Auditing – an occupational hazard?

MICPA MALAYSIA THE ACCOUNTANT'S PERSPECTIVE

IT IS almost unbelievable that within a short span of three months, we witnessed three separate corporate scandals in different corners of the world: Germany's Wirecard AG, China's Luckin Coffee, and, closer to home, Singapore's Hin Leong Trading.

As expected with every corporate scandal, the auditor's role has been called into question to such an extent that some so-called experts are now labelling the present model of auditor engagement by companies as faulty.

Others have suggested that a regulator – perhaps Bursa Malaysia – should step in to appoint auditors, whose fees are to be paid from a contribution pool administered by a regulator, and that the auditee company has no say on the appointment.

So, is there any merit to cast doubts on the work or role of the auditor? Let's look at each of the three recent cases in detail, mostly based on publicly available information.

Wirecard AG

As early as 2016, EY Germany questioned some of the unorthodox arrangements under which Wirecard operated. In particular, the company's cash was held in bank accounts it did not control, on the basis that its third-party partners were processing payments in markets that Wirecard did not have operating licences.

Thus, revenue from these businesses had to be deposited into trust accounts instead of being paid directly to Wirecard, purportedly to facilitate the provision of refunds and chargebacks to customers by Wirecard's third party partners in the event of credit card transaction disputes.

While the auditors were professionally sceptical, as required by auditing standards, this did not stop EY Germany from signing off the annual audit since 2016.

It should be noted that EY Germany only refused to sign off the 2019 accounts after realising that fake balance confirmations had been received for the trustee account at two banks amounting to US$2 billion (RM8.5 billion) meant for Wirecard's operations, after repeated requests. While obtaining a bank confirmation is an audit step 101 usually reserved for the most junior auditor in the team, getting a confirmation from a trust account's banker can be tricky to say the least, especially one not within the client's control.

How EY Germany had discovered the fake confirmations will be an interesting twist to be shared at a court in Munich, since the firm is now being sued by a group of Wirecard's investors.

Clearly there was a very high probability of management collusion, with the CEO of Wirecard arrested and the ex-COO uncontactable since the end of June, but the bigger question for EY Germany is why the same rigour was not exercised when questions were raised way back in 2016.

Luckin Coffee

It was EY Hua Ming LLP China (an independent unit to EY Germany) that pulled the trigger on Luckin Coffee in early 2020 while performing the audit for the 2019 financial year. An anonymous short seller had alerted EY China to some financial irregularities which then prompted the firm to send a 10-person anti-fraud team to the company to probe its affairs. Apparently, this move eventually pressured the Chinese coffee chain to come clean with the scandal.

With the CEO and the COO fired and the chairman removed in a recent EGM, this is another incident of possible collusion happening at a very high level within the corporation. If EY China had not been vigilant, the reputation of the firm would have been severely tarnished following the massive scandal involving over US$300 million in inflated sales and brazen fabrication of three quarters of the sales for 2019.

While rumblings were heard about EY China's involvement with Luckin Coffee for its pre-IPO reporting (the 2017 and 2018 financial statements included in the IPO prospectus were audited by EY China), there was no substantial evidence that such fraud had taken place prior to 2019. In this case, any attempt to blame EY China would have been misguided at best.

Hin Leong Trading

It is rare to come across a scandal of such proportions in squeaky clean Singapore: US$1.14 billion in losses concealed over the past few years and millions in oil inventory pledged for loan collateral being secretly sold by the company's founder. The question on everyone's mind is – where were the auditors then?

Deloitte Singapore has been adamant that the audit of Hin Leong was conducted in accordance with rigorous auditing standards set by the International Auditing and Assurance Standards Board.

It may be premature to judge the auditor as Hin Leong is an exempt private company (EPC) and its accounts are not lodged with the authorities. The current Judicial Manager from PwC, according to news reports, mentioned two major issues – inflated receivables were used to conceal losses over the past few years and the missing oil inventory that was pledged as receivables.

As far as the latter issue is concerned, the auditor cannot be blamed as stock-take, at most, can only prove the existence of the inventory but ownership of the inventory, or in this case competing claims of the inventory's ownership, is very difficult to prove.

In respect of the inflated receivable amounts to conceal losses of the past few years, the auditors should be given the right forum to justify their stand that those receivables had been fairly stated at the value that they were booked into the financial records of previous years, based on their audit work performed.

As an EPC, Hin Leong managed to procure exempt private certificates for lodgment with ACRA, the company's regulator in the past years on the basis of its solvency. This may point to a deliberate attempt by its owner-manager to mislead the auditors by concealing the accumulated losses to support the company's solvency claim.

Perhaps the saving grace, if any, is the fact that the owner had confessed to many of the allegations raised in the recent police raid and investigation.

An occupational hazard?

The auditors of two of the three cases above will need to step forward at the right forum to shed light on how the audit of those companies was undertaken. It is certainly not as straightforward as publicly thought and with fraud and collusion at the highest levels of management, things could only get messier.

The public must also be educated that in most circumstances, the buck needs to stop with those charged with governance, i.e. the management and the owner of the company (in the case of Hin Leong). After all, the auditor only certifies that the accounts are true and fair based on sampling work done on selected financial components in the financial statements.

It is the management, on the other hand, that attests to the accounts being true and correct – at all times, and under oath, no less.

It is unfortunate that when a corporate scandal arises, the auditor will be unfavourably judged in the court of public opinion, even when the dust has yet to settle. Perhaps this is an occupational hazard like no other.

Hence, attracting the best talent and getting them to stay on in the profession is certainly not going to be easy with such hazards hanging overhead.

Finally, do consider this allegory. Instead of hoping that the school (in this case, the audit) will train one's offspring to become good citizens with impeccable integrity and values, the family must realise that such disciplining does not start in school, and the auditor is not the Discipline Master.

The inculcation of these values begins much earlier when the child is growing up at home (or, in the case of a company, when people are being appointed to leadership roles).

That surely, must be the collective responsibility of the family and society at large.

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