



Suruhanjaya Sekuriti
Securities Commission
Malaysia

Reference No: AOB/PCAOB/R&RT/2015-009/AQI

1 October 2015

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006-2803

Attention: Gregory J. Jonas, Director, Office of Research and Analysis

Dear Sir

COMMENTS ON PCAOB RULEMAKING DOCKET MATTER NO. 041
PCAOB RELEASE NO. 2015-005
CONCEPT RELEASE ON AUDIT QUALITY INDICATORS

We thank you for the opportunity to comment.

The Audit Oversight Board, Malaysia (AOB) supports the efforts of the Public Company Accounting Oversight Board (PCAOB) in seeking to promote audit quality through a portfolio of quantitative measures of public company auditing, or audit quality indicators ("AQI").

Functioning as a 'balanced portfolio' of audit quality, it is clear that AQIs operate in an integrated manner along with contextual information. In this respect, the AOB agrees that AQIs' greatest use may well be as generators of questions and triggers of discussions that can strengthen audit planning and execution while creating an environment conducive to sustained audit quality and its recognition.

With this in mind, the AOB wishes to draw attention to the following key areas:

(i) **Practicability of AQIs**

The AOB cautions that the implementation and use of AQIs must be carefully considered to ensure that the benefits of the data collection and analysis of the AQIs continue to outweigh the costs.

In particular, the PCAOB may wish to consider the value expected to be attained against the level of detail required, frequency and availability of data to be captured, parties involved in the collection and analysis of the data, and the practicability of making the AQI results available in the public domain potentially without the necessary contextual information, e.g. AQIs derived from public information collected and published by data aggregators.

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(ii) **Qualitative analysis and judgment required for context**

The AOB commends the PCAOB for recognising that AQIs, while quantitative, can and often will require qualitative analysis and judgment of the persons using the indicators to provide the necessary context to understand the interactions of the AQIs as a group, in order to facilitate more informed discussion and decision making.

In light of the above, users of AQIs should be mindful at all times of its quantitative nature, and that without the necessary and relevant accompanying context, there is a risk that the understanding behind the principles and contexts within which AQIs are determined are lost in implementation. Under such circumstances, AOB wishes to caution that a seemingly unfavourable AQI result may not necessarily signify an audit failure.

(iii) **Regular evaluation of AQIs**

Identified AQIs should be regularly evaluated, say on a yearly basis, to ensure continued relevance. With the current fast-paced environment that auditors and companies operate and compete in, it is of paramount importance that AQIs evolve at the same pace.

(iv) **Comparability of AQIs**

The concept release acknowledges comparability as one of the challenges of the AQI project, and that since AQIs are not benchmarks, even comparability of AQIs in two audits may not imply comparable audit quality. This applies even in audits of companies of ostensibly the same size.

In this respect, the AOB wishes to highlight that comparability would further increase in complexity where tiering of firms and/or companies is practiced, e.g. by market capitalisation. In this situation, usage of AQIs may instead become less meaningful, in particular if the results are reduced to a single set of weighted figures, without the necessary accompanying contextual information.

(v) **AQIs should not be a benchmark for fee negotiation**

The AOB is cognisant that ultimately each audit committee will have to judge for itself whether and how it wishes to use AQIs in its decision-making.

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In view that AQIs are envisaged to stimulate competition by audit firms based on quality, the AOB wishes to highlight a potential unintended consequence where less-than-satisfactory AQI results may be used by management or audit committees, etc. to penalise the audit firm by way of reduction of audit fees, which could in turn negatively impact the firm's resourcing capabilities and quality of audit performed thereafter.

In this regard, the AOB wishes to caution that AQIs should be used wisely and objectively, and not as a benchmark to negotiate for lower audit fees.

(vi) **Tone at the top and leadership**

To complement analysis of AQIs, AOB further recommends that leadership and tone at the top be measured based on the consistency of performance of the firms' individual partners as a result of internal or external inspection activities, and how this relates back to the global and country leaderships' explanation on the performance of their network partners.

In this regard, AOB is of the view that the managing partner must drive both business and quality of the network / firm as a whole.

In addition to the above, AOB's comments to specific questions raised in the concept release are as set out in **Appendix I**.

Should you require any further clarification, please do not hesitate to contact Lim Fen Nee at +603 2091 0608 or at her email FNlim@seccom.com.my.

Thank you.

Yours sincerely



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**SECURITIES COMMISSION MALAYSIA
AUDIT OVERSIGHT BOARD**

**Comments on
Public Company Accounting Oversight Board
Rulemaking Docket Matter No. 041
PCAOB Release No. 2015-005
*Concept Release on Audit Quality Indicators***

The Audit Oversight Board, Malaysia (AOB) supports the efforts of the Public Company Accounting Oversight Board (PCAOB) in seeking to promote audit quality through a portfolio of quantitative measures of public company auditing, or audit quality indicators ("AQI").

In this regard, our specific comments on the Concept Release on Audit Quality Indicators are as follows:

Audit Professionals – Availability

(1) Staffing Leverage

Question 44 – Would addition of a calculation of staffing leverage indicators that measures the ratio of partner and manager hours to total audit hours be helpful?

AOB is of the view that the ratio of partner and manager hours to total audit hours for calculation of staffing leverage indicators would be useful as an AQI. However, AOB wishes to remind that the ratio is quantitative in nature, and must be read in context for the right understanding. For example, higher partner and manager hours to total audit hours could be due to the size of the client, the complexity of the client's business, or both.

(4) Technical Accounting and Auditing Resources

Question 45 – How should technical accounting and auditing resources be measured in a situation in which those resources are retained from outside the firm conducting the audit?

AOB supports the engagement of technical audit resources in the audit firm in resolving complex accounting and auditing issues in an effective manner.

However, it should be noted that accounting and auditing issues encountered in the course of audit faced differ in complexity and are often unique and not comparable. In addition, it is important to be mindful that not every accounting and auditing issue encountered by the audit engagement team is in need of a consultation with the technical team of the firm.

In view of the above, AOB cautions that the usage of technical resource chargeable hours as a percentage of total engagement hours as an AQI may give rise to the unintended consequence where technical consultations are relied on to the extent that the responsibility of judgment and decision making of the engagement partner is diluted. In this respect, AOB wishes to emphasise that the key audit partners of an engagement are fully responsible and accountable for the final decision made regardless of the results of the technical consultation.

It is also imperative that users of this AQI are fully aware that high chargeability of technical hours in the audit is not necessarily an indication of high audit quality. This is in view that as much as technical consultation is encouraged, the number of technical hours charged very much depends on the complexity of the issues arising for consultation.

Audit Professionals – Competence

(7) Industry Expertise of Audit Personnel

Question 47 – In measuring experience, would overall experience (including auditing and accounting experience) in the relevant industry be the best measure? Would such a measure disadvantage smaller firms? Would a measure based on number of audits performed in a particular industry be a better indicator for smaller firms?

AOB is of the view that it would be more meaningful to measure auditing and accounting experience by specialised industry, e.g. finance (banking and insurance) and construction.

(10) Training Hours per Audit Personnel

Question 52 - How can the effectiveness of a firm's training program best be measured?

AOB is cognisant of the challenges in determining the effectiveness and quality of training received by auditors. In this regard, AOB is of the view that to a certain extent, effectiveness of the firm's training programme can be measured through the completion of post-training assessments, with Continuing Professional Education (CPE) hours only being awarded if upon passing the assessment.

AOB further is of the view that the above measurement when in relation to the effectiveness of the firm's training programme can be more meaningful when complemented by the outcome of internal and / or external subsequent re-inspection or review on these firms, e.g. whether there are recurring inspection findings or notable improvements from prior inspections.

In this regard, firms should be encouraged to instil a culture of sharing of inspection findings with all audit staff, as this can assist to increase the level of awareness and understanding, as well as improve the level of audit quality throughout the firm and its network firms on a consistent basis.

(12) Allocation of Audit Hours to Phases of the Audit

Question 54 – Does the "percentage of hours" metric at the firm level of this indicator provide a meaningful basis for comparison with the engagement level of the metric? Would it help to disaggregate the numbers by audit client size?

AOB has previously conducted an analysis using the "percentage of hours" metric at various stages of the engagement. From this experience, AOB is of the view that aggregation of this AQI is most meaningful when presented in ranges.

Audit Process – Tone at the Top and Leadership

(13) Results of Independent Survey of Firm Personnel

Question 56 – Who should administer the survey described in this indicator? What steps would be necessary to assure that the results of anonymous surveys were comparable? Would the same set of questions be necessary? Would the same individual or organisation have to administer each of the surveys?

Question 58 – What other logistical issues might arise from a survey of this sort?

AOB wishes to emphasise the importance of tone at the top from the global leadership and its leadership and commitment towards the improvement of audit quality. While the idea of using a survey tool to assess this is commendable, other practical considerations which need to be addressed prior to implementation include the source of funding for this exercise.

In this regard, AOB recommends more engagement with stakeholders to identify the best way forward, which includes reaching out to stakeholders on a global basis.

AOB further recommends that leadership and tone at the top be measured based on the consistency of performance of the firms' individual partners as a result of internal or external inspection activities, and how this relates back to the global and country leaderships' explanation on the performance of their network partners. In this regard, AOB is of the view that the managing partner must drive both business and quality of the network / firm as a whole.

(15) Audit Fees, Effort, and Client Risk

Question 60 – One issue that this indicator raises is how to fashion a workable definition of "high risk" that allows comparability among firms or even among engagements within a firm. Comment is specifically requested on that subject.

AOB is of the view that the levels of client risk should be determined by the auditor when accepting or continuing the audit engagement, with updates to the clients' risk profiles as and when necessary, as part of the usual audit process.

In addition, AOB wishes to highlight that if an engagement is designated as "high risk", further follow up questions should be raised to understand the nature of the risks and their impact on the audit, as well as the level of involvement of senior personnel in the engagement as a countermeasure.

(18) Audit Firms' Internal Quality Review Results

Question 64 – How should internal quality inspection findings be compared to or analysed alongside PCAOB inspection results in applying indicators 18 and 19 (PCAOB Inspection Results)?

AOB is of the view that comparability can only be determined by looking into the substance of the deficiencies identified, and not ratings which are at best, quantitative in nature. If required, there must be a developed framework to streamline the rating process.

Audit Results – Financial Statements

(21) Frequency and Impact of Financial Statement Restatements for Errors

Question 65 – What are the best methods for measuring magnitude of restatements for errors? Is one method superior to the others? Why?

AOB wishes to remind that the responsibility of the preparation of financial statements rests with the clients' management and those charged with governance. In light of this, AOB cautions that the root cause of financial statement restatements for errors may well have arisen from the clients' actions, and not necessarily that of the auditors.

Hence, users of the AQIs need to be mindful of this fact, and take care to understand the context of financial statement restatements of errors collectively before coming to a conclusion on the quality of audit.