

WATCHING THE watchdogs

Majella Gomes

With the recent passage of the Securities Commission Amendment Act 2010 in Parliament, the Audit Oversight Board (AOB) is now a reality in Malaysia. What does this mean for local public interest entities? What will be the impact on audit and assurance firms? Can stakeholders anticipate better corporate governance and improved policing against fraud and mismanagement?

Over the last few years, several fraud incidents were uncovered in errant local companies – Transmile, Energro, Welli Multi, Megan Media, GP Ocean and that behemoth, the Port Klang Free Zone – that taken together could put Enron in the shade. Fraud has siphoned away billions of ringgit – and that’s just what came to light. How much remains unaccounted for?

Is it any wonder that the klaxons have sounded, and the authorities have moved to set up more stringent checks and balances? As far back as 2007, plans were already in the pipeline to establish a Public Companies Accounting Oversight Board under the Securities Commission. In 2008, the SC set up a task force to hammer out a framework that would be acceptable to all parties, and in December 2009, the Securities Commission (Amendment) Bill 2009 – which proposed the establishment of the Audit Oversight Board (AOB) – was passed by both Houses.

Plainly, the AOB will have immense implications on auditor quality. There is no doubt that the role of auditors is critical because the efficient functioning of the capital market depends on investors having confidence in the financial reporting of companies. “Statutory auditors play

an important role in ensuring that companies’ accounts are trustworthy and reliable. Audit plays a vital role in a market economy,” noted Securities Commission Executive Director Goh Ching Yin at a



forum on ‘The Audit Oversight Board & Ethical Dimensions — Credibility of Accountants’ organised by the Malaysian Institute of Accountants (MIA), Universiti

Teknologi Mara (UiTM) and the Malaysian Accountancy Research and Education Foundation (MAREF).

REFORMING THE FRAMEWORK

● While the collapse of large firms and increasing fraudulent practices had raised concerns regarding the credibility of the audit profession, this has nevertheless spurred the reform of the current audit oversight framework via the Securities Commission Amendment Act 2010, which will promote and develop an effective audit oversight framework in Malaysia.

Under the amended act, the Audit Oversight Board (AOB) will be established. “The AOB’s mission is to oversee the auditors of public interest entities and protect investors’ interests by promoting confidence in the quality and reliability of their audited financial statements. It will ensure that our regulatory framework for auditors is on par with international best practices,” added Goh.

Malaysia is the latest in a long line of countries to set up an independent AOB. The US has the Public Company Accounting Oversight Board (PCAOB), while the UK has the Professional



Oversight Board for Accountancy. Australia has an Auditing & Assurance Standards Board which sets auditing standards, and a Financial Reporting Council that monitors auditor independence. Egypt, Lithuania, Mauritius and Sri Lanka all have some form of independent regulatory oversight over their respective auditing professions, but with differing levels of empowerment.

THE ROLE OF THE AOB

●● The AOB will work with other regulatory agencies like the Companies Commission of Malaysia, Bank Negara and the MIA. It is empowered to share information with these bodies, granting it a wider regulatory and enforcement reach. In other words, the AOB will facili-

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Collaboration, particularly with the auditing profession, is imperative if the AOB is to succeed. “Our commitment to working with the auditing profession

will be reflected in the composition of the AOB,” said Goh. “Individual AOB members must understand their responsibilities, and the nature of the financial disclosures as required by public interest entities.” To fulfill this role, two of the six non-executive AOB members will be members of the MIA, i.e. accountants.

Benefits arising from the AOB are not a one-way street, and the AOB’s emphasis on audit quality will boost the profes-

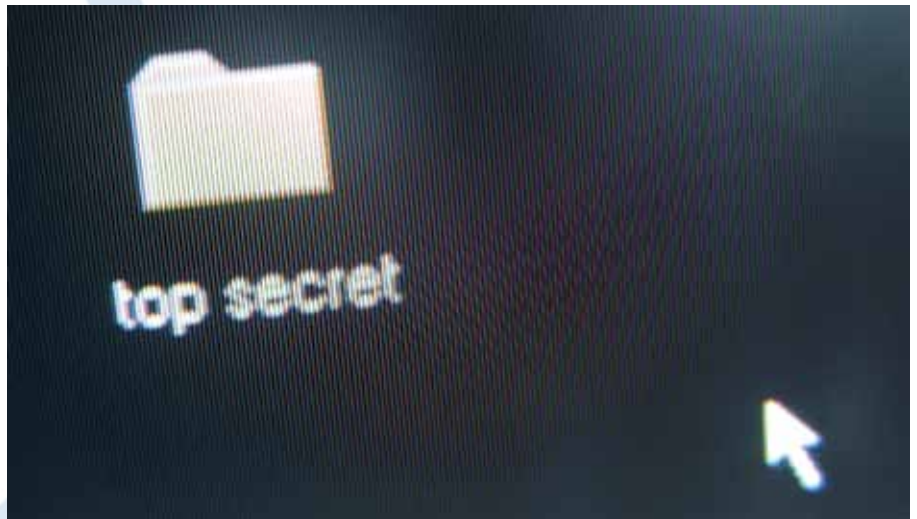
sion. “While the AOB oversees auditors and protects the interests of investors, it also benefits the auditing profession. Audit quality will be raised, which in turn will promote confidence in the assurance work that is performed by the auditing profession,” said Goh.

To cope with concerns on independent oversight and thus the need to improve audit quality, the MIA recommended that audit firms of all sizes should aim to be fully compliant with the International Standards on Quality Control 1 (ISQC 1), which aims to embed best practices and enhance quality control among firms that perform audits and other assurance and related engagements. Speaking at the forum, MIA President Abdul Rahim Abdul Hamid stressed that “compliance with the international accounting best practices of ISQC 1 and MIA By-Laws will prepare audit firms to face the rigour of any additional oversight regime that may be introduced at a local level.”

GOOD FOR THE PROFESSION

●● Instead of being daunting, the AOB’s oversight function should be regarded as a catalyst to the profession, particularly in helping auditors identify weaknesses. For this reason, the AOB would prioritise incentives rather than sanctions. The AOB has also set its sights on helping local auditors by reducing the regulatory burden that is inevitable with cross-border trade and globalisation.

A case in point is the EU Directive on Statutory Audits, which provides that firms auditing companies incorporated in a third country but listed on a regulated market in the EU should come under the independent public oversight of the EU Member State concerned. This will lead to public oversight bodies in the EU Member States starting to regulate and inspect audit firms in non-EU countries. To avoid this, the AOB can try to get EU Member States to recognise its oversight over Malaysian audit firms, thus relieving local audit firms of the addi-



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tional weight of individually conforming to these regulations.

Extend this a little further, and the now-global characteristics of auditing will become apparent. Multinational companies with cross-border activities and subsidiaries abroad will require international audit services. Auditing is a global activity, and thus close co-operation between audit regulators is necessary. The AOB will be playing a crucial role in establishing mutual relationships with foreign counterparts, which has been provided for under the Act, enabling it to enter into arrangements and share information with foreign audit regulators. Critically, where local audit firms are concerned, compliance with ISQC 1 will be vital if they want to take advantage of international opportunities.

ENFORCEMENT

●● As an oversight body, the AOB’s main thrust will be to ensure only fit and proper persons are allowed to con-

duct audits. It will also modernise the appeal process and put in place a broad range of sanctions. To do this, it will first establish a registration process for all individual auditors and audit firms to determine auditing ability and capacity. Non-registration will be an offence, and auditors who are found unfit run the risk of suspension or may have their licences revoked.

The AOB’s activities will also encompass inspection, inquiry, enforcement and standards-setting, which will coalesce into a supervisory model. There are future plans to expand into research and risk analysis to supervise the audit firms and auditors who will by then be registered with the body. The subsequent phase will be to gain international recognition from ASEAN counterparts.

With the AOB ensuring compliance with relevant auditing standards, the risks of auditing failures would likely be reduced, strengthening the local capital market. “I firmly believe the independent oversight by the AOB will promote higher quality audit work,” remarked

Goh further. “Knowing that the auditor’s work is subject to independent review will increase the standard of care and thought that goes into it.”

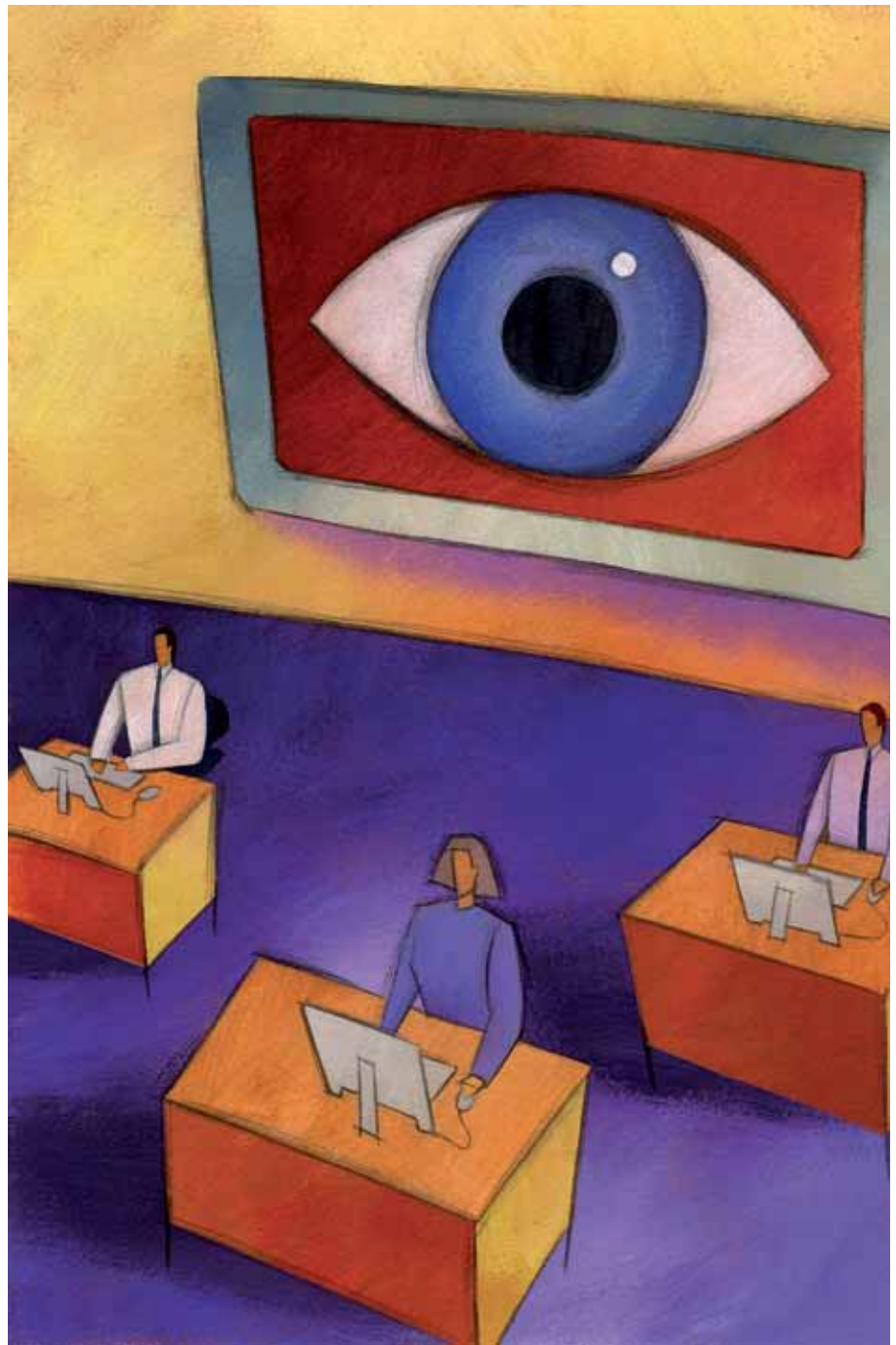
Adding that the AOB may also review how to resolve difficult audit issues, Goh pointed out that this is expected to empower auditors to exercise prudent judgement and resist management pressures on questionable accounting concepts. “Don’t ignore red flags that arise in the course of audits,” he urged.

BENCHMARKING

● ● Malaysia is not alone in its review and reform of auditing. The entire global perspective of audit is changing. In response to higher expectations from stakeholders, the auditing profession itself has undertaken some initiatives to provide comfort to stakeholders; the most notable being the Audit Firm Governance Code, a project by the Financial Reporting Council of the UK.

Singapore too is moving to enhance governance via boosting audit quality. Shirlyn Loo, Head of Strategy & Planning of the Accounting & Corporate Regulatory Authority (ACRA) of Singapore said that ACRA’s objectives were similar. Its strategy focuses on attaining an internationally reputable policy and legislative framework, high-quality audit and financial reporting, and effective and efficient regulation. ACRA sees this as a concerted move towards a transparent and informed market, supported by a strong professional environment.

Its Public Accountants Oversight Committee (PAOC) is already registering public accountants, and administering the Practice Monitoring Programme (PMP) and continued professional education programmes for public accountants. “The PAOC protects the public interest by helping the ACRA to determine codes of professional conduct and ethics for public accountants,” Loo explained. “This includes investigating complaints against public accountants and public accounting entities, and – where necessary – instituting disciplinary proceedings.”



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AUDIT AND ETHICS GO HAND-IN-HAND

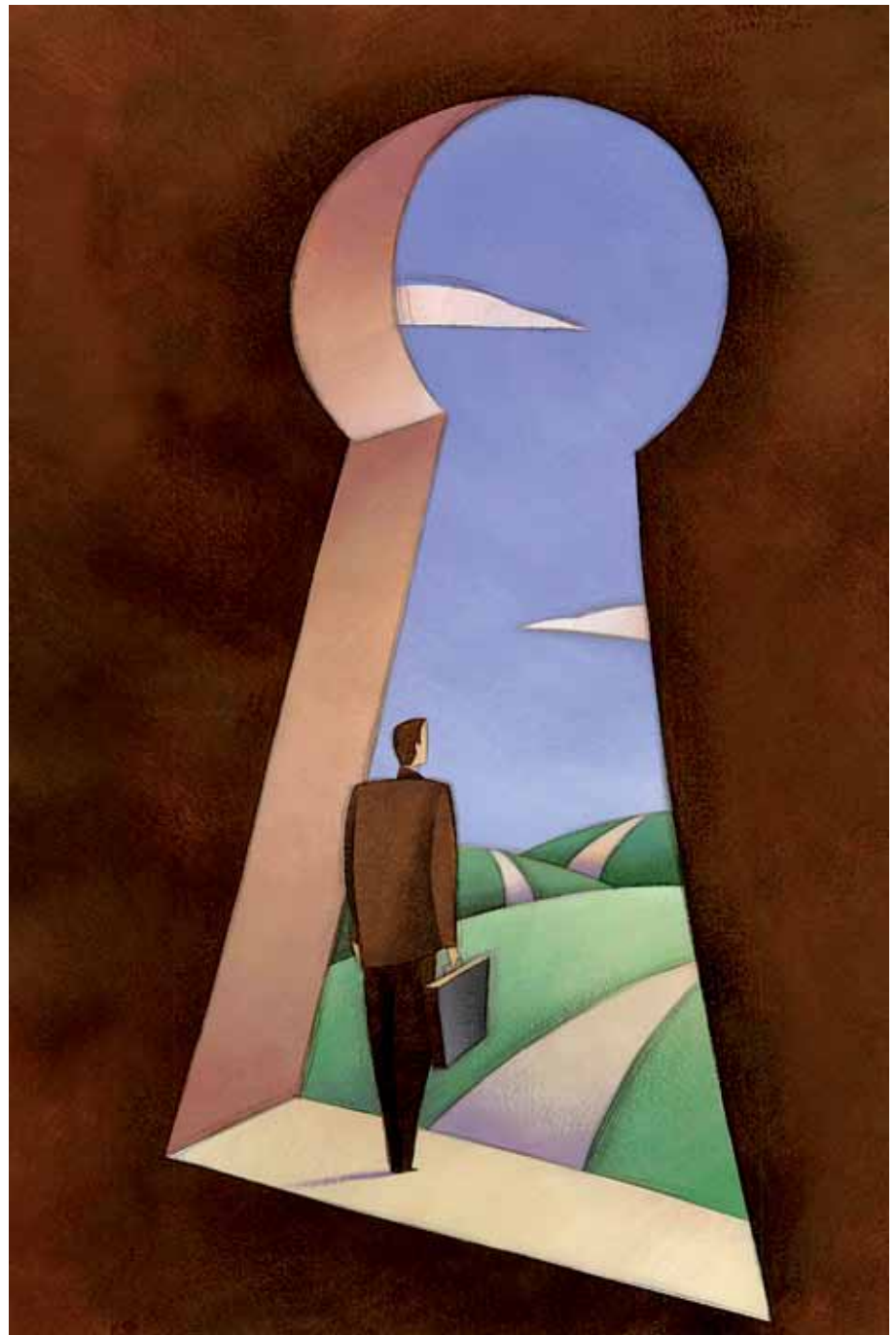
●● There may be impressive structures being constructed to ensure the quality of audit in various countries, but these would be hollow without a good set of ethics. The two elements complement each other in the professional environment when high ethical standards become the yardstick by which audit practice is judged.

To promote and support high standards of rules and regulations governing audit assurance and professional practice and conduct, MIA introduced the Audit Assurance Standards Board (AASB) and the Ethics Standards Board (ESB) in June 2009. The Boards, through MIA, also play an active role in international standard-setting processes to ensure that the standards are relevant and applicable in the Malaysian context.

Furthermore, accounting regulations will be reformed to support ethical best practices going forward. “We will be amending our By-Laws (of Professional Ethics) to reflect revisions in the International Federation of Accountants (IFAC) Code of Ethics,” said MIA Vice-President Christina Foo, who also chairs the ESB.

To embed the link between ethics and audit quality, MIA’s mission is to promote good ethical practices and global best practices among accounting professionals in Malaysia. One of its main objectives is to speak out on public interest issues where professionalism and the ethical conduct of accountants are required and relevant. The audit-ethics link becomes evident when viewed within the context of the By-Laws of Professional Ethics.

Ethics underpin the fundamentals of the profession. Auditors and accountants are called upon to uphold integrity and to be straightforward in all business dealings. “They should not allow bias, conflict of interest or the undue influence of others to override



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their professional business judgement,” said Ravi Navaratnam, Member, Ethics Standards Board, Malaysian Institute of Accountants. “It is their responsibility to maintain their knowledge and skill at a professional level to appropriately service their clients, and be able to maintain confidentiality where necessary. Their behaviour must be professional at all times.”

While relationships or circumstances could cause threats that could compromise an auditor’s compliance with the fundamental principles, there are safeguards that can be put in place to mitigate these possibilities. These safeguards include continuing professional development, corporate governance regulations, professional or regulatory monitoring, and external review by a third party.

However, in focusing on ethics, the

profession ran the risk of losing sight of integrity, which is just as important. Whereas ethics is an external system of rules and laws, integrity is an internal system of principles which guides our behaviour. “Integrity is a choice rather than an obligation,” said Navaratnam. “When we act with integrity, we are doing what is right, even if nobody is watching. Compassion, dependability, generosity, honesty, kindness, loyalty, maturity, objectivity, respect, trust and wisdom are the virtues which form the core of integrity. These are what the individual brings to his/her position every day.”

Integrity and ethics strengthen and reinforce each other. Personal integrity is the foundation of ethics, and a person who has developed a high level of integrity is likely to transfer these principles to his/her professional life. Like many

of life’s core values, integrity starts at home, and should ideally be built into the education system. “We need to understand that ethical standards themselves are not enough,” Navaratnam concluded. “Integrity is vital – it’s what you do when there is nobody around to police you. Just knowing what is right is insufficient. This knowledge has to be applied.”

Finally, integrity goes deeper than simple rules-based compliance. “We want our members to go beyond complying with the ethical minimum,” urged Foo. To achieve this, MIA is championing ‘human governance’, which is principles-based rather than rule-based. Human governance which comes from a good heart is congruent with rising global expectations of genuinely good corporate behaviour and substance, and dovetails perfectly with the AOB’s objectives. ■