The Enron, WorldCom, Parmalat and Tyco accounting scandals that broke in the early 2000s spawned a new wave of whistle-blowers and unequaled deficiencies in the audits of public companies around the world. Malaysia’s established audit oversight mechanisms, including audit oversight boards to oversee auditors of public companies, periodic inspections and setting auditing standards.

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While it is undeniable that regulations are necessary, a new framework that authenticates financial reports often used in decision-making, over-regulation can still stifle growth. Unsurprisingly, views on the regulatory body are divided. Some lament that the AOB has become too bureaucratic in its oversight, while others praise it for keeping them on their toes.

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"Auditors are now regularly reminded of the need to align their function with the AOB's mission, which is to foster high-quality independent auditing. It is important to understand that the AOB is not just an enforcement agency. It also helps provide support and guidance to audit firms in improving their quality-control policies, procedures, and systems. As a result, we have seen a significant improvement in audit practices and compliance since the AOB was established," explains Rasifik, PwC Malaysia Assurance leader Pauline. He adds that she says this can be seen in the changes in audit opinions, audit team composition, and audit procedures as well as the restatement of financial statements, which was directly or indirectly caused by the AOB's inspection of 12 audit firms and 35 individual auditors in 2015. Through the PwC global network’s interactions with regulators, we have found that the AOB appears to be one of the more progressive regulators globally, one which listens closely to the concerns of its profession," adds no.

Besides, she says, PwC has kept audit firms vigilant. In 2015, for the first time, the AOB took action, deregistering an audit firm and its managing partner.

However, some auditors think that some companies that intentionally understated or overstated their accounts have got off scot-free, while the auditors are the ones who suffer for not following certain audit procedures.

Does reprimanding the audit firms really help? The AOB may be sending the wrong message to the public. Whenever something goes wrong with a company, the auditor gets the blame first. With AOB publicity reprimanding audit firms, it kind of confirms the public perception that fault is caused by the auditors, which is definitely not the case," says a visibly upset audit partner who declines to be named.

PwC’s Ethics Committee has reprimanded and punished actions do play a role. However, internal culture shaped by a strong tone at the top that focuses on audit quality is more important. I believe that there should be recognition for audit quality where demonstrated. So that there is more balanced view of the profession. It is important to note that audit quality is not the sole responsibility of the AOB and the auditors. All parties in the financial reporting ecosystem and regulators need to play their roles effectively to ensure that the quality of financial reporting and auditing is enhanced," she says.

Rasifik admits that the AOB has faced the challenge of reaching out to various parties in the financial reporting ecosystem for feedback and hopes to see continuous engagement with all stakeholders in order to better understand the challenges faced by the industry.

"The AOB has a privileged position to have an overview of the various issues and challenges faced by the industry and profession from the larger international audit firms to the smaller and medium-sized ones. Perhaps it could extend its role further by providing benchmarks or guidance on addressing common issues faced by the audit firms, and by creating a forum for the sharing of best practices," he suggests.

He adds that the AOB could also consider issuing periodic alerts to the auditing profession and highlighting emerging or notable circumstances that may affect how auditors conduct their audit under the existing requirements and relevant laws.

**CRIMINAL PROSECUTION**

<table>
<thead>
<tr>
<th>Nature of offence/misconduct</th>
<th>Parties involved</th>
<th>Case description</th>
<th>Sentence/action taken</th>
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<tbody>
<tr>
<td>Abetting in making a misleading statement to Bursa Malaysia</td>
<td>Yue Chi Khin who was at the material time the audit partner of Messrs. Roger Yen Tan &amp; Associates, which audited United U-Li Corp Bhd's financial results for FY ended Dec 31, 2004</td>
<td>On Oct 21, 2016, the Kuala Lumpur Sessions Court found Yue Chi Khin guilty of abetting United U-Li Corp Bhd in making a misleading statement to Bursa Malaysia in its annual report and financial statements for FY ended Dec 31, 2004, in an offence under Section 122B(b)(bb) read together with Section 122C(3) of the Securities Industry Act 1983. Yue was charged on April 28, 2009.</td>
<td>1 year's imprisonment and RM40,000 fine</td>
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**AOB SANCTION**

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Breach of AOB's registration condition imposed under Section 310(3) of the Securities Commission Act 1993 (SCMA)</td>
<td>Lee Kok Wai, partner of Crowe Horwath who was the engagement partner in the audit of 31.2 Group Bhd's financial statement for the year ended Oct 31, 2010</td>
<td>Failure to comply with the requirements of the International Standards on Auditing in the discharging of his professional duties in auditing the public-interest entity (PIE)</td>
<td>Reprimand and RM500,000 penalty on Jan 16, 2015. Lee appealed but the Securities Commission rejected it on Feb 29, 2016 (Application for a judicial review was filed twice against the SC's inspector of the AOB's inquiry against Lee on January and February 2014 but the High Court dismissed the application with costs).</td>
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<tr>
<td>Breach of AOB's registration condition imposed under Section 310(3) of the SCMA read together with paragraph 5(5)(b)(c) of the AOB's Handbook on Registration relating to compliance with auditing and ethical standards, honest and competent practice</td>
<td>Wong Weng Foo &amp; Co. (audit firm)</td>
<td>Wong Weng Foo &amp; Co failed to ensure that the auditor who audited the financial statements of PIE is properly qualified, sufficiently trained and competent. As a result, there was raising and numerous significant deficiencies in the audit of two public-listed entities for the financial years ended Dec 31, 2013 and June 30, 2014</td>
<td>Revocation of registration with AOB pursuant to Section 310(1)(a)(b) of the SCMA on Dec 2, 2015. The appeals are pending.</td>
</tr>
<tr>
<td>Breach of AOB's registration condition imposed under Section 310(4) of the SCMA</td>
<td>Wong Weng Foo, managing partner; Wong Weng Foo &amp; Co. and Abdul Haim Hakim partner Wong Weng Foo &amp; Co. engagement partner in the audit of two public-listed entities for the financial years ended Dec 31, 2013 and June 30, 2014</td>
<td>Failure to comply with Section 310(5) of the SCMA which requires audit firms to register with AOB when acting as auditor; and failure to comply with the By-Laws (On Professional Ethics; Conduct and Practice) of the Malaysian Institute of Accountants requirement, which relates to the independence of an auditor</td>
<td>Revocation of the managing partner and partner's registration with AOB pursuant to Section 310(1)(a)(b) of the SCMA on Dec 2, 2015. As at Dec 31, 2015, the auditors had appealed to the SC against the AOB's decision. Pending the decision on the appeal, the AOB's decision to revoke their registration shall not take effect.</td>
</tr>
<tr>
<td>Breach of AOB's registration condition imposed under Section 310(4) of the SCMA</td>
<td>Lim Kok Beng, partner of Ong Boon Ee Hsi &amp; Co. who was the engagement partner in the audit of a PIE for the financial year ended June 30, 2011</td>
<td>Failure to comply with the requirements of the International Standards on Auditing in the discharging of his professional duties in auditing the public-interest entity (PIE)</td>
<td>Reprimand and RM100,000 penalty on Feb 18, 2014. AOB also requested the audit firm (which continued to act the PIE) to furnish copies of the audit working papers to prove that all significant deficiencies were rectified in the subsequent year's audit.</td>
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No easy task for transition to accrual accounting in public sector

BY ESTHER LEE

Malaysia's move to accrual accounting for the public sector has been on the wish list of many since the government embarked on this journey four years ago. However, the transition from cash basis to accrual basis is a work in progress that has been hampered by resistance from the public sector itself.

"We need more time, it will be done on a staggered basis. We will try to do as much as everyone is ready. We need perfectionism by the ministry, agency, and department levels," Deputy Finance Minister Datuk Jalani Abdul Ghani tells The Edge.

Perhaps the government was a little too ambitious on the transition timeframe. According to Ross Campbell, the director of public sector at the Institute of Chartered Accountants for England and Wales, most countries that have made the transition from cash to accrual accounting took five to eight years for full implementation to take place.

Campbell is the former accounting policy lead and financial reporting standard setter for the UK central government at HM Treasury. He also served as the group chief accountant at the Ministry of Defence and the director at the National Audit Office in the UK.

"Malaysia benefits at least from having quite a strong accounting profession compared with many countries. It is a relatively sophisticated country with a relatively good understanding of information systems. So, it would be, in theory, possible to do it in five to six years. Very few countries can do it much faster. It is just the scale of what is required," Campbell tells The Edge in an interview.

The accrual method of accounting is known to give a more accurate picture of public finances, especially when it comes to the government's balance sheet. In recent years, there has been increasing awareness among governments to shift to the accrual method as people demand more accountability in the way public funds are allocated and used.

"Everybody is feeling the squeeze and that is throwing the spotlight on how we could manage public expenditure better, particularly government expenditure. It generally comes in waves where it is seen that the public, as a result of public expenditure, is living in discomfort," says Campbell.

"This is not entirely transparent, more so to policy makers. But you do need to create that feedback loop of public accountability because it is only really through that accountability that you have the pressure to reform," he says.

Australia is no different. The government has emphasized the switch to accrual accounting in order to strengthen fiscal discipline and improve financial management to ensure the stability and sustainability of public funds. Treasury secretary-general Tan Sri Dr Mohd Irwan Serigar Abdullah said in his speech at the Public Sector Forum 2015 earlier this month that the transformation from cash to accrual accounting will provide a more comprehensive reporting of the government's financial position, its financial performance and cash flow for the periods under review. With this, decision-making will improve and eventually lead to more optimal usage of public resources, he said.

"We added that accrual accounting will meet the growing demand from the various stakeholders for more transparency and provide more meaningful benchmarking of financial performance and the position of Malaysia and foreign public-sector entities.

"Given the transparency and more reflective disclosure, the adoption of accrual accounting should, theoretically, reduce the number of accounting scandals. Campbell opens that the numbers displayed in the accounts would offer an added dimension in the way the balance sheet is managed — including its growth, assets and liabilities and the changes that take place.

"No major corporation would try to run its business without this sort of information. The government is not really any different in that sense. It has income and expenses, it employs people and it incurs liability associated with that. It owns things and it incurs tax and borrows money. There is nothing that much difference in the numbers and bottlenecks of financial management. The difference is in the purpose.

"Invariably, when you start to shine a light on people who have never been audited before, you find things, and not all the things you find are pleasant surprises. In the long run, what gets measured, gets managed. If the numbers aren’t there and are invisible, politicians will feel that they need to do something about them," Campbell says.

"The issue of government accounting inevitably has its challenges. Besides tangible problems, like the changing of the entire information system and the painstaking process of accounting for government assets, the bigger challenge, according to Campbell, is embedding the culture of transparency and different way of thinking about the numbers.

"That is a journey and that does not happen overnight. People have to change their minds. We have been doing this (accrual accounting) in the UK for 20 years, but only now do we have people who are coming up to the senior jobs in government to whom this has always been normal and it is the way things work," says Campbell.

Good businesses want to be associated with credible audit firms

FROM PAGE 56

"This is being afraid of losing clients for raising audit standards. Firms determined to maintain audit quality and professional standards "are not worst off economically compared with their peers and in certain market segments, are more competitive" because good businesses want to be associated with credible audit firms.

"There is a commercial element in what we do. We highlight something from an independent point of view, so many firms actually see that as a positive way of dealing," Nik says.

"It makes good business sense for audit firms to maintain quality work. It’s not like ‘Don’t go to this firm, its standards are high. It doesn’t work like that. There are companies that want to be associated with such firms ... it is a positive thing. I’m quite happy with where we are today.

"There is always room for improvement, even among the "Big Four plus two" (BDO Binder and Crowe Horwath). They lead the pack of eight firms with "more than 10 partners", which collectively (with 191 auditors) audit 922 PEs covering 95.64% of the market capitalisation of public-listed companies and 872 schedule funds covering 59.3% of the fund size in Malaysia.

"The workload means each partner, on an average, audited 217 audit reports last year, which could range up to 24 PEs, 288 entities related to PEs, or 1,342 PEs per partner," AOB says in its 2015 annual report, flagging that "unreasonable workload causes doctors to turn down incoming audit business, which ultimately affects audit quality.

"Nik also says the complexities that come with globalisation and a fast-changing business environment mean auditors have to understand a client’s business in order to perform a good audit.

"Today, banks are driven by technology, so the auditors must have the ability to look at IT audit, complementaries are involved in different industries and they are everywhere in the world, so it’s not as easy as last time," he says.

Nik also warns against having a false sense of security when auditing companies that are familiar with and to all say’s obtain evidence to support their judgement, because circumstances and context can change over time. "One of the threats is when the auditors don’t bother to check — I’m familiar with the company; I’ve seen it before, so it must be the same thing," he says, when they get caught.

"Also, it brings up that an audit firm should not accept a client if its people are not confident in doing a good job.

Nik adds that audit firms have become more pro-active in highlighting audit issues and audit quality in Malaysia in recent years following AOB’s engagement with auditors.

"Things still happen, yes, but we have to look at what those issues were. Last time, there were companies that suddenly collapsed. So the company may fail first, only then do people realise that it was an audit issue.

"But today these incidents are more driven by the audit firms. They refuse to sign (off the accounts), they alert the market, they issue a disclaimer. In that respect, they have done what they are supposed to do, although we still find some audit issues today. What is more important is, we expect the auditors to do a better job, not necessarily honestly and diligently," he says.

AOB’s 2015 annual report, released on 6 May, also noted "instances of change in audit opinion subsequent to its regulary activities", widely in the case of some high-profiled cases in AOB’s inspection findings. AOB also observed instances of changes in the scope section and audit procedures to obtain more reliable audit evidence. It did not provide specific statistics on the number of audits or how substantial the changes were.

To be sure, there is no perfect system. What is certain, though, is that there is a need to safeguard investor confidence with regard to the reliability of financial statements because a breakdown of trust would mean a higher risk premium and higher costs for companies seeking funds from the market.

A chat with The Edge journalists on the story behind their stories each week. Uploaded on Monday @ 1.30pm

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