

Qualified opinions due to business complexity

BY YEN NE FOO

A number of Bursa Malaysia-listed companies with small market capitalisation, including those with prominent shareholders like self-made tycoon Tan Sri Vincent Tan and businessman Datuk Tey Por Yee, saw their FY2014 financial accounts slapped with a “qualified” opinion by external auditors.

Are financial shenanigans on the rise or have auditors turned more cautious following an explosion of mega financial fraud in recent years? Former stock market darling Transmile Group Bhd, whose investors include billionaire Tan Sri Robert Kuok, comes to mind.

Audit practitioners put the development down to evolving financial reporting and auditing standards as well as growing complexity in businesses today.

“As businesses and (accounting) standards become more complex, the challenges involved in auditing these financial statements become more pronounced. The key areas where difficulties could be encountered are in obtaining sufficient audit evidence to support assertions made by management,” Pauline Ho, PwC Malaysia’s assurance leader tells *The Edge*.

To be sure, a qualified account, on its own, does not automatically mean there is financial fraud. It is merely an expression of professional disclaimer post-audit, dished out when an external auditor cannot affirm that certain elements of the financial statements have been truly and fairly presented in accordance with International Financial Reporting Standards and the requirements of the Companies Act 1965.

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(EY), for instance, qualified the FY2014 accounts of StemLife Bhd (fundamental: 1.95; valuation: 0) because it did not comply with the requirement of the Malaysian Financial Reporting Standards (MFRS) 4 for the assessment of insurance liabilities and revenue associated with insurance contracts. There was also insufficient access to the financial information and management of a Thai associate for audit purposes.

According to filings with Bursa, Tan, who is Berjaya Group founder, was deemed interested in about 10.37% of StemLife as at June 25.

SJ Grant Thornton, the external auditor for Wintoni Group Bhd (fundamental: 1.70; valuation: 0), issued a qualified opinion on the latter’s FY2014 financial statements after it was unable to sight the group’s computer equipment with a net carrying amount of RM3.7 million. The computer equipment was said to be in the US, the disclaimer read.

Tey, an executive director and second largest shareholder of Wintoni, held a 4.5% stake in the company as at May 15.

Time constraints also prove to be a challenge, as was the case for EY with oil palm plantation player NPC Resources Bhd (fundamental: 0.50; valuation: 0.80). The auditor said there was insufficient time to perform sufficient audit procedures as the financial statements of three of NPC’s Indonesian subsidiaries were only available close to the date of the group’s own FY2014 financial statements.

Investors, however, tend to pay more attention to qualified opinions involving the recoverability of receivables. There have been instances where fictitious invoices were used to artificially inflate sales, resulting in elevated levels of receivables without a corresponding increase in operating

cash flow. An extensive audit — which might cost more than the plain vanilla type — would usually show whether it is a case of gaps in record-keeping or financial fraud, if stakeholders have concerns.

Baker Tilly Monteiro Heng, the auditor for Silver Ridge Holdings Bhd (fundamental: 0.95; valuation: 0.30), issued a qualified opinion on the telecommunications solutions provider’s FY2014 accounts after it was unable to obtain sufficient and appropriate audit evidence on the recoverability of receivables amounting to RM890,627.

The FY2014 accounts of Malaysia Steel Works (KL) Bhd (fundamental: 0.35; valuation: 1.40) also fell short. Nexia SSY Chartered Accountants raised concerns about its transactions worth RM287 million and flagged that it could not verify the recoverability of Masteel’s trade receivables of RM334.54 million.

EY Malaysia country managing partner Datuk Abdul Rauf Rashid argues that there is no change in the auditor’s role as a kind of “watchdog, not bloodhound” that raises red flags where necessary over inconsistencies in a company’s financial statements.

“The tightening of regulations surrounding financial reporting, the increasing complexity of business transactions and the emergence of governance and control risks surrounding corporations have affected the extent to which auditors design their audit strategies, risk assessments and consequently the formulation and execution of auditing procedures,” he explains.

“[But] we disagree that there has been a change in the degree of ‘carefulness’ in the execution of audit procedures. The work of an external auditor is guided by a comprehensive set of auditing principles,” he says.

All the same, the qualified opinions of auditors

— whose work is usually confined to the backroom — to ensure the integrity of the financial statements of public-listed entities are starting to come to the fore. This is a signal that shareholders, potential investors and the general public are starting to view auditors’ opinions as a reflection of a company’s financial credibility and weigh their investment decisions accordingly.

Abdul Rauf acknowledges the growing interest in what auditors have to say about financial statements, especially among the media and the general public, who he calls the “non-traditional users of financial statements”.

“We believe this is due to the increased number of corporate scandals and financial issues in recent years, hence attracting the interest of the media and the general public to try to obtain more information surrounding the financial health of listed companies,” he observes.

The attention given to auditors and their opinions, even with their limitations, is “not necessarily bad,” says PwC’s Ho, highlighting the importance of these professionals in building trust in the context of the capital market and prompting the board of directors to ensure a quality audit is carried out by external auditors.

This aspect of auditors’ work will become more prominent as auditing standards continue to evolve to keep up with the complexities of business. **E**

Note: The Edge Research’s fundamental score reflects a company’s profitability and balance sheet strength, calculated based on historical numbers. The valuation score determines if a stock is attractively valued or not, also based on historical numbers. A score of 3 suggests strong fundamentals and attractive valuations. Visit www.theedgemarkets.com for more details on a company’s financial dashboard.