



## Implications of the audit oversight board: external auditors' perspective

Foong Sook Hwa<sup>1</sup>, Mazlina Mustapha<sup>2\*</sup>

<sup>1,2</sup> Department of Accounting and Finance, Faculty of Economics and Management, Universiti Putra Malaysia, 43400 Serdang, Selangor, Malaysia.

\* Corresponding author: mazlina05@gmail.com

### Abstract

The purpose of Audit Oversight Board (AOB) is to oversee the external auditors who audit the listed companies. Its establishment is expected to improve the quality of the audited financial statements and to increase the confidence of the public on the quality of the services provided by the auditors. This study explores how the establishment of audit oversight board affects the auditors in Malaysia. As the study is exploratory in nature with limited studies being carried out on AOB, face-to-face interviews were conducted with the external auditors. The findings show that the establishment of AOB affects the job of external auditors, especially on the documentation and training costs, which vary across audit firms of different sizes. There are opinions that the increased pressure on the external auditors is not solely due to the establishment of AOB, but it is also due to the revised accounting standards and other regulations. The study also finds that the external auditors' reliance on the internal auditors is not affected by the establishment of AOB. In addition, regardless of whether the internal audit department is in-house or outsourced, it will not affect the reliance of external auditors on the internal auditors work.

**Keywords:** Audit oversight board, external auditor, Malaysia.

### ARTICLE INFORMATION

Received: 25 April 2015  
Revised: 25 May 2015  
Accepted: 25 June 2015

**DOI:**  
<http://dx.doi.org/10.31580/jmi.v7i1.39>

© Readers Insight Publication

### Background of the study

The Public Company Accounting Oversight Board emerged after the corporate scandals and the fall of two giants, Enron Corporation and Arthur Andersen. Audit firms have been criticized on their role in producing high quality auditors' reports (AOB forms official collaboration, 2012). These episodes of financial scandals also sound familiar in Malaysian context, with companies such as Transmile, SilverBird, and Megan Media fail amidst misconduct of its management (Gomes, 2010). This had also caused the auditing profession in Malaysia to face a serious dilemma as the auditors had lost public confidence (Lee and Ali, 2008).

Since then, many countries started to establish audit oversight mechanisms, including Malaysia (Enhancing Audit Quality, 2008). Audit Oversight Board (AOB) in Malaysia was established on 1 April 2010 under the Securities Commission (Amendment) Act 2010. Its main objectives are to promote and develop an effective oversight framework and to promote confidence in the quality and reliability of audited financial statements of public interest entities (PIEs) in Malaysia. Audit firms and individual auditors dealing with PIEs are required to register with AOB. In addition, the Malaysian Code on Corporate Governance 2012 also states that AOB can improve the corporate governance framework by providing independent oversight over the external auditors.

In order to enhance the quality of audits, AOB requires registered firms to be fully compliant with the International Standards on Quality Control (ISQC 1), which exerts more pressure on the public accounting firms (Enhancing the Audit Quality: The Impact of AOB, 2008). It is claimed that smaller firms may face problems to enforce ISQC 1, but there is always a starting point for these firms to follow the steps of the large firms in order to be more competitive in the industry (Jayaseelan, 2010). According to AOB's chairman, Nik

Mohd Hasyudeen (2010), the ISQC 1 shall ensure that the firm is responsible for its system of quality control and that it is to be read with relevant ethical requirements such as the By-Laws (on Professional Ethics, Conduct and Practice). Thus, the stringent rules will indeed create a huge impact on the management, external auditors, internal auditors, and other regulatory bodies, either directly or indirectly. In audit firms, the areas that are expected to cause an increase in cost are documentation, audit fees, professional trainings and infrastructure (Bakar, 2010). AOB will also works with other regulatory bodies in Malaysia such as the Companies Commission of Malaysia, Bank Negara and Malaysian Institute of Accountants (Gomes, 2010). Several issues were raised after the establishment of AOB. For example, the issue of lack of sufficient appropriate audit evidence in key audit areas, poor documentation and the transparency of information communicated to the audit committee. These issues show that AOB has direct effect on external auditors (Enhancing Audit Quality, 2008).

To date, there is limited study being carried out on AOB in Malaysia as it was only recently established in 2010. Considering the importance of the establishment of AOB, this study aims to focus on how the establishment of AOB affects external auditors as they will be directly monitored by AOB. In addition, it also examines whether it will affect the relationship between the external auditors and internal auditors. The results of this study may provide information to AOB, Malaysian Institute of Accountants (MIA) and Institute of Internal Auditors (IIAM) on how the establishment of AOB would affect the auditors, and indirectly provide information on how these bodies can help the auditors to enhance their roles, for example by providing trainings and courses to the respective parties.

### Literature review



After the fall of Enron in 2001, the Sarbanes-Oxley Act of 2002 created the Public Company Accounting Oversight Board (PCAOB) in the United States. Since then, the auditors in the U.S. were subject to an "external and independent oversight" by PCAOB. The main objectives of PCAOB are to protect investors and the public interest by ensuring that the auditors comply with relevant professional practice standards (PCAOB, 2012). Moreover, PCAOB also regularly reviews issues relating to audit, address changes on risk measurement and provide guidance to auditors (Diaz-Trejo, 2011). Diaz-Trejo further claimed that with the establishment of PCAOB, the accounting firms can better provide accurate financial information to the users.

Other countries in the world also come out with their own oversight board. In Malaysia, AOB was established in 2010. By carrying out regular inspection on the public interest entities, AOB's objective is to ensure that audit firms comply with the necessary standards (Enhancing Audit Quality, 2008). AOB will also ensure that the regulatory framework for auditors is in line with the international practices, in order to promote investors' confidence on the financial statements issued (Gomes, 2010).

AOB's main emphasis is on enhancing audit quality in order to achieve its objective to promote confidence and reliability of the audited financial statements among the investors (Gomes, 2010). Additionally, AOB has many other roles and responsibilities to rebuild the confidence in the profession. In the first stage, AOB is involved in the registration of the audit firms who audit the public interest entities. AOB also strengthen its relationship with the other regulators, particularly Bank Negara Malaysia (BNM), Securities Commission (SC) and Companies Commission Malaysia (CCM). During the second stage of its implementation, AOB's inspection activities on the registered firms aimed to provide an independent oversight on the firms. Other than assessing the quality of audit performed, AOB also identified key improvement areas and provided the relevant remedial actions to the auditors (AOB Annual Report, 2011). AOB also conducted inquiries and imposed appropriate sanctions against auditors who fail to comply with the required standards.

In addition, AOB had also formed collaboration with other international bodies overseas. Recently, it had connection with the Japan Financial Services Authority and the Certified Public Accountants Audit Oversight Board (AOB forms official collaboration, 2012). As AOB continues to strengthen its core function to register and inspect the firms, it would also focus on the latest development in the financial reporting environment, regulatory changes as well as global audit development changes (AOB Annual Report, 2011).

In order to enhance audit quality, firms must comply with the International Standards on Auditing, it is also important that they comply with ISQC 1 (Enhancing Audit Quality, 2008). These firms are also supposed to comply with the By-Laws (On Professional Ethics, Conduct and Practice) and International Auditing Standards. Any non-compliance by the firms would result in the issue of warning letter before any sanctions are imposed (AOB Annual Report, 2011). However, it was not known how these regulations affect the audit firms in Malaysia.

With the establishment of AOB, it was reported that the external auditors are to be more careful and thorough in their work, which may cause an increase in their workload and documentation (Bakar, 2010). This is because they need to ensure their audit procedures and documentations comply with the relevant standards and requirements set by AOB. It is also expected that external auditors may have more and frequent meetings with the internal auditors of their client compared to previously. This is to better understand the internal audit work and may rely more on the work of the internal audit in the course of their audit work. This study will explore this domain relating to the effect of AOB on external auditors.

## Research Methodology

This is a qualitative research. Face-to-face interviews were conducted with four external auditors. External auditors are selected

because they are directly monitored by AOB, thus they would get the greatest impact compared to other parties, such as internal auditors or financial statement preparers.

Prior to the interviews, the samples chosen were contacted via telephone to obtain their agreement to participate in the interview. Before starting each interview, the participants were informed about the purpose of the interview and the related research objectives. A permission to record the interview was put forward before the interview session begins. The participants were also assured of the confidentiality of the information.

A semi-structured questionnaire was utilized as a guideline for the interview, where the questions were revolving on how AOB affect external auditors and their relationship with internal auditors. The interviews, which were conducted in March 2013, ranged in duration from thirty minutes to forty five minutes for each interviewee. The interviews were recorded and transcribed.

## Results and discussions

### Descriptive statistics

The respondents were selected from audit firms in Klang Valley. There are 4 external auditors. Three of them are male and one is female. Two of them are the audit manager, one is an assistant audit manager, and another one is an audit director. The audit director has more than 15 years of experience in accounting related field, one of the managers has 7 years-experience, and another two have about 6 years of experience in external auditing. In Malaysia, the Big Four audit firms dominated 80% of the public interest entities as their clients, which implied that AOB affected them the most. Thus, the external auditors chosen as samples were mainly those from the Big Four firms. Three of them are from Big Four audit firm and one from small audit firm.

### Knowledge and awareness

The external auditors were asked about their awareness of AOB and their understanding of the roles played by AOB. Their replies indicate that they are aware about AOB, as AOB monitor their work and some of them even admit that establishment of AOB affect their work. Among others, their replies are as follows:

*"...it is a body that regulate the audit firms to control how they perform their audit and to protect stakeholders' interest".(Mr K)*

*"...it was established to govern and monitor the quality and conducts of audit for PIEs, AOB goes from one firm to one firm to check the audit of PIEs".(Mr L)*

*"AOB is established to assists the SC in regulating auditors to promote investors' protection as well as confidence in the quality and reliability of audited financial statements of PIEs." (Mr M)*

*"... to promote quality and confidence in the PLC's audited accounts". (Miss N)*

### The impacts of establishment of aob on the external auditors

#### Quality of the audit work

The external auditors were asked about how the establishment of AOB affects them. They were asked about whether the quality of audit work has changed after the establishment of AOB, as now the work of external auditors is closely monitored and sanction may be imposed if they do not follow ISQC or the code of conducts.

These are the replies from external auditors who are attached to Big Four:

*"...There have been no changes in approach. Quality has never been an issue. With AOB, perhaps people are more meticulous and careful, when it comes to audit approach and audit conclusion. More things are considered as now there is a third eye."(Mr L)*

*"Quality.....emm.....yes....I think with the AOB and recent changes in the accounting standards ... however, it depends on the competence of the preparer... yes, somehow AOB enhance the quality..." (Miss N)*

This is a reply from Mr K, who is attached to a small firm. His firm has just started to audit PIEs recently:



"Audit quality for our firm is moderate, not so good and not so bad. We still follow the auditing standard, but not so detail...I have looked at other firm's workings, they are more detailed compared to us. ...but .....Yes, with AOB, we have to work harder and improve the quality"(Mr K)

These comments show that the audit firms want to ensure that their works are of certain quality or are workings towards the quality required by the standards and code of ethics as now they have AOB to monitor their work.

## Workload and documentation

They were also asked about the impact of AOB on their audit work. Most of the external auditors admit that there are more documentation and administration need to be done after the establishment of AOB. Among others they commented that:

"...there are more disclosures and compliance works need to be done. We need to prepare report and documentations when registered with AOB. We also establish quality procedures....as we may be visited by the AOB..... ISQC is compulsory for all... with AOB, more and more compliance work need to be done. The trainings costs have also increased." (Miss N)

"We, external auditors conducted audit in accordance with approved standards on auditing in Malaysia all the times. The impact of AOB will be more on documentation and administration part." (Mr M)

"More documentation are done.... More pressure from Partner to do better and quality work"(Mr K).

However, one of the interviewees claimed that not all changes and increase in workload is due to AOB, she commented as follows:

"However not all changes really because of AOB, some may be due to the revised accounting and auditing standards, this also cause more changes and increase in procedures.....and with all the financial fraud cases, auditors are now more careful in their work, not only because of AOB....."(Miss N)

## Audit opinion issued to clients

The external auditors were also asked whether the establishment of AOB affect the type of audit opinion which they issue to their clients. They were shown an article from the Star Online (2011, May 4) and were asked for their opinion and experience relating to that topic. The title of the article is "Auditors qualified accounts of a large number of companies due to the stricter requirements of AOB". Among others, these are their replies:

"I do not agree. Auditors express opinion according to ISA and not stricter requirement of AOB."(Mr M)

"Actually you qualified the accounts not because of AOB, because of circumstances and basis. Before AOB is there, there are accounts being qualified too. AOB does not force you to decide on your opinion. If you find evidence for you to qualify or to issue another opinion, you do that based on the evidence, not because of AOB."(Mr L)

"May be....partially true....it was just that now we are more careful." (Miss N).

"...emm...(hesitate quite long)....may be.....we are more careful and if there is no evidence to support we will issue our opinion accordingly..." (Mr K)

## Relationship with the internal auditors

The external auditors were also asked if the establishment of AOB has affected their relationship with the internal auditors in their client companies. For example, whether with the requirement set by AOB, do they communicate more with the internal auditors to resolve the matters arise, and therefore more meetings are set between them, or do they rely more in the work of internal auditors now. And these are their replies:

"The reliance does not change, no frequent meeting...just as before. The fact as to whether they are in-house or outsource make no difference to us whether to rely or not to rely on their work".(Miss N)

"Our relationship with the internal auditors are still the same, no difference, we consider their work based on ISA. Establishment of

AOB not a factor that affects the number of meetings that need to be held with IA if EA rely on the work of IA."(Mr M)

"....Our relationship with the internal auditors are still the same and professional as before...If we choose to rely, we need to do some work. We have to perform walkthrough tests and select certain samples. If we choose not to rely, we can always devise our own approach. It depends.....Does not matter whether it is outsourced or in house." (Mr L)

## Small and big firm matters?

In addition, it is also noted that establishment of AOB appear to affect the auditors in big and small audit firm differently. These are the responses from those from Big Four firms:

"With the establishment of AOB, we are very mindful, .....however, there is no significant impact of the review on our firm..... there is no major impact, because AOB is just regulating and supervising the conduct of audit. All this while, audit quality has always been the important thing in our firm.... AOB is there to claim that we have done this and that. ISQC is compulsory and has been embedded in the audit approach whether in the form of questionnaire or checklist. All firms should have this. If you are a big auditing firm, ISQC is something that you already have in place. Those which might be affected may be the smaller firms." (Mr L)

"Good thing??...emm... There are pros and cons of AOB.... Small one may be a bit difficult, but those big ones are ok. .in terms of requirements, due to the size of the company." (Miss N)

And this is the comments from an auditor from small firm (Firm A) which support the earlier claim by the above auditors. This auditor claimed that more workload and alternative procedures need to be done in his firms after the establishment of AOB. He responses as follows:

"When we register with AOB, our workings procedures have been modified. For e.g before that we did not focus on subsequent clearance / receipt tests, we just get confirmations. Now we need to do that kind of procedures. As for ISQC – this is one of the changes that we need to adapt. Before that, we don't practice that.

The problem is...we are small firm and have limited staff...emm...we have no department to take care of the quality and control the audit procedures.....such as to study the new guidelines.... Such as in valuation of assets, there are new changes, there are no person take care of it. Staff, assistant managers and managers need to study themselves. Firm will send selected person to program done by MIA and ACCA. From that program we share with the other staffs. We just modified a little bit of the procedures".(Mr K)

Hence, from this interview, smaller firms such as Firm A will have more difficulties to comply with the standards as they are still new to the standards and there was no proper training being conducted. For big firms, providing training may not be a problem to them, as claimed by Mr L from one of the Big Four. Mr. L posits that it is compulsory for all MIA members to maintain their CPE hours, thus training has always been provided by his firm even before the establishment of AOB.

## Conclusion

After analyzing the responses from the external auditors, it can be observed that their workload increased for the past few years, in which one of the reasons may be due to AOB. The auditors claimed that the increase in documentation and costs was not solely due to the establishment of AOB, but may also due to the revised accounting and auditing standards in recent years. The amendments and introduction of new financial reporting standards in the recent years had urged the external auditors to update themselves in order to perform their work with due care and diligence.

According to these external auditors, the extents of their reliance on the internal auditors also do not change after the establishment of AOB. This was due to AOB was not a factor in determining the extent of reliance. This is because the decision to rely or not depends on the factors such as the quality of the work, the qualification of the internal auditors and the relevant of the work to the external auditors' work,



and not merely because of the establishment of AOB. The frequency of meetings between them also does not change. In addition, regardless of whether the internal audit department is in-house or outsourced, it will also not affect the reliance of external auditors on the internal auditors work.

The results also appear to suggest that the Big Four firms are not affected much by the establishment of AOB as they had already complied with the standards and requirements before that. There were appropriate controls and sufficient guidelines for the employees working at the Big Four to conduct their work even before the establishment of AOB. Thus, there is no major impact on the Big Four firms. But it is not the same for the small firms. May be this is where MIA can help the small firms by providing updates, guidance and trainings to help them ensuring quality audit work.

This study is exploratory in nature, which gives an overview of the opinions of external auditors on the establishment of AOB. Due to difficulties in getting the respondents to be interviewed, only four external auditors were interviewed, hence, the results cannot be generalized. Future studies can include more samples and involve more firms from small, medium and Big Four firms.

## References

- AOB forms official collaboration. (2012, October 5). *The Star Online*. Retrieved November 30, 2012, from <http://biz.thestar.com.my/>
- Audit Oversight Board. (2011). *Annual Report*. Retrieved October 12, 2012 from
- <http://www.sc.com.my/main.asp?pageid=1038&linkid=3057&yearno=2011&mod=paper>
- Bakar, A.A. (2010, August 4). AOB Terms a Challenge for Accounting Firms. *Business Times*, p. B6.
- Diaz-Trejo, C.M. (2011). Role and function of the PCAOB and AS 5. Social Science Research Network. Retrieved December 2, 2012, from <http://ssrn.com/abstract=1835022>.
- Enhancing the Audit Quality: The Impact of AOB (2008). *Accountants Today*, 21 (12), 8-10.
- Gomes, M. (2010). Watching the Watchdogs. *Accountants Today*, 23 (4), 6-11.
- Hasyudeen, N.M. (2010). Speech at CPA Australia Luncheon Talk.
- Jayaseelan, R. (2010). Implications of the Audit Oversight Board. *The Star*. Retrieved October 9, 2012 from <http://biz.thestar.com.my/news/story.asp?file=/2010/1/9/business/5438265&sec=business>
- Lee, T.H. & Ali, M.A. (2008). Audit challenges in Malaysia today. *Accountants Today*, 21(10), 24-26.
- Malaysian Code on Corporate Governance 2012. Securities Commission Malaysia.

