

ISQM – accounting firm's quality practices

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THE International Auditing & Assurance Standards Board (IAASB) recently finalised a suite of standards (ISQM 1 and 2 and ISA 220 [Revised]) that prescribe the necessary quality management (QM) processes in accounting firms that offer assurance and other related services.

Viewed as too reactive, the old standards issued in 2009 did not go far enough to encourage management accountability over the firm's quality practices. In addition, much has changed over the last 10 years, be it audit methodology as well as increased use of technology and service delivery centres.

What's in it for you?

As a member of the public, why should you care? Here are five compelling reasons:

➔ A reorientation of auditing standards with an emphasis on risk assessment and risk responses towards the firm's QM processes while imposing a higher standard of diligence through the exercise of professional scepticism and professional judgement can go the distance to reduce the expectation gap between the public and the auditing profession.

While the role of the auditor as a watchdog (compared to that of a bloodhound) has not changed, the needle may have moved just enough to recognise that the auditor's work has a huge element of public interest and hence, audit efforts should focus on areas with the highest potential risk of material misstatement.

This change in approach - which compels the auditor to exercise a heightened sense of professional scepticism as well as professional judgement along with a need for a stand-back assessment when undertaking the audit - will focus the auditor's attention on areas that really matter, consequently ensuring proper disclosure either in the auditor's report or timely reporting to those charged with governance, including regulators, within the Malaysian corporate reporting ecosystem.

➔ It is now timely for accounting firms and their networks to communicate the QM processes to

the public as a demonstration of their commitment to quality and to enhance public trust in the auditing profession.

One form of reporting slowly gaining traction in Europe and other developed capital markets is the transparency report. Firms that currently prepare transparency reports usually belong to the bigger networks - those performing audit engagements of public-listed companies (PLCs) - but it is hoped that more mid-tiered and smaller-sized firms auditing PLCs will be embracing such practices in the future.

The IAASB has made the reporting format flexible; it can even be posted on the firm's webpage for clients' and public's access.

The Securities Commission of Malaysia in early 2020 directed larger firms to submit their transparency report to the Audit Oversight Board privately, although it is not known if such a directive had been withdrawn because of the Covid-19 pandemic. Meanwhile, boards of directors of PLCs evaluating prospective auditors for their companies may want to request for a copy of the accounting firm's transparency report with an analysis of the firm's audit quality indicators as a first line of evaluation.

Apart from fees, the firm's QM practices would enable the Board's choice of auditor to be an informed one - by comparing different firm's relevant audit quality indicators.

➔ The ISQM places great emphasis on firms' resource planning, be it human, intellectual or technology up front. For example, firms should be mindful of the resources to be committed for an assignment when accepting a new client or when considering re-appointment. This will reduce the incidence of firms resigning a few months after their appointment (or re-appointment) at AGMs on the excuse that resources required for the audit had not been fully considered earlier on.

Under the new QM standards, partners of accounting firms are not allowed to put profit ahead of quality. Such an implementation will have a bearing on the firm's long-term efficient management of



The ISQM 1 & 2 and ISA 220 (Revised) will address issues of the old standards whereby they did not go far enough to encourage management accountability over a firm's quality practices. – **AFPPIX**

resources. In the new standards, accountability of firm's top leadership in this area cannot be delegated.

➔ The new standards have greatly enhanced the monitoring and remediation process. New two-way communication requirements allow firms to better manage their QM processes consistently across all engagements, using timely information about the quality metrics collated from the whole spectrum of the QM system. Over the longer term, this will enhance overall audit efficiency and delivery and, hopefully, lead to a less stressful audit experience for the client due to poor audit planning.

➔ The introduction of root cause analysis will lead to a better grasp of quality issues among audit practices and, hopefully, leading to fewer errors and mistakes over time as the QM process encourages better refinement of procedures. Learning from the mistakes of others can set a good training ground for younger auditors joining the profession - and in turn, can attract younger talent to

advance their auditing career. This addresses the regular grievance of firms regarding the difficulty in attracting and retaining experienced staff. Clients will also have fewer complaints of firms sending different junior staff every year, asking for the same documents or clarifications.

What about the impact on accounting firms?

From the responses to the draft QM standards back in 2019, the main concerns of firms are:

➔ Substantial resources required to support the firm's overall change management process. The continuous investment in the practices will have to be seriously considered; this may also compel firms to eventually pass on the additional costs to the consumer; and

➔ Robust documentation requirements under these new QM standards have many smaller practices potentially struggling to understand and comply with the requirements in totality. This issue is important as regulators, with hindsight, will be asking firms to

justify their action or inaction when engagements are selected for review during the practice inspection cycle.

Effective date

The new ISQM is expected to come into force on Dec 15, 2022. While this may seem a while from now, the QM system must be operational by then. The work to fully embrace the QM process will have to start now since the monitoring and remediation process will need time to be fully assessed in terms of their effectiveness.

More importantly, buy-in from staff and partners is essential for the QM culture to eventually be part of the firm's DNA. And culture will definitely need time to permeate throughout the firm, starting with the top leadership. For this to happen, planning and critical execution by the firms will have to be key, starting now.

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