BY MAJELLA GOMES

Enhancing Audit Quality

How can the expectations of auditors and management be bridged to enhance audit quality and improve the credibility of disclosure and assurance in a rapidly evolving landscape?

"AUDITORS have never faced more challenges than they do today," warned Ken Pushpanathan, immediate past President of MICPA, Board Member of MASB, and Honorary Secretary of the Financial Reporting Foundation, at the recent Audit World 2014 conference.

Among the challenges are bridging the expectations gaps between different stakeholders – such as the public and the preparers and users of financial statements. Equally important is to bridge the knowledge gap between the profession and preparers, said Dr. Yap Kim Len, Technical Director of Deloitte Malaysia.

CLARIFYING EXPECTATIONS

Since auditors are accountable to the public, it is necessary to understand what the public expects. However, it can be difficult, even impossible to deliver on public expectations. "Public expectations can be different from what the profession provides," conceded Pushpanathan. "And public misperceptions have sometimes been the cause of legal liability, locally and globally. More is expected of auditors, but they cannot always provide or be expected to provide it."

BALANCING AUDIT COMMITTEES

One means of plugging the expectation and knowledge gaps and hence enhancing audit quality is to compose a balanced Board Audit Committee. Nevertheless, this is easier said than done in reality. "The Audit Committee represents the Board, and as such, has to maintain integrity," said Raja Faridah Raja Ahmad, CFO of MSM Holdings. "But the Chairman of the Audit Committee comes to Board meetings wearing two hats; he/she has to look at investments and the direction of the organisation. How do you handle this if there is conflict of interest?" Hong Hee Leong, Audit Committee Chairman, MK Land Holdings, suggested appointing more independent non-executive directors to address this conflict.

EDUCATING PREPARERS AND AUDITORS

Expectation and knowledge gaps exist between management and auditors, particularly when it comes to disclosure and assurance on key audit matters under new audit reporting standards. “If users cannot understand key audit matters, it’s a waste of time and money,” pointed out Dr. Yap. “Auditors determine what goes into key audit matters but too much information is confusing and could lead to misconceptions.”

Raja Faridah opined that internal and external auditors should collaborate to circumvent this, saying, “Preparers of financial statements want discussions to be quick, so close the gap as soon as it is encountered. Don’t wait for matters to be brought up.”

Dr. Yap remarked that it was not so much the expectation gap that needed to be addressed, as the current knowledge gap.

Pushpanathan concurred that auditors’ roles had shifted over the years, and their scope of work had changed to become more onerous. This has necessitated wider knowledge and greater awareness of many business-related matters, because audit is perceived as setting the seal of financial integrity on financial statements.

Apart from knowledge, clarity and conciseness should be essential competencies of auditors, especially in relation to auditors’ commentary and input on key audit matters. Nurul Ain Abd Latif, Assurance Partner, PwC said, “There’s always a battle between what auditors want to put into the report, and what management feels should be in the report. There needs to be a balance between information overload and what is relevant. Many things may need to be reported, but in time the information becomes diluted and less effective.”

“The more information you reveal, the more jittery the Board will become,” asserted Raja Faridah. “Auditors have to scrutinise the information and be prepared to answer anything that comes up.” If auditors do not agree with the accounts, they should say so in the audit report, in which case there must be modifications or explanations on the matter.

IR COMPLICATES ASSURANCE?

While panellists welcomed integrated reporting (IR) as enhancing disclosure, it will be difficult to provide assurance on an integrated report. While many firms have adopted a wait-and-see attitude regarding its implementation, others have expressed concerns about the extended liability that such comprehensive reporting could cause. “If a firm’s confidentiality is compromised through IR, such extensive reporting will definitely be regarded as disadvantageous,” Hong said. The main worry is always about confidentiality because it could mean losing the firm’s competitive edge.

Pushpanathan remarked that for preparers, IR will shift the dynamics of the current reporting framework as it would require dissemination of both financial and non-financial value-added information in a meaningful and succinct manner. For most companies, IR will be a matter of getting used to doing things differently. “There will have to be a review of what needs to change, and whether it will be positively received by the users of the organisations’ financial statements,” he said.

Raja Faridah concurred, adding, “There is a need to explain what it is all about, how it will be beneficial, and find resolutions to issues. There also needs to be a change of mindset, together with current policies and procedures which may need a revamp.” Panellists generally agreed that for all this to happen, the tone has to be set from the top. “If that doesn’t happen, you won’t be able to convince middle management or new talent to go along with it,” opined Dr. Yap. Nurul Ain cautioned that significant investment in time is needed to pull things together.

One of the major challenges faced by IR is credibility. For this, independent assurance will be necessary. There are currently no frameworks for IR review, although audits are based on guidelines. “So is it an audit, or a review?” asked Nurul Ain. “There are different levels. Every (level of assurance in the) hierarchy will have its own guidelines. Right now, integrated reports are a combination of financial and non-financial information. To have to do assurance work on this will be very challenging. The current framework is still open to interpretation, so signing off on an IR audit opinion takes longer.” ■

Ken Pushpanathan, Nurul Ain Abd Latif, Raja Faridah Raja Ahmad, Dr. Yap Kim Len, & Hong Hee Leong