



Audit Oversight Board

annual report
2011

AUDIT OVERSIGHT BOARD
Securities Commission Malaysia

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Mission Statement

Fostering high quality independent auditing to promote confidence in the quality and reliability of audited financial statements of public interest entities in Malaysia.

TABLE OF CONTENTS

Executive Chairman's Message	i
Overview of the AOB's Strategies	iv
Part One	
Support Adoption and Implementation of Standards	1-1
• Active Involvement in Standard Setting	1-1
• Engaging Stakeholders on Developments in Auditing Standards	1-1
• Participating in the Post-implementation Review of Clarified ISAs	1-2
• European Union Proposals in Restoring Confidence in Financial Reporting	1-3
Part Two	
Promote High Quality Audit Practices	2-1
• Registration of Audit Firms and Individual Auditors	2-1
• Setting Regulatory Expectations	2-2
• Recognition of Foreign Audit Firms and Individual Auditors	2-3
• Enforcement	2-3
Part Three	
Influence the Financial Reporting Ecosystem and Leverage on Stakeholders' Support	3-1
• The Financial Reporting Ecosystem	3-1
• Engaging the Accounting Profession and Leadership of Audit Firms	3-1
• Strengthening Relationships with Other Regulators	3-1
• Promoting High Quality Financial Reporting Practices by Listed Companies	3-2
• Supporting Accounting Education	3-2
• Continued Participation in IFIAR	3-2
• Supporting the Initiation of the ASEAN Audit Regulators Group	3-4
• Sharing Experience in Audit Regulation Internationally	3-4
• Arrangement with the European Union	3-5

Part Four	
Inspection Activities	4-1
• Introduction	4-1
• Summary of Activities	4-1
• Inspection Process and Basis of Reporting	4-2
• Scope of Inspections and Remediation	4-3
• Overview of Findings	4-4
– Findings of firm level reviews	4-5
– Findings of engagement reviews	4-11
• Remediation	4-16
• Conclusion	4-16
 Part Five	
Assessment of Performance and Effectiveness	5-1
 Part Six	
2012 Outlook	6-1
• Remediation Efforts by Audit Firms	6-1
• Effectiveness of Implementation of Standards	6-1
• The Accounting Profession and Self-discipline by Audit Firms	6-1
• Developments in Audit Regulation	6-2
• Inspection Priorities and Challenges	6-2
 Part Seven	
Statement on Governance	7-1
• Members of the Audit Oversight Board	7-1
• Meeting Attendance	7-4
• Responsibilities of the Board	7-4
• Meeting Procedures	7-4
• Registration Committee	7-4
• Organisation Structure	7-5
 Part Eight	
Financial Statements and Others	8-1
• Financial Statements of the Audit Oversight Board Fund	8-1
• Acronyms and Abbreviations	8-16
• Definitions	8-17



Executive Chairman's Message

EXECUTIVE CHAIRMAN'S MESSAGE



A number of strategic initiatives were launched last year to spur the growth of the Malaysian capital market and further strengthen its corporate governance landscape. Among the initiatives were the launch of the *Capital Market Masterplan 2* and the *Corporate Governance Blueprint 2011*. With that in the background, the Audit Oversight Board (AOB) continued to expand our audit oversight activities in line with the annual plan approved by the Board, leveraging on the foundation built last year.

The economic and financial crisis faced by many countries globally heightened the risks of mis-statement of financial statements. As the reliability of financial information including audited financial statements is critical to the capital market, we observed a number of global initiatives to enhance audit quality. These ranged from the review of auditor reporting by the International Auditing and Assurance Standards Board (IAASB) and the Public Company Accounting Oversight Board (PCAOB) to the proposals by the European Union (EU) aimed at restoring confidence in financial reporting.

While the outcomes of the above efforts may not be observable in the short term, the message brought by them is very clear; status quo is no longer acceptable. However, given that the financial reporting ecosystem consists of many parties, it is important that every party plays its role to ensure the quality of financial reporting and auditing is enhanced. Notwithstanding that, we believe that audit firms are the primary group which determines the quality of audit and the diversity of

performance by other parties should not be an excuse for not attaining high quality audit.

Enhancement of our regulatory framework

The *Securities Commission Act 1993* (SCA) was amended as we continued to enhance our regulatory framework. The changes include recognition of foreign auditors, empowerment of the Board to delegate its powers and clarifying when AOB could conduct its inquiries.

The AOB continued to participate in international activities to validate our operational models and leverage on the experience of more matured audit regulators in enhancing the effectiveness of our oversight activities.

Expansion of the scope of inspection

In addition to the six Major Audit Firms which were covered in 2010, the AOB also inspected 11 Other Audit Firms in 2011. The scope of inspection was also extended to cover, amongst others, revenue recognition of public-interest entities (PIEs) with complex business arrangements which rely on information technology to support their operations and accounting functions. The mid-tier and smaller firms were scoped in for inspection to enable us to review their audit practices.

We continued to identify areas for the audit firms to improve despite most of them having quality control

frameworks and audit methodologies imposed by their international networks.

While the auditing framework in Malaysia remains sound and all international standards have been adopted, the findings from our oversight activities suggest that more efforts are required to enhance audit quality.

Commencement of remediation

Audit quality would be enhanced when audit firms rectify weaknesses in their systems and processes as well as ensure their people are competent and capable of auditing PIEs with different risk characteristics and business models. Commitment to professional values and ethics are also important elements in achieving high quality audits.

The AOB requires all audit firms which were inspected to come up with their remediation plans by identifying the root causes of the deficiencies which we reported and to set out plans to rectify those weaknesses. Among the areas we considered important to be incorporated by audit firms in their remediation plans are leadership, methodology and training needs.

13 remediation plans were approved by the AOB and are at various stages of implementation. Given the timing of their implementation, it is too premature for us to assess their effectiveness even though we noted a number of key measures, such as governance changes, were implemented.

International activities

One of the key developments in global audit oversight in 2011 was the approval of the International Forum of Independent Audit Regulators (IFIAR) Core Principles which cover the structure of audit

oversight, operations of audit regulators and principles for inspection processes. These principles would facilitate co-operation among audit regulators in the future.

The AOB has been supporting an initiative for the audit regulators in the ASEAN region to co-operate in enhancing audit quality within the region. So far, Malaysia, Singapore and Thailand have set up independent audit oversight structures and a number of ASEAN countries are at different stages of setting up their respective audit oversight structures. A number of meetings and events were organised by these regulators including the first meeting with the leadership of the Big Four Audit Firms from Malaysia, Singapore and Thailand.

An effective audit oversight in the ASEAN region would support the efforts of integrating the capital markets in the region as financial information forms the base of information for capital formation and transaction.

Financial reporting under the IFRS regime

Malaysia officially joins more than a hundred other countries in adopting the International Financial Reporting Standards (IFRS) as the reporting standards for PIEs effective 2012. This change in the financial reporting landscape does not merely affect auditors. The PIE, as the preparer, needs to have the capacity to prepare IFRS-compliant financial statements before being audited. Directors need to lead in financial reporting as this in itself is part of the value creation process.

The AOB has been engaging audit firms to gain an understanding of their level of preparedness to audit under the IFRS regime. While most firms appear to be ready, additional efforts need to be put in place to ensure the change in the financial reporting standards does not erode confidence in financial reporting.

Closing

I would like to thank my fellow Board members who provided their counsel, guidance and support to enable the AOB to progress to where we are now. The AOB continued to receive support from fellow regulators in Malaysia and I believe the level of co-operation will continue to grow in the future. I would also like to acknowledge the hard work and dedication of our staff in delivering the achievements outlined in this report.

Last but not least, I would like to thank Dato' Azmi Ariffin and Datuk Ali Abdul Kadir who retired from the Board in 2011. Their commitment and efforts in supporting the establishment and growth of the AOB are highly appreciated.



Nik Mohd Hasyudeen Yusoff

Overview of the AOB's strategies

The AOB aims to achieve the following desired outcomes:

- High quality financial reporting practices by PIEs
- Resourceful and high quality audit practices
- Independent and high quality audits
- High quality and reliable audited financial statements
- Enhanced confidence in audited financial statements

Support adoption and implementation of standards

Auditing and ethical standards provide the baselines for high quality independent auditing to be achieved. In this respect, we pursue the following goals:

- Ensure no significant gaps
- Promote substance over form implementation
- Facilitate the implementation of standards among audit firms

Promote high quality audit practices

Our key oversight activities such as registration, inspection and inquiry are aimed at ensuring audit firms and individual auditors are committed to delivering high quality independent audits while achieving their business objectives. Towards this end, the goals pursued are:

- Enforce registration policy that promotes quality and capacity
- Drive quality audit practices through inspection and remediation of auditors
- Set the tone for quality through enforcement actions

The AOB has adopted a strategic framework which links our service areas and activities to the desired outcomes which manifest the attainment of our mission. The strategic framework has four strategic themes, which are:

- Support the adoption and implementation of standards
- Promote high quality audit practices
- Influence the financial reporting ecosystem
- Leverage on stakeholders' support

Influence the financial reporting ecosystem

High quality financial reporting would only be achieved if all the key components in the financial reporting ecosystem are effective in playing their respective roles. Recognising this, we would also focus in influencing other important stakeholders to ensure audit quality remains high on their business agenda. The goals pursued are:

- Increase collaboration among stakeholders in the financial reporting ecosystem
- Promote research and discourse on audit quality

Leverage on stakeholders' support

The effectiveness of the AOB would be enhanced if it could leverage on the efforts of like-minded stakeholders who share the same interest in enhancing the quality of financial reporting of PIEs. This includes co-operating with international counterparts as auditing itself has become a global affair. We aim to achieve the following goals:

- Enhance the co-ordination of activities with other authorities in Malaysia and abroad
- Participate in international activities to gain knowledge and experience and promote confidence in Malaysian audit quality
- Obtain higher financial support from stakeholders

Part One

Support Adoption and Implementation of Standards

SUPPORT ADOPTION AND IMPLEMENTATION OF STANDARDS

ACTIVE INVOLVEMENT IN STANDARD SETTING

One of the drivers of audit quality is the effective application of standards in audit engagements. In this respect, the AOB was involved in a number of initiatives in influencing the promulgation of auditing and ethical standards as well as engaging various stakeholders who are involved in their implementation.

During the year, we provided views and comments to the IAASB and the MIA on the following exposure drafts and discussion papers:

- Proposed revision of *International Standard on Review Engagements (ISRE) 2400, Engagements to Review Historical Financial Information*;
- The discussion paper on *The Evolving Nature of Financial Reporting: Disclosures and Its Audit Implications*;
- The *IAASB's Strategy and Work Program for 2012–2014*;
- Proposed revision of *International Standard on Related Services (ISRS) 4410, Compilation Engagements*; and
- Proposed revision of *International Standards on Assurance Engagements (ISAE) 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*.

Since the AOB's appointment to the MIA's Auditing and Assurance Standards Board and Ethics Standard Board as an observer, we have been attending their respective meetings. This provided the opportunity to articulate our views relating to certain auditing issues as well as to have a better understanding of the challenges faced by the auditing industry in implementing the standards and attaining high quality audits.

ENGAGING STAKEHOLDERS ON DEVELOPMENTS IN AUDITING STANDARDS

The global financial crisis highlighted certain issues relating to audit quality. This includes the question on the relevance and usefulness of auditors' reporting, particularly in the context of listed entities.

In May 2011, the IAASB issued a consultation paper on *Enhancing the Value of Auditor Reporting: Exploring Options for Change*. The paper discussed the desire of the users of financial information to obtain richer information regarding the reporting entity and the audit itself which would assist them in assessing the financial condition and performance of the entity, as well as the quality of its corporate reporting and the quality of the audit.

This perceived 'information gap' could be narrowed through some combination of additional reporting by management or those charged with governance, or by the auditor. Options considered by the consultation paper ranged from the change of format and structure

of the auditor's report, auditor's commentary on matters significant to the user's understanding of the audited financial statements, to the provision of additional assurance services by auditors.

In June 2011, the PCAOB issued a concept release to discuss the alternatives for changing the auditors' reporting model similar to the IAASB initiative.

As these initiatives would significantly influence auditor's reporting worldwide, we organised engagements with relevant stakeholders in Malaysia to update them on these developments and to understand their views. The feedback would be used when we engage with other relevant stakeholders. Two roundtables were held as follows:

- a. Roundtable with representatives of the Federation of Public Listed Companies Bhd consisting of directors and preparers of financial statements. Representatives from the MIA Auditing and Assurance Standards Board (AASB) were invited to observe the discussion.

Key issues raised were:

- While the directors present were appreciative of the proposal to enhance auditor's reporting they felt that the auditors should focus their efforts on the financial audit;
- Auditors may not have the expertise in reviewing proposed areas such as business models; and
- The directors were concerned about the cost implications of expanding the scope of work of auditors.

- b. Roundtable with academicians who are involved in teaching and research in accounting and auditing from various local institutions of higher learning.

Key issues raised were:

- Auditors should disclose information that is available to them which has significant impact on the financial statements;
- The materiality level and going concern assumptions need to be explained in greater detail; and
- Simplify current rigidity of the audit report format and standardise the definition of terms used by auditors to assist users to gain a better understanding of the audit report.

PARTICIPATING IN THE POST-IMPLEMENTATION REVIEW OF CLARIFIED ISAs

In October 2011, the IAASB published its plan for a post-implementation review of the Clarified International Standards on Auditing (Clarified ISAs). The post-implementation review will focus on whether the Clarified ISAs are consistently understood and implemented in a manner that achieves the IAASB's goals in revising them.

Key areas of interest to IAASB:

- Consistency
- Effectiveness
- Efficiency

We have been monitoring the implementation of the Clarified ISAs through our audit inspection activities as Malaysia is amongst the countries that have implemented the Clarified ISAs in full. As the areas to be covered by IAASB coincide with our interests in ensuring the effective implementation of the Clarified ISAs, we will provide feedback to IAASB based on our observations and findings through our oversight activities.

EUROPEAN UNION PROPOSALS IN RESTORING CONFIDENCE IN FINANCIAL REPORTING

In November 2011 the EU released a consultation document, *Audit Policy: Lessons from the Crisis* (Green Paper) which contains proposals to enhance confidence in financial reporting by clarifying the role of the auditors. These proposals introduced more stringent rules for the audit sector aimed at strengthening the independence of auditors as well as introducing greater diversity into the current highly-concentrated audit market in Europe.

Among the key proposals are:

- Mandatory rotation of audit firms after a maximum engagement period of six years;

- Mandatory tendering where PIEs will be obliged to have an open and transparent tender procedure when selecting a new auditor; and
- Audit firms will be prohibited from providing non-audit services to their audit clients. In addition, large audit firms will be obliged to separate audit activities from non-audit activities in order to avoid all risks of conflict of interest.

We have been tracking the initiatives of the EU since the release of the Green Paper in 2011 and will continue to monitor further developments of these proposals as they could have significant impact on ethical standards, industry practices and audit quality if implemented on a wider scale beyond the EU.

Part Two

Promote High Quality Audit Practices

PROMOTE HIGH QUALITY AUDIT PRACTICES

REGISTRATION OF AUDIT FIRMS AND INDIVIDUAL AUDITORS

The AOB began operations by receiving applications for registration manually in 2010. On 28 February 2011, the electronic registration system known as Auditor Registration Application System (ARAS) was launched where auditors are able to submit their applications for registration through the system. This is in line with our efforts to systemise the registration process for efficiency and to create a database which would also benefit the auditors.

Audit firms and individual auditors seeking registration with the AOB are required to submit information to support their declaration of fit and properness. In addition, audit firms are required to submit their compliance with International Standards on Quality

Control (ISQC) 1. Taking into account the findings of the 2010 cycle of inspections and the introduction of the Clarified ISAs, audit firms were required to provide information in their application on how they have kept themselves abreast of the Clarified ISAs and their efforts in enhancing their audit documentation.

As at 31 December 2011, the AOB had not rejected any application for registration. Nonetheless, based on our evaluation of their applications, certain obligations in the form of additional registration conditions were imposed on certain audit firms and individual auditors, including five individual auditors from four audit firms who were registered for a period of six months instead of 12. The reduction in the tenure of registration was made pursuant to our powers provided for under section 31S of the SCA.

Table 1

Registration Statistics

Profile of audit firms	No. of audit firms	No. of individual auditors	No. of PIEs audited	% of Market capitalisation
Partnerships with more than 10 partners	6	138	885	93.60
Partnerships with 5 – 10 partners	8	38	148	1.07
Partnerships with 2 – 4 partners	48	108	138	5.30
Sole proprietors	13	13	13	0.03
TOTAL	75	297	1,184	100

Table 2

Comparison between 2010 and 2011 Registration Statistics

Profile of audit firms	No. of audit firms (2011)	No. of audit firms (2010)	No. of individual auditors (2011)	No. of individual auditors (2010)
Partnerships with more than 10 partners	6	6	138	136
Partnerships with 5 – 10 partners	8	8	38	35
Partnerships with 2 – 4 partners	48	55	108	125
Sole proprietors	13	14	13	14
TOTAL	75	83	297	310

SETTING REGULATORY EXPECTATIONS

As a responsible regulator, regulatory expectations are established upfront before the AOB takes any further action on non-compliance. In 2011, we conducted a thematic review on partner rotation and the requirements of the *By-laws (On Professional Ethics, Conduct and Practice) of the Malaysia Institute of Accountants* (MIA By-laws) and ISA of having an Engagement Quality Control Reviewer (EQCR) for all audit engagements of PIEs. Compliance with both requirements is regarded as being fundamentally important to ensure audit quality is not compromised.

Partner Rotation Requirement

The AOB identified 15 individual auditors from six sole proprietorships and nine audit firms with two to four partners who may not comply with the five-year partner rotation requirement of the MIA By-laws¹ if they continue to audit for financial year ending 2011. In this regard, we sought explanation from them and advised them to ensure the MIA By-laws are complied with. Table 3 represents the breakdown of the responses.

Table 3

Partner Rotation Requirement

Response	Profile of firm	No. of firms
Partner will rotate for the FYE 2011	2 – 4 Partners	7
Partner will not seek reappointment for the FYE 2011 audit	2 – 4 Partners	2
	Sole Proprietorship	2
Firm withdrew from AOB registration due to inability to comply with partner rotation requirement	2 – 4 Partners	1
	Sole Proprietorship	3

¹ Paragraph 290.151 of the MIA By-laws provides that "In respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than five years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry specific issues, transactions or events or otherwise directly influence the outcome of the engagement."

Requirement of having an Engagement Quality Control Reviewer

Through the declarations made by the audit that firms at the point of registration, the AOB identified that 11 sole proprietorships and two audit firms with two to four partners may not have been in compliance with the requirement of ISA 220² to have an EQCR for the audit engagement of PIEs. In this regard, we sought written explanation from them.

Table 4 represents the breakdown of the responses.

Table 4

EQCR Requirement

Response	No. of firms
Firm appointed EQCR from outside the firm	8
Firm withdrew from AOB registration due to inability to comply with EQCR requirement	5

RECOGNITION OF FOREIGN AUDIT FIRMS AND INDIVIDUAL AUDITORS

As part of the AOB's regulatory enhancement efforts, Part IIIA of the SCA was amended in September 2011, to introduce a statutory framework which caters for the recognition of foreign auditors who audit the financial statements of foreign incorporated corporations listed on Bursa Malaysia.

The main requirement for recognition of a foreign auditor is that the foreign auditor must be approved

or registered with a relevant foreign authority which exercises similar functions to the AOB. In this respect, we recognise the role and importance played by the relevant foreign authority.

The recognition of the foreign auditor framework will be fully operationalised in the first quarter of 2012.

ENFORCEMENT

The AOB adopts a strategic enforcement approach whereby the principles of proportionality, efficiency and achieving the desired outcome are employed before a sanction is imposed on any person. In determining the type of sanction that will be imposed on any contravention or breach, we take into account the nature and seriousness of the offence, previous regulatory record and other mitigating factors.

The AOB is empowered by section 31W of the SCA to conduct an inquiry if there is reason to believe that an auditor has contravened any provision of Part IIIA of the SCA, any condition imposed under section 31O(4) of the SCA or any written notice or guidelines issued by the SC.

As part of our ongoing enforcement efforts, a warning letter was issued to one audit firm for failure to register with the AOB before accepting appointment as an auditor of a PIE.

The AOB views breaches of any provision of the SCA very seriously and will not hesitate to take stern action against those in breach.

² ISA 220 (Redrafted) on Quality Control for Audits of Historical Financial Information. Paragraph 19 of ISA 220 (Redrafted) provides that—
“For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

- (a) Determine that an engagement quality control reviewer has been appointed;
- (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- (c) Not date the auditor's report until the completion of the engagement quality control review.

Part Three

Influence the Financial Reporting Ecosystem
and Leverage on Stateholders' Support

INFLUENCE THE FINANCIAL REPORTING ECOSYSTEM AND LEVERAGE ON STAKEHOLDERS' SUPPORT

THE FINANCIAL REPORTING ECOSYSTEM

The roles played by the parties in the financial reporting ecosystem in Malaysia are critical in shaping the quality of financial reporting practices and the reliability of audited financial statements of PIEs. In this respect, the AOB continued to engage the accounting profession, audit firms, regulators, directors and academicians and participated in events to share our insights and promote practices which support the enhancement of financial reporting and audit quality.

ENGAGING THE ACCOUNTING PROFESSION AND LEADERSHIP OF AUDIT FIRMS

The AOB discussed key aspects of observations and other matters related to our oversight activities with the Public Practice Committee of the MIA and the Executive Committee of MICPA. It is very important for the accounting bodies to set the right tone and establish baseline quality in auditing across the board through the enforcement of professional standards which have been adopted by them.

As auditing standards applicable to the PIE and non-PIE sectors in Malaysia are the same, the risks of having different levels of application of the standards in different sectors would affect confidence in the work performed by auditors in the PIE sector. Ensuring high market discipline would complement our efforts to promote high quality audit practices.

Regular discussions and dialogues were held with the leadership of Major Audit Firms on our observations and challenges faced by them as an industry. Issues such as pressure on audit fees and availability of competent talent remained pervasive in the auditing industry in Malaysia.

The dialogues also provided opportunity for the accounting profession and audit firms to share their ideas in further promoting quality practices among their members.

The AOB participated in events organised by the accounting bodies in Malaysia including forums on audit quality, impact of the Clarified ISAs and the joint conference organised by the MIA and the ASEAN Federation of Accountants.

STRENGTHENING RELATIONSHIPS WITH OTHER REGULATORS

Building on the relationship which we started in 2010, the AOB continued to enhance our collaboration with other regulators, particularly Bank Negara Malaysia (BNM) and the Companies Commission of Malaysia (CCM). We also assisted the SC in areas involving standards, conduct and performance of auditors and shared our experience in audit oversight with other regulators through programmes organised by the Securities Industry Development Corporation (SIDC).

The AOB also engaged Bursa Malaysia on the issue of auditor performance and agreed on certain areas of collaboration.

These efforts allow us to leverage on the supervisory and enforcement roles of other regulators while at the same time minimising any duplication of efforts.

PROMOTING HIGH QUALITY FINANCIAL REPORTING PRACTICES BY LISTED COMPANIES

Engagement with directors and members of audit committees is one of the ways to promote high quality financial reporting practices by listed companies. In this respect, the AOB participated in the following events:

- Forum on 'Improving Corporate Governance in the Malaysian Capital Market – The Role of the Audit Committee' organised by the Institute of Chartered Accountants and the MICPA in Australia;
- Forum on 'Integrated reporting: New Dawn for Reporting' during the SC-Bursa Malaysia Corporate Governance Week 2011; and
- Conference on 'Building Confidence in the Capital Market' in Penang organised by the MIA.

Given their role in setting the tone for financial reporting and overseeing the performance of external auditors, members of audit committees should continue to ensure that financial reporting practices in their companies enable high quality financial statements to be prepared. At the same time, audit committees should actively engage their external auditors and ensure all issues raised by the auditors are satisfactorily resolved before financial statements are authorised.

SUPPORTING ACCOUNTING EDUCATION

The quality of graduates entering the accounting profession is an important factor which influences the quality of financial reporting. They would be employed by the PIEs and audit firms and are involved in one way or another in influencing the quality of audited financial statements.

Given such importance, engaging the academicians who are responsible for the education and training of future accountants is very important. In this respect, we participated in the National Accounting Educators Symposium organised by the MIA with the support of the Institute of Chartered Accountants in England and Wales where we shared the developments in the auditing profession worldwide and how the AOB influences the auditing profession in Malaysia.

We also participated in events organised by local and foreign institutions of higher learning where we shared with the students the developments in auditing particularly on the issues of audit quality and audit oversight.

CONTINUED PARTICIPATION IN IFIAR

The International Forum of Independent Audit Regulators (IFIAR) was established on 15 September 2006, with the following objectives:

- To share knowledge of the audit market environment and practical experience of independent audit regulatory activity;
- To promote collaboration in regulatory activity; and
- To provide a focus for contacts with other international organisations which have an interest in audit quality

In 2011, the AOB participated in two plenary meetings of IFIAR which were held in Berlin, Germany and Bangkok, Thailand.

One of the key developments in global audit oversight in 2011 was the approval of the IFIAR Core Principles which cover the following key areas:

- Structure of audit oversight
- Operations of audit regulators
- Principles for inspection processes

IFIAR engaged with other stakeholders such as IOSCO, the Financial Stability Board, the Monitoring Group, World Bank, investor groups, the IAASB and the International Ethics Standards Board for Accountants (IESBA).

Other key matters discussed included:

- Current market conditions and findings of recent inspections;
- The engagement of IFIAR with the Global Public Policy Committee audit firms (i.e. BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG and PricewaterhouseCoopers); and
- Co-operation among independent audit regulators.

The participation in IFIAR's activities enables us to understand the developments in audit oversight globally

and develop working relationships with other audit regulators.

The AOB also participated in IFIAR's inspection workshop in February 2011 in Washington, United States. This proved beneficial as it provided us with the opportunity to compare our inspection approach with those applied by other audit regulators and confirmed the consistency of findings from our inspection. In addition, the sharing of knowledge and practical experiences by other participants provided us with valuable insights on areas of concern, further developing inspection skills and readiness to address challenges going forward.

IFIAR Core Principles

IFIAR is an organisation of independent audit regulators. Its primary aim is to enable its members to share information regarding the audit market environment and practical experiences of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.

Consistent with the IFIAR Charter, the Core Principles seek to promote effective independent audit oversight globally, thereby contributing to members' overriding objective of serving the public interest and enhancing investor protection by improving audit quality.

IFIAR's Core Principles are as follows:

Part A: Structure

- Principle 1: The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation.
- Principle 2: Audit regulators should be operationally independent.
- Principle 3: Audit regulators should be transparent and accountable.

Part B: Operations

- Principle 4: Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.
- Principle 5: Audit regulators should ensure that their staff are independent from the profession and should have sufficient staff of appropriate competence.
- Principle 6: Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements.
- Principle 7: Audit regulators should make appropriate arrangements for co-operation with other audit regulators and, where relevant, other third parties.

IFIAR Core Principles *(cont)***Part C: Inspections**

- Principle 8: Audit regulators should as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.
- Principle 9: Audit regulators should ensure that a risk-based inspections programme is in place.
- Principle 10: Audit regulators should ensure that inspections include effective procedures for both firm-wide and file reviews.
- Principle 11: Audit regulators should have a mechanism for reporting inspection findings to the audit firm and ensuring remediation of findings with the audit firm.

SUPPORTING THE INITIATION OF THE ASEAN AUDIT REGULATORS GROUP

The AOB participated in an informal meeting with audit regulators in the ASEAN region, held in Singapore in January 2011. At the meeting, audit regulators from Malaysia, Singapore, Thailand and Indonesia shared their experiences in inspection and discussed issues related to audit quality and future areas for co-operation.

The AOB and audit regulators from Singapore, Thailand, Indonesia, Laos, Vietnam, Cambodia and Myanmar also attended a subsequent meeting in Bangkok, Thailand in September 2011.

At this meeting, in addition to exploring the approaches to formalise the ASEAN Audit Regulators grouping, the Accounting and Corporate Regulatory Authority (ACRA) Singapore shared key messages from their inspection findings. The meeting also discussed international developments in audit regulation and agreed to hold the first inspection workshop for ASEAN audit regulators in January 2012 in Singapore.

In conjunction with this, audit regulators from Malaysia, Singapore and Thailand had a dialogue with the leadership of the Big Four Audit Firms from Malaysia, Thailand and Singapore to discuss the challenges faced by the audit firms in the region. The regulators communicated their expectations with respect to the performance of audit firms and a periodical dialogue between regulators and audit firms in the ASEAN region was agreed to.

SHARING EXPERIENCE IN AUDIT REGULATION INTERNATIONALLY

The AOB was invited to share its views and experience at the following international events:

- a. Panel discussion on the role of audit and trends in auditing at the Hong Kong Institute of Certified Public Accountants annual conference in Hong Kong on 18 June 2011. The Executive Chairman spoke on the influence of regulation and shared the Malaysian audit oversight experience.
- b. The Public Accountants Conference 2011 organised by the ACRA Singapore where the Executive Chairman delivered a speech on Malaysia's experience in the setting up of an independent audit oversight function.
- c. The International Seminar on 'The Essence of Independent Audit Oversight System' organised by the Securities Exchange Commission of Thailand on 28 September 2011. The Executive Chairman delivered a speech on 'How do ASEAN independent audit regulators work with professional bodies to maximise value of the audit profession'. The seminar was attended by ASEAN audit regulators and members of the profession in Thailand.
- d. The Executive Chairman presented on 'Financial Reporting Ecosystem' and participated in a panel discussion at the ACCA International Assembly 2011 in London, UK.

ARRANGEMENT WITH THE EUROPEAN UNION

Article 45 of the *European Union Directive on Statutory Audit 2006/43/EC* (the EU Directive) requires European registration and oversight for audit firms which audit the annual or consolidated accounts of a company incorporated in a third country (i.e. jurisdiction outside an EU Member State) but which is listed in an EU Member State. To avoid supervision by an EU Member State, the European Commission could decide that a third country has equivalent supervision for auditors in their own jurisdiction.

In 2008, the European Commission decided to provide for a transitional period until 1 July 2010 during which certain third-country auditors which included Malaysia, could continue their audit activities subject

to certain assessment by the European Commission. Before the transitional period expired, the European Commission performed another evaluation on the Malaysian audit oversight framework. Based on the evaluation performed, Malaysia was included in a transitional period from 19 January 2011 to 31 July 2013. During this transitional period, Malaysian auditors will continue to be allowed to perform audit activities on companies listed in the EU without being subject to EU auditor oversight or being required to register with EU oversight authorities.

The European Group of Auditors Oversight Bodies (EGAOB) will be undertaking a technical assessment on the audit oversight framework in Malaysia to assess for an equivalence decision which will entail no supervision by any oversight body in the EU.



Part Four

Inspection Activities

INSPECTION ACTIVITIES

INTRODUCTION

The AOB's mission is to foster high quality independent auditing to promote confidence in the quality and reliability of the financial statements of PIEs in Malaysia. In discharging our duties, the registered audit firm and auditor will be subject to our inspection, in accordance with section 31V(1) of Part IIIA of the SCA, to assess the degree of compliance with the auditing and ethical standards by the auditor and the quality of the audit reports prepared by the auditor relating to the audited financial statements of the PIEs.

The function of the inspection is to provide an independent oversight to monitor the auditors of PIEs in carrying out their duties in accordance with the auditing and ethical standards and legal requirements. The inspection process is designed to assess the quality of the audit performed by the audit firms, identify improvement areas and ensure remedial actions are taken by the audit firms to enhance audit quality.

This section provides an overview of the inspection activities, inspection process and basis of reporting, scope of inspections and overview of findings.

SUMMARY OF ACTIVITIES

Annually, the AOB inspects the Big Four Audit Firms and two major audit firms which have more than 10 partners and audit more than 40 PIEs (Major Audit Firms). We

intend to cover the mid-tier audit firms and sole proprietors (Other Audit Firms) within a pre-determined inspection cycle.

In 2011, the AOB conducted regular inspections on 17 audit firms which audit over 98% of the market capitalisation of public-listed companies or 86% of the total number of PIEs.

The inspections encompassed both the audit firms' overall quality control and compliance with ISQC 1 and the MIA By-laws together with the review of 52 audit engagements of PIEs for compliance with the ISAs.

In 2011, the AOB also commenced the review of remediation plans proposed by the audit firms that were inspected. By the end of the year, 16 final regular inspection reports were issued, six were pending finalisation and 13 remediation plans were approved.

We also continued to enhance our risk assessment function and process to ensure we have a better understanding of the risk profile of audit firms and engagements.

The AOB acknowledges the importance of sharing experiences with international regulators including benchmarking consistency of approach and understanding current emerging issues as these enable us to apply them in inspections. In this respect, we participated in the annual international

Table 1

Inspections conducted in 2010 and 2011

Year	No. of audit firms inspected	No. of auditors inspected	No. of audit engagements inspected	Inspection report	Remediation plan received and approved
				Final	
2010 [^]	6	24	22	2 ^{**}	–
2011	17 [*]	48 ^{^^}	52	16	13
TOTAL	23	72	74	18	13

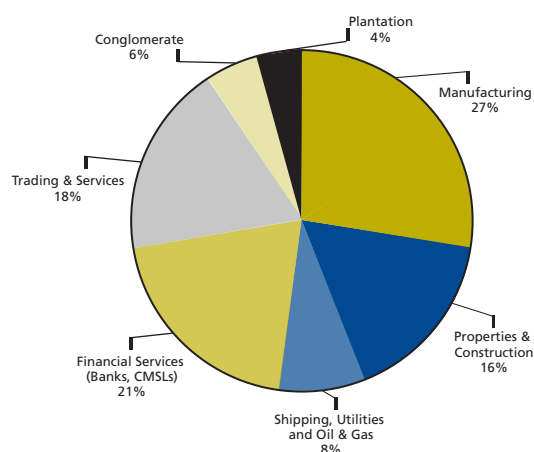
[^] : The first inspection activity commenced in August 2010

^{*} : Includes the 6 audit firms which are subject to annual regular inspection

^{^^} : Includes 7 auditors inspected in 2010

^{**} : Includes 1 special inspection in 2010

Chart 1

Audit engagements inspected by industry sector

inspection workshop organised by the IFIAR, conducted internal training, and require all inspection officers to be certified by the Institute of Chartered Accountants in England and Wales (ICAEW) International Standards on Auditing Programme.

INSPECTION PROCESS AND BASIS OF REPORTING

We conduct our inspection based on the auditing and ethical standards promulgated by the MIA which have been adopted by the AOB as provided for under section 31U of Part IIIA of the SCA.

In determining compliance with the relevant auditing and ethical standards, we emphasise compliance of the requirements in substance rather than in form. As such, any compliance of the standards in form but not in substance may be regarded as non-compliance with the standards.

The inspection process commences with communication with the audit firms, following through with planning matters, the entrance meeting, on-site inspection and the exit meeting.

An essential aspect of audit quality is that all audit procedures and audit evidences should be documented properly and adequately to support the audit opinion. Some deficiencies may be of such importance that they could indicate the auditors may have failed to obtain sufficient and appropriate evidence to support their audit opinion on the financial statement at the time of issuing the audit report. Robust written explanations on critical areas such as estimates and professional judgment are pertinent, with an appropriate depth of analysis as evidence to support the audit conclusion. Therefore, in the absence of documentation or other persuasive evidence, even if the auditor claimed to have performed the procedure, the auditor is regarded to have failed to perform an audit procedure.

At the conclusion of each inspection, the AOB issues a draft inspection report to the audit firm which includes deficiencies observed during the inspection, notwithstanding such deficiencies may have been addressed by the firm or in other audit engagements after the deficiencies were uncovered by us. The audit

firms are expected to provide their responses within specific time periods prescribed by the AOB. We will finalise the inspection report after taking into account representations made by the audit firms. Remediation measures and timelines would also be agreed with the audit firms with a focus on safeguarding and enhancing audit quality.

Each audit firm is required to report on the outcome of the remedial measures which have been or are being taken in relation to address the deficiencies raised in the inspection report. The AOB may publish the inspection report if the auditor fails to take the relevant remedial measures.

SCOPE OF INSPECTIONS AND REMEDIATION

The AOB conducts regular inspection on Major Audit Firms on an annual basis. In addition, we perform risk assessments annually and select Other Audit Firms for inspection based on a pre-determined cycle. In 2011, there were 17 audit firms scoped in for inspection, which included Major Audit Firms. We envisage that Major Audit Firms will continue to be inspected annually while Other Audit Firms registered with us will be subject to inspection over a pre-determined cycle.

The AOB may inspect a registered audit firm either through a regular inspection or special inspection. Regular inspection refers to an inspection conducted on a routine basis to ensure that all audit firms of PIEs are at least reviewed within a pre-determined cycle. A regular inspection is conducted with a focus on high risk areas and generally considers the possible impact the audit firm or auditor's quality would have on the overall confidence of the market and investors.

Special inspection is usually driven by specific concerns, either by events or industry issues that may pose a risk to investor protection or raise concerns over the quality and reliability of the related audited financial statements. Such an inspection covers specific aspects of an audit with greater depth and detail as compared to a regular inspection.

We adopt a risk-based approach which considers the risks of the audit firm and its portfolio of clients to enable us to focus on the areas of highest risk. This approach was designed to focus on aspects of these audit firms' operations that have an impact on audit quality. The inspection methodology provides a framework for the application of a consistent process for all inspections.

The principle risk that will impact the market and investor confidence in audited financial statements of the PIEs is where an audit firm forms an inappropriate audit opinion on these financial statements. Consequently, the key challenge of an inspection is to detect the gaps in the audit firms' application of auditing and ethical standards.

As our inspections are risk-based, we do not review all aspects of the firm's quality control policies and procedures or audit engagements to identify all deficiencies. Hence, an inspection should not be taken to provide an assurance that the quality control of the firm, its audits or the financial statements are free from any deficiencies not specifically uncovered.

For a firm review, the evaluation of the system of quality control entails how an audit firm has established and maintained the system that includes policies and procedures which address each of the following elements stipulated in ISQC 1:

- Leadership responsibilities for quality within the firm
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

The matters arising from the firm level review fall into two categories i.e. design and compliance issues. A design issue refers to the absence of control to address the identified risk. A compliance issue is defined as the failure of the firm's control to detect the risk

identified. The objectives of the engagement reviews are to assess the degree of compliance with auditing and ethical standards by the auditor and to assess the quality of audit reports prepared by the auditor relating to the audited financial statements of the PIEs. In essence, the inspection places emphasis on the sufficiency and appropriateness of audit evidence obtained, in particular for key audit judgment areas that support the audit opinion.

In 2011, we commenced our review on remediation plans submitted by the audit firms that were inspected for continuous improvement in audit quality. The AOB acknowledges that there is no generic prescription to fully eliminate risk to audit quality. However, positive relevant measures implemented to address the deficiencies identified during inspection and their corresponding root causes are pertinent to drive audit quality. The remediation plan generally covers certain firm-specific improvement areas in the short, medium and long term including specific performance indicators and timelines.

The AOB expects audit firms to provide a holistic approach to remediation, mainly to identify and address the root causes of the audit deficiencies. We discuss the proposed plans with the audit firms and provide views on their appropriateness. A remediation plan typically consists of measures to achieve firm-wide improvements such as:

- firm's structure, policies and procedures;
- audit methodology;
- human resource strategy and training needs ;
- independent reviewer's role;
- communication;
- monitoring of quality review; and
- performance measures for remediation.

Since the establishment of the AOB on 1 April 2010, a total of 13 remediation plans have been approved.

OVERVIEW OF FINDINGS

In general, Major Audit Firms had a quality framework in place and recognised the importance of quality in the performance of audit. However, maintaining a uniform audit quality across all engagements is their main challenge. Consequently, there continued to be potential for lapses that may compromise audit quality. At end-2011, most of the remediation plans were still at various stages of completion, hence there are still potential gaps that may not be fully closed.

Inspections of the Other Audit Firms also identified areas that require more improvements to close the gaps in the area of quality control policies and procedures. Additionally, deficiencies in the application of such policies and procedures were also prevalent.

The deficiencies in audit documentation and evidence for significant judgment areas continue to require more effort and discipline across the audit firms. Such deficiencies range from insufficient documentation to instances where the necessary audit procedures and evidence were not performed or obtained. It is pertinent to note that without sufficient evidence and analysis, the auditor may not have a basis to support their opinion.

The areas for improvement observed by the AOB may not necessarily imply that an inappropriate audit opinion was issued. However, to enhance the reliability of audited financial statements of PIEs, we will continue to challenge the sufficiency and appropriateness of audit evidence used to support the audit opinion formed by auditors.

FINDINGS OF FIRM LEVEL REVIEWS

1. Leadership Responsibilities for Quality Within the Firm

Tone from the top

The overall control environment in an audit firm is influenced by strong leadership that sets the tone for professional conduct. The AOB observed examples of good practices applied by audit firms although they continue to face challenges in balancing business needs with audit quality. It is also important for the leadership of audit firms to continue to reinforce the recognition and rewards of high quality work, while on the other hand penalising auditors for compromising audit quality.

We recognise the current challenges faced by the audit firms in securing the right and competent talent. In this respect, we observed that some of the firms had taken measures to rebalance capacity and risks.

Major Audit Firms

The AOB observed that the Major Audit Firms had made positive efforts to balance risk and capacity. However, maintaining consistent quality in the performance of audit engagements within the audit firms continued to be the main challenge.

Other Audit Firms

The Other Audit Firms, it was observed, did not have the necessary holistic framework which defines, measures, monitors and rewards audit quality. There is also a need to review their current performance evaluation process to ensure audit quality is given the appropriate emphasis. We also have concerns about some audit firms which did not have formal partnership agreements to govern their practices.

We wish to re-emphasise the need for the leaders of audit firms to continue to reinforce the tone for quality while driving the development of their audit practices, given the intense competitive environment and mature market.

2. Relevant Ethical Requirements

(a) Independence and ethics

Major Audit Firms

The Major Audit Firms had in place systems and processes to facilitate compliance with independence policies and procedures, however there were still instances where annual independence confirmations and independence declarations at the engagement level were not completed on time.

Other Audit Firms

A number of Other Audit Firms did not have in place independence compliance system and processes, to support their compliance with ethical requirements. The AOB is particularly concerned that there was no documentation to support facts relating to circumstances that had the potential to undermine independence.

Such documentation is important to provide clear communication to staff on the appropriate action to be taken to safeguard independence, where such circumstances or relationships exist. Other areas of observation included insufficient or no definition of prohibited investment in audit clients and their related entities for independence declaration by audit personnel.

Although we noted that most of the Other Audit Firms required their partners and employees to submit independence declarations, their commitment to audit quality could be further demonstrated by conducting independence

testing, to detect breaches of independence, and penalising any non-compliance detected.

We also observed instances of incomplete independence declarations by some members of the engagement team at the audit engagement level. This implies insufficient supervision by the engagement partner.

We will continue to focus on areas of independence and compliance with other ethical requirements for future inspections as we would like to see audit firms comply with the requirements in substance rather than in form to mitigate the relevant threats.

(b) Monitoring of Senior Personnel Involvement on Engagements

The MIA By-laws stipulate that using the same engagement key audit partners and senior personnel for a financial statement audit over a prolonged period may create familiarity threats. Safeguards should be applied in such situations to reduce such threats to an acceptable level.

Major Audit Firms

The inspections revealed that most Major Audit Firms had yet to establish a written policy that defines persons, apart from the partners, who are senior personnel who should be subjected to the rotation requirements and the relevant safeguards put in place to mitigate the familiarity threat of such persons.

The AOB observed that most Major Audit Firms defined senior personnel as the engagement partner or equivalent. In substance, the engagement partners placed significant reliance on their senior personnel who could be a principle, director, senior manager or personnel with equivalent role in the performance of an audit engagement. Such senior personnel may exert influence on the outcome of an audit engagement. Consequently, such senior

personnel are similarly at risk of the familiarity threat. Whilst we acknowledge that there are safeguards that can be put in place, there is merit in having a written policy to clearly define senior personnel and the relevant safeguards.

Other Audit Firms

Instances of breaches of the partner rotation requirement were more apparent amongst Other Audit Firms. There appears to be an inherent limitation for Other Audit Firms to comply with this requirement as the number of partners may not be sufficient to be rotated after serving the maximum period as prescribed by the rotation requirement.

The Other Audit Firms did not have in place a policy defining senior personnel and how they should be subjected to the rotation requirement.

3. Acceptance and Continuance of Client Relationships and Specific Engagements

(a) General policy and procedures

The majority of the audit firms had policies and procedures in place for the assessment of client acceptance and continuance to address considerations such as independence, possible conflicts of interest and whether appropriate talents were available to perform the service.

Major Audit Firms

Although there were still instances of non-timeliness in the completion of acceptance and continuance assessment before the commencement of audit work, this was being remediated as part of their current year remediation plan.

Other Audit Firms

There were instances where certain Other Audit Firms did not have complete policies and

procedures in place. In addition, the need for timely evaluation is crucial in order to achieve an objective evaluation before the acceptance of an audit engagement.

(b) Policy on termination of services and documentation

Other Audit Firms

Whilst the Major Audit Firms maintained an internal policy to provide guidance on circumstances for withdrawal or termination of audit services, particularly when there is potential threat to independence and objectivity, there is merit for the Other Audit Firms to ensure that such policy is in place to safeguard the audit firms from difficulties in disengaging themselves when necessary.

4. Human Resources

(a) Partners' workload

Major and Other Audit Firms

Previously, the AOB reported challenges faced by many audit firms with regard to the shortage of talents and the increase in the partners' workload. The Major Audit Firms had initiated measures to rebalance their partners' workload.

While some audit firms had tried to spread the workload of partners, the statistics gathered during the inspection revealed insufficient time charged by partners. In addition, the deficiencies identified from the audit engagement reviews revealed that supervisory function was not effective. The concentration of audits with similar financial year end also adds concern about the workload of the engagement partners.

The audit firms continued to voice their concern over the relatively low audit fees in Malaysia although generally we observed marginal increments in the fee level. The increase however, may not be sufficient to cover the general rise in

salary costs due to greater competition for talent in Malaysia.

We would like to reiterate the need for audit firms to reconsider their capability in respect of time and resources before accepting further audit engagements.

(b) Training needs

Training is an important aspect that enables the partners and staff to develop and maintain the required levels of competence and capabilities in line with the developments within specific industries and market.

Major Audit Firms

The Major Audit Firms had put in place efforts to educate their auditors on the Clarified ISAs and the new/revised Financial Reporting Standards (FRS).

Whilst in general, all training at Major Audit Firms was conducted in a timely manner, audit engagements selected for inspections revealed instances where the Clarified ISAs had not been effectively applied.

Other Audit Firms

The AOB observed instances in some Other Audit Firms where the partners and staff had not attended the relevant training, especially on the Clarified ISAs and new/revised FRS. We also observed minimal training hours for certain complex accounting standards which raises concern over the adequacy of time spent for such training. There was also no monitoring mechanism in place to track the staff's attendance at training.

(c) Staff recruitment process

Other Audit Firms

Whilst the Major Audit Firms had in place the relevant recruitment policies and procedures,

some Other Audit Firms did not necessarily have consistent emphasis on audit quality while performing recruitment. It is pertinent that an established process be put in place to ensure only suitably qualified and competent staff are recruited to be involved in audit engagement.

5. Engagement Performance

(a) Engagement Quality Control Review

Major and Other Audit Firms

The AOB remains concerned about the quality of work performed by the EQCR, in light of the deficiencies identified during inspections. Further, based on our analysis of the statistics gathered during the inspection of audit engagements, there was minimal time spent by the EQCR on each audit engagement. This raised doubt on the effectiveness of the EQCR's role in an audit engagement.

It is also pertinent to understand the principle of professional scepticism when undertaking the role of EQCR as an effective EQCR must be able to provide the relevant challenge on key areas of judgment. Accordingly, there is a need to reinforce the message on the EQCR's role in providing an 'objective evaluation' of an audit engagement. It is important to recognise that the 'character and discipline' of EQCR differs from the role of an engagement partner.

There is therefore a need for audit firms to revisit the role of the EQCR. In the remediation plans of the Major Audit Firms, there was some progress in refining the role of the EQCR, as this was driven by their network firms. However, the effectiveness of the clarified role has yet to be ascertained as the remediation has not been fully implemented.

(b) Professional scepticism

Major and Other Audit Firms

The AOB observed that Major Audit Firms were in the process of undertaking initiatives to reinforce the importance of exercising professional scepticism in the conduct of their audit work. This included guided training and structured communications on professional scepticism. Although we believe that more initiatives should be put in place across the audit industry, the application of professional scepticism varies, depending on the level required when auditing a particular audit engagement.

We will continue to give particular attention to the application of professional scepticism in 2012 inspection.

(c) Thinking audit

Major and Other Audit Firms

Although the methodologies of Major Audit Firms and Other Audit Firms provide the relevant audit guidance, we are particularly concerned about certain audit areas which are checklist-driven. Such approach appeared to stifle the thinking process of auditors especially when, under pressure, the auditors may sacrifice due consideration of the wider perspectives on issues in their haste to complete the checklists.

(d) Audit consultation

Other Audit Firms

Whilst Major Audit Firms continued to enhance their consultation process and the documentation on consultation, we noted that some Other Audit Firms need to put in place the relevant consultation policies and procedures.

Consultation on the relevant accounting and auditing matters is a critical process in engagement performance. Hence, the lack of a policy to require documentation and/or consultation on complex transactions or areas of critical judgment is an area of concern.

(e) Revised auditing standards

Major Audit Firms

The Major Audit Firms had incorporated the Clarified ISAs which became effective in Malaysia for the December 2010 financial year end into their audit methodologies. However during inspections, we identified some gaps in the implementation of Clarified ISAs, as further described in the engagement observations section of this report.

Other Audit Firms

Shortcomings were identified on the state of preparedness of Other Audit Firms. This was particularly so where Other Audit Firms require more effort to acquire knowledge on Clarified ISAs, disseminate the Clarified ISAs to their audit staff and apply the standards in the performance of audit.

(f) Audit work programme

Other Audit Firms

The AOB observed that some Other Audit Firms did not have an updated audit work programme. Some cases even revealed that the audit work programmes had not incorporated the requirements of the Clarified ISAs. We also observed instances where there was no audit guide for the audit staff to refer to in carrying out audit engagements.

(g) Completion of the assembly of final engagement file

Major and Other Audit Firms

In general, the audit firms continued to struggle

with the archiving of audit engagement files within 60 days from the date of the auditor's report as guided by ISQC 1. There were various reasons for this ranging from information technology glitches, lack of relevant resources to structural and administrative issues.

Whilst some audit firms managed this seriously, the AOB is particularly concerned where sufficient audit evidences were not available at the time of signing the auditor's report as opposed to merely administrative issues. In various instances and based on statistics available, substantial time was spent during the wrap up procedures. We expect that there should be a shift towards more time spent at the planning, execution and gathering of audit evidence stages.

In addition, we observed the absence of policies and procedures with respect to the assembly of final engagement files in some Other Audit Firms.

(h) Time spent at various stages of an audit engagement – direction, supervision and performance

Major Audit Firms

An analysis of the time spent at various stages of the audit engagement process amongst the Major Audit Firms inspected revealed an average ratio for 'planning' to 'engagement performance and conclusion' of 14 : 86. Whilst there is no prescribed ratio, audit planning is pertinent to ensure that the right audit strategy fits the business model of a particular audit engagement and that the relevant risks identified during the planning stage are mitigated to provide a level of comfort to form an audit opinion. As such, the audit firms are expected to ensure an appropriate amount of time spent on audit planning.

A reasonable time spent during audit planning is crucial to ensure all relevant risks are identified accordingly, appropriate brainstorming has been carried out, the relevant skills or expertise are available in the audit engagement team and

there is appropriate follow-through with the right audit procedures during audit execution to support the audit conclusion.

(i) Documentation

Major and Other Audit Firms

Although the AOB observed that audit documentation for Other Audit Firms was generally less extensive than those practised by Major Audit Firms, it is important for all audit firms to devote more effort to putting in place the relevant documentation to support the evidence that forms the basis of audit opinion.

Oral explanations alone do not provide adequate support for the work the auditor has performed and can only be used to provide clarification on information contained in the audit documentation.

The ISAs prescribe that the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand. It is pertinent that the audit firms recognise when inadequate audit documentation would result in insufficient audit evidence; and what constitutes sufficiently robust written explanation of judgments, decisions on conclusions and analysis.

There were instances where the nature, timing and extent of work performed were not sufficiently documented amongst both Major and Other Audit Firms. Disposition of exceptions noted from the testing results were not appropriately concluded with documentary evidence. We are particularly concerned with respect to areas involving judgment where discussions of significant matters were not supported.

The AOB believes that documentation requires discipline of the engagement team and

this requires consistent messages from the engagement partners.

6. Monitoring

Monitoring of quality control policies and procedures

Major Audit Firms

The AOB observed that Major Audit Firms need to place more effort in the follow up action plan on the exceptions noted arising from the monitoring of the firm's quality control policies and procedures to ensure effectiveness of the controls. Inspection observations recorded last year showed that the Major Audit Firms had included this aspect in their current remediation plans and enhancement efforts were in progress.

Other Audit Firms

On the other hand, we observed that the monitoring of the firm's quality control policies and procedures was absent in some Other Audit Firms resulting in no monitoring process performed by these audit firms. These firms need to establish such process urgently as required by ISQC1. Monitoring the performance of the engagement partner is an important process to enable appropriate follow up remedial measures to be undertaken to safeguard audit quality.

An established process should address cases where the results of the monitoring procedures indicate that an audit report may be inappropriate or that procedures were omitted during the performance of the audit engagement. Such process could be applied as a network review or internal quality control review depending on the structure of the audit firms.

FINDINGS OF ENGAGEMENT REVIEWS

In 2011, the inspections were focused on more complex engagements across PIEs with different business models. One of the common observations identified was in the area of audit strategy.

1. Planning and Risk Assessment

Major and Other Audit Firms

The AOB reiterates the importance of audit planning which establishes the overall audit strategy for the engagement and development of an audit plan. It is beneficial to ensure proper planning is strategised to identify risk areas and significant areas of concern in an audit engagement. It provides direction for the engagement team members to carry out the audit work as planned and to make the changes when necessary and where relevant. Setting expectations is one of the key functions especially where different skills and expertise are required to assist in the audit engagement.

While the risk appetites of audit firms may influence their audit strategy, we observed that the risk appetite of the audit firms was not necessarily aligned with risks faced by the capital market. The potential elements of business risks factored in when forming an audit opinion may affect the audit risks of an audit engagement. Auditors need to be cautious about their own risk appetite when forming an audit conclusion.

Major Audit Firms

Whilst the Major Audit Firms had in place structured audit planning within their methodologies, there is still a need to re-emphasise the time spent on audit planning as there were observations that relate to a disconnect

between audit planning, audit execution and audit conclusion.

As reported earlier, a reasonable time spent during audit planning is pertinent to ensure that the right audit strategy fits the business model of a particular audit client and that the relevant risks identified during the planning stage are mitigated at the assertions level to provide a level of comfort to form an audit opinion.

Other Audit Firms

We observed a tendency by some Other Audit Firms to immediately perform the substantive procedures without comprehensive audit planning. There were also instances where the planning performed was insufficient to address the risks at the financial statements and assertions levels.

Overall, it is pertinent to acknowledge the value of proper planning and relevant mandatory audit procedures, in understanding the audit client's risks and controls before executing the audit work. The audit plan should include the nature, timing and extent of planned risk assessment procedures to address the audit risks. The absence of such procedures in some audit engagements is a concern to the AOB.

2. Revenue Recognition

Major and Other Audit Firms

In response to past business cases of revenue manipulation, revenue recognition was chosen as one of the focus areas in our audit inspection in 2011.

We observed that the basic revenue cut off issue seems to indicate insufficient testing

on the underlying data or inappropriate reliance on control testing. Based on available statistics, the possible root causes of the observations could relate to greater complexity and technologically driven business and operating environments or when the revenue is captured from various entry points and globally.

The AOB is concerned about observations where the audit strategy did not entirely cater to the business model for capturing transactions and where the engagement teams lacked understanding of the audit risks resulting from the complexity of transactions described in the preceding paragraph. In view of the complexity of the business model and processing system, the data captured may not be easily traced and identified, in the traditional manner.

In such cases, substantive procedures alone may not be sufficient to address the risk of inaccurate and incomplete recording which is normally associated with highly automated transactions. The entity's controls over such risk are relevant to the audit and hence the auditor should obtain an understanding of them. Notwithstanding that, drawing comfort from high level controls (entity level) and general IT controls may not be sufficient to support the basis of audit conclusion.

There were also instances where the controls could either be directly or indirectly related to the assertions, whereby the more indirect the relationship, the less effective the control in preventing, or detecting mis-statements in that assertion. We observed many instances where the controls reviewed were not necessarily demonstrative of the actual performance or direct control related to the assertion, thus compromising the quality of audit evidence.

In addition to the above, we also focused our reviews on asset management companies. The audit risk of an asset management company (AMC) is heightened when the AMC does not manage its own funds whilst the risk is

reasonably contained when the AMC manages its own funds. This is especially so when the auditor of the AMC is also the auditor for the funds as the audit of its underlying assets for the calculation of the AMC's revenue is performed at this level, hence the reliance placed on the audit of a fund. However if the AMC does not manage its own fund, there could be potential risk of insufficient audit procedure performed to verify the underlying assets.

From our observations, the audit fee for this sector may not be reflective of the actual efforts performed by the auditors. In this context, the audit firms should consider reviewing their pricing model to commensurate with the potential risks that could be faced by the audit firms.

As the auditing standards presume that revenue recognition is susceptible to fraud risk, this will continue to be a focus area of the AOB.

3. Going Concern

Major and Other Audit Firms

The AOB reiterates the need for assessing the fundamental assumptions of going concern made by management in the preparation of financial statements. Audit firms need to improve in this area as our inspection revealed that the performance of audit procedures is generally lacking.

It is important to acknowledge that going concern considerations involve risks of key judgment area especially when the management's assessment may not be realistic.

Numerous observations that affected the quality of audit evidence included the following:

- Over reliance on audit client's explanations and representations on the assumptions

and analytical procedures especially on past history of business growth that could not support future estimated growth with business case, unsupported discount rates and lack of challenge on the sustainability of cash flow projections based on other key assumptions;

- Insufficient challenge on the validity of going concern assumptions in view of the existence of indicators of going concern;
- Instances where various methods in the calculation of terminal values were not supported; and
- Wrong sensitivity analysis performed on the cash flow projections.

The AOB will continue to focus on going concern in view of its highly judgmental and subjective nature. We also recognise the initiatives by the Major Audit Firms in reinforcing the importance of exercising professional scepticism in this area.

4. Impairment of Goodwill, Assets and other Intangibles

Major and Other Audit Firms

As the global economy remains volatile, the likelihood of impairment in the carrying value of assets will continue to remain high. Consistent with 2010, the AOB's observations in 2011 are as follows:

- Inadequate documentary evidence to support the basis for identification of Cash Generating Unit (CGU) and the conclusions;
- Inadequate challenge and justification on why a CGU can be larger than an operating segment;

- Inappropriate impairment assessment which is not in accordance with the relevant provisions of FRS 136 – '*Impairment of Assets*'; and
- Inadequate evidence of challenge of assumptions and key estimates used, for example, the growth rate and discount rate

We will continue to focus on this area in 2012 inspections.

5. Accounting Estimates

Major and Other Audit Firms

Accounting for estimates requires judgment and understanding of the management process, consistent with the Clarified ISAs. The AOB observed that this is still lacking in a number of the audit engagements selected for review. Although the framework on understanding the management process is in place for Major Audit Firms, the majority of Other Audit Firms require improvement in this area.

There were also instances where significant accounting estimates were not identified as a key risk area and there was no documentary evidence to support the decision.

6. Related Parties Transactions and Disclosures

Major Audit Firms

The AOB acknowledges the efforts by Major Audit Firms to rectify the audit procedures by including the understanding of the management's process in order to identify related parties and related-party transactions in their audit procedures. However there were still observations on the implementation of the audit procedures.

Other Audit Firms

On the other hand, we identified insufficient audit procedures in Other Audit Firms to review management's process to identify related parties and related-party transactions.

We also observed the tendency to place reliance on management's representation on related-party transactions. When disclosures were made on arms' length transactions, there were no further audit procedures to verify the transactions in accordance with FRS 124 – *'Related Party Disclosures'*.

7. Sampling

Major Audit Firms

The AOB continued to observe instances where there was no documentation to support the basis for samples selection and there was undue reliance placed on the completeness of the population. We also observed instances where there was no documentary evidence to support the reasons for untested population although the amounts were above the relevant materiality threshold set for the audit engagement.

Other Audit Firms

Some key observations we identified on the inspection of the Other Audit Firms included no basis for the sample size used for control and substantive testing purposes. In addition, there was no structured approach in the identification of sampling methods.

8. Third Party Confirmations

Major and Other Audit Firms

The timeliness of follow up action with the third party on audit confirmations continues to be a challenge to the audit profession. Although

there could be alternative audit procedures performed to mitigate the risk, the AOB observed that the alternative procedures performed did not necessarily address the intended audit objectives of the assertions.

We acknowledge the efforts by the Major Audit Firms to give greater priority to this area. Given the availability of technology to forge documents, the audit firms need to be cautious when reviewing documents as audit evidence.

Numerous findings in the Other Audit Firms included the reliance placed on photocopies, scanned and faxed copies of confirmations received without performing any further validation of the source of these replies. There were also situations where there was no follow up procedures performed on the original copies of the confirmations.

9. Use of Experts

Major and Other Audit Firms

In 2011, the AOB also reviewed audit engagements of PIEs with complex business models. We are concerned about areas where there is an integration of audit between the information technology (IT) auditors and the financial audit engagement team, whereby there appears to be a lack of co-ordination between the two parties, which resulted in the work performed not fully addressing the audit objectives.

We continued to observe that where the audit firms placed reliance on work performed by the experts especially professional valuers, several audit firms did not perform audit procedures to evaluate the competence, objectivity and terms of engagement of those experts before placing reliance on their reports. Auditors also need to consider whether the risk of an expert's objectivity may be impaired or tainted especially where the expert is employed by the PIE.

10. Group Audit Arrangement

Major and Other Audit Firms

Consistent with 2010, in considering the extent of the principal auditor's involvement and use of the work of other component auditors, the AOB identified limitations in the scoping process, and consistency in the application of work done based on the threshold set.

There is also a need to critically evaluate the work of component auditors. There were other shortcomings which include the effective follow up of post balance sheet reporting by other component auditors and the minimum audit procedure required to be performed on non-significant components.

11. Presentation and Disclosures

Major and Other Audit Firms

We observed instances of insufficient rigour in the review of financial statements resulting in the omission of and insufficient disclosures in accordance with the relevant accounting standards. In 2011, the areas of insufficient disclosures which were apparent amongst others included the following:

- FRS 8 – '*Operating Segments*'
- FRS 7 – '*Financial Instruments: Disclosures*'
- FRS 139 – '*Financial Instruments: Recognition and Measurement*'

In addition, we observed instances where the drafting of financial statements was heavily assisted by the auditor. These instances were prevalent amongst the Other Audit Firms.

It is pertinent to acknowledge that the drafting of financial statements is not the role of the auditor. Such time taken to assist the audit client may taint their independence and preclude

the auditors from devoting sufficient time to perform their actual audit work and may affect the quality of their audit work. The auditors should only review the financial statements drafted by their audit client and in the review of the financial statements, the auditors should clearly document any differences of opinion between themselves and the audit clients. Any material departure of any disclosure requirements may affect the basis of the audit opinion.

12. Substantive Analytical Review

Major and Other Audit Firms

Many audit firms rely on substantive analytical review as one of their audit procedures, in particular on the income statement items. The AOB observed that the majority of the audit firms had not performed the function sufficiently. The Clarified ISAs require the following in performing substantive analytical review:

- Determine the suitability of substantive analytical procedures
- Evaluate the reliability of data used to set expectation
- Develop an expectation and evaluate whether the expectation is sufficiently precise
- Set the threshold for investigating differences

Substantive analytical review performed by the majority of the audit firms was limited to the comparison of 2011 figures with the figures for 2010. It would be crucial for the audit firms to enhance this procedure to include the requirement of the Clarified ISAs as described above so as not to compromise the quality of audit evidence obtained to support the audit conclusions. It would be important for the audit firms to carry out training on substantive analytical review based on different industries and share expectations for varied industries.

13. Materiality Concept

Major and Other Audit Firms

ISA 320 '*Materiality in Planning and Performing an Audit*' requires the auditor to determine the materiality for the financial statements as a whole when establishing the overall audit strategy, whilst performance materiality is used for the purpose of assessing the risks of material mis-statement and determining the nature, timing and extent of further audit procedures.

It is important to distinguish between overall materiality and performance materiality.

Although the determination of both overall and performance materiality is based on professional judgment, the AOB is concerned about areas where the consideration for the determination of materiality is only limited to quantitative factors. In addition, we are concerned when the conclusion of uncorrected mis-statements above the overall materiality was concluded as not material based on a different materiality such as 'over total assets'.

The AOB also identified several audit engagements reviewed in Other Audit Firms, where there was no materiality threshold established.

REMEDIATION

The AOB believes that audit firms will continue to maintain their focus on enhancing audit quality, as observed by the measures taken by the audit firms in addressing the deficiencies identified during inspections and their commitment in the remediation plans. This will contribute to an improvement in the overall quality of audit work to maintain the confidence in the quality and reliability of financial statements of PIEs in Malaysia. Some positive measures in the remediation plans that were submitted include:

- Strengthening the governance structure, tightening the audit quality improvement plan
- Enhancing the consultation process
- Formulating a structured communication plan on audit quality matters
- Introducing enhancement to performance evaluation of partners and staff
- Rebalancing of partners' portfolio and workload
- Enhancing the role of the EQCR
- Creating a structured annual training plan and making relevant changes to audit methodology, policies and procedures

- Tightening the approach to professional scepticism
- Raising the commitment to enforce compliance on proper and relevant documentation

CONCLUSION

While the auditing framework in Malaysia remains sound and all international standards are adopted, the findings from the AOB oversight activities suggest that more efforts are required to enhance audit quality.

It is pertinent for audit firms to acknowledge the need to strengthen audit planning and to have a consistent approach from audit planning to audit conclusion. Any deviation from planned procedures should be sufficiently documented to support the facts. The materiality concept should not be limited to only quantitative factors or be based on a materiality threshold which differs from the planned materiality. Any discrepancies should be appropriately justified.

We observed that the testing of relevant controls to address the relevant assertions plays an important

part in the audit strategy to ensure that the relevant audit risks are appropriately addressed. There is also a continuous need for the audit firms to ensure that audit strategy is updated with the changes of the audit client's business model. When reliance is placed on the IT auditor's work in an audit engagement, appropriate co-ordination and documentation is pertinent to mitigate miscommunication that could be detrimental to audit evidence gathering.

The key judgment areas are inherently a main challenge in the audit industry. Although some audit firms have taken measures to re-emphasise the importance of key judgment areas across the audit firms, it is pertinent to understand the need to exercise professional judgment and not only rely on mechanical views in arriving at a conclusion.

Appropriate disclosure in financial statements is one of the main thrusts for good financial reporting. It provides transparency and useful information to the users of financial statements so that proper decisions can be made. Lack of relevant disclosures may lead to misleading information that may not address the intended objective of financial reporting. Hence, it is pertinent that the auditors place greater emphasis when reviewing to ensure that the disclosures are made not only in compliance with the minimum requirement of the accounting standards but to meet the intended objective of financial reporting in substance. In addition, there is merit in good corporate governance to enhance disclosures for transparency and better communication to shareholders.

The AOB continues to observe instances where documentation in the engagement files failed to provide sufficient and appropriate audit evidence to support certain audit assertions. However the Major Audit Firms are making efforts to enhance the discipline of documentation. A lack of audit documentation meant there was a lack of sufficient and appropriate evidence in the engagement files to support the assertions, even allowing for oral representations. The absence of audit procedures and audit evidence would cast concern as to whether the audit work had been

adequately performed. Another key observation relates to inadequate direction, supervision and performance by the engagement partner.

Although there has been positive movement in the audit fee for Major Audit Firms, this will continue to pose a challenge to the audit firms as the costs of securing adequate and relevant resources have also increased. The AOB emphasises that this issue requires immediate attention and the accounting profession, together with institutions of higher learning, have to take the lead in ensuring adequate supply of competent accountants into the market.

While the AOB acknowledges that some audit firms focused on audit efficiency, we believe the audit strategy should reinforce its focus on mitigating risks of material mis-statements rather than the former which may compromise audit quality. In this respect, the AOB believes that it is necessary to align the capital market risks and the business risks of the audit firms to mitigate the audit risks which may affect the audit quality.

Despite the challenges above, the Major Audit Firms continued to reinforce their tone from the top and messages on audit quality, though greater effort is required to ensure consistency of audit work among the partners within the audit firm, especially when there were continual observations identified in the audit engagement reviews. The Other Audit Firms need to devote greater effort to considering ways to safeguard audit quality. The AOB will continue to maintain lines of communication and consistent interactions with the stakeholders to contribute to improving audit quality.

The above observations should be taken seriously by audit firms including identifying their root causes and the corresponding remediation plans. While most audit firms inspected had commenced their remediation efforts, it is critical for audit firms to measure their effectiveness through the overall improvement in audit quality rather than the mere completion of each action plan.

Audit evidence and documentation

The audit firms should ensure timeliness and completeness of their audit files based on their archiving policy and consequently for the AOB's inspection as they stand at the date of our request. It was therefore a concern that there were instances of audit evidence not originally in the audit files. Partners and staff of firms are reminded that submission of evidence after the commencement of inspection casts doubt over the integrity and quality of such evidence. It is important to recognise that "Audit procedures claimed to have been performed but not documented, is considered not done and where evidence is not originally in the audit file, is considered not obtained". Audit firms should take

cognisance that in such circumstances, we will consider such evidence as non-admissible.

As provided under Section 31V(3) of Part IIIA of the SCA, the partners and employees of the audit firms shall co-operate with the AOB in providing access and subsequently copies of or extracts of such books, accounts, working papers or other related documents which we require, in a timely manner. The AOB expects the audit firms to provide such documents on a timely basis to assist in the inspection progress. Any concern relating to confidentiality issues with PIEs is a matter that the audit firms should appropriately resolve with their PIEs.

Part Five

Assessment of Performance and Effectiveness

ASSESSMENT OF PERFORMANCE AND EFFECTIVENESS

The AOB has established a strategic framework linking its service areas to the outcomes envisaged by the mission. While the core services such as registration and inspection are ongoing activities, focus areas were identified after considering the operating environment, developments in financial reporting and auditing, regulatory changes as well as global developments in audit regulation.

At the beginning of the year, the AOB Board considers and approves proposals from management on the annual operational plan including areas that require emphasis when performing our audit oversight function. The progress of our oversight activities are reported to the AOB Board on a monthly basis. A performance review is conducted in mid-2011.

As 2011 was the second year of AOB's operation, the focus was to strengthen our core functions, develop remediation and enforcement frameworks, reach out to more stakeholders and develop working arrangements with Malaysian and foreign regulators.

In addition to the discussion on the initiatives of the AOB in the preceding sections, the table below summarises the progress of our focus areas in 2011 in line with the overall aim of our strategic framework.

The AOB's assessment of significant risks relating to the quality and reliability of financial statements of PIEs and the key measures recommended to address such risks are reported in Part 4 of this report.

The audit firms are responding to the findings of our inspection reports by implementing remediation plans as agreed with the AOB. Among the measures implemented are strengthening the governance structure of the audit firms, improvement of methodology and rebalancing partners' portfolio and workload. This will contribute to an improvement in the overall quality of their audit work.

Based on the activities and outcome reported, the Board believes that the AOB is progressing in line with its strategic plan.

In 2011, the AOB was in the process of developing key performance indicators to measure the outcomes envisaged in its strategic plan, which are:

- High quality financial reporting practices by PIEs
- Resourceful and high quality audit practices
- Independent and high quality audit
- High quality and reliable audited financial statements
- Confidence in the audited financial statements of PIEs

As the outcomes are highly subjective, we are working on indicators which enable certain levels of measurement to be made. We foresee this to be achieved in 2012.

Table 1

2011 Focus areas and outcomes

Focus areas for 2011	Outcomes
Work with the accountancy profession to ensure clear understanding of standards	<ul style="list-style-type: none"> Submitted five comments on exposure drafts and consultation documents of IAASB Attended meetings of AASB and ESB of MIA as an observer Participated in forums and events organised by MIA and other accounting bodies relating to auditing issues
Enhance registration process to ensure all registered firms have the structure to perform quality audit	<ul style="list-style-type: none"> Firms are required to indicate their efforts to comply with Clarified ISAs in their registration application 28 auditors were required to explain on their compliance with auditing standards
Enhance Inspection Risk Model and perform deeper audit inspection with specific focus and covering a wider range of firms	<ul style="list-style-type: none"> Inspection Risk Model revised and approved by the board
Monitor audit firms' remediation progress to ensure effectiveness	<ul style="list-style-type: none"> 17 remediation plans were received by the AOB and 13 were approved for implementation
Roll out inquiry activities and set tone for quality through sanctions	<ul style="list-style-type: none"> Inquiry policy and procedures approved
Focus on enhancing effectiveness of audit committees in performing their function with respect to financial reporting and audit quality	<ul style="list-style-type: none"> Attended forums and events with audit committee members and directors and discussed their roles in enhancing the quality of financial reporting
Enter into MoUs with key stakeholders	<ul style="list-style-type: none"> Initiated discussions on memoranda of understanding with regulatory agencies in Malaysia and abroad
Work with institutions of higher learning on audit related research	<ul style="list-style-type: none"> Participated in workshops and events involving institutions of higher learning Invited education institutions to submit research proposals for the consideration of the AOB
Continue to participate in IFIAR activities and initiate co-operation among ASEAN audit regulators	<ul style="list-style-type: none"> Attended IFIAR plenary meetings in Berlin and Bangkok Attended inspection workshop in Washington D.C. Attended ASEAN Audit Regulators Group meetings in Singapore and Bangkok Participated in events relating to audit oversight in the ASEAN region
Commence initiative to obtain EU recognition by their next review	<ul style="list-style-type: none"> Transitional period on recognition extended by the EU Information for recognition provided to the EU at their request
Influence other stakeholders to contribute financial support	<ul style="list-style-type: none"> This initiative is still being pursued



Part Six

2012 Outlook

2012 OUTLOOK

REMEDiation EFFORTS BY AUDIT FIRMS

While the AOB will continue to inspect audit firms through its annual audit inspection programme, the most critical component of our oversight framework is when audit firms close the gaps identified through remediation. The principle behind remediation is when any improvement across the board would enhance the overall audit performance of the audit firms, hence improving the reliability of the opinion of auditors.

Among the key control areas applied by audit firms are the alignment of profits and audit quality, engagement quality control review and monitoring of engagement quality. These three areas will be our focus as their effectiveness would provide significant assurance on the quality of engagement performance.

An effective remediation should be reflected by enhanced effectiveness of audit work performed. This is where audit firms need to go beyond completing agreed remediation efforts on a piecemeal basis. Clear key performance indicators on the effectiveness of remediation are expected.

EFFECTIVENESS OF IMPLEMENTATION OF STANDARDS

PIEs in Malaysia would be applying IFRS beginning 2012. While the AOB has no direct mandate on the preparers of financial statements, we would like to encourage directors of the PIEs to assess

the state of preparedness of their financial reporting functions in ensuring that financial statements prepared by them comply with IFRS without the assistance of auditors. This is an important part of their governance responsibilities as reporting to shareholders and stakeholders is a continuum of value creation.

At the same time the IAASB would be conducting a post implementation review of the Clarified ISAs in the same year. The AOB will participate in this effort to contribute towards enhancement of the implementation of the Clarified ISAs. Given that many PIEs are operating in complex group structures across many countries, one standard which is of particular interest to us is ISA 600 *'The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements'*.

Whilst all relevant accounting, auditing and ethical standards are adopted, it is imperative that the implementation of these standards is effective to ensure enhanced confidence in the financial reports of PIEs. We will continue to review the efforts made by audit firms in ensuring their people, systems and processes are aligned with all these standards.

THE ACCOUNTING PROFESSION AND SELF-DISCIPLINE BY AUDIT FIRMS

The MIA is responsible for the regulation of the accounting profession including the performance of

their members who are preparers of financial statements and auditors. The performance of MIA members is an important aspect of ensuring that high quality audited financial statements are made available to stakeholders of the capital market. In this respect, the tone set by MIA with regard to not compromising on its expectations of the highest levels of professional conduct by members, is extremely critical. Consequently, MIA should demonstrate its commitment to regulate its members by continuing to enhance its disciplinary processes and applying them effectively.

A stronger self-discipline adopted by audit firms would enable us to focus more of our efforts on dealing with other external factors which influence audit quality. This includes the demonstration that shortcomings identified in the performance of audit engagements are dealt with decisively via the audit firms' disciplinary processes. Audit firms should uphold the principles behind the relevant standards rather than emphasising on their form.

DEVELOPMENTS IN AUDIT REGULATION

The AOB expects more developments in audit regulation as the global efforts to prevent systemic market failures continue. These include the completion of the review of the auditor reporting model and the finalisation of the EU recommendations on restoring confidence in financial reporting.

At the regional level, co-operation among audit regulators in ASEAN is expected to grow further with more collaborations beyond the present sharing of information. While this development would benefit the regulators through more co-ordinated efforts, it should also benefit the audit firms through a more consistent application of standards and principles across jurisdictions by audit regulators.

INSPECTION PRIORITIES AND CHALLENGES

Inspection Approach

The focus of the AOB inspection will continue to be on audit work of high-risk areas such as fair value

measurements of assets and liabilities, the impairment of assets (including goodwill and other intangible assets), the evaluation of going concern, revenue recognition, accounting estimates, fraud risks, segmental reporting, group audit arrangements, related-party transactions, disclosures of material assumptions, disclosures of segment information and compliance with ethical standards. The AOB will continue to place more emphasis on key areas of judgment and the application of professional scepticism. In 2011, the AOB expanded its coverage to include the review of financial institution audit focusing on certain classes of transactions and a review on the information technology audit. In 2012, we intend to cover other regulated industries and place more emphasis on remediation.

The AOB will continue to evolve our inspection process, enhance the quality of monitoring processes, remediation framework and continuous advancement in our risk assessment methodology both internally and externally. We will continue to invest in technical training programmes, industry knowledge and technology to enhance our operational effectiveness.

As part of our efforts to understand the impact of the current economy, emerging issues and changes to the accounting standards on audit quality, the AOB will continue to interact with domestic and international regulators and other stakeholders in the financial reporting ecosystem and to enhance dialogue with audit firms.

Inspection Challenges

The Major Audit Firms have made significant efforts to adopt the Clarified ISAs which took effect for audits with December 2010 year ends. The AOB is also cognisant of the positive progress with respect to the remediation measures made by the Major Audit Firms to safeguard audit quality. The audit firms will continue to face increasing costs as they invest in the necessary infrastructure and talent to move towards 2012 IFRS Convergence and in auditing the fair value of complex financial instruments.

The exposure to countries with economic uncertainties continues to raise concern over its potential impact on the financial statements. In view of the globalisation of

the current business environment, some of the Major Audit Firms have moved to a regional model. We view this positively as long as such structures do not compromise audit quality and there is no undue pressure by the regional leadership to achieve unreasonable business targets for local member firms.

Managing expectation gaps among the investors, regulators and auditors is pertinent in managing the risks associated with misunderstanding of responsibilities and accountability. In this respect, auditors should increase dialogues with these stakeholders to manage expectations.

Although international debate continues on the provision of non-audit services by the audit firms to their listed clients which may be perceived to impair independence, auditors should exercise caution

about such perceptions in order to manage any potential threats that could exist.

One of the other responsibilities of auditors is to communicate with those charged with governance. The AOB continues to emphasise the need for audit firms to ensure that time spent with those charged with governance is sufficient to carry out their responsibilities effectively especially when discussing issues on key risk areas, significant audit findings and internal control matters.

The shortage of talent, increasing cross border transactions and audit fee pressure faced by many audit firms will continue to be a challenge for the industry. The AOB believes that the audit firms acknowledge their key role as the gatekeepers of financial reporting and will continue to, focus and invest in audit quality to maintain investor confidence.

Part Seven

Statement on Governance

STATEMENT ON GOVERNANCE

MEMBERS OF THE AUDIT OVERSIGHT BOARD



NIK MOHD HASYUDEEN YUSOFF

Nik Hasyudeen is the Executive Chairman of the Audit Oversight Board since its establishment on 1 April 2010.

Nik is presently a member of the Operational Review Panel of the Malaysian Anti-Corruption Commission. He also serves on the Corporate Debt Restructuring Committee which was set up by Bank Negara Malaysia (BNM). Nik is an Adjunct Professor at the Faculty of Business and Accountancy, University of Malaya.

Nik was the former President of the Malaysian Institute of Accountants and also the former Vice-President of the ASEAN Federation of Accountants. He had served on the Malaysian Accounting Standards Board and the Listing Committee of Bursa Malaysia.

He holds a Bachelor of Business degree from Curtin University of Technology and is a Fellow of CPA Australia.

GOH CHING YIN

Goh Ching Yin is the Executive Director for Strategy and Development of the Securities Commission Malaysia (SC). He is responsible for strategy and research, market development, economics and risk management.

He takes lead with his team in conceptualising and formulating capital market strategy, developmental initiatives and the SC's business plan to ensure the direction and plans are responsive and relevant, taking into account domestic and international developments; to provide policy analysis of key issues and input to the government on wider issues affecting the capital market and the boarder economy.

Prior to joining the SC in March 2007, Goh had led a career that spans 12 years in the investment banking arena. The earlier part of his career had seen him holding various leadership and management positions in regional business development, strategic consultancy, corporate insolvencies and auditing. He holds a Master of Business Administration from the Cranfield School of Management, Cranfield University.





DATUK NOR SHAMSIAH MOHD YUNUS

Datuk Nor Shamsiah is currently the Deputy Governor in Bank Negara Malaysia (BNM).

Datuk Nor Shamsiah is responsible for the supervision division that supervises commercial banks (conventional and Islamic banks), investment banks, insurance companies (conventional and Takaful) and development financial institutions. She also oversees the Risk Management Department that formulates the internal enterprise risk management framework for BNM. She is also responsible for the unit that is responsible for combating abuses in the financial system. Datuk Nor Shamsiah sits as one of the member at the BNM Board of Director. She is also a member of the BNM Monetary Policy Committee and Financial Stability Policy Committee.

Datuk Nor Shamsiah represents BNM in a number of regional and international fora in the areas of banking supervision. She joined BNM in April 1987 and has extensive experience in the development of prudential regulation, legislation, policies and guidelines for the financial sector. She holds a Bachelor's Degree in Accountancy from the University of South Australia and is a Certified Practising Accountant.

CHEONG KEE FONG

Cheong Kee Fong has been a Partner of Cheong Kee Fong & Co. since January 1990. He was the sole proprietor of Cheong Kee Fong & Co. from November 1988 to December 1989.

He is currently the Deputy Chairman of Corporate and Commercial Law Committee of the Malaysian Bar Council. He was previously a member of the Company Law Reform Committee established by the Companies Commission of Malaysia and a member of the Finance Committee on Corporate Governance Working Group II on Corporate Governance in Malaysia. Cheong was also a member of Financial Reporting Foundation from 1997–2001, Companies Commission of Malaysia and its Audit Committee from 2002–2005.

Cheong obtained his LLB (Hons) from the University of Singapore and his Master of Laws from Harvard Law School. He is an advocate and solicitor of the High Court of Malaya and of the Supreme Court, Republic of Singapore.



CHOK KWEE BEE

Chok Kwee Bee is the Managing Director of Teak Capital Sdn Bhd, a venture capital management company managing a technology fund under the MAVCAP Outsource Partner Programme.

Prior to that, Chok was with Walden International, a Silicon Valley based venture capital firm, overseeing the operations and investments of Walden International and BI Walden in Malaysia. Before becoming a venture capitalist, Chok was Head of Corporate Finance at AmlInvestment Bank.

Chok is currently a member of the Malaysian Venture Capital Development Council (MVCDC) and a member of the Exchange Committee of Labuan International Financial Exchange. She also sits on the board of several portfolio companies. She was previously a member of the SC Capital market Advisory Council and also a past Chairman of the Malaysian Venture Capital and Private Equity Association (MVCA).



DATO' GUMURI HUSSAIN

Dato' Gumuri is currently the Chairman of SME Bank and a member of the SC.

Dato' Gumuri is a fellow of the Institute of Chartered Accountants in England and Wales, member of the MIA and the MICPA. He sits on the Board of Media Prima Bhd, Metrod Holdings Bhd and KUB Malaysia Bhd.

He was the Managing Director and Chief Executive Officer of Penerbangan Malaysia Bhd from August 2002 to August 2004. Prior to this, he was a Senior Partner and Deputy Chairman of Governance Board of PricewaterhouseCoopers Malaysia. He had served as the non-executive director of Bank Industri & Teknologi Malaysia Bhd, Malaysian Airlines System Bhd, Kurnia Setia Bhd and Sabah Bank Bhd.

MOHD NAIM DARUWISH

Mohd Naim Daruwish is the Chief Executive Officer of the Companies Commission of Malaysia.

Mohd Naim started off his career as a Legal Officer with the Legal Department of Bank Pertanian Malaysia in April 1984 before being appointed as Magistrate in 1985 and later as a Senior Magistrate.

He was then appointed as the Manager and later as the Senior Manager of the Prosecution/ Litigation Division, Legal Department of the Employees Provident Fund (EPF), Kuala Lumpur. Among the positions held by him in EPF were the General Manager of the Enforcement Department, the Senior General Manager of Legal Department and the Senior General Manager of the Contribution Department. Mohd Naim graduated with a LLB (Hons) degree from the University of Malaya.



MEETING ATTENDANCE

In 2011, the AOB held a total of eight Board meetings.

Table 1

Attendance at Board meetings in 2011

Board member	Number of meetings attended
Nik Mohd Hasyudeen Yusoff	8
Datuk Ali Abdul Kadir	6
Dato' Azmi Ariffin	6
Goh Ching Yin	8
Datuk Nor Shamsiah Mohd Yunos	5
Cheong Kee Fong	7
Chok Kwee Bee	8

Dato' Azmi Ariffin and Datuk Ali Abdul Kadir retired as Board members during the year. Mohd Naim Daruwish and Dato' Gumuri Hussain were appointed effective 1 January 2012.

RESPONSIBILITIES OF THE BOARD

The Board is responsible in assisting the SC in the discharge of its functions under the SCA. The Board's responsibilities are to:

- Implement policies and programmes in ensuring an effective audit oversight system in Malaysia;
- Register or recognise auditors of PIEs for the purposes of the SCA;
- Direct the MIA to establish or adopt, or by way of both, the auditing and ethical standards to be applied by auditors;
- Conduct inspections and monitoring programmes on auditors to assess the degree of compliance of auditing and ethical standards;
- Conduct inquiries and impose appropriate sanctions against auditors who fail to comply with auditing and ethical standards;
- Co-operate with relevant authorities in formulating and implementing strategies for

enhancing standards of financial disclosures of PIEs;

- Liaise and co-operate with oversight bodies outside Malaysia to enhance the standing of the auditing profession in Malaysia and internationally; and
- Perform such other duties or functions as the AOB determines necessary or appropriate to promote high professional standards of auditors and to improve the quality of audit services provided by auditors.

MEETING PROCEDURES

Due notice is given on issues to be discussed with the distribution of agenda and papers for consideration at Board meetings. These meetings provide a forum for balanced deliberation of issues and transparent decision-making.

A full set of minutes of all Board meetings are kept properly by the Secretary of the Board.

REGISTRATION COMMITTEE

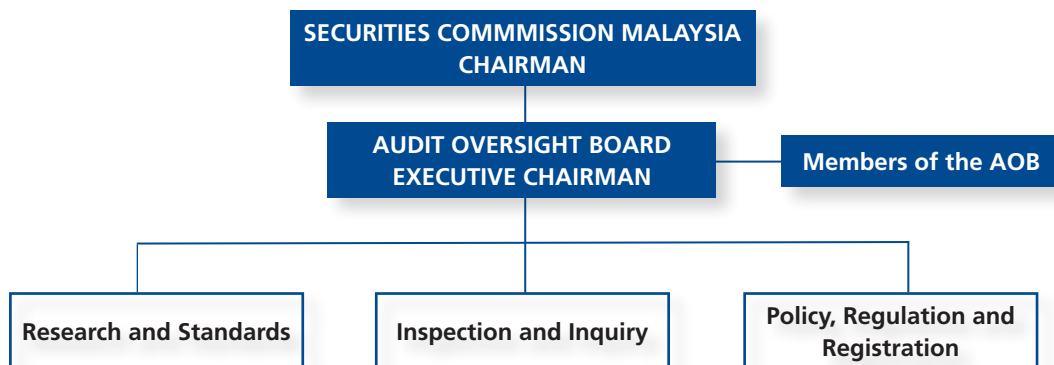
Section 31EA of the SCA provides that the AOB may establish such committees as it considers necessary or expedient to assist in the performance of its responsibilities as specified under section 31E(1) of the SCA.

In this regard, a Registration Committee was established in 2011 to determine matters regarding the approval of registration/renewal of registration of auditors with the AOB. The Registration Committee shall recommend to the Board, wherein the Board will deliberate and decide, for matters pertaining to revocation, suspension and non-approval.

The members of the Registration Committee are:

- (a) Nik Mohd Hasyudeen Yusoff
- (b) Goh Ching Yin

ORGANISATION STRUCTURE



Part Eight

Financial Statements and Others

FINANCIAL STATEMENTS OF THE AUDIT OVERSIGHT BOARD FUND


STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2011

	Note	2011 RM	2010 RM
Assets			
Current assets			
Other receivables	4	130,285	124,293
Cash and cash equivalents	5	3,117,332	4,424,959
Total assets		<u>3,247,617</u>	<u>4,549,252</u>
Reserves			
Fund from the Securities Commission Malaysia	6	5,000,000	5,000,000
Accumulated deficit	7	(2,375,609)	(549,555)
Total reserves		<u>2,624,391</u>	<u>4,450,445</u>
Current liability			
Other payables and accruals	8	623,226	98,807
Total liabilities		<u>623,226</u>	<u>98,807</u>
Total reserves and liabilities		<u>3,247,617</u>	<u>4,549,252</u>

The notes set out on pages 8-4 to 8-12 are an integral part of these financial statements.



Tan Sri Zarinah Anwar
Chairman
Securities Commission Malaysia



Nik Mohd Hasyudeen Yusoff
Executive Chairman
Audit Oversight Board

20 January 2012

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	1.1.2011 to 31.12.2011 RM	1.4.2010 to 31.12.2010 RM
Income			
Registration fee		1,690,000	1,535,000
Interest income from fixed deposits		113,130	62,196
		<u>1,803,130</u>	<u>1,597,196</u>
Operating expenditure			
Administrative expenses	9	(3,629,184)	(2,146,751)
		<u>(1,826,054)</u>	<u>(549,555)</u>
Loss before tax			
Income tax expense	12	–	–
Total comprehensive loss for the year/period	7	<u>(1,826,054)</u>	<u>(549,555)</u>

The notes set out on pages 8-4 to 8-15 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2011

	1.1.2011 to 31.12.2011 RM	1.4.2010 to 31.12.2010 RM
Cash flows from operating activities		
Loss before tax	(1,826,054)	(549,555)
Adjustment for:		
Interest income	(113,130)	(62,196)
Operating deficit before working capital changes	(1,939,184)	(611,751)
Changes in working capital:		
Other receivables	(200)	(80,650)
Other payables and accruals	524,419	98,807
Net cash used in operating activities	(1,414,965)	(593,594)
Cash flows from investing activity		
Interest income	107,338	18,553
Net cash from investing activity	107,338	18,553
Cash flows from financing activity		
Funding received from the Securities Commission Malaysia	–	5,000,000
Net cash from financing activity	–	5,000,000
Net (decrease)/increase in cash and cash equivalents	(1,307,627)	4,424,959
Cash and cash equivalents at 1 January 2011 / 1 April 2010	4,424,959	–
Cash and cash equivalents at 31 December	3,117,332	4,424,959

The notes set out on pages 8-4 to 8-15 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. General

On 1 April 2010, the Securities Commission Malaysia (SC) established the Audit Oversight Board (AOB) under section 31C of the *Securities Commission Act 1993* (SCA). The AOB was established for the purposes set out in section 31B of SCA, namely:

- a. to promote and develop an effective and robust audit oversight framework in Malaysia,
- b. to promote confidence in the quality and reliability of audited financial statements in Malaysia, and
- c. to regulate auditors of public interest entities.

To facilitate the abovementioned purposes, a fund known as the AOB Fund was established under section 31H of the SCA. The AOB Fund is administered by the SC. The SC provides administrative and accounting support to the AOB Fund and the accounts are kept separately from the accounts of the SC in accordance with section 31L(5) of the SCA.

2. Basis of preparation

(a) Statement of compliance

The financial statements of the AOB have been prepared in accordance with Financial Reporting Standards (FRSs) and accounting principles generally accepted in Malaysia.

The AOB shall apply the following accounting standards, amendments and interpretations that have been issued by the Malaysian Accounting Standards Board (MASB) once they become effective:

FRSs, Interpretations and amendments effective for annual periods beginning on or after 1 July 2011

- IC 19, 'Extinguishing Financial Liabilities with Equity Instruments'
- Amendments to IC 14, 'Prepayments of a Minimum Funding Requirement'

FRSs, Interpretations and amendments effective for annual periods beginning on or after 1 January 2012

- FRS124, 'Related Party Disclosures' (revised)
- Amendments to FRS 1, 'First-time Adoption of Financial Reporting Standards – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters'
- Amendments to FRS 7, 'Financial Instruments: Disclosures – Transfers of Financial Assets'
- Amendments to FRS 112, 'Income Taxes – Deferred Tax: Recovery of Underlying Assets'

FRSs, Interpretations and amendments effective for annual periods beginning on or after 1 July 2012

- Amendments to FRS 101, 'Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income'

FRSs, Interpretations and amendments effective for annual periods beginning on or after 1 January 2013

- FRS 9, 'Financial Instruments' (2009)
- FRS 9, 'Financial Instruments' (2010)
- FRS 10, 'Consolidated Financial Statements'
- FRS 11, 'Joint Arrangements'
- FRS 12, 'Disclosure of Interests in Other Entities'
- FRS 13, 'Fair Value Measurement'
- FRS 119, 'Employee Benefits' (2011)
- FRS 127, 'Separate Financial Statements' (2011)
- FRS 128, 'Investments in Associates and Joint Ventures' (2011)
- IC Interpretation 20, 'Stripping Costs in the Production Phase of a Surface Mine'

The AOB's financial statements for annual period beginning on 1 January 2012 will be prepared in accordance with the Malaysian Financial Reporting Standards (MFRSs) issued by the MASB and IFRSs. As a result, the AOB will not be adopting the above FRSs, Interpretations and amendments.

The change of the financial reporting framework is not expected to have any significant impact on the financial position and performance of the AOB.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis.

(c) Functional and presentation currency

These financial statements are presented in Ringgit Malaysia (RM), which is the AOB's functional currency. All financial information presented in RM.

(d) Use of estimates and judgments

The preparation of financial statements in conformity with FRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

There are no significant areas of estimation uncertainty and critical judgments in applying accounting policies that have significant effect on the amounts recognised in the financial statements.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to the periods presented in these financial statements, and have been applied consistently by the SC, unless otherwise stated.

(a) Financial instruments

Financial instruments are categorised and measured using accounting policies as mentioned below.

(i) Initial recognition and measurement

A financial asset or a financial liability is recognised in the statement of financial position when, and only when, the AOB becomes a party to the contractual provisions of the instrument.

A financial instrument is recognised initially, at its fair value plus, in the case of a financial instrument not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial instrument.

(ii) Financial instrument categories and subsequent measurement

The AOB categorises financial instruments as follows:

Financial assets

Loans and receivables

Loans and receivables category comprises other receivables and cash and cash equivalents.

Financial assets categorised as loans and receivables are subsequently measured at amortised cost, using the effective interest method.

All financial assets are subject to review for impairment (see Note 3(d)).

Financial liabilities

All financial liabilities are subsequently measured at amortised cost, using the effective interest method.

(iii) Derecognition

A financial asset or part of it is derecognised when, and only when the contractual rights to the cash flows from the financial asset expire or the financial asset is transferred to another party without retaining control or substantially all risks and rewards of the asset. On derecognition of a financial asset, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognised in equity is recognised in profit or loss.

A financial liability or a part of it is derecognised when, and only when, the obligation specified in the contract is discharged or cancelled or expires. On derecognition of a financial liability, the difference between the carrying amount of the financial liability extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit or loss.

(b) Other receivables

Other receivables are categorised and measured as loans and receivables in accordance with Note 3(a).

(c) Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, balances and deposits with banks which have an insignificant risk of changes in value with original maturities of six months or less.

Cash and cash equivalents are categorised and measured as loans and receivables in accordance with Note 3(a).

(d) Impairment

Financial assets

All financial assets are assessed at each reporting date whether there is any objective evidence of impairment as a result of one or more events having an impact on the estimated future cash flows of the asset. Losses expected as a result of future events, no matter how likely, are not recognised.

An impairment loss in respect of loans and receivables is recognised in profit or loss and is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account.

(e) Income

Registration fees

Registration fees from auditors of public interest entities are recognised in profit or loss when the payment is received.

Interest income

Interest income is recognised as it accrues using the effective interest method in profit or loss.

4. Other receivables

	2011 RM	2010 RM
Interest receivable	49,435	43,643
Deposits and prepayments	80,850	80,650
	<u>130,285</u>	<u>124,293</u>

5. Cash and cash equivalents

	2011 RM	2010 RM
Cash and bank balances	22,869	410,088
Deposits placed with a licensed bank	3,094,463	4,014,871
	<u>3,117,332</u>	<u>4,424,959</u>

The deposits placed with a licensed bank earned interest at the rate of 3.55% per annum (2010: 3% per annum) and mature in six months.

6. Fund from the Securities Commission Malaysia

	2011 RM	2010 RM
Cash contribution from: Securities Commission Malaysia	5,000,000	5,000,000

7. Accumulated deficit

	2011 RM	2010 RM
At 1 January / 1 April	(549,555)	–
Loss for the year/period	(1,826,054)	(549,555)
At 31 December	<u>(2,375,609)</u>	<u>(549,555)</u>

8. Other payables and accruals

	2011 RM	2010 RM
Amount due to the SC	586,819	–
Other payables	36,407	98,807
	<u>623,226</u>	<u>98,807</u>

Amount due to the SC arose from expenses paid on behalf. The amount owing is unsecured, interest free and repayable on demand.

9. Administrative expenses

	1.1.2011 to 31.12.2011 RM	1.4.2010 to 31.12.2010 RM
The administrative expenses consist of:		
Auditor's remuneration	20,000	8,000
Executive member:		
– Emoluments	647,269	459,436
Honorarium payment	6,380	4,098
Non-executive members' allowance	56,000	55,500
Other miscellaneous charges	300,271	108,786
Rental of premises	326,273	173,829
Staff costs	2,272,991	1,337,102
	<u>3,629,184</u>	<u>2,146,751</u>

10. Financial instruments

10.1 Categories of financial instruments

The table below provides an analysis of financial instruments categorised as follows:

- (a) Loans and receivables (L&R); and
- (b) Other financial liabilities measured at amortised cost (OL).

	Carrying amount RM	L&R RM	OL RM
2011			
Financial assets			
Other receivables	130,285	130,285	–
Cash and cash equivalents	3,117,332	3,117,332	–
	3,247,617	3,247,617	–
Financial liabilities			
Other payables and accruals	(623,226)	–	(623,226)
2010			
Financial assets			
Other receivables	124,293	124,293	–
Cash and cash equivalents	4,424,959	4,424,959	–
	4,549,252	4,549,252	–
Financial liabilities			
Other payables and accruals	(98,807)	–	(98,807)

10.2 Financial risk management objectives and policies

The AOB is primarily exposed to liquidity risk in the normal course of the AOB's operations. As the AOB is administered by the SC, the AOB is subject to the SC's financial risk management policies.

10.3 Credit risk

Credit risk is the risk of a financial loss to the AOB if a counterparty to a financial instrument fails to meet its contractual obligations.

The AOB is not exposed to any credit risk as the AOB does not have any trade debts.

10.4 Liquidity risk

Liquidity risk is the risk that the AOB will not be able to meet its financial obligations as they fall due.

The AOB, via the SC, monitors and maintains a level of cash and cash equivalents deemed adequate to finance the AOB's operations and to mitigate the effects of fluctuations in cash flows.

Maturity analysis

The table below summarises the maturity profile of the AOB's financial liabilities as at the end of the reporting period based on undiscounted contractual payments.

	Carrying amount RM	Contractual cash flow RM	Under 1 year RM
Financial liabilities			
Other payables and accruals	623,226	623,226	623,226

10.5 Market risk

Market risk is the risk that changes in market prices, such as interest rates that will affect the AOB's financial position or cash flows.

10.5.1 Interest rate risk

The interest rate profile of the AOB's significant interest-bearing financial instruments, based on carrying amounts as at the end of the reporting period was:

	2011 RM	2010 RM
Fixed rate instruments		
Financial assets	3,117,332	4,424,959

Interest rate risk sensitivity analysis

Fair value sensitivity analysis for fixed rate instruments

The AOB does not account for any fixed rate financial assets at fair value through profit or loss, and the AOB does not designate derivatives as hedging instruments under a fair value hedge accounting model. Therefore, a change in interest rates at the end of the reporting period would not affect profit or loss.

10.6 Fair values

In respect of cash and cash equivalents, other receivables, other payables and accruals, the carrying amounts approximate fair value due to the relatively short-term nature of these financial instruments.

11. Fund management

	2011 RM	2010 RM
Fund from the SC	5,000,000	5,000,000
Accumulated deficit	(2,375,609)	(549,555)
	<u>2,624,391</u>	<u>4,450,445</u>

The AOB's objective is to maintain adequate reserves to safeguard the AOB's ability to perform its duties and functions independently. The reserves are managed by the SC.

12. Taxation

The SC was granted approval from the Minister of Finance to be exempted from taxation with effect from Year Assessment (YA) 2007 onwards. Accordingly, the AOB is tax-exempted.

13. Authorisation of financial statements

The financial statements for the year ended 31 December 2011 were authorised by the SC for issuance and signed by the Chairman of the SC and Executive Chairman of AOB on 20 January 2012.

STATUTORY DECLARATION

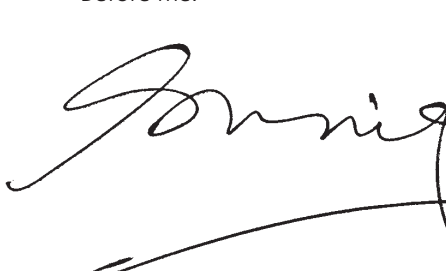
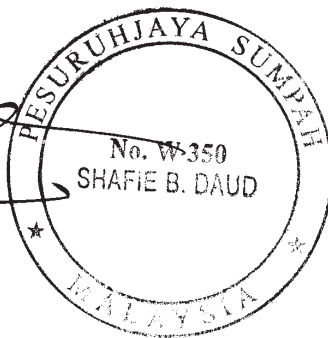
I, Vignaswaran A/L Kandiah, the officer primarily responsible for the financial management of the AOB, do solemnly and sincerely declare that the financial statements set out on pages 8-1 to 8-12 are, to the best of my knowledge and belief, correct and I make this solemn declaration conscientiously believing the same to be true, and by virtue of the provisions of the *Statutory Declarations Act, 1960*.

Subscribed and solemnly declared by the abovenamed in Kuala Lumpur on 20 January 2012.



Vignaswaran A/L Kandiah

Before me:



38A, JALAN TUN MOHD FUAD 1
TAMAN TUN DR. ISMAIL
60000 KUALA LUMPUR

INDEPENDENT AUDITORS' REPORT TO THE AOB

Report on the Financial Statements

We have audited the financial statements of the AOB, which comprise the statement of financial position as at 31 December 2011, and the statements of comprehensive income and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information, as set out on pages 8-1 to 8-12.

Commission Members' Responsibility for the Financial Statements

The Commission Members of the SC in Malaysia are responsible for the preparation of these financial statements that give a true and fair view in accordance with FRSs in Malaysia, and for such internal control as the Commission Members of the SC determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with approved standards on auditing in Malaysia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material mis-statement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material mis-statement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the SC's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the AOB's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Commission Members of the SC, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the AOB as at 31 December 2011, and of its comprehensive income and cash flows for the year then ended in accordance with FRSs in Malaysia.

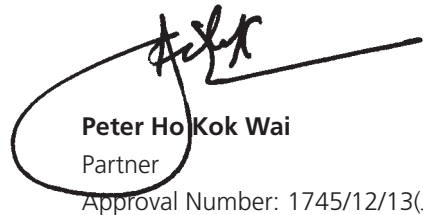
Other Matters

This report is made solely to the SC, as a body, and for no other purpose. We do not assume responsibility to any other person for the content of this report.

**KPMG**

Firm Number: AF 0758

Chartered Accountants


Peter Ho Kok Wai
Partner

Approval Number: 1745/12/13(J)

Petaling Jaya, Malaysia

Date: 20 January 2012

ACRONYMS AND ABBREVIATIONS

AASB	MIA Auditing and Assurance Standards Board
AMC	Asset Management Company
AOB	Audit Oversight Board
ASEAN	Association of Southeast Asian Nations
EQCR	Engagement Quality Control Reviewer
EU	European Union
FRS	Financial Reporting Standards
IAASB	International Auditing and Assurance Standards
IASB	International Accounting Standards Board
IESBA	International Ethics Standards Board for Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
ISQC 1	International Standards on Quality Control 1: Quality Controls for Other Assurance and Related Services Engagements
MIA	Malaysian Institute of Accountants
MICPA	Malaysian Institute of Certified Public Accountants
PCAOB	Public Company Accounting Oversight Board
PIE	Public-interest entity
SC	Securities Commission Malaysia
SCA	<i>Securities Commission Act 1993</i>

DEFINITIONS

Auditor	An individual auditor or audit firm who is registered under section 310 of the <i>Securities Commission Act 1993</i> as an auditor of a public interest entity.
Big Four Audit Firms	Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers.
Clarified ISAs	International Standards on Auditing effective for financial statement for December 2010 financial year end
Major Audit Firms	Audit firms with more than 10 partners and audit more than 40 PIEs.
MIA By-laws	<i>By-laws (On Professional Ethics, Conduct and Practice) of the Malaysian Institute of Accountants</i>
Other Audit Firms	Mid-tier audit firms and sole proprietors
Public interest entity	<p>An entity meeting the following definition:</p> <ul style="list-style-type: none"> (a) A public-listed company or a corporation listed on the stock exchange; (b) An institution licensed under the <i>Banking and Financial Institutions Act 1989</i>; (c) An insurance company licensed under the <i>Insurance act 1996</i>; (d) A takaful operator registered under the <i>Takaful Act 1984</i>; (e) An Islamic bank licensed under the <i>Islamic Banking Act 1983</i>; (f) A development financial institution prescribed under the <i>Development Financial Institutions Act 2002</i>; (g) A holder of Capital Market Services Licence for the carrying on of the regulated activities of dealing in securities, dealing in derivatives and fund management; and (h) Any other person as the Minister may, by order published in the Gazette, prescribe.

