become auditors to the high standards of the profession.

- We have long scrutinised, and will continue to scrutinise the conduct of auditors during the course of our surveillance and enforcement efforts. Neither will we hesitate to pursue auditors where their conduct may indicate that they are a threat to the MIA's objective in upholding the audit quality of the audit profession in Malaysia.

Summary of Proposed Sanctions/ Fines due to failure of Practice Review:

Type of Rating by the PRC	Proposed Revised Sanctions/ Fines
Type 3 (RAP not drawn up/ Failure of implementation of approved RAP)	- Regulatory Penalty (Fines) – Maximum of RM50,000 - No support given by MIA for renewal of audit license - Suspension of Membership (6 months – maximum of 3 years)
Type 4 (Unsatisfactory)	- Regulatory Penalty (Fines) – Maximum of RM50,000 - No support given by MIA for renewal of audit license - Suspension of Membership (6 months – maximum of 3 years) - Referral to other relevant Regulatory Authorities (e.g. SSM, AOB, Accountant General, Bank Negara Malaysia (BNM) and Inland Revenue Board (IRB))

4.4 Enforcement Initiatives

Given the vast scale of recent accounting scandals and their devastating effects on the audit profession, it is noted that one of the key factors that has jeopardised the image and credibility of the audit profession is broadly derived from three (3) categories of enforcement problems which are:

(i) bogus accountants - people who offer accounting services without being a Chartered Accountant;
(ii) bogus auditors - people who offer audit services without an audit license; and
(iii) cheating auditors - licensed auditors who do not perform audit work as prescribed by the laws.

It is crucial for MIA to carry out its surveillance and enforcement activities rigorously to protect and uphold the rights of members, especially public practitioners, and defend the profession's integrity. The Surveillance & Enforcement (S&E) Division in MIA which is headed by Dato 'Hj Muhammad Redzuan Bin Abdullah has acted decisively to weed out this menace of bogus and cheating accountants and auditors. Dato Redzuan's division covers both proactive and reactive enforcement. This means the team monitors serious violations and abuses in the market, where processes are being manipulated by practitioners and non-members. The team is determined to identify the abusers and nail them on the scales of justice with appropriate sanctions, especially those engaging with unqualified accountants who offer public practice services. Practitioners too should be wary of engaging the services of non-audit firms (in outsourcing audits). The division will collaborate and engage with co-regulators to share information and initiate penal action where necessary under their respective jurisdictions, apart from initiating investigation and disciplinary proceedings against their members so as to ensure that no one who encroaches on the realm of law escapes penal consequences.

Following are some of the enforcement initiatives taken by the S&E Division:

(i) issuing show cause letters;
(ii) lodging reports with relevant regulatory authorities such as SSM, IRB, Malaysian Communications and Multimedia Commission (MCMC) and the Police; and
(iii) taking out public advertisements to warn the unsuspecting public of such entities and persons.

Such actions will ensure that the interest of properly registered practitioners especially SMPs are protected from illicit fee competition and more importantly, their reputation as the trusted partners of the SMEs and the general public is upheld.

5.0 Key Findings, Lessons and Takeaways

5.1 Key Findings of the Practice Review Programme

This report does not constitute a comprehensive list of all findings identified during PRP. Instead, this report summarises the pertinent and common findings that PRC views as requiring particular attention from the audit firms. These findings were gathered from the PRD during the period from 1st July 2017 — 30 June 2018 as attached in Appendix 1 & Appendix 2.

Appendix 1 lists out key findings related to ISQC 1 elements through the firm level reviews whereby Appendix 2 sets out sample case studies of common findings and Practice Review's expectations. With the common findings and the recommended practices to the deficiencies noted, It is hoped that these common findings and the recommended practices to the deficiencies will be beneficial and informative for the audit firms, and that they will take the necessary corrective actions to improve and enhance the quality of their audit work.

Appendix 1

ISQC 1 Elements

- Leadership Responsibility for Quality Within the Sole Proprietor / Audit Firm
- Acceptance and Continuance of Client Relationship and Specific Engagements
- Human Resources
- Monitoring

Appendix 2

Sample Case Studies related to Audit Engagement Inspection

- Going Concern
- Inventory
- Construction Contract
- Audit Planning and Materiality

5.2 Key Lessons and Takeaways for the Audit Profession

Be firm

Auditors should seek internal advice particularly when difficult matters arise. Therefore, firms should have competent and committed personnel ready to assist in sensitive areas, and they must stand firm against the client when their concerns are not addressed.

Equip yourself

Before engaging with an audit client, auditors should ensure that the firm and its assigned audit team members possess sufficient capacity and competency to audit the client according to professional standards. Where there are red flags suggesting a lack of competency by audit team members, the firm must act accordingly and rectify the situation.

Exercise professional scepticism

Auditors need to exercise appropriate professional scepticism, gather sufficient appropriate audit evidence, adequately document work, and require more sufficient evidential matter than representations from management particularly when there are red flags. Auditors perform a key role in providing a check on management's financial reporting and they must perform that role with a sceptical eye and appropriate objectivity.

Plan your audit

Audits need to be appropriately planned and implemented, with significant risks identified and addressed through adequate audit procedures. Proper planning goes a long way towards executing a successful audit. Good project management skill and ensuring a deep understanding of the client and the industry in which it operates are crucial.

Embrace monitoring process

Firms should have a robust monitoring process. The monitoring programme should be overseen by a partner, or other senior personnel, who has appropriate competence, experience and authority. The personnel who performs the engagement and the engagement quality control reviewer should not be involved in the monitoring process of their own completed engagements. For smaller firms with limited resources, the firm may bring in a suitably qualified external party to carry out the monitoring review programme or establish a peer review arrangement with another audit firm so long as there is no conflict of interest or independence issues.

OVERVIEW OF MIA CURRENT INITIATIVES IN ENHANCING THE AUDIT PROFESSION

6.0 Overview of MIA Current Initiatives in Enhancing the Audit Profession

6.1 SMP Roadmap 2015-2020

SMP Department (SMPD)

- Established in May 2015 to support capacity building activities for SMPs.
- SMPD also acts as the coordinating department for all Institute initiatives and activities and a focal point for SMPs to obtain information and assistance.

3-Pronged Strategic Thrust (ST) of SMPD

ST1 : Quality Enhancement

ST2 : Capacity Building and Capability Development

ST3 : Professional Reform

ST 2

Capacity Building and Capability Development

focusing on the non-technical aspects with the objective of enhancing SMP productivity.

ST 1

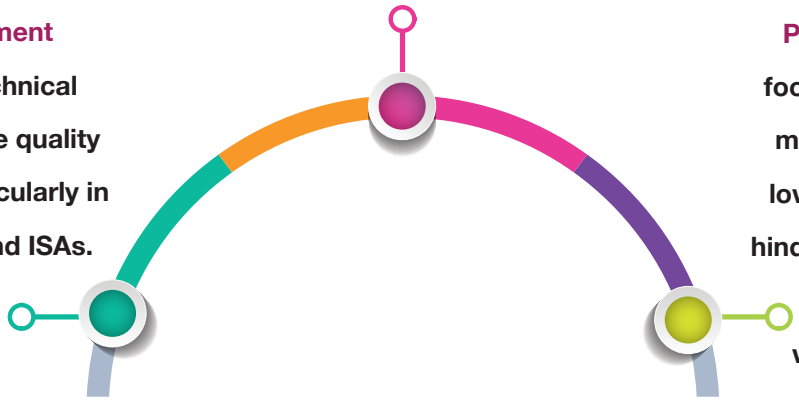
Quality Enhancement

focusing on the technical aspects of raising the quality of performance, particularly in relation to ISQC 1 and ISAs.

ST 3

Professional Reform

focusing on addressing macro issues such as low fees and removing hindrances in legislations and regulations where appropriate.

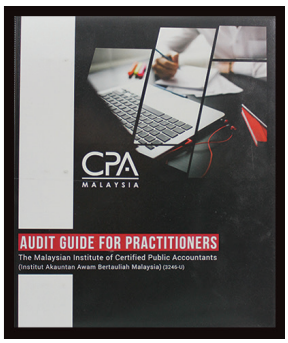


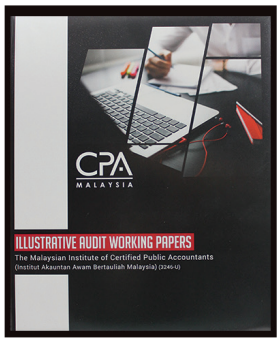
"The SMP Department will continuously monitor the environment in which it operates and seek to proactively shape that environment through fine-tuning its strategic direction, the way it operates and the services it delivers."

6.2 Enhancing Competency and Capacity of SMPs

(i) Audit Guide for Practitioners (AGP) and Illustrative Audit Working Papers (IAWP)

To assist practitioners, specifically in the SMPs, in the audit of Small and Medium Enterprises (SMEs), the Malaysian Institute of Certified Public Accountants (MICPA) launched in October 2017 the Audit Guide for Practitioners (AGP) and the Illustrative Audit Working Papers (IAWP) to accompany the AGP for training purposes.





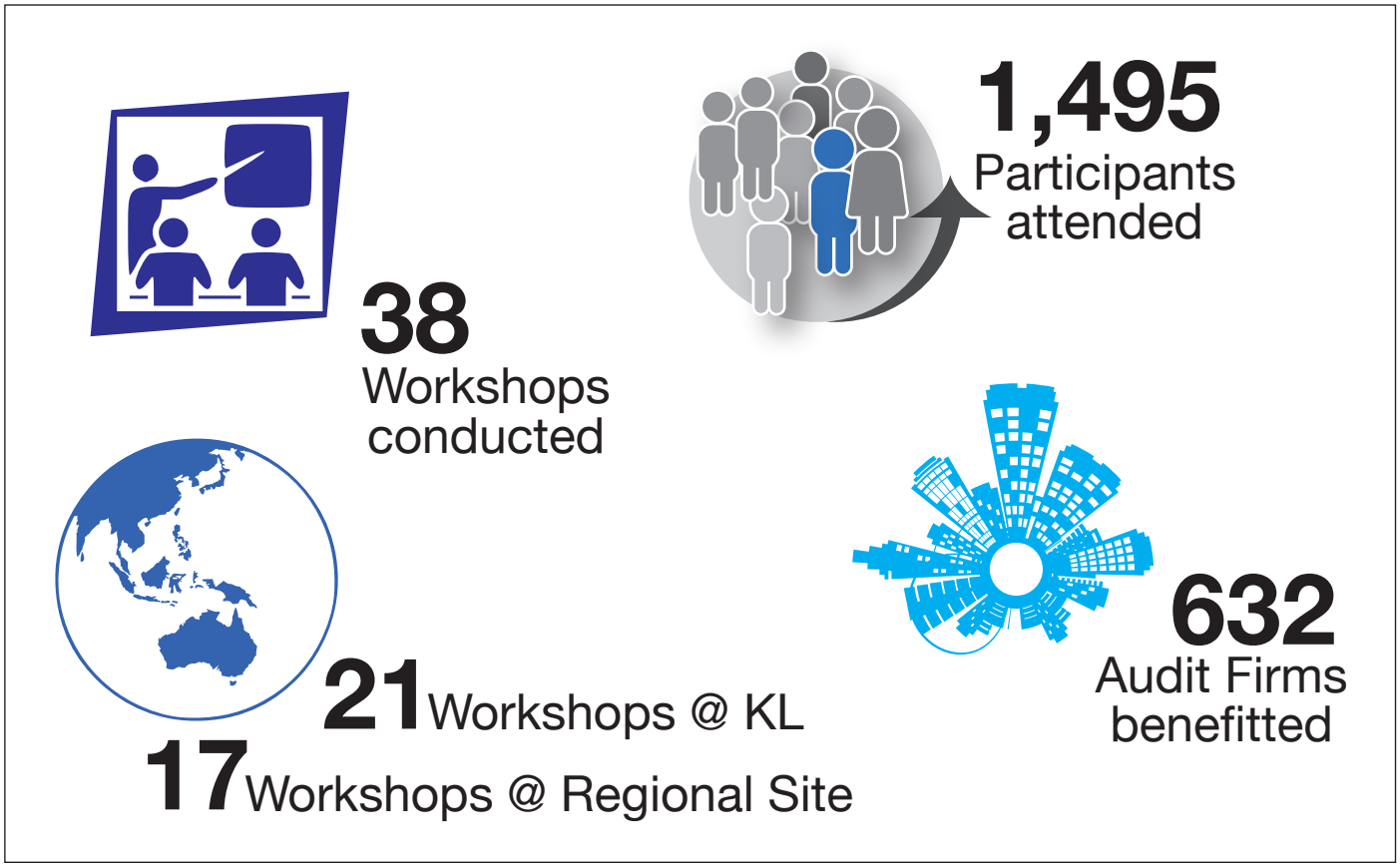
Following the signing of a joint training agreement on the AGP and IAWP on 18 July 2017, a series of joint training workshops has been rolled out nationwide by MIA and MICPA beginning in August 2017.

(ii) Practical Auditing Methodology for SMPs

The 2-day workshop on *'Practical Auditing Methodology for SMPs'* covered practical auditing methodology and illustrated how practitioners can utilise the AGP and IAWP in their audits. The workshop also sought to enhance SMP understanding of the practical aspect of SME audits, in meeting the requirements of the ISAs.

Participants attending the joint training programmes received complimentary copies of the AGP and IAWP.

Status as at 30th June 2018:



(iii) Quality Assessment Programme (QAP)

Another initiative carried out jointly by MIA and MICPA is the Quality Assessment Programme (QAP). The objectives of the QAP are to promote continuous improvement in audit quality in Malaysia and compliance with applicable approved auditing standards and MIA By-laws in relation to audits by SMPs.

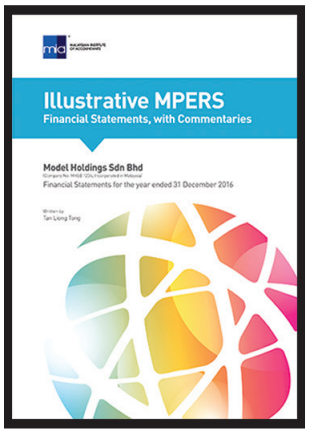
Since the QAP was launched in October 2016, a total of 6 SMPs have completed this voluntary programme. It is hoped that more SMPs will take the opportunity to improve their quality.

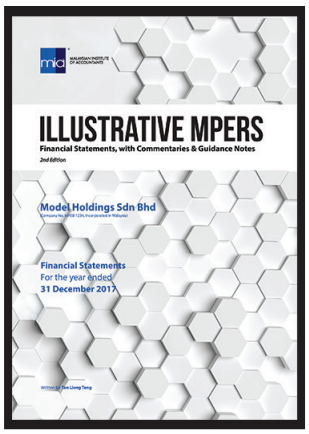
Further information about the QAP can be found via this link:
https://www.mia.org.my/v2/smp/activities/quality_assessment_programme.aspx

(iv) Publication of Illustrative MPERS Financial Statements, with Commentaries

To assist members in the implementation of the Malaysian Private Entities Reporting Standard (MPERS) Framework in Malaysia, MIA unveiled the *"Illustrative MPERS Financial Statements, with Commentaries".*

The first version was released on 15 April 2016 and the second edition (prepared in accordance with the new Companies Act 2016) was released on 17 July 2018.





6.3 Advocacy and Professional Reforms

- Throughout the years, the Institute has continued to ensure members' views are heard by policymakers. The Institute regularly makes submissions to the Government and other stakeholders on matters of policy, especially where the profession has expertise.

- MIA continues to strengthen ties with other agencies such as Suruhanjaya Syarikat Malaysia (SSM), Inland Revenue Board (IRB), Royal Malaysian Customs Department (RMCD), Bank Negara Malaysia (BNM), Securities Commission (SC), Audit Oversight Board (AOB), Malaysian Department of Insolvency (MDI) and the Association of Banks in Malaysia (ABM).

- MIA is presently in discussions with the ABM on the implementation of an industry-wide electronic bank confirmation platform. On 12 June 2018, an agreement was signed with an independent and external service provider, paving the way for the implementation of an industry-wide electronic bank confirmation platform.

- With support from the Accountant General's Department, the MIA By-Laws were amended in 2017 to include the requirement for members in public practice seeking renewal as approved company auditors to complete a minimum of 10 out of 20 structured CPE hours per year on areas in relation to ISQC 1, approved auditing standards and/or approved accounting standards. This was initiated to improve technical competencies and quality of members in public practice, in meeting the high standards expected of them by the industry.

- Following the issuance of the Practice Directive 3/2017 on Qualifying Criteria for Audit Exemption for Certain Categories of Private Companies, the Institute published a booklet *"Why Audit Matters for SMEs"* in 3 languages in 2017, conducted 10 engagement sessions with stakeholders on the value of audit and will continue to study the impact of audit exemption on SMPs.

ACKNOWLEDGEMENT

PRACTICE REVIEW COMMITTEE (PRC)

Objective

The primary objective of the Practice Review Committee (PRC) is to oversee the conduct of practice review and to ensure all members in public practice comply with all applicable professional standards, legal and regulatory requirements in the performance of their work.

Composition for 2017/2018

Chairman
Mr. Huang Shze Jiun (MIA Council Member)

Committee Members
Mr. Alex Khaw Hock Hoe (MIA Council Member)
Mr. David Siew Kah Toong
Mr. James Chan Kuan Chee
Mr. Lee Teck Leong
Mr. Ooi Chee Kun
Ms. Pauline Ho
Mr. Peter Lim Thiam Kee

First and foremost, the PRC wishes to express its heartfelt Public Practice Committee (PPC) and Small and Medium secretaries for their kind co-operation extended during the this Practice Review Report – "The Audit Profession in enthusiasm, and spirit of both PPC and SMPC that PRC could

SMALL & MEDIUM PRACTICES COMMITTEE (SMPC)

SMPs provide a broad range of professional services — from the traditional audit, accounting, and tax services, to value-adding business advisory, to meet the needs of their clients who are typically small and medium enterprises (SMEs). Recognising the importance of addressing the needs of SMPs, MIA started the SMP Department in 2015 to help raise audit quality within the profession. In conjunction with the setting up of the SMP Department, MIA established a SMP Committee in May 2015. Under the leadership of the inaugural Chairman, Datuk Zaiton Mohd Hassan, several development programmes were outlined to transform the current SMP landscape to one that is progressive, able to move up the value chain of professional services and meets the needs of businesses. The SMPC first embarked on the reform journey with a 5-year SMP Roadmap with 3 strategic thrusts (ST), i.e. Quality Enhancement, Capacity Building and Capability Development; and Professional Reforms.

Objective

The primary objectives of the SMP Committee are to build the capacity of SMPs, facilitate the adoption and implementation of new standards, promote the value of SMPs in supporting SMEs and represent SMPs' interests to regulators. The Committee also serves as a forum for consultation to address issues/challenges relevant to SMPs.

Composition for 2017/2018

Chairman
Dato' Narendra Kumar Jasani (MIA Council Member)

Committee Members
Dato' Gan Ah Tee (MIA Council Member)
Dato' Heng Ji Keng
Ms. Lim Fen Nee (MIA Council Member)
Mr. Peter Lim Thiam Kee
Mr. Lew Sze How
Tuan Haji Mohd Noh Jidin

"During my nationwide engagement sessions from December 2017 to May 2018, it is gratifying to know that our efforts have received positive feedback from members. Many members I met informed me that MIA has done a lot for SMPs in the last few years, and that our initiatives have been impactful. In my mind, there is always room for improvement. The strategic goal of implementing ST 1 Quality Enhancement is to reduce the practice review failure rate and we hope to see the outcome of a lower PR failure rate in near future."

Dato' Narendra Kumar Jasani, Chairman of SMPC, MIA.

appreciation to the two (2) Committees, Practices Committee (SMPC) and their various stages of the publication of Malaysia". It was with the co-operation, make this publication a grand success.

PUBLIC PRACTICE COMMITTEE (PPC)

Objective

The primary objective of the Public Practice Committee (PPC) is to enhance the professional performance (competency, quality and growth) of the members in public practice. The Committee also serves as a forum for consultation and discussion of accounting and auditing practice issues relevant to members in public practice.

Composition for 2017/2018

Chairman
Mr. Brian Wong Wye Pong (MIA Council Member)

Committee Members
Mr. Huang Shze Jiun (MIA Council Member)
Mr. Billy Kang Wei Geih
Mr. Leong Kah Mun
Mr. Peter Lim Thiam Kee
Dato' Sri Raymond Liew Lee Leong
Mr. Ooi Chee Kun
Mr. Steve Ooi Poh Lim
Mr. Subramaniam A V Sankar
Mr. Michael Tan Cheng Hooi
Mr. David Yap Weng Seong

"Patience is a virtue. As with everything else in life, success in public practice requires the disciplined and consistent application of effort over time. It does not happen over successfully securing one major client or from the completion of a single landmark assignment. It takes millions of effective hours in: continuously building knowledge and resource capabilities and capacities, ensuring that your team consistently delivers in accordance with strict quality systems, improving client communications and relations for reducing gaps in service expectations, persisting with efforts to grow a reputation to facilitate repeat successes, and expanding your network for resources and skills to add to your value chain. A successful practice requires a lot of effort and patience."

Mr. Brian Wong Wye Pong, Chairman of PPC, MIA.

Many audit failures brought to light stem from one main thing - weaknesses in the firm's structure, processes and resources. To avoid audit failures, the firm's leadership will need to make a conscious effort to assess the adequacy and sufficiency of its resources, before deciding on whether to accept an assignment or continue with a pre-existing engagement relationship. The 6 elements of ISQC 1 combined provide for the complete quality framework required in an audit practice, however, Acceptance and Continuance of Client Relationships is perhaps the key element for practitioners to determine at the outset the firm's risk appetite for external liability. It is therefore crucial that deep understanding and greater appreciation is accorded on the considerations contained therein.

The risk of audit failures can be mitigated to a substantial extent when practitioners are honest in making the assessment on whether the audit and review structure is adequate and ready, whether there is the technical or relevant resource experience to deliver on the ISAs, and whether its resources are able to commit to the assignment with requisite diligence. Every decision on whether to earn a fee comes with risk and an even greater cost. There is no shame to admitting reservations on being unable to deliver a first-class job and declining an appointment.

There are tremendous opportunities in public practice. Changes in technology and how they impact the profession will enable those that take the lead to succeed. As accounting standards are set to become potentially more complex, and regulatory standards correspondingly more stringent, the Institute will continue to play its role in nurturing and regulating the ecosystem to ensure practitioners are equipped to thrive. With the right attitude and effort, building a successful practice can be both gratifying and rewarding.

KEY FINDINGS & SAMPLE CASE STUDIES

PRACTICE REVIEW DEPARTMENT 2018

Appendix 1

Key Findings from ISQC 1 Elements

The following are key findings from ISQC 1 elements gathered from the PRP during the period from 1st July 2016 to 30 June 2018.

1. Failure to establish and implement a firm-wide system of quality control system with its compliance with ISQC 1

(a) Leadership Responsibilities for Quality Within the Sole Proprietor/Member firm

- *Failure by practitioners or partners to inculcate a culture of quality in the firm. "Tone at the top" is that audit quality can be compromised.*

Practice Review continues to observe a significant number of deficiencies related to leadership and culture, a key determinant of an effective quality control system. A firm's culture reflects the cumulative actions and behaviours of its personnel, including those that affect audit quality. Those cumulative actions and behaviours are influenced by the leadership's communications, directive, actions and behaviours, also referred to as the Tone at the Top. Audit practitioners should carefully assess and evaluate this element in order for the firm to achieve an effective quality control system.

Like any organisation, an audit firm faces risks in achieving its objectives. To maintain an effective quality control system, firms need to design and implement policies and procedures that provide reasonable assurance that their personnel comply with applicable professional standards and the firm's standard of quality. This includes policies and procedures to address risks of not being able to achieve the required reasonable assurance of compliance. Firms may face risks from a variety of sources, for example, staffing shortages, changes to the firm's audit practice that affect its quality control system, or changes to the industries in which the firms audit clients operate that present new audit risks. Establishment of the firm's risk assessment element could lead registered firms to take proactive measures to identify and address risks to its quality control system to avoid potential systemic issues in their practice.

(b) Acceptance and Continuance of Client Relationships and Specific Engagements

- *Tendency to blame the client and the environment*
- *Attitude of accepting all assignments without considering the resources and ability of the firm and its personnel*

When accepting or continuing client relationships and specific engagements, the firms need to ensure firstly that it has ascertained the integrity of the client, and secondly that it can comply with the relevant ethical requirements. The onus also lies with the firm to ensure that it has competent and adequate resources to complete engagements in a timely manner.

In addition, the firms need to focus on Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA) and Personal Data Protection Act 2010 (PDPA). The firms need to assess the compliance of AMLA imposed by BNM before accepting or continuing the audit engagement.

(c) Human Resources

- *Tendency to blame the staff without considering the adequacy of training*
- *Lack of proper recruitment and retention policy and procedures*

An important contributor to audit quality is the breadth and relevance of the firm's training programmes as well as the extent of participation of partners and staff in these programmes. Equipping staff with the necessary skills and knowledge on a timely manner would avoid any wastage of time spent in re-performing and re-documenting audit work due to unfamiliarity with the client's industry, the audit procedures required and/or the firm's audit methodology. This creates a win-win situation where firms stand to benefit from productivity improvement as a result of equipping and empowering staff with the necessary understanding, skills and knowledge to do the right things from the start.

(d) Monitoring

- *No procedures in reviewing the firm's operational effectiveness and compliance within its system of quality control leads to accumulation of audit deficiencies and outdated knowledge*

An effective system of quality control includes a monitoring process designed to provide the firms with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate and operating effectively. Monitoring procedures provide the essential feedback for a quality control system to evaluate current practices and determine where changes are needed to maintain an effective quality control system. A robust monitoring process enables the firms to obtain reasonable assurance that its system of quality control is effective. Further, firms need to dedicate additional focus and resources on the preventive aspect of their quality control systems to build quality into the audit process in addition to using mere detection and monitoring techniques.

2. Insufficient documentation

One of the most common findings is insufficiency of appropriate documentation on audit evidence. The audit engagement team members typically know about the client's business and system and are able to describe in some degree of detail how the audit engagement team members approached their testing. But at times, it is impossible to follow files without this additional explanation. Clearly, a good final review should ensure documentation is appropriate and complete. Gaps raise the question of whether the review process has been carried out with sufficient depth. Therefore, in the absence of documentation or other persuasive evidence, even if the auditor claims to have performed the procedure, the auditor is regarded to have failed to perform an audit procedure.

Considerations Specific to Smaller Entities

Pursuant to ISA 230 (A16) and (A17), the audit documentation for the audit of a smaller entity is generally less extensive than that for the audit of a larger entity. Further, in the case of an audit where the engagement partner performs all the audit work, the documentation will not include matters that might have to be documented solely to inform or instruct members of an engagement team, or to provide evidence of review by other members of the team (for example, there will be no matters to document relating to team discussions or supervision).

Nevertheless, the engagement partner complies with the overriding requirement in ISA 230 (8) to prepare audit documentation that can be understood by an experienced auditor, as the audit documentation may be subject to review by external parties for regulatory or other purposes. When preparing audit documentation, the auditor of a smaller entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its internal control, the overall audit strategy and audit plan, materiality determined in accordance with ISA 320, assessed risks, significant matters noted during the audit, and conclusion reached.

Definition of smaller entity based on MIA By-Laws:

A smaller entity is an entity which typically processes qualitative characteristics such as:

(a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and

(b) One or more of the following:

i. Straightforward or uncomplicated transactions;
ii. Simple record-keeping;
iii. Few lines of business and few products within business lines;
iv. Few internal controls;
v. Few levels of management with responsibility for a broad range of controls; or
vi. Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all these characteristics.

Appendix 2

Sample Case Studies Related to Audit Engagement Inspection

(i) Going Concern

Deficiencies identified from audit firms:

Sample 1

The company is at the net current liability position with positive shareholder fund. Despite a "going concern checklist" being used by the audit firm, this condition was not considered in the checklist when concluding that the use of the going concern assumption is appropriate and therefore an "unmodified report" was expressed. Furthermore, there was a lack of documentation on additional audit procedures, including consideration of mitigating factors, performed to justify and conclude that sufficient appropriate audit evidence was obtained to support the use of the going concern assumption made by the management.

Sample 2

The company had net current liabilities and a deficit in the shareholder's fund as at the reporting date. The auditor's report was modified to include an emphasis on going concern uncertainties and indicated that the financial support letter had been obtained from the shareholders/ directors. However, the following were noted from the audit working papers of the audit firm: -

(i) The "Going Concern checklist" concluded that going concern assumption is appropriate and therefore the audit firm expressed an "unmodified opinion". However, this was not reflective of the modified audit opinion issued subsequently.

(ii) There was no indication of additional procedures documented in the audit working paper to assess the company's ability to continue as a going concern pursuant to ISA 570 (16).

(iii) There was no evidence that a letter of financial support had been obtained from the shareholder/directors.

The work done by the audit firm in its assessment of the existence of any going concern uncertainty for the client mentioned above was primarily evidenced by the completion of a going concern checklist. But there was no working paper available to record the detailed procedures performed, the findings and the results to support the modified report.

Guidance from Practice Review Department:

Going Concern is an important assumption underlying the preparation of financial statements. Under the going concern assumption, an entity is assumed to be able to continue as a going concern for a foreseeable future period of time. A reasonable future period of time is considered to be at least twelve (12) months beyond the year-date of the financial statements being audited. When preparing financial statements, management is required to make an assessment of the entity's ability to continue as a going concern.

The auditor's responsibility is to consider (1) the appropriateness of the management's use of the going concern assumption in the preparation of the financial statements; and (2) whether there are any material uncertainties about the entity's ability to continue as a going concern that should be disclosed in the financial statements (ISA 570).

In conducting risk assessment procedures and planning the audit, the auditor should consider whether there are events and related business risk that may cast doubt on the entity's going concern ability. Throughout the audit, the auditor should remain alert for indications and business risks that may give rise to going concern uncertainties. At the completion of the audit, but before finalising the auditor's report, the auditor must also consider the results of the audit in evaluating the appropriateness of the going concern assumption. If the going concern assumption is considered doubtful, the auditor should obtain sufficient audit evidence to resolve his doubt. A number of the audit procedures discussed above, in particular analytical procedures and review of subsequent events – are used by the auditor in assessing whether the entity will be able to continue as a going concern.

The following explains the steps an auditor should follow in assessing going concern:

1 Evaluate

Evaluate whether the results of audit procedures performed during the course of the audit (from risk assessment, planning to completion of the audit) provide any indication of events or conditions which may cast substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time (12 months).

2 Doubt

If there is substantial doubt, the auditor should obtain information about the management's plan to mitigate the going concern problem and assess the likelihood that such plans can be implemented.

3 Consider

If the auditor concludes, after evaluating management's plans, that there is substantial doubt about the ability of the entity to continue as going concern, the auditor considers the adequacy of the disclosure with respect to such uncertainty and include an explanatory paragraph in the audit report.

Note:

In Sample 2 point (i) above, the different opinion between the auditor's report and the working paper clearly shows that the audit team had failed to identify the indicator correctly, resulting in an evaluation of the going concern attributes which was contrary to the practitioner's opinion. Furthermore, there was no justification in the audit working paper to support the reason for the change of audit opinion. Thus, the conclusion in the checklist was not consistent with the opinion expressed by the audit firm.

As for Sample 2 point (iii) above, the audit firm in the audited report indicated that a financial support letter had been obtained from the shareholders/directors, but no such documents were filed. This would indicate that the letter of financial support had not been obtained from the shareholders/directors. The justification on the non-performance of such audit procedures was not clearly documented and there was also no reference in the audit working papers to indicate that such representation of financial support had been made in the letter of representation.

(ii) Inventories

Deficiencies identified from audit firm:

Sample 1

No audit working paper to indicate that observation of physical inventories count had been performed. Neither was there any record of alternative procedures performed together with the necessary explanations required for a situation when attendance at physical inventory counting is not possible or practicable. A copy of a stock certificate confirming the existence and value of inventories as at balance sheet date was obtained. However, the audit firm may not have obtained sufficient appropriate audit evidence on the existence of inventories as at the balance sheet date.

The was also no documentation to attest the performance of the following procedures in respect of inventories:

(a) Test on costing method adopted in the accounting policy

(b) Assessment on slow moving/ obsolete/damaged inventories which may warrant for impairment

(c) Test on lower of cost or net realisable value

(d) Cut off test

Sample 2

Based on the documentation from the audit working papers, the stock observation count was performed 8 days after the financial year end. There was no indication that any documentation of roll backward procedures been performed to reconcile the movement of inventories during the intervening period between the date of inventories count and the balance sheet date. There was also no justification for the non-performance of roll backward procedures. Consequently, there was no audit evidence about whether changes in inventory between the count date and the date of the financial statements were properly recorded pursuant to ISA 501 (5).

Guidance from Practice Review Department:

When inventory is material to the financial statements, the auditor is required to attend the entity's physical inventory counting unless it is impracticable (ISA 501). However, if attendance at physical stock count is impracticable, due to factors such as the nature and location of the inventory, the auditor should consider performance alternative procedures to obtain necessary evidence regarding the existence and condition of the inventory. For example, observe the physical count on an alternative date and perform tests on intervening transactions, and check on purchases made prior to financial year end and subsequent sales of specific inventory items.

If the performance of alternative procedures is also not feasible or practicable, the auditor shall modify the opinion in the auditor's report in accordance with ISA 705.

An inventory count memorandum should be prepared and documented to include the following:

- The observation made on the entity's inventory count procedures.
- Perform test of controls and record sample counts in the working papers. This information will be used to check the accuracy and completeness of the entity's inventory compilation.
- Basis of sample items selected on the company's inventory count procedures.
- Percentages of coverage of the test count samples selected in relation to the total inventory value.
- Cut off information, including the number of the last shipping and receiving documents issued on the date of the physical inventory count.
- Audit procedures and findings on goods held for others on consignment basis. Such items should not be included in the entity's inventory. The auditor must enquire about held on consignment for the entity. These goods should be included in inventory count.
- Observe and document the condition of the inventory for items that may be obsolete, slow moving, or carried in excess quantities.

Note:

For one of the samples mentioned above, the audit firm represented that attendance at physical inventory counting is impracticable due to lack of manpower and difficulty in arranging for the inventories count as it is located far from the audit firm's office. This is not sufficient to support a decision by the auditor that attendance is impracticable. The matter of difficulty, time or cost involved is not in itself a valid basis for the auditor to omit audit procedures for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

When inventory is material to the financial statements, the auditor is required to attend the entity's physical inventory counting unless it is impracticable (ISA 501).

(iii) Construction Contracts

Deficiencies identified from audit firm:

Sample 1

The documentation in the audit working papers revealed that the assessment of the stage of completion of construction contracts was not sufficiently or independently verified. This shortcoming arose due to the following:

(i) Ascertaining the total contract sum for revenue recognition – no work was performed to ascertain the completeness and accuracy of the total contract revenue sum which serves as a component for revenue recognition of construction contracts. In other instances, the auditor recognised contract revenue based on progress billings raised without performing other audit procedures to determine if such revenue recognition was appropriate under the construction contract standards.

(ii) Ascertaining the total estimated contract costs and contract costs incurred to-date – no or inadequate work was performed (instead place undue reliance on management representation during the audit) to address the relevant existence, accuracy and/or cut off audit assertions pertaining to total estimated contract costs and contract costs incurred to-date.

(iii) Assessment of the provision for foreseeable losses.

Sample 2

The audit working paper documented the wages for sub-contracted workers and merely verified these against internally generated payment slips. There was no documentation on cut-off tests for contract costs and progress billings. For the same engagement reviewed, the project budget was reviewed but there was inadequate documentation on certain aspects of the budget review. For two (2) of the projects, certain variation orders on contract revenue were not reflected accordingly in the budget, due to dispute over the variation orders. However, the impact of the variation orders of the profit recognition was not quantified. The auditors also represented that the budgeted costs for all projects were estimated between 90% to 95% of the budgeted revenue based on similar projects. However, there was no corroborative evidence to justify the reasonableness of significant budgeted costs.

In ascertaining the completeness and accuracy of contract revenue, it is crucial that the auditor performs a review of all significant contracts entered into on a contract-by-contract basis.

Guidance from Practice Review Department:

Auditors should exercise due care and diligence when auditing construction contracts. Recognising that there are various methods that can be used to determine the stage of completion of a contract, the auditor should fully understand the method adopted by management when designing and performing the audit procedures. With this understanding, the auditor should perform an independent assessment on whether the method adopted by management is reflective of the nature of the contracts entered into by management and whether it is a reliable measurement of the actual work performed. In this respect, it is noted that progress payment made, and advances received from customers which are not associated with completion of the physical proportion of the contract work should not be used as a basis to determine the stage of completion for construction contracts.

In ascertaining the completeness and accuracy of contract revenue, it is crucial that the auditor performs a review of all significant contracts entered into on a contract-by-contract basis. As part of this review, the auditor should ascertain that the total contract revenue accurately captures not only the initial contract sum signed but also any subsequent variation orders or relevant correspondences arising from changes in the scope of construction work. For the variation orders noted, the auditor should also demonstrate a healthy level of professional scepticism by inquiring into and obtaining an understanding of the nature of the variation works entered into and their potential corresponding impact or revision to the total estimated contract costs.

In ascertaining the reasonableness of the estimated total contract costs and the existence and occurrence (cut-off) of costs incurred to date, the auditor should perform independence verification which include verification of significant components in such contract costs to quotations obtained, contractual agreements signed or assessing the basis used to determine overhead estimates such as labour costs. In respect of costs incurred to date, the auditor should obtain breakdown of individual costs and verify the costs incurred to source documents such as supplier's invoices with delivery orders and assess the reasonableness and appropriateness of the allocation basis for allocated costs.

Further, the auditor should also look out for indicators of foreseeable losses in construction contracts. Such indicators typically include contract specific factors such as the specific project's attributable profit in comparison to similar project's attributable profits and stage of completion, major construction delays, costs overruns, termination of contracts resulting in lawsuits or activation of penalty and compensation clauses to macro-economic factors such as interest rate hikes or prolonged and significant economic downturns. In instances where foreseeable losses had been determined by management, the auditor should perform corroborative procedures to assess the reasonableness of these estimates.

Note:
Consideration for element of ISQC 1 - Acceptance and continuation of client relationships and specific engagements.

This element emphasises that before accepting or continuing with any client and engagements, a firm should have the competency and capabilities required by the engagements. If the firm does not possess expertise and skills as measured by the knowledge and familiarity with the client's industry, standards and reporting requirements, the engagement partner should not approve the acceptance or continuance.

Apart from the competency and capabilities required by the engagements, the firm also needs to assess the integrity and ordinary course of business of every client. For instance, the firm needs to assess the compliance of AMLA imposed by BNM before accepting or continuing the audit engagement.

(iv) Audit Planning and Materiality

Deficiencies identified from audit firm:

Sample 1

There was no or inadequate documentation to attest to the performance of the following audit procedures:

i. Audit planning was inadequately documented (ISA 300). The standard checklist was completed but it was supported with limited documentary evidence and cross referencing.

ii. Risk assessment procedures and related activities, understanding of the entity and its environment, including its internal control and auditor's responses to assessed risks were inadequately performed (ISA 315 and ISA 330). For instance, preliminary analytical review was performed by the AXP software but there was no conclusion and audit steps were populated by the AXP software but there was no conclusion and indication of linkages to the relevant sections where the audit procedures had been performed. Also, process flows for the selected business cycle were documented but the key control activities were not documented. No walkthrough test was performed to evaluate the design of controls and determine whether they have been implemented.

iii. Materiality level was set but it was not applied consistently throughout the audit. Also, there is no indication that the determination of materiality level was approved by the engagement partner. Planning materiality and clearly trivial material level (i.e. amount below which misstatements would be clearly trivial and not reported as an unadjusted misstatement) were not established.

iv. No documentation on the consideration of risk of material misstatement in the financial statements due to fraud (ISA 240). The firm had completed the standard checklist without supporting it with documentary evidence such as record of discussion with management on fraud, test of journal entries, review of significant accounting estimates and unusual transactions.

Sample 2

Audit planning memorandums were prepared but noted inadequate documentation on the following areas:

i. Planning documentation was strictly based on a checklist and generally not moderated for the audit team to gain an understanding of the client's business. (e.g. did not specify the names of key customers and key suppliers). Some of the procedures in the checklist were not completed by the audit firm.

ii. Certain comments made in the planning documents were not further explained or cross referenced to establish a linkage between the audit evidence gathered during the planning stage.

iii. Preliminary analytical review was mainly confined to some calculation of variances without explanation to interpret the results computed. There was also no cross reference to planning checklists on risk of material misstatement.

iv. Inadequate documentation on the consideration of risk of material misstatement in the financial statements due to fraud (ISA 240). The firm had completed the standard checklist without supporting it with documentary evidence such as record of discussion with management on fraud, test of journal entries, review of significant according estimates and unusual transactions.

Guidance from Practice Review Department:

Audit planning is an important audit procedure to enable the auditor to devote appropriate attention to important areas of the audit and resolve the potential problem on a timely basis. In addition, audit planning could help the auditor to properly organise and manage the audit engagement so that it is performed in an effective and efficient manner and to reduce audit risk to an acceptable low level. Audit planning and overall audit strategy should be completed before the execution of audit procedures and should be revisited if there are any significant findings noted during the audit.

Pursuant to ISA 300 (12), an auditor shall include in the audit documentation the overall audit strategy, the audit plan and any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. The availability of the documents mentioned above would benefit an audit engagement in several ways which include, inter alia, the following as depicted in ISA 300 (2):

- Helping the auditor to devote appropriate attention to important areas of the audit;
- Helping the auditor identify and resolve potential problems on a timely basis; and
- Helping the auditor properly organise and manage the audit engagement so that it is performed in an effective and efficient manner.

Pursuant to ISA 330: "The Auditor's Responses to Assessed Risks", the auditors shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risk of material misstatement. In addition, ISA 315 (Revised) requires the auditor to make a risk assessment on the financial statements and assertion levels, through understanding the entity and its environment, including the entity's internal control. The risk assessment procedures shall include inquiries of management and of others within the entity who in the auditor's judgement may have information that is likely to assist in identifying risks of material misstatement due to fraud or error, analytical procedures, observation and inspection.

Audit planning is an important audit procedure to enable the auditor to devote appropriate attention to important areas of the audit and resolve the potential problem on a timely basis.

When obtaining an understanding of controls that are relevant to the audit, the auditor should evaluate the design of those controls and determine whether they have been implemented by performing procedures in addition to inquiry of the entity's personnel (e.g. tracing transactions through the information system that are relevant to financial reporting).

Pursuant to ISA 240 (2), the auditor shall consider the risks of material misstatements in the financial statements due to fraud. The auditor needs to obtain sufficient appropriate audit evidence regarding the assessed risk of material misstatement due to fraud, through designing and implementing appropriate procedures. In addition, the auditor shall respond appropriately to fraud or suspected fraud identified during the audit.

Materiality levels (overall materiality, performance materiality and clearly trivial materiality) shall be established for all audit engagements with their basis clearly documented and once determined, these shall be strictly applied as otherwise the overall risk of the engagement concerned may not be properly addressed. Consequently, the overall opinion expressed on the financial statements may not be appropriate.

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