Revised audit standards a double-edged sword

While characterised as a game-changer for shareholders and the accounting profession, a new section on key audit matters could invite investor backlash

THE soon-to-be implemented new and revised audit reporting standards mandated by Bursa Malaysia may prove a boon or bane for corporate Malaysia. On the one hand, it is expected to enhance the transparency and corporate governance standards of listed companies and provide shareholders and the investing public with more in-depth information.

However, listed companies can expect compliance costs and audit fees to increase. Additionally, companies with financial and accounting irregularities will be open to greater scrutiny and can expect investor backlash if they are unable to adequately explain the issues raised in the new auditor’s report.

To provide investors with more information, Bursa Malaysia Bhd had, in March, announced it will be compulsory for listed companies to provide more details and analyses of their business while implementing the new auditing standards for the period ending Dec 15 onwards.

Coming on the heels of the Goods and Services Tax rollout last year, large corporations are now facing the prospect of increased compliance cost to adhere to the new auditing standards, sustainability reporting as well as future changes to international accounting standards.

The new auditor’s report, which has been characterised as game-changing for shareholders and the accounting profession, introduces a number of key changes which include a new section on key audit matters (KAM) as well as a description of the responsibility of the auditor and management in relation to a going concern (see table).

The International Auditing and Assurance Standards Board (IAASB) defines KAM as those which, in the auditor’s judgment, are most significant in the audit of the financial statements.

**Impact on investor sentiment**

While the KAM’s introduction improves a company’s corporate governance disclosure, some listed entities FocusM spoke to are worried it will dampen positive impact on investor sentiment.

An executive chairman of a listed company says previously, KAM were usually communicated internally, between the auditors and the audit committee. Hence, the public was not privy to such information.

The chairman says more emphasis will be needed to ensure the management’s answer to the KAM raised by the auditors is fair and understood by investors.

“If investors see the issues differently, yes, I think it will have an impact on the share price,” he says.

A fund manager also foresees issues brought up in the KAM as impacting investor sentiment. “If the KAM are negative, investors may pull out from a company. As you know, investing in shares is tantamount to investing in the management of the company.

“We have to see how susceptible investors are with regards to this new auditor’s report, and to really determine the impact,” he says.

PricewaterhouseCoopers (PwC) assurance partner Lee Tuck Heng says the KAM will shed light on audit matters which were most significant during the period in question. “In a sense, providing a window into issues will keep the auditor up at night,” he says.

Despite concerns it might affect investor sentiment, he believes the new reporting standard, which provides insights and enhances transparency, helps to build investor confidence.

“Investors need to be properly engaged on the changes impacting their businesses so that they can understand the context and rationale for KAM,” he says.

Benjamin Johnson points out that KAM need not just be on negative issues and can also feature positive developments within the organisation that benefit the business and stakeholders.

“There must always be a middle ground on the KAM, or somewhere auditors and management can agree. It may be difficult to determine what should be or qualifies to be in the KAM. It should always come with some sort of explanation on how those matters will be addressed by the management,” says Johnson, who is also PwC Malaysia executive director.

**Disclosure exceptions**

While there might be instances where an auditor believes an issue should be included as a KAM, the company concerned may view it as sensitive. However, for listed companies, independent auditor Ong Chee Wai and professional practice executive director Yeoh Seok Luan say the IAASB has addressed such concerns relating to non-disclosure of a KAM.

“The IAASB agreed to add a requirement in the International Standard on Auditing (ISA) 701 to allow for the possibility, in extremely rare circumstances, where the auditor may decide not to communicate a matter determined to be a KAM in the auditor’s report,” they say.

According to ISA 701, auditors are allowed not to communicate a KAM when a law or regulation precludes public disclosure about the matter, or the auditor determines that the matter should not be communicated in the auditor’s report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Despite this clause in ISA 701, the new auditor’s report which promotes KAM may lead to legal liabilities on the auditor, opinions the partner of a mid-sized audit firm. “If the clients deem the KAM does not sufficiently address what they wish to know,” he says.

PwC’s Lee anticipates that the audit profession and companies can face issues arising from the new standards. Potential issues that may creep up include clarifications that include sharing of information which they feel are sensitive.
Benefits of KAM

The introduction of the new auditor's report is aimed at enhancing communications between auditors and investors, as well as those charged with corporate governance, by enhancing financial reporting based on public interest.

Ernst & Young (FY) assurance partner Ong Chee Wai and professional practice executive director Yeah Seok Luan say KAM's introduction is a significant enhancement that not only changes the auditor's report, but also the quality of financial reporting as it provides more information to investors and stakeholders.

The enhanced auditor's report will communicate relevant information to users about the entity and its financial performance, they say.

"An example of this can be the position taken by the company to support a legal case involving them," he says. "Lee also says it is important that auditors and clients avoid approaching KAM from a mere compliance or "tick-the-box" mindset. He says it is important for companies to tell their side of the story in regards to the KAM communicated by auditors.

Audit committees, he says, should ensure that issues raised in the KAM are addressed in the audit committee report and adequately disclosed in the company's financial statements.

"In this way, shareholders will not only get the perspectives of auditors but more importantly also the viewpoints of management and the directors," he says.

Higher fees
Changes to the auditor reporting standards will not come cheap. PwC's Lee says the introduction of the new auditor's report will result in higher audit fees.

The quantum of increase, he says, will ultimately depend on the complexity of the issues involved.

KPMG partner Thong Foo Yung says KAM's benefit will outweigh the cost incurred. He explains that the reporting of KAM promotes and enhances audit quality as the audit engagement partner will need to be more involved in the audit.

"Identifying suitable KAM to be reported requires the audit engagement partner to have a strong understanding of the business and hold dialogue with the directors or audit committee members of the company," he says.

However, Thong foresees the biggest implementation issue for KAM is the availability of competent resources to draft the audit report since they will no longer be "standard".

"It will require most annual reports and audit reports being in English, audit professionals will need to upskill themselves to enable effective communication," he says. "This is also the issue of proper translation of the audit report to other languages.

An important addition to the new auditor's report is the key audit matters (KAM).

"The new auditor reporting standards require more audit time and effort, particularly from the [audit] partner and senior audit teams representing the client. Logically, this will translate into higher audit fees," Lee says.

KPMG partner Thong Foo Yung tells FocusM that the new standards will not significantly change the auditing process. However, he expects the compliance cost for the audit to increase due to the greater involvement of the audit partner and engagement quality control review.

Nevertheless, Thong thinks that the increase in audit fees "should not be substantial".

An auditor with a small to medium size firm concurs with Thong and Lee. However, compared with the bigger accounting firms, he says he faces difficulties in seeking an increase in audit fees.

He says a majority of his clients are based in suburban or rural areas where a fee increase is perceived as unjustified.

"We have to remain competitive to retain clients, and one way is to maintain our audit fee," he says.

With regards to enforcement, an auditor who fails to adhere to the new standards can be charged with negligence if he signs off the accounts, says a partner of a mid-sized audit firm.

He adds that disciplinary action can be taken by the auditor's accounting institution such as Malaysian Institute of Accountants (MIA) or Malaysian Institute of Certified Public Accountants (MICPA) if he is found negligent. An auditor could also lose his auditing licence revoked.

With the adoption of the new auditor reporting standards virtually around the corner, time is running out for listed companies' directors, audit committee members and staff to get up to speed with the changes.

MICPA president Datuk Abdul Rauf Rashidi says a key issue is awareness and education from the perspective of the corporation as most believed the new auditor reporting standards only applied to and impacted auditors.

Abdul Rauf says besides company staff affected by the change in auditing standards, its audit committee members and board of directors also have to attend training on the new developments.

"We wish to highlight that this is of the essence, so companies, especially public listed ones, need to start now," he stressed.

Ernst & Young Ong Yaik Yeah says staff training cost to be incurred by companies will vary as the issues to be raised in the KAM will also vary among companies.

Meantime, Johnson says auditors and accountants have to undergo training whenever there are changes to reporting standards.