

Audit Oversight Board Annual Report 2016

Audit Oversight Board Annual Report 2016

© Audit Oversight Board, Securities Commission Malaysia 2017

Address Suite 8-6 Level 8 Wisma UOA Damansara II No. 6, Jalan Semantan Damansara Heights 50490 Kuala Lumpur

Telephone +603 2091 0666

1003 2031 0000

www.sc.com.my/audit-oversight-board www.investsmartsc.my

Fax +603 2091 0600

The cut-off date for the data included in this report was 31 December 2016.



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

CONTENTS

Executive Chairman's Message	6
Overview of the Audit Oversight Board's Strategies	10
PART ONE Assessment of Performance and Effectiveness	
Introduction 2016 Performance Review	13 14
PART TWO Promote High Quality Audit Practices	
AUDITING LANDSCAPE Registered Audit Firms and Individual Auditors Recognised Foreign Audit Firms and Individual Auditors Insights on the Top 10 Audit Firms in Malaysia	19 19 23 23
AUDIT QUALITY Introduction Summary of Activities Focus Interview with Partners Phase 2 of the Small Firms Initiative to Drive Capacity Building Among Smaller Audit Firms Box Article 1: Key Insights on the Small Firms Initiative Key Observations from Firm Level Review of Major Audit Firms Key Observations from Firm Level Review of Other Audit Firms Key Observations from Engagement Level Review of Major Audit Firms and Other Audit Firms Box Article 2: Observations on Certain High Risk Areas Remediation Box Article 3: Impact from AOB's Regulatory Activities Conclusion	31 31 33 35 36 37 38 42 50 52 54 56
ENFORCEMENT Appeals to the Securities Commission Malaysia Legal Challenges	58 58 58

PART THREE Influence the Financial Reporting Ecosystem and Leverage Stakeholders' Support

International Development Engaging Audit Firms and Other Stakeholders Promoting High Quality Financial Reporting Practices Enhancing the Accountancy Profession New and Revised Auditor Reporting Standards Box Article 1: Key Audit Matters	
PART FOUR Support Adoption and Implementation of Standards	
Development and Implementation of Standards and Regulations Global Initiatives in Reforming the Audit Market and Practices	71 77
PART FIVE Statement on Governance	
Members of the Audit Oversight Board Statement on Governance	83 89
PART SIX Financial Statements and Others	
Financial Statements of the Audit Oversight Board Acronyms and Abbreviations Definitions	93 112 114



Global recognition of efforts

The Corporate Governance (CG) Watch 2016 from the Asian Corporate Governance Association (ACGA) highlighted that AOB has a 'solid inspections programme'. Our enforcement effort on audit oversight also received notable mention in the CG Watch 2016.

During the year, the European Commission (EC) recognised AOB's requirements as being comparable to that complied by its European Union (EU) counterparts for the purpose of transferring audit working papers and other related documents of inspection and investigation. This will facilitate effective co-operation and mutual reliance between AOB and its EC counterparts' oversight systems. It also further acknowledges that Malaysia's audit framework is on par with international best practices, with its rules pertaining to public oversight, quality assurance, investigations and penalty systems for auditors.

Continuous efforts to drive capacity building among the audit firms

In recognising the importance of capacity building and sustainable audit quality, AOB has held annual dialogues and various events to engage with all registered audit firms. More recently, AOB has also engaged with 12 smaller audit firms through the Small Firms Initiative to encourage them to strengthen their capacity and their systems of quality controls.

Since 2015, AOB has been collecting data from the top 10 audit firms (based on the market capitalisation of their clients) encompassing their revenue mix, human resources, training as well as the firm's internal monitoring activities. The data collected has allowed AOB to gain greater insights into the current state of the larger audit firms. In addition, AOB has used this data to benchmark the firms relative to their peers, results of which were used as a basis for discussion to encourage capacity building. Moving forward, AOB seeks to analyse data collected over the years to establish trends as well as to identify indicators that may impact audit quality. The output of these analyses would help supplement AOB's effort to achieve effective regulation through active monitoring and engagements with the audit firms.

Reinforcement that AOB's enforcement processes are robust and sound

While oversight activities such as inspections and monitoring programmes provide an avenue in detecting non-compliance of standards and regulations by firms and auditors, enforcement continues to be a core function of AOB. This is of utmost priority to protect investors and other stakeholders as well as drive audit quality in Malaysia.

We are happy to report to date that AOB successfully concluded legal challenges brought against the AOB enforcement process. This further validates that AOB's enforcement processes are robust and sound.

AOB will continue to monitor developments in the market particularly on current and emerging enforcement issues with the view of enhancing enforcement effectiveness.

Giving the market more information through auditor's reports

Having laid the foundation for the new audit reporting model in recent years, AOB is committed to maintaining this positive momentum by continuing to focus on key areas and gamechangers such as the New and Revised Auditor Reporting Standards as a means to drive innovation and greater transparency in auditors' reports as well as financial reporting by Malaysian public-interest entities (PIEs) and schedule funds.

Key audit matters (KAM) were developed as part of efforts to address the gap between information available to the market and information available to the auditor by providing some 'auditor insight' to users about matters most significant to the audit.

Implementation of these standards will help drive the flow of useful and relevant information to the capital market, reduce speculation and promote better understanding of the financial statements. This will further empower investors and help structure more relevant and meaningful discussion among stakeholders. Companies and directors would also be guided to be more vigilant in areas where shareholders show heightened interest.

AOB strongly believes initiatives such as these will accelerate the closing of the audit expectation gap between stakeholders and auditors. Cognisant that one of the main purposes of the New and Revised Auditor Reporting Standards is to provide more useful and relevant information to the capital market, AOB is keen to work with stakeholders to engage users of financial statements and seek their views on what makes a good auditor's report. AOB will closely monitor the auditors' experience in implementing the New and Revised Auditor Reporting Standards through various means including its inspection regime to identify instance of non-compliance, trends as well as innovation in reporting.

The next phase

As elaborated further in this year's annual report, AOB remains concerned with the high number of deficiencies in the work of auditors as identified by AOB's oversight activities. In light of this, AOB will continue to engage with audit firms to understand the root causes of deficiencies and ensure that the necessary remediation actions are taken by firms to effectively address the identified root causes. Additionally, there are plans to embark on a number of initiatives in the coming year that will be incorporated in AOB's existing oversight activities with particular attention on audit firms' engagement performance track record, organisational structure, culture and investment in audit quality.

AOB understands that to successfully raise audit quality in Malaysia, it is imperative that it works together with those that it regulates and also other stakeholders in the country's financial reporting ecosystem. Therefore, it is most critical that we remain focused and aware of the challenges faced by auditors and audit firms to ensure continued development of a sustainable culture of audit quality with the aim of upholding high quality financial reporting in Malaysia. This can only be achieved if all key components in the financial reporting ecosystem play their respective roles effectively.

Acknowledgement

Former Executive Chairman of AOB, Encik Nik Mohd Hasyudeen Yusoff and four other Board members of AOB concluded their statutory terms in March 2016. They are Datuk Nor Shamsiah Mohd Yunos, Mr Goh Ching Yin, Mr Cheong Kee Fong and Ms Chok Kwee Bee.

I was Board member from 1 January 2012 until 17 November 2016 and was appointed as the Executive Chairman of AOB on 18 November 2016. AOB also welcomed Mr Eugene Wong Weng Soon, Cik Che Zakiah Che Din, Mr Wong Chong Wah and Puan Darawati Hussain who joined the Board.

I would like to express my sincere appreciation to my predecessor, Encik Nik Mohd Hasyudeen Yusoff and the previous Board members for their pioneering efforts in developing AOB into what it is today. I also wish to record my appreciation to all Board members for their counsel and advice provided from the very first day of my appointment as Executive Chairman.

I would also like to take this opportunity to thank fellow regulators, the professional accountancy bodies and other stakeholders for the support that they have provided to AOB. I hope that the high degree of support and co-operation will continue as AOB embarks on its next phase of development. AOB has been fortunate to have had the input from its past and present Board members as well as hard working, committed and dedicated management and staff. On this note, I would like to say a fond farewell and many thanks to the previous Head of AOB, Ms Lim Fen Nee, who has contributed significantly to AOB during her many years with us.

In conclusion, I would like to express my sincere gratitude to the existing AOB management and staff for their support and outstanding performance in the past year that has enabled AOB to continue its efforts in promoting high quality audits in the country.

mh

Dato' Gumuri Hussain

OVERVIEW OF THE AUDIT OVERSIGHT BOARD'S STRATEGIES

The Audit Oversight Board (AOB) aims to achieve the following desired outcomes:

- High quality financial reporting practices by public-interest entities (PIEs) and schedule funds;
- Resourceful and high quality audit practices;
- Independent and high quality audits;
- High quality and reliable audited financial statements; and
- Enhanced confidence in audited financial statements.

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

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

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, the goals pursued under this theme are:

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

Influence financial reporting ecosystem

High quality financial reporting would only be achieved if all key components in the financial reporting ecosystem are effective in playing their respective roles. Understanding this, the AOB focuses on 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; and
- Promote research and discourse on audit quality.

Leverage stakeholders' support

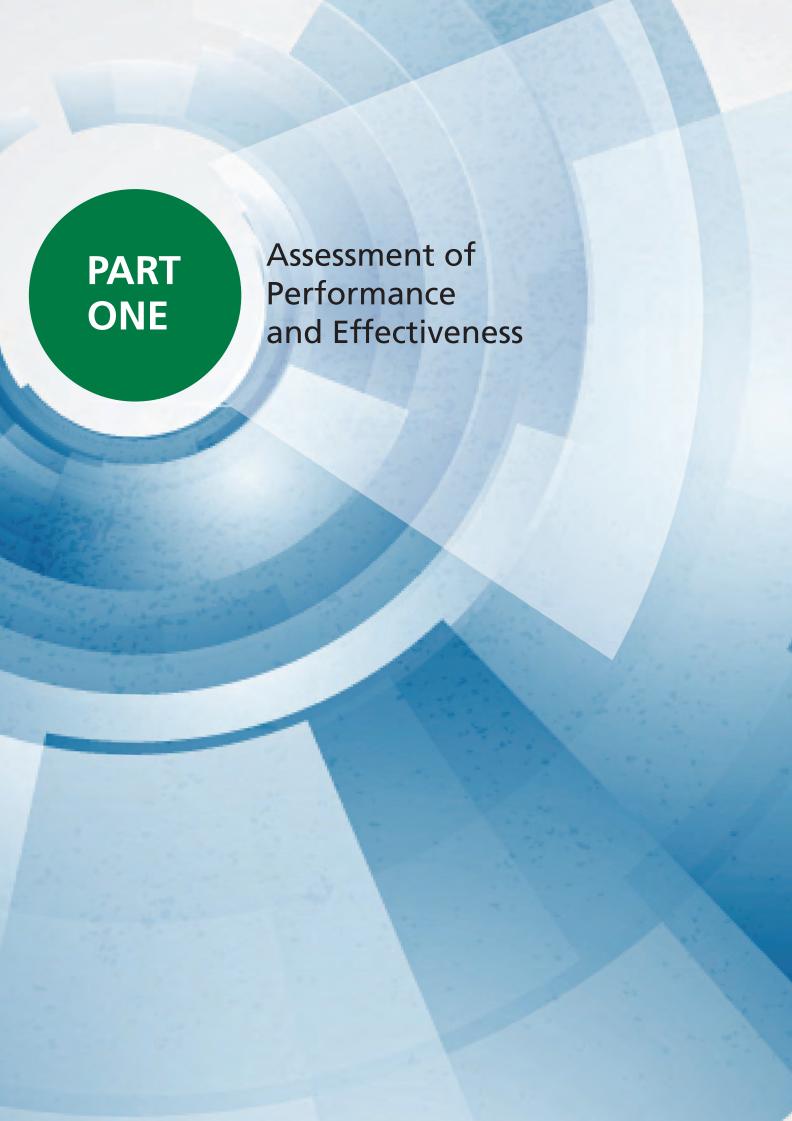
The effectiveness of AOB would be enhanced if it could leverage efforts of other stakeholders who share the same interest in enhancing the quality of financial reporting of PIEs and schedule funds. This includes co-operating with international counterparts as auditing itself has become a global affair. AOB aims 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; and
- Obtain higher financial support from stakeholders.

Support adoption and implementation of standards

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

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



Introduction

A strategic framework was drawn up for purposes of enhancing the confidence in the quality and reliability of audited financial statements of PIEs and schedule funds which is in line with AOB's mission. Year 2016 marks the last year of AOB's 2013–2016 strategic framework drawn up since its establishment. The intended strategic outcomes:

- Confidence in audited financial statements;
- Audit opinions which are based on sufficient and appropriate evidence;
- Externalisation of professional values and ethics;
- Resourceful and capable audit practices;
 and
- High quality financial reporting practices by PIEs

During 2016, AOB formulated the *Strategic Plan* for 2017–2020 (Strategic Plan) for the next phase of its development. To reinforce the audit quality

initiative, the Strategic Plan will focus on the following:

- Provide deeper and insightful analysis of the audit profession;
- Strengthening the risk-based inspection focus;
- Focused and impactful enforcement outcome; and
- Effective communication and collaboration with stakeholders.

AOB continues to be vigilant over emerging issues and global developments in financial reporting and auditing that would have an impact on its operating environment and stakeholders. In order to be responsive to these changes, AOB continuously re-evaluates its priorities and focused areas to ensure that it achieves its mandate in enhancing the confidence in the quality and reliability of audited financial statements of PIEs and schedule funds.

A snapshot of AOB's performance assessment for 2016 is outlined in Table 1.

Table 1

2016 PERFORMANCE REVIEW

AOB strategic outcomes	Activities	Performance assessment for 2016
Confidence in audited financial statements	 Participated in public events to send key messages on audit quality to key stakeholders. Created awareness among key stakeholders and promoted views on the importance of audit oversight in the capital market. 	AOB participated in nine local and three international events.
Audit opinion based on sufficient and appropriate evidence	 12 audit firms and 34 individual auditors were inspected under the regular inspection conducted during the year. Monitored the subsequent impact to auditors as well as the respective PIE engagements as part of evaluating the effectiveness of AOB's regulatory activities since its establishment in 2010. 	 The following actions taken by auditors can be directly or indirectly attributed to AOB's activities: Changes in audit team composition; Changes in audit procedures; and Restatement of financial statements.
Externalisation of professional values and ethics	 Engaged with the audit firms to generate greater awareness on the need to comply with relevant ethical requirements. Encouraged audit firms to perform internal monitoring to ensure that relevant ethical requirements are complied with to safeguard independence and audit quality. The introduction of Annual Declaration submissions is in line with AOB's efforts to guide its registrants towards a more preemptive mindset through more regular internal reporting and monitoring within respective firms. 	During the year, instances of non-compliance had been identified via firms' monitoring and was reported to AOB.

2016 PERFORMANCE REVIEW

AOB strategic outcomes

Activities

Performance assessment for 2016

Resourceful and capable audit practices

- Continuous engagement with audit firms to ensure that they have quality control frameworks in place.
- Firms were required to identify root causes for deficiencies highlighted by AOB during inspection.
- Monitoring by AOB on quarterly basis on the implementation status of the inspected firms' remedial plan.
- Continued sharing of key statistics with the leadership of the top 10 audit firms in Malaysia by PIEs' client's market capitalisation.
- Embarked on Phase 2 of the Small Firms Initiative with the aim of promoting good practices to strengthen audit quality among smaller audit firms. (Firms with four partners or less and the number of PIEs audited by these firms range from one to seven).
- Conducted interviews with a selection of partners from the larger audit firms and shared results of the interview with the audit firms' leadership to ensure continuous capacity building and right infrastructure, tone from the top and culture to support audit quality.
- Participated as observer in meetings held by the Auditing and Assurance Standards Board (AASB) and Ethics Standards Board (ESB).

- AOB observed continuous commitment from some of the audit firms to build capacity through succession planning for partners and staff retention initiatives.
- Some improvements in audit quality among the Major Audit Firms (Audit firms with more than 10 partners and audit more than 50 PIEs clients with a total market capitalisation of above RM20 billion) have been observed where the overall percentage on the number of engagements requiring significant improvements has reduced from previous year.
- Nine individual auditors were subjected to specific remediation measures as a continuous effort to ensure sustainable audit quality.
- Effective remediation plans were drawn up by firms which are based on deeper understanding of the root cause behind AOB's findings. Two firms inspected in 2016 recorded no recurring findings while the number of recurring findings for six other firms were reduced from their previous inspection.
- Facilitated performance benchmarking within the audit industry and identification of areas for improvement to enhance audit quality.
- Facilitated mutual understanding within the profession with regard to perceptions and challenges faced in relation to current accounting and auditing issues.

Table 1 (continued)

2016 PERFORMANCE REVIEW

AOB strategic outcomes

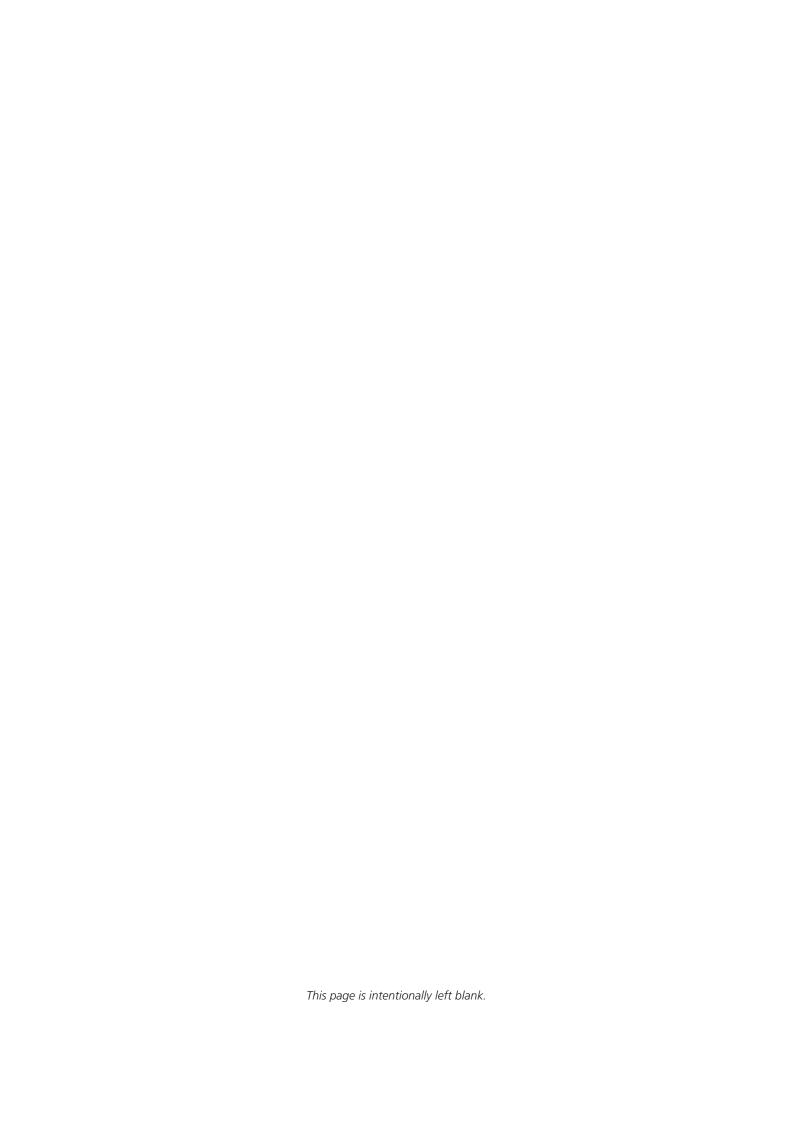
Activities

Performance assessment for 2016

High quality financial reporting practices by PIEs

- A Steering Committee was established to develop strategies and provide guidance on issues and risks identified in respect of the New Auditor's Report. In this respect. AOB continued to work and facilitate discussions among members of the Steering Committee.
- The Steering Committee organised 10 key outreach programmes.
- Continuous engagements with stakeholders to promote high quality financial reporting practices such as
 - facilitating sharing of the UK experience in implementing the New and Revised Auditor Reporting Standards to directors of PLCs and auditors of PIEs and schedule funds; and
 - facilitating discussion among regulators, accounting profession and industry.

- The co-ordinated efforts among the Steering Committee members has led to the following:
 - Regulatory changes particularly amendments to Bursa Malaysia's listing requirements on:
 - Immediate announcement on modified audit opinion and material uncertainty related to going concern (MUGC);
 - Quarterly reports disclosure on modified audit opinion and MUGC; and
 - Strengthening the role of audit committees.
 - Assisted in the issuance of the publication, Board of Directors -Are you ready for the enhanced auditors' report? by MIA.
- Provided input to develop a workable implementation plan to address the 15 recommendations that were presented in the Report by the CSAP.





Auditing Landscape

In today's environment of increasingly complex financial reporting, audit quality is key in safeguarding public trust and strengthening investor confidence in the capital market. AOB recognises that effective audit oversight is pivotal towards achieving this. AOB continues to enhance registration, research, inspection and enforcement activities with regular monitoring and review of policies and processes.

The recent Securities Commission Malaysia
Act 1993 (SCMA) amendments in September
2015 have had a significant impact on AOB's
registration regime. Notably, AOB's regulatory
reach was extended to capital market institutions
and schedule funds¹, whereby a transitional
period of three months from the date of
operationalisation was allowed. The requirement
for renewal of registration has also been removed.

Assurance and Related Services Engagements have been complied with. Its partners must also have the appropriate qualifications and skills, are capable, as well as be fit and proper. In this connection, audit firms and individual auditors seeking registration with AOB are required to make a declaration relating to their fit and proper status. Thereafter, registered audit firms are responsible for ensuring that the audit firm and its partners registered with AOB shall remain at all times fit and proper, as required by the SCMA.

Registered Audit Firms and Individual Auditors

The registration, inspection and enforcement functions of AOB continue to be a core part of AOB's efforts to provide oversight over auditors who are involved in the audits of financial statements of PIEs and schedule funds.

To be eligible for registration, an audit firm must first demonstrate how the requirements of the International Standard on Quality Control (ISQC) 1 Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other 66Registered audit firms are responsible for ensuring that the audit firm and its partners registered with AOB shall remain at all times fit and proper, as required by the SCMA 22

¹ The list of capital market institutions and schedule funds is set out under Schedule 1 of the SCMA.

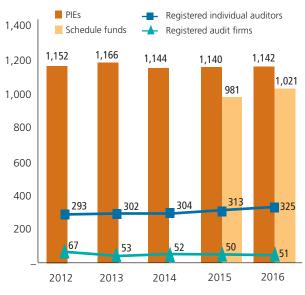
As at 31 December 2016, the audits of PIEs and schedule funds remain concentrated with audit firms with 10 and more partners, collectively auditing 842 PIEs covering 94.30% of total public-listed companies' (PLCs) market capitalisation and 992 schedule funds covering 99.24% of total net asset value (NAV) in Malaysia. (Table 1)

Chart 1 further shows the number of audit firms and individual auditors registered with AOB as well as the number of PIEs audited for the last five years. The continued upward trend in the number of individual auditors registered with AOB against a backdrop of minimal movement in the number of audit firms is indicative of ongoing capacity building by various audit firms.

For the year under review, AOB approved all applications for registration. Year 2016 marks the sixth year since its inception and also the implementation of audit oversight regulation in Malaysia, and all transitional provisions relating to its implementation have ended. The AOB expects that all audit firms and individual auditors are now well aware of the requirements surrounding audit oversight regulation and the importance of continuous efforts towards improving audit

quality. The profession and PIEs as well as schedule funds should also be mindful that any non-compliance with regulation and standards will not be taken lightly.

Chart 1 5-year registration statistics of registered audit firms and individual auditors



Source: AOB

Table 1 Registration of audit firms and individual auditors as at 31 December 2016

Profile of audit firms	No. of audit firms	No. of individual auditors	No. of PIEs	% of market capitalisation	No. of schedule funds	% of total net asset value
Partnerships with 10 and more partners	7	185	842	94.30	992	99.24
Partnerships with 5–9 partners	12	58	190	2.03	9	0.04
Partnerships with 2–4 partners	32	82	110	3.58	20	0.72
TOTAL	51	325	1,142	99.91	1,021	100.00

Source: AOB

All audit firms and individual auditors are reminded that they are required to be registered or recognised with the AOB before acting as an auditor of a PIE or schedule fund. Failure to do so is a breach of section 31N(1) of the SCMA.

AOB subscribes to the philosophy of proportionate regulation and exhorts all audit firms and individual auditors to ensure compliance with the relevant standards, laws and regulations, as required at all times. An audit firm and its individual auditors pleading ignorance of the law is not acceptable to AOB.

66An audit firm and its individual auditors pleading ignorance of the law is not acceptable to AOB.**9**

Enhanced operational efficiency

AOB has taken the opportunity to make greater strides towards improving operational efficiency during its implementation. Initiatives in this direction include phased enhancements to AOB's Auditor Registration Application System (ARAS). The enhancements simplify and improve the registration processes which facilitate AOB registrants' submission of information and AOB's monitoring efforts.

In place of renewal of registration, AOB currently requires an Annual Declaration by all registered audit firms via ARAS within seven working days after 30 June of each calendar year. This is in line with AOB's efforts to guide registrants towards a more pre-emptive mindset through regular internal reporting and monitoring within the respective firms. Such initiative also strengthens the base for AOB's ongoing monitoring activities. As such, it is imperative to ensure that registrants' submissions to AOB are accurate, complete and timely.

Annual Declaration submissions is in line with AOB's efforts to guide registrants towards a more pre-emptive mindset through regular internal reporting and monitoring within the respective firms. As such, it is imperative to ensure that registrants' submissions to AOB are accurate, complete and timely. ??

In the introduction stage of the Annual Declaration in year 2016, two audit firms failed to submit their Annual Declarations on time. Considering that this is the first year of implementation, action was not taken against these audit firms. However, moving forward, all registrants should be well aware of the submissions' requirements. Accordingly, registrants should manage their submissions to ensure timely information updates are within the stipulated timeframes.

PIE clients' movements

Year 2016 shows continued movement of PIE audit clients from Major Audit Firms² to Other Audit Firms. Once again, AOB finds the increased competitiveness encouraging. However, auditors are required to be mindful of their responsibilities and duties to act in the public interest and ensure that audit quality is not compromised in the pursuit of growth or fees.

In line with this, audit firms must consider all their available resources and capabilities before accepting new PIE or schedule fund audit engagements. This includes ensuring careful consideration of available partners within the firm to perform engagement quality control reviews and adequate internal monitoring as per the requirements of ISQC 1.

Table 2 Clients' movement among registered and recognised audit firms during 2016

					PIEs				
Firm size		As at 1	Delisted/	No. of PIEs incoming from			No. of PIEs outgoing to		. As at 31
	Jan 2016	New	Removed	Major	Other	PIE Without Auditor	Major	Other	Dec 2016
Major Audit Firms ^(a)	786	11	(12)	_	3	_	-	(12)	776
Other Audit Firms ^(b)	354	6	(4)	12	16	1	(3)	(16)	366
Foreign	7	_	-	-	_	-	_	-	7
PIE Without Auditor	2	1	(2)	-	-	-	-	(1)	-
TOTAL	1,149	18	(18)	12	19	1	(3)	(29)	1,149

	Schedule funds				
Firm size	As at 1 Jan 2016	New	Ceased	As at 31 Dec 2016	
Major Audit Firms ^(a)	952	86	(48)	990	
Other Audit Firms ^(b)	29	9	(7)	31	
TOTAL	981	95	(55)	1,021	

Note:

(a) Major Audit Firms are audit firms with more than 10 partners and audit more than 50 PIEs with a total market capitalisation of above RM20 billion.

Other Audit Firms are audit firms other than Major Audit Firms. (b)

Source: AOB

Major Audit Firms collectively audit approximately 94% of the PIEs listed on Bursa Malaysia by market capitalisation.

Recognised Foreign Audit Firms and Individual Auditors

The AOB continuously reviews and refines its recognition framework to encourage capacity building of foreign auditors to enhance their quality control framework to deliver consistent quality audits.

As at 31 December 2016, six foreign audit firms and 19 foreign individual auditors are recognised with AOB. They audited seven of the foreign incorporated companies listed on Bursa Malaysia.

*Chart 2*5-year recognition statistics of recognised foreign audit firms and individual auditors



A foreign audit firm applying for recognition with AOB must be an internationally affiliated network firm, with effective technical support from its network firm. Simultaneously, the foreign

audit firm's quality control monitoring framework must be effective and is being supervised by a monitoring partner, complemented with periodic peer review conducted by its network firm to safeguard against quality control issues.

When considering applications for recognition, AOB relies on the oversight frameworks of the foreign auditors' home jurisdictions to determine whether they are fit and proper. In particular, AOB considers whether these audit firms comply with international quality control, auditing, ethical and other assurance standards, and whether they are subjected to regular inspection by their home audit regulators.

It is thus part of the recognition process for foreign auditors to disclose their findings from the inspections carried out by their home audit regulators, which will then be carefully considered. AOB expects that these disclosures are accurate and complete at all times. Information updates should also be submitted in a timely manner, as required by the conditions of recognition.

For recognised auditors returning for subsequent applications for recognition, AOB continues to stress the importance of timely and accurate submissions to ensure continuity of the audits of their PIE clients.

Insights on the Top 10 Audit Firms in Malaysia

In keeping abreast with industry trends and to further stimulate ongoing discussions on audit quality with the audit firms, AOB continues to collect data from the Top 10 Audit Firms based on PLCs' market capitalisation in Malaysia (Top 10 Audit Firms).

Key statistics and findings were shared with the industry and with certain statistics and findings shared in greater granularity with the respective leaderships of the Top 10 Audit Firms. Such sharing has paved the way for audit firms to benchmark their performance among those involved in PIE and schedule fund audits. AOB has also consistently stressed the importance of continued conversation between the audit firms and its stakeholders, both internal and external.

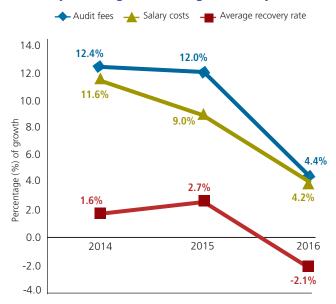
Audit firms have welcomed continued data collection and subsequent sharing of findings. This facilitates the identification of areas for improvement which could then drive efforts to further support audit quality improvements.

In 2016, as in previous years, AOB once again gathered data from the Top 10 Audit Firms. These audit firms collectively audited 930 PIEs and 994 schedule funds representing 98.02% of the PLCs' market capitalisation, and 99.87% of total NAV of the schedule funds in Malaysia respectively as at 31 December 2016. Results of the analysis are presented below.

Audit fees, salary costs and chargeable hours

Total audit fees and salary costs have continued to increase in 2016 but their respective growth rates of approximately 4% each are significantly lower in 2016, compared to previous years. The lower rates of growth were mainly attributed to uncertain economic conditions as well as continued movement of PIE clients away from the Top 10 Audit Firms (Table 2, page 22).

Chart 3 Comparison of growth in audit fees and salary costs against average recovery rate



Note: This graph excludes information from one of the Top 10 Audit Firms as it was unable to provide certain information for comparability.

Source: AOB Analysis – Top 10 Audit Firms in Malaysia

Chart 3 shows that the growth in audit fees is now more closely aligned to the increase in salary costs. Further analysis revealed a drop in the average recovery rate, a measure of the extent to which time spent by the audit firms is being translated to audit fees.

The decrease in the average recovery rate despite the growth in audit fees denoted that more time was spent on audit engagements in 2016³ but was not reflected in the amount of audit fees subsequently charged to clients. Such practices may not be sustainable over a longer period.

There was an increase of 3% in the number of hours incurred by managers and a 6% increase in the number of hours incurred by audit staff.

While it is commendable that more time was spent to ensure audit quality is upheld, audit firms need to also ensure that audit fees are commensurate with the time committed and work effort undertaken.

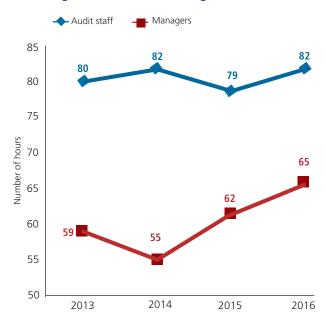
Training

In 2016, audit firms provided training in preparation for the implementation of the *New and Revised Auditor Reporting Standards* which are effective for audits of financial statements with financial periods ending on or after 15 December 2016. These training sessions include those organised by AOB in collaboration with various key players of the financial reporting ecosystem. Further details are available in Part 3 of this annual report.

Chart 4 shows an incremental trend in the average number of training hours incurred by managers⁴ while those of the audit staff⁴ remain largely consistent with previous years. It is noted that the average number of training hours continues to exceed the average of Malaysian Institute of Accountants' (MIA) mandatory Continuing Professional Education (CPE) training hours⁵ of approximately 40 hours per calendar year basis.

Proactive measures should be taken to cultivate and maintain a strong coaching culture to facilitate effective experience and knowledge sharing with audit staff. This is especially important given the increasing headcount in the audit practice (Chart 10), where 84.9% of the audit firms' total headcount in the audit practice comprise audit staff (Chart 5) with an average of only two years experience (Chart 6).

Chart 4
Average number of training hours incurred



Source: AOB Analysis - Top 10 Audit Firms in Malaysia

The impact of a large proportion of the less experienced audit staff on audit quality is an important consideration at both audit firm and engagement levels. Hence, audit firms' emphasis on training for audit staff is key to ensure that they are equipped with the fundamental basics of audit.

Human resources: Experience

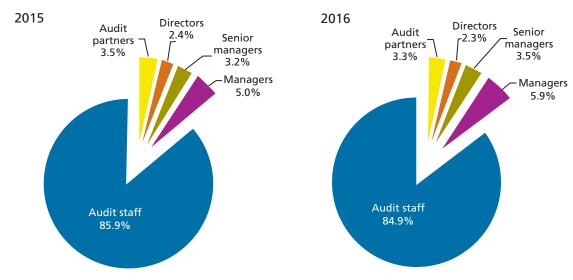
It is evident from Chart 5 that the audit staff level continues to dominate the audit practice workforce. However, the increase in the percentage at the manager level has resulted in a lower staff to manager ratio (Chart 7).

⁴ For the purpose of this analysis:

⁽a) "Manager" generally refers to those at the director, senior manager, manager and assistant manager levels; and (b) "Audit staff" generally refers to members of the audit engagement team below managerial level.

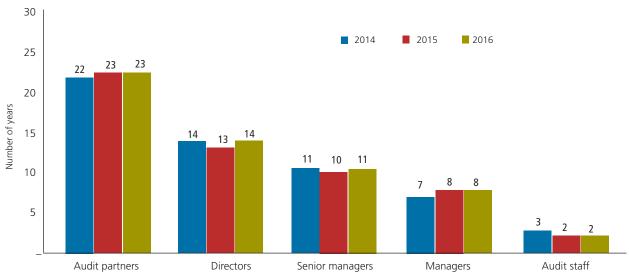
⁵ MIA's mandatory CPE requirements are aligned with global standards and those of the International Federation of Accountants (IFAC).

Chart 5 Audit practice staff by level to total headcount



Source: AOB Analysis - Top 10 Audit Firms in Malaysia

Chart 6 Average years of experience for audit practice staff

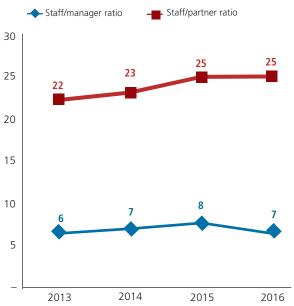


Source: AOB Analysis - Top 10 Audit Firms in Malaysia

A lower staff to manager ratio allows for more time spent by managers in coaching, guiding and developing less experienced staff. These, coupled with regular and consistent communication, are crucial in ensuring that all members of the audit

engagement team have a common understanding and goal in achieving and maintaining the appropriate levels of audit quality in the performance of audit engagements.

Chart 7
Staff to partner and manager ratios



Source: AOB Analysis - Top 10 Audit Firms in Malaysia

Audit partners of the Top 10 Audit Firms, with an average of 23 years of experience, bring a wealth of knowledge which can be shared with members of their teams. Constructive and effective sharing can ease the steep learning curve that all audit personnel, including partners and managers, need to undergo, ultimately assisting to uphold audit quality in the performance of audit work. However, a growing staff to partner ratio may limit such sharing opportunities.

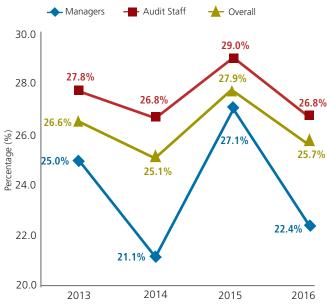
AOB recognises that the staff to partner and staff to manager ratios need to be tailored to respective audit firms' structural needs. In arriving at the right balance, it is important to remember that greater partner involvement and more frequent coaching opportunities have a positive impact on both audit quality and overall talent retention. This is of particular significance given the audit firms' continuing reliance on a large number of audit staff with an average of only two years of experience.

Human resources: Talent attrition

Consistent with previous years, talent retention has continued to be a large concern for the Top 10 Audit Firms. Nevertheless, talent attrition at the manager levels in 2016 has reduced; an improvement from the previous year (Chart 8). This has resulted in a slight increase in headcount percentage and average years of experience for the more experienced managers (Charts 5 and 6).

Chart 8

Average audit staff turnover rate



Source: AOB Analysis - Top 10 Audit Firms in Malaysia

Ongoing conversations with the audit firms revealed a perception that talent attrition stems from reduced attractiveness of the audit profession, exacerbated in part by better employment opportunities overseas, rising costs of living and fluctuations in the foreign exchange rate.

In 2016, AOB collected information from the Top 10 Audit Firms to verify the perception. It is noted that a large number of audit firm leavers declined to disclose their next work employer. However, of those who shared their next work destination, approximately 14.2% joined other audit firms. 80.8% left audit practice but remained in the accounting profession. It is clear that while the accounting profession is still attractive, more could be done to promote the appeal of the work of the auditor. This includes more initiatives to allow for greater work-life balance and flexibility.

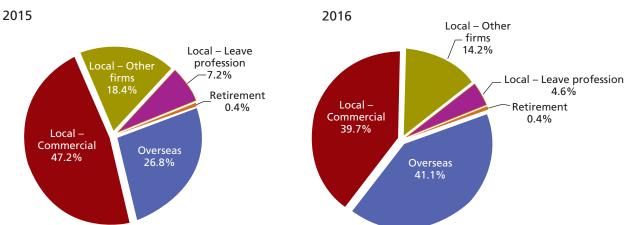
Chart 9 confirms escalated movement of former audit staff in pursuit of overseas opportunities to 41.1% (2015: 26.8%). A further 39.7% joined the commercial sector (e.g. as staff in finance roles of PLCs and small and medium enterprises). The apparent mobility and employability of experienced audit staff at both international and local fronts are encouraging as it underscores the value of the robust training regime forming the base of each individual's experience and knowledge gained from working in the Malaysian audit practice.

Monitoring and quality control

A robust and effective monitoring control framework is important to an audit firm's ability to navigate the increasing complexities in the capital market, while maintaining good quality audits. This must be complemented by adequate and proficient quality control staff to support the audit firm's technical, training and risk management functions, particularly in view of the inherent urgency and required timeliness in responding to issues raised. Regardless of the involvement of the quality control team, responsibility for audit quality continues to rest with the audit partners and their respective audit engagement teams.

With improved talent retention and lower attrition in 2016, total headcount has continued to grow, albeit at a slower pace. AOB's detailed analysis over the last four years found that the ratio of audit practice to quality control headcount was at its peak in 2016.

Chart 9 Disclosed post-resignation staff movement



Note: The charts exclude audit firm leavers who declined to disclose their next work employer.

Source: AOB Analysis - Top 10 Audit Firms in Malaysia

Chart 10
Total headcount in quality control vs total headcount in audit practice



Source: AOB Analysis - Top 10 Audit Firms in Malaysia

As the audit practice headcount expands, audit firms need to do more in identifying new talent and attracting the right resources for the quality control function. This is in addition to current efforts focusing on talent retention and capacity building of existing quality control staff. Ultimately, audit firms must be able to sustain consistent and good quality audits in the long run.

Partner workload

Through various communications, AOB has continuously emphasised that partners' involvement is essential in maintaining consistency in engagement performance and good quality audits. For this to be effective, it is imperative for audit partners to have sufficient time to properly lead and supervise audits.

Chart 11 shows an improvement in the number of clients per partner in 2016, a positive indication that the audit firms have taken steps to improve workload distributions. Such steps include the reduction of the number of higher risk clients while retaining quality clients. In 2016, an audit partner reviewed and signed 203 auditor's reports on average, compared to 217 auditor's reports in 2015. AOB is actively monitoring the movement of PIEs and schedule funds among the audit firms. This is along with various inspection activities and other existing efforts, such as the Small Firms Initiative.

AOB commends the steps taken by the Top 10 Audit Firms to address issues surrounding the partners' workload relating to PIE audits. However, notwithstanding that non-PIEs do not fall within AOB's scope of inspection, AOB wishes to reiterate that a higher non-PIE per partner workload can still have a negative impact on the performance of the same audit partner in PIE audit engagements.

Conclusion

Overall, talent retention and attrition have shown some improvements in 2016, although the continuing exodus of experienced talent in pursuit of better opportunities overseas and in the commercial sector remains a challenge.

The apparent mobility and employability of experienced talent is an acknowledgement of the value created through the robust training regime forming the base of each individual's experience and knowledge gained from working in the Malaysian audit practice. In particular, audit firm leavers are uniquely poised to positively influence the quality of the financial reporting functions that they go on to be a part of. This is in line with AOB's strategy to achieve high quality financial reporting by influencing the financial reporting ecosystem.

0 20 40 60 80 100 120 160 180 5 partner 2015 per 2016 Entities related to PIEs 2015 58 per partner 2016 154 2015 oer partner 2016 144

Chart 11 Average number of clients per partner

Source: AOB Analysis - Top 10 Audit Firms in Malaysia

However, AOB finds that the lower growth in audit fees and salary cost which results in the falling average recovery rates during the year is a cause for concern. Audit firms are reminded that time commitment and work effort which do not commensurate with the audit fees charged is not a sustainable practice and is likely to counter improvements in talent retention and attrition.

Audit firms should also actively cultivate and maintain a strong coaching culture to facilitate effective experience and knowledge sharing among peers and the partner, manager and audit staff levels. Such culture would facilitate and complement the audit firms' monitoring and quality control functions in carrying out their responsibilities in an increasingly complex capital market. Audit firms still need to do more to identify

new talent and attract the right resources for the quality control function, in addition to current talent retention and capacity building efforts.

Partners' workload with respect to PIE audits appears to be moderating, an improvement from the previous year. Partners' involvement is essential in maintaining consistency in engagement performance and good quality audits. This would only be effective with sufficient time to properly lead and supervise audits. Audit firms are reminded that a higher non-PIE per partner workload can still have a negative impact on the performance of the same partner in PIE audit engagements, and that this should be carefully considered when deciding on workload distribution.

Audit Quality

Introduction

Section 31V(1) of Part IIIA of the SCMA mandates the AOB to conduct regular inspections on auditors of PIEs or schedule funds with the primary aim to promote high quality audits and foster confidence in the quality and reliability of the audited financial statements of PIEs and schedule funds in Malaysia.

Regular inspections comprise both firm and engagement level reviews. A firm level review seeks to assess a firm's compliance with the requirements of the ISQC 1 while an engagement review involves an assessment on the auditor's compliance with the *International Standards* on Auditing (ISAs) as well as relevant ethical standards at the audit engagement level. The engagement review also seeks to determine whether sufficient and appropriate audit evidence has been obtained in relation to the audit reports of PIEs or schedule funds. For firms that have been inspected in the past, subsequent inspections of these firms would also include a follow-up review on the implementation of the firm's remedial action plan.

AOB would issue a report to each inspected audit firms. These firms would be required to identify the root causes relating to the deficiencies highlighted in the inspection report, and subject to AOB's approval, relevant remedial actions to address the inspection findings would be implemented.

Summary of Activities

In 2016, AOB conducted regular inspections on five Major Audit Firms and seven Other Audit Firms. Collectively, AOB conducted regular inspections of 12 audit firms that audited approximately 96% of the market capitalisation of the PLCs and over 86% of the total number of PIEs. (Table 4)

AOB recognises that the pursuit of audit quality is a collective responsibility of audit firms, audit partners as well as audit engagement teams. Hence, apart from conducting inspections, AOB also engages with relevant stakeholders to encourage capacity building with respect to sufficiency and competency of resources as well as encouraging firms to establish adequate

Table 3
Profile of Major Audit Firms and Other Audit Firms

	Major Audit Firms	Other Audit Firms
Number of firms	6	45
Number of audit partners	172	155
Number of PIEs audited	776	366
Market capitalisation of PIEs audited (RM' billion)	1,512.4	105.04

Source: AOB

Table 4 Inspection coverage of Major Audit Firms and Other Audit Firms in 2016

Profile	Major Audit Firms	Other Audit Firms
Number of inspected firms	5	7
Number of audit partners inspected	20	14
Number of engagements inspected	20	14

Source: AOB

Table 5 International events participated by AOB in 2016

Events	Location / Date
 4th ASEAN Audit Regulators Group (AARG) Annual Inspection Workshop This workshop is an avenue for inspection officers from AARG member countries to gain deeper insights into the current regulatory regimes in the region, share inspection techniques as well as findings. Also attended by regulators from the region including Japan, China and Hong Kong. 	Bali 20 to 22 January
 10th International Forum of Independent Audit Regulators (IFIAR) Inspection Workshop Attended by global audit regulators who are members of IFIAR to share knowledge, relevant inspection findings and best practices in the inspection of audit firms with the ultimate aim of promoting greater consistency among global regulators. 	Abu Dhabi 22 to 24 February
 Annual AARG Meeting Serves as a platform for regulators in the region to engage with the regional leadership of the Big 4 firms on audit quality issues and initiatives. 	Singapore 26 August

Source: AOB

support structures within the firm to continuously maintain audit quality.

In 2016, AOB embarked on Phase 2 of the Small Firms Initiative with the aim of promoting good practices to strengthen audit quality among smaller audit firms.⁶ Further, AOB conducted interviews with selected partners from a selection of firms that have been inspected during the year to obtain their views on matters relating to the audit profession, their firm and challenges

faced. Results of the interview were shared with the respective firm's leadership so that relevant improvements could be made.

AOB continues to actively participate in events organised by the International Forum of Independent Audit Regulators (IFIAR) and the Association of Southeast Asian Nations (ASEAN) Audit Regulators Group (AARG) in order to remain up-to-date with regional and international developments and best practices as depicted in Table 5.

In 2015, AOB carried out an initiative to engage with six smaller audit firms that have yet to be inspected. Phase 2 of this initiative involves engaging the remaining six smaller audit firms that have yet to be inspected.

Focus Interview with Partners

Auditors are seen as independent gatekeepers whose role is to safeguard the interests of the various users of the audited financial statements. As such, the role played by audit partners to drive audit quality is highly critical as they are ultimately

responsible for leading and supervising audit engagements.

In 2016, AOB interviewed 30 partners from a selection of audit firms to obtain their feedback and views on matters relating to the audit profession, their firm and work. Results of the interviews with the partners are summarised in Table 6.

Table 6
Results of interviews with the partners

Matters discussed	Interview findings
Attractiveness of the profession	 There are mixed views among audit partners whether the audit profession remains attractive to the younger generation. Some partners felt that the audit profession in Malaysia is no longer attractive due to various reasons which include: Long work hours; Heavy workload; Perceived risks faced by auditors in the event of audit failure; Tight regulatory environment; Better remuneration offered by the commercial sector; and Better job opportunities overseas. On the other hand, certain audit partners viewed that the audit profession remains attractive to fresh graduates. Audit firms in particular are viewed as training organisations that offer good exposure and learning opportunities. To a certain extent, audit firms are seen as making a positive contribution to the capital market when talents that are professionally trained by the audit firms leave to join PLCs.
Key challenges faced by audit partners	Common challenges cited by the partners are: Retention of experienced staff; Sufficiency of staffing during peak periods due to high staff turnover; Competency of their clients' financial reporting functions; Complexity of accounting standards; and Low audit fees. Partners interviewed shared that there are ongoing efforts undertaken by their firms to address the common challenges. Some of which are elaborated below.
Talent retention efforts	 Partners interviewed shared that their firms are taking various measures to promote better staff retention. Common measures cited are: Ensure that a strong support structure covering audit methodology, training and technical consultations are in place to support the audit engagement teams; Periodic review of salary packages to ensure that firms remain competitive in the market; Organise social and outdoor activities to promote closer relationship between partners and staff as well as among staff members; and Establish better resource planning to ensure staff workload is more manageable.

Table 6 (continued) Results of interviews with the partners

Matters discussed	Interview findings
Competency of clients' financial reporting function	 Audit partners shared that a number of their clients face similar challenges to attract and retain competent staff in their accounting and finance functions. Consequently, competency of their clients' financial reporting function is a common issue faced by auditors and is viewed as a major contributing factor to the workload of the auditors. To address this issue, audit partners have taken various measures which include providing feedback to the Audit Committee and management on the quality of the deliverables, upfront planning of audit schedules and allocating more time for the affected audit reviews. In some instances, clients with relatively weaker financial reporting function are being charged with higher audit fees as the auditors would need to incur more time to review the deliverables provided by their clients. Arising from the various measures taken, some of these clients subsequently strengthened their financial reporting function and improved the quality of deliverables. Notwithstanding, some audit partners highlighted that they would not hesitate to decline re-appointment as auditors of the PIE if there are significant weaknesses with a client's financial reporting function that are not addressed in a timely manner.
Tone at the top	 Firms in general have established a framework linking monitoring review results to the performance evaluation and remuneration of the partners. Partners felt that such measures demonstrate the leadership's emphasis on audit quality. Notwithstanding the reward or penalty measures that a firm may undertake, some partners shared that inherently, they want to safeguard audit quality as their reputation would be at stake in the event of audit failure. While all firms aim for business growth, partners highlighted that their respective firms have not been under undue pressure to meet business growth targets.
Support structure of the firm	 Partners recognise the important role of the firm's support structure that covers, among others, training, consultation and monitoring programmes in aiding audit engagement teams to achieve audit quality. Partners generally agree that in order for the firm's support structure to be strong, they must continuously invest to ensure that the support functions are adequately resourced with the right talent. While firms have implemented cold file reviews⁷, the results of AOB inspections as well as internal monitoring reviews reflect that ensuring consistency of engagement performance remains a challenge for some firms. Firms in general recognise the limitations of a cold file review which is a form of detective control. As a result, a majority of the firms have implemented a hot file⁸ review monitoring programme to complement their cold file review programme. Partners are supportive of this programme and believe that it would be beneficial towards promoting quality audit in view that the objective of a hot file review is to prevent or minimise audit deficiencies. The audit engagement teams are expected to address all findings raised by the hot reviewers before the audit report is finalised.

⁷ A cold file review is a review undertaken after the audit report has been signed off. The purpose of the cold file review is to ensure that the audits have been completed in accordance with the firms' procedures and ISAs and the financial statements have been prepared in accordance with the relevant legislation.

A hot file review is a review undertaken before the audit report is signed off.

Matters discussed	Interview findings
Partner's workload	 There is greater awareness among the firms on the importance of ensuring that partners are given sufficient time to properly lead and supervise audits. Measures taken by the firms to ensure partner workload is at a manageable level are as follows: Increasing the number of partners to share the workload; Monitoring by the firm on partners' workload and rebalancing of client portfolio where necessary; Reducing the number of higher risk clients while retaining quality clients; and Increasing the efforts to retain experience audit staff to support the partners.
Engagement quality control reviewers role undertaken by partners	 Apart from playing the role as engagement partners, some audit partners also undertake the role as engagement quality control reviewers (EQCR). The tight turnaround time for the engagement quality control review to be completed by an EQCR has been cited as a common challenge. This is being addressed by some partners through early engagement between the audit team and EQCR, performed reviews on piecemeal basis by the EQCR and effective time management. The partners acknowledge the important role played by the EQCR to serve as the "check and balance" for an audit engagement. In this regard, some partners are supportive for EQCRs to be held partly accountable for audit failures, especially when it is clear that the EQCR has been negligent in performing his or her duties.

Phase 2 of the Small Firms Initiative to Drive Capacity Building Among Smaller Audit Firms

In 2016, AOB continued with Phase 2 of the Small Firms Initiative by engaging with six smaller audit firms with the view of achieving the following objectives:

 Encourage smaller audit firms to strengthen their capacity;

- Create greater awareness among the smaller audit firms' leadership on the requirements and importance of ISQC 1; and
- Obtain an understanding of the challenges faced by the small audit firms as well as the relevant actions that have been taken by these firms to overcome the challenges faced.

The firms engaged comprise there with four partners or less. The number of PIEs audited by these firms range from one to seven.

Key Insights on the Small Firms Initiative

System of quality controls at the small firms

The small firms engaged by AOB are cognisant on the need to comply with the requirements of ISQC 1. While these firms have established quality control manuals, forms and templates to facilitate compliance, AOB identified the following areas for improvement through our engagements with these firms:

- A majority of the firms have not clearly defined criteria for the evaluation of partner's performance which should take into consideration results of internal monitoring reviews and linking results of this evaluation to partner's remuneration. A similar observation was noted in some firms relating to the performance evaluation of their staff. Performance evaluation and remuneration are useful mechanisms that a firm could use to encourage the right behaviour among partners and staff;
- The emphasis placed by firms on training varies from one firm to another. Positive actions observed include conducting structured training covering both auditing and accounting, engagement of external trainers to conduct in-house training and ensuring that staff who attend external training, conduct subsequent sharing with other staff within the firm. However, there are some firms where the AOB observed a lack of structured training to ensure that audit staff have been equipped with the relevant knowledge and skills to perform a PIE audit;
- A majority of the small firms have a policy that requires for the audit engagement team to consult when faced with 'difficult or contentious matters' without providing further elaboration or examples of what constitute 'difficult or contentious matters'. Hence, the audit engagement team may not be appropriately guided on matters that should be escalated for consultation; and
- Some firms have failed to perform an annual monitoring review at both the firm and engagement levels as required by ISQC 1 to determine whether the firm's system of quality controls are operating effectively. It is imperative that firms have an effective monitoring system in place as it is essential towards supporting the achievement of audit quality.

Challenges faced and future outlook

Similar with the larger audit firms, the small audit firms face a key challenge of striking the right balance between the existing level of audit fees and rising costs to ensure audit quality is not compromised. Smaller firms face greater challenges to attract top talent and retain experienced resources. To attract the right talent, firms have to ensure that the remuneration offered by them is competitive. Further, the high staff turnover and changes in accounting standards necessitate these firms to continuously invest in training of their staff.

The small audit firms cited various measures to stem attrition of staff such as promoting better work life balance within the firm, providing staff with accelerated opportunities for progression to partnership as well as focus on building closer relationships between partners and staff. Some of the smaller audit firms have observed better retention rates among their senior level staff due to the various initiatives undertaken by the firms.

The smaller audit firms have welcomed the Small Firms Initiative and have expressed their commitment to further improve their systems of quality controls.

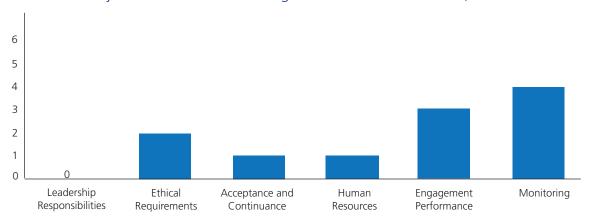
Key Observations from Firm Level Review of Major Audit Firms

Over the years, AOB observed that the leadership of the Major Audit Firms have set a stronger tone at the top, aimed to cultivate the right culture and behaviour within the firm. Nevertheless, AOB continues to observe findings across five of the six

elements of ISQC 1 as depicted in Chart 12 during the 2016 inspection.

In performing a firm level review of the Major Audit Firms, AOB found no shortcoming for one Major Audit Firm while for the remaining inspected firms; several shortcomings were noted for each. A higher number of shortcomings which were observed under the ISQC 1 elements of engagement performance and monitoring have been elaborated in Table 7.

Chart 12
Number of Major Audit Firms with findings in the six elements of ISQC 1 in 2016



Source: AOB

Table 7
Shortcomings found by AOB during the 2016 inspection of the Major Audit Firms

Shortcomings found by the AOB grouped by ISQC 1 elements

Engagement Performance

(i) Consultation

- Non-compliance with the firm's policy on consultation:
 - Instances of mandatory consultation not carried out;
 - Consultations not approved in accordance with firm's policy; and
 - Consultations not retained within the consultation database for future reference, as required by the firm's policy.

The process for consultation helps to mitigate the risk of insufficient and inappropriate audit evidence being obtained to support the audit opinion to be rendered by a firm. Hence, it is important that firms ensure that the consultation policies and procedures are adhered to.

Table 7 (continued)

Shortcomings found by AOB during the 2016 inspection of the Major Audit Firms

Shortcomings found by the AOB grouped by ISQC 1 elements

Engagement Performance

Engagement quality control review (ii)

Instances of some PIEs not subject to an engagement quality control review although required by the firm's policy due to incorrect classification of these entities as non-PIEs by the audit engagement teams. While these entities are not PLCs, they are deemed to be PIEs as they hold a Capital Markets and Services Licence to carry out regulated activities of dealing in securities, dealing in derivatives or fund management.

The engagement quality control review process is an important process where an independent partner would provide the check and balance to the audit process through his independent evaluation of key judgement areas and significant matters and assessment whether related audit procedures and documentation support the conclusions reached.

(iii) Assembly of final audit engagement files

Despite efforts made by firms over the past year, AOB still identified weaknesses with the assembly of audit engagement files that were not completed within 60 days after the date of the audit report which is a requirement of the ISQC 1 standards.

Monitoring

Remedying identified deficiencies arising from AOB's inspection (i)

Instances of repeated findings identified during AOB's inspections of selected engagements.

Key Observations from Firm Level Review of Other **Audit Firms**

In 2016, AOB carried out inspections on four Other Audit Firms that have been inspected in the past while another three Other Audit Firms were inspected for the first time. Significant gaps were noted in the firms' compliance with the requirements of ISQC 1 for two Other Audit Firms inspected for the first time, while the remaining firm had several gaps.

As depicted in Chart 13, a higher number of firms have shortcomings under the ISQC 1 elements of ethical requirements, engagement performance and monitoring.

The common shortcomings found by AOB for the seven inspected Other Audit Firms are elaborated in Table 8.

7 6 5 4 3 2 0 Leadership Ethical Acceptance and Human Engagement Monitoring Responsibilities Requirements Continuance Resources Performance

Chart 13
Number of Other Audit Firms with findings in the six elements of ISQC 1 in 2016

Source: AOB

Table 8

Common shortcomings found by AOB during the 2016 inspection of the Other Audit Firms

Common shortcomings found by $\ \mbox{AOB}$ grouped by ISQC 1 elements

Relevant Ethical Requirements

(i) Engagement independence confirmation/declaration

- Instances where the audit engagement partners did not review and conclude on the respective engagement team's independence confirmation at the beginning of the audit as required by the ISAs;
- Instances where independence confirmation by the audit engagement team were either untimely or not performed; and
- Independence declarations by members of the audit engagement team were not sufficiently comprehensive as it excluded confirmation on the team's independence relating to financial interest, loans and guarantees.

For the four firms that were inspected in the past, AOB noted that these firms have shown improvement with respect to ISQC 1 compliance with a lower number of firm level review findings identified during the 2016 inspection as compared

to prior inspections. Notwithstanding, AOB continues to have concerns with the results of the engagement reviews that have culminated to certain actions being taken by AOB on some firms and their partners as highlighted in Table 9.

Table 8 (continued)

Common shortcomings found by AOB during the 2016 inspection of the Other Audit Firms

Common shortcomings found by AOB grouped by ISQC 1 elements

Acceptance and Continuance of Client Relationships and Specific Engagements

Acceptance of new audit client and audit engagements

Instances where the firm's policies and procedures for the acceptance of new audit clients and audit engagements were not complied with are as follows:

- Approvals for the acceptance of new audit clients and engagements were granted prior to the completion of the firm's internal independence evaluation;
- Consent to act letters have been issued to PIEs before the evaluation process for the acceptance of new clients and engagements were completed; and
- The new client evaluation form was not signed-off by the Head of Audit to present evidence on an approval of new client acceptance although required by the firm's policy.

It is vital for firms to apply sufficient rigour in the client and acceptance evaluation process as it helps to prevent firms from accepting clients and audit engagements that are beyond the firm's capacity.

Engagement Performance

(i) Audit methodology for sampling

- For one firm, the basis of sampling on the testing of reconciliation items for the audit of cash and bank may result in insufficient audit evidence to be obtained over reconciling items where the total value of untested population may be above audit materiality;
- The sampling calculator tool of one firm which is used to determine the number of samples for the purpose of test of details does not take into consideration the population size, key items tested separately and planning materiality although required by Paragraph 7 of ISA 530 Audit Sampling; and
- Certain firms did not provide any guidance to its audit engagement teams on audit sampling. This resulted in inconsistent practices with respect to the determination of sample size among audit engagement teams including the possibility of insufficient number of samples being selected for testing.

(ii) Consultation

Certain firm's consultation policies require consultation on 'significant, difficult or contentious issue'. However, the definition or quidance as to what would constitute a 'significant, difficult or contentious issue' has not been provided. Hence, audit teams may not be appropriately guided on matters that should be escalated for consultation.

Table 8 (continued)

Common shortcomings found by AOB during the 2016 inspection of the Other Audit Firms

Common shortcomings found by AOB grouped by ISQC 1 elements

Monitoring

(i) Monitoring on the firm's quality control policies and procedures

- Two audit firms did not conduct an evaluation on their firms' system of quality controls including periodic inspection of a selection of completed engagements to determine whether the firms' system of quality controls are adequate and operating effectively.
- While one audit firm has a programme for the conduct of monitoring reviews, the scope of this programme in 2016 was not comprehensive as it was limited to a review of engagement continuance and a review of selected audit engagements. Further, the rigour of the firm's engagement review was insufficient in view that the firm's reviewer failed to identify significant deficiencies for a PIE audit engagement that was subject to both AOB and the firm's internal review.

(ii) Evaluating identified deficiencies arising from monitoring reviews

- Some firms have not developed clear criteria to conclude on an overall basis their assessment of each engagement that was subject to internal review. The conclusion on the overall engagement performance would be useful to support the basis for appropriate actions to be taken in relation to an individual engagement or member of the engagement team; and
- While some firms have processes to conclude on the overall quality of reviewed engagements by assigning a grade, these firms have not provided a definition for each grade. This definition is necessary to facilitate a more objective determination of the grades as well as to promote a better understanding of the grading system among audit partners and staff.

(iii) Remedying identified deficiencies arising from AOB's inspection

• Three out of four firms that were re-inspected by AOB in 2016 have some repeated engagement review findings.

Table 9
Actions taken by AOB on the Other Audit Firms in 2016

Firms inspected by AOB	Actions taken by AOB on Other Audit Firms that were inspected		
Three newly inspected firms	 One firm was issued with a warning and had specific remedial measures imposed on the firm. Further, one of its audit engagement partners was also referred to AOB's Enforcement Department for further action. One firm had specific remedial measures imposed on both the firm and its partners. The audit partner for one firm was referred to AOB's Enforcement Department for further action. 		
Four re-inspected firms	 One firm had specific remedial measures imposed on both the firm and its partners. One firm had a partner that was imposed with specific remedial measures and another that was referred to AOB's Enforcement Department for further action. The audit partner of one firm was referred to AOB's Enforcement Department for further action. 		

In view of the above, there is a need for the firm's leadership to ensure that a strong tone at the top is maintained to promote a culture that gives due emphasis to audit quality. Further, the firms should also strive to continuously make improvements to its system of quality controls and implement a robust monitoring mechanism to safeguard audit quality.

Key Observations from Engagement Level Review of Major Audit Firms and Other Audit Firms

AOB's inspection activities are important to measure the firm's performance in exercising and demonstrating high quality independent audits of PIEs and schedule funds. The engagement review specifically assesses the degree of compliance of an audit engagement with the ISAs and compliance with the By-Laws (On Professional Ethics, Conduct and Practice) of the MIA (MIA By Laws). Over the years, AOB has observed the firm's positive commitment towards achieving audit quality by taking various remediation actions in addressing the potential root causes for the

> 66...depending on the firm's overall capacity, certain remediation actions taken by the firm towards engagement performance may not be sufficiently holistic to address the identified root causes. 22

deficiencies highlighted by AOB. However, depending on the firm's overall capacity, certain remediation actions taken by the firm towards engagement performance may not be sufficiently holistic to address the identified root causes. Thus, AOB still continues to observe findings for both Major Audit Firms and Other Audit Firms on certain areas despite being highlighted in AOB's past annual reports.

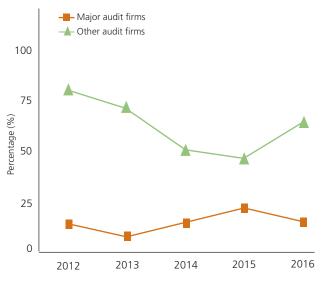
For Major Audit Firms, AOB observed significant findings on certain key audit areas involving revenue and receivables as well as related party transactions. In most instances, there was a lack of evaluation and audit evidence obtained to demonstrate the firms' understanding of certain complex and complicated business transactions and arrangements. There were also findings on certain fundamental areas involving inventory costing which were inappropriately perceived as a low risk area despite the amount being material to the financial statements.

For Other Audit Firms, AOB continues to observe a lack of documentary evidence on the nature, extent and timing of audit procedures performed on key audit areas. Some of these Other Audit Firms had been inspected in the previous years. It is important that the firms constantly evaluate its existing capacity which may include the firms' audit methodology and resources capability. Where gaps are identified, firms need to ensure that proper safeguards are in place to uphold audit quality.

Engagements with significant improvements required

As shown in Chart 14, AOB observed an increase in the number of such engagements for Other Audit Firms in 2016. Chart 14 also depicts gaps in the overall performance between Other Audit Firms as compared to Major Audit Firms over the

Chart 14
Percentage of inspected engagements with significant improvement required



Source: AOB

five-year period since 2012. Although, other Audit Firms are not subject to inspection on an annual basis, the firm's leadership needs to be mindful to establish effective policies and procedures in promoting audit quality culture within their respective organisations.

For Major Audit Firms, although the overall percentage of number of engagements requiring significant improvements had reduced in 2016, greater efforts are needed by the firms to promote audit quality among its engagement partners. To achieve the desired outcome from its remediation action respectively, it is vital that the firm's leadership identifies the actual root causes and address the systemic issues affecting their firms.

Engagement Quality Control Review process

The effectiveness of the EQCR process is dependent on whether the EQCR has effectively provided the required check and balance during the review process.

As highlighted in previous years, notwithstanding the fact that the primary responsibility of the performance of the audit lies with the audit engagement partner, AOB continues to regard the importance of the EQCR's role towards achieving audit quality. The EQCR should demonstrate his or her ability to provide independent and objective evaluation for key judgement areas and significant matters of an audit. Where disagreements exist between EQCR and the engagement partner, the firm's consultation process should be adequately robust to manage the situation with the ultimate objective of safeguarding audit quality.

Over the years, AOB observed the positive commitment by firms in recognising the importance of the EQCR's role. The following, among others, are common factors that may contribute to the effectiveness of the EQCR review:

- EQCR having sufficient and appropriate authority level over the engagement partner;
- EQCR having sufficient and appropriate experience with relevant industry knowledge;
- Adequate involvement throughout the duration of the audit engagement; and
- Appropriate documentation of the extent and timing of the review.

Paragraph 20 of ISA 220 Quality Control for an Audit of Financial Statements requires the EQCR to perform an objective evaluation of the significant judgements and conclusions made by the engagement team. This evaluation shall involve the following:

- Discussion of significant matters with the (a) engagement partner;
- (b) Review of the financial statements and the proposed auditor's report;
- (c) Review of the selected documentation of the significant judgments made and the conclusions reached by the engagement team; and
- (d) Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate.

Common significant deficiencies for Major Audit Firms and Other **Audit Firms**

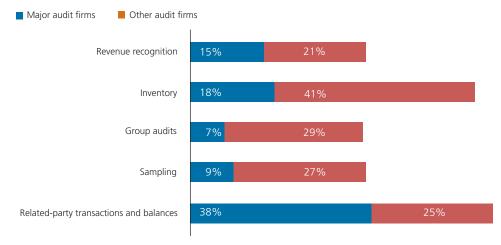
The following are the common significant deficiencies observed for both Major Audit Firms and Other Audit Firms:

- Revenue recognition;
- Inventory;
- Group audits;
- Sampling; and
- Related-party transactions and balances

Diagram 1 Number of inspected engagements



Chart 15 Common significant deficiencies over scoped in engagements



Source: AOB

question the judgement of audit partners but it questions the appropriateness and sufficiency of audit evidence to support an audit partner's judgement. 99

Revenue recognition

The common findings observed from AOB's 2016 inspections in the area of revenue recognition are as follows:

- Determination of percentage of completion for property development and construction revenue was not adequately challenged;
- Inappropriate evaluation on the impact of identified uncorrected misstatements;
- Shortcomings in testing the cut-off assertion; and
- Substantive analytical procedures not performed in accordance with ISA requirements.

Revenue is one of the critical components to the financial statements of an entity. In auditing revenue, ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* specifically requires the auditors to assess the risk of material misstatements from the revenue recognition based on presumption that it carries the risk of fraud. Despite the overall reduction in deficiencies, AOB continued to observe high number of significant deficiencies

within this area. Certain deficiencies highlighted were still comparable to the deficiencies reported in previous years particularly in determining the percentage of completion of projects and the testing of cut-off assertion.

Determination on the percentage of completion for a project often involves significant estimates and judgement by the preparers especially when the stage of completion is determined by reference to the contract costs incurred to date bear to the estimated total contract costs. AOB does not question the judgement of audit partners but it questions the appropriateness and sufficiency of audit evidence to support an audit partner's judgement. AOB observed instances where the total estimated contract costs were not sufficiently challenged by the auditors particularly when there is evidence of potential revision required on the total estimated contract. For property development activities, AOB observed instances where the percentage of completion determined by an entity inappropriately included the land cost that would not reliably depict the actual work performed. Consequently, the percentage of completion used to determine the revenue would not be accurate.

As highlighted in previous years, AOB continued to observe development by Major Audit Firms when applying substantive analytical procedures as its primary substantive procedure in accordance with ISA 520 *Analytical Procedures*. However, there were still instances of gaps in application, particularly on the reliability of the data used to determine the auditors' expectations as well as insufficient evaluation of differences noted from the analysis. AOB also observed instances where available checklists and templates introduced by certain firms in this area were not effectively used or wrongly applied by the engagement team.

For Other Audit Firms, AOB still observed that substantive analytical procedures were performed in the form of variance analysis which was limited to comparing the current year figures with the previous years.

ISA 330 The Auditor's Responses to Assessed Risks required auditors to design and perform substantive procedures for each material class of account balance, transactions, and disclosure regardless of the assessed risks of material misstatement. Substantive procedures comprise test of details and substantive analytical procedures.

If substantive analytical procedures are to be applied, it is key that auditors comply with the requirements of ISA 520 Analytical Procedures. In performing the procedures, when the auditors identify fluctuations or relationships that are inconsistent with the expected values, exceeding the auditors' acceptable variance, such differences need to be further investigated by:

- (a) Inquiring management and further obtaining appropriate level of audit evidence to corroborate management's response; and
- (b) Performing other necessary audit procedures particularly when management are unable to provide explanation, or the explanation, together with the audit evidence obtained relevant to the management's response, is not considered adequate.

Inventory

For 2016 inspections, AOB inspected a number of audit engagements relating to PIEs involved in manufacturing, trading and property development activities that carry high levels of inventory as of the financial reporting date. Findings observed in this area are as follows:

Failure to address the existence and valuation of certain types of inventories;

- Insufficient evaluation to address the appropriate classification of certain type of assets as inventory;
- Inappropriate testing of costing models adopted by PIEs;
- Insufficient evaluation of obsolescence and slow moving inventories;
- Performing test of details based on management reports which were not tested for reliability and accuracy; and
- Relevance and reliability of information used to support the net realisable value of property inventory was not addressed.

Findings on inventories were prevalent in Other Audit Firms particularly when judgement was involved in the process such as capitalisation of inventory based on management's standard costing, appropriate classification of assets under construction as inventories, appropriate classification of property inventories that also generated rental income as well as review of obsolescence in addressing inventories' net realisable value. In most instances, there was a lack of documentary evidence to support the auditors' understanding of the nature and process involved or whether sufficient challenge was made over the management's judgement and estimates in the recognition of the inventory. Consequently, the designed audit procedures were not effective to address its intended objectives.

For Major Audit Firms, AOB observed instances of gaps in the designed audit procedures particularly in the testing of management costing and physical test count procedures.

Inventories shall be measured at the lower of cost and net realisable value in accordance with Malaysian Financial Reporting Standard (MFRS) 102 *Inventories*. For a manufacturing entity, apart from the purchase cost, cost inventory may include direct labour cost or overheads cost that are incurred in converting the materials to a finished goods. When verifying the inventory costing based on details provided by the entity, ISA 500 *Audit Evidence* required the auditors to ensure the reliability of such information, including the following, as necessary:

- (a) Obtain audit evidence about the accuracy and completeness of the information; and
- (b) Evaluate whether the information is sufficiently precise and detailed for the auditors' purposes.

Group Audits

AOB continued to inspect audit engagements relating to PIEs with multiple components and business operations in 2016. Findings observed from AOB's 2016 inspections are as follows:

- Inadequate planning and assessment to design the appropriate response to address the risks of material misstatements for significant components;
- Untimely response of Group Audit
 Instructions by the component auditors as a result of untimely requests made or lack of follow up on reporting deliverables required by the group auditors;
- Insufficient audit evidence obtained for certain financial information of the significant components;

- Insufficient evaluation or follow up procedures performed on matters highlighted by the component auditors in their response to the *Group Audit Instructions*;
- Insufficient evaluation of the works performed by the component auditors including the tendency to rely on the work performed by the component auditors particularly when those component auditors are within the firm's own network; and
- Inconsistent application of the extent of audit procedures performed by the component auditors.

As highlighted in 2015 annual report, AOB has concerns on the effectiveness of the firms' effort to improve audit quality in this area since a majority of the above findings were highlighted in AOB's previous annual reports. For certain Other Audit Firms that were inspected for the first time, AOB observed that certain fundamental audit procedures performed in this area were weak due to inadequate planning and assessment in responding to the relevant risks associated with the significant components. There was also a tendency for the firms to rely on the work performed by the component auditors without evaluating the adequacy of the audit procedures performed by the component auditors particularly for certain high risk areas such as revenue recognition, existence of cash and bank balances as well as impairment of assets.

For certain Major Audit Firms, AOB still observed limited procedures performed to evaluate the adequacy of audit procedures performed for certain high risk areas identified particularly when the component auditors are within the firm's own global network.

ISA 600 Special Consideration – Audits of Group Financial Statements (including the Work of Component Auditors) requires the group auditors to include the following documentation:

- An analysis of components, indicating (a) those that are significant, and the type of work performed on the financial information of the components;
- (b) The nature, timing and extent of the group engagement team's involvement in the work performed by the component auditors on significant components, including the result of the review on relevant parts of the component auditors' audit documentation and conclusion, where applicable; and
- (c) Written communications between the group engagement team and the component auditors about the group engagement team's requirements.

Related-party transactions and balances

In 2016, AOB inspected a number of engagements that included large transactions and balances with related parties. The common findings observed in this area are summarised as follows:

- No or lack of audit procedures performed to review management's process to identify related-parties and related-party transactions;
- Certain significant business arrangements and transactions entered with related parties were not sufficiently evaluated; and
- Lack of procedures performed to verify the completeness and accuracy of the disclosures relating to related parties.

Findings in this area were prevalent for audit of entities that are controlled by certain individuals or a group of individuals/families that transacted with related parties connected with the shareholders. There were instances of certain business transactions that were not sufficiently evaluated due to a lack of formalised business arrangements entered with the related parties. Consequently, the substance of the transactions was not supported.

For Other Audit Firms, there were instances of undue reliance on management representations to verify the existence and accuracy of the relatedparty transactions without incorporating any additional procedures. As a result, there were related-party transactions and balances that were not or incorrectly disclosed in the financial statements.

To effectively address the potential risk of material misstatements for the related-party transactions and balances, application of the appropriate level of professional scepticism is necessary when auditing this area.

In forming an opinion on the financial statements when evaluating the accounting for and disclosure of identified related-party relationships and transactions, ISA 550 Related Parties requires auditors to evaluate the following:

- (a) Whether the identified related-party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and
- (b) Whether the effects of the related-party relationships and transactions:
 - Prevent the financial statements (i) from achieving fair presentation;
 - (ii) Cause the financial statements to be misleading.

Sampling

The common findings observed from the 2016 inspections are:

- Inappropriate basis of sampling;
- Incorrect inputs being used or wrong application of the firm's sampling tool/ calculator;
- Potential exceptions from test samples were not identified and properly evaluated;
- Potential identified misstatements were not projected to entire population;
- Completeness of sampling population was not addressed; and
- No sample selected on untested population.

AOB continued to observe findings in relation to sampling. As highlighted in 2015, the continued observations of the above raised concerns on the effectiveness of the firm's designed audit procedures to minimise its sampling risk when performing an audit of a population. AOB findings above were prevalent for Other Audit Firms that do not have any specific sampling methodology or for the firms that applied a self-developed sampling methodology. There were instances of lack of clarity on the basis of sampling used as well as inconsistent sampling application among the engagement teams due to lack of guidance or resources made available by the firm. As highlighted in AOB's past annual reports, there were still instances where the basis of sampling was limited to selecting key items or high valued items. Such basis is not representative of the population being tested leading to a material untested population.

For Major Audit Firms, AOB observed instances of potential misstatements that were not projected to the entire population in order to obtain a broad view of the scale of misstatement in arriving at the audit conclusion. There were also instances of lack of clarity in respect of the basis of sampling used in accordance with the sampling methodology particularly when judgement was applied to determine the number of samples.

ISA 530 Audit Sampling stipulated that the objective of the auditor in applying audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected. The auditor shall determine a sample size that is sufficient to reduce its sampling risk to an acceptably low level as well as sample items are selected in a way that each sampling unit has a chance of selection. In doing so, ISA 230 Audit Documentation requires auditors to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements;
- (b) The results of the audit procedures performed, and the audit evidence obtained; and
- (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

Observations on Certain High Risk Areas

The recent change in global and local economic situation has a direct financial impact on certain industries in Malaysia. As part of the objective to protect public interest in the capital market, AOB continues to focus on certain high risk areas of the financial statements in its inspection which include impairment of assets and audit of cash and cash equivalents.

Impairment of assets

The unfavourable global economic situation affecting certain industries such as the oil and gas businesses as well as the uncertainties over global economic concerns have further heightened the risk of impairment of assets.

Overall, AOB observed a reduction in the percentage of findings in this area in 2016. This is encouraging given AOB has consistently highlighted the concern over the rigour of procedures performed in AOB's previous annual reports. Nevertheless, it is essential that firms to continuously consider the appropriate level of audit procedures to address the risk of material misstatements involved.

For Major Audit Firms, AOB observed a positive outcome by certain firms when it engaged a separate team of internal experts to review not only the applied discount rate but also the overall appropriateness of the cash flow projections prepared by management for the impairment assessment. However, AOB still observed findings on the lack of sufficient challenge over management's key assumptions used in the cash flow projections or basis of impairment particularly when there was a high level of uncertainty due to complexity of business arrangements as well as unsecured future projects.

For Other Audit Firms, AOB still has concerns over the depth of the procedures performed to challenge the key assumptions and discount rates used by management in the cash flow projections to address the assets' recoverable amount as well as appropriate determination of the cash generating unit (CGU). AOB also observed instances of lack of documentary evidence in the archived working papers to support the impairment assessment performed.

The common findings observed from AOB's 2016 inspections in relation to impairment of assets are as

- CGU assets were inappropriately determined or excluded when performing impairment assessment for intangible assets:
- Lack of verification and challenge of management's key assumptions used in the cash flow
- Impairment assessment for intangible assets not yet available for use were not performed;
- Basis of impairment using certain percentage of assets value provided by management was not challenged; and
- Relevance and reliability of information used to support the valuation of an asset was not addressed.

Audit of cash and cash equivalents

Cash and cash equivalent balance is one of the crucial elements to determine the liquidity of an entity.

Although the findings in this area were not prevalent in 2016, AOB has concerns over the effectiveness of audit procedures performed by certain auditors in this area particularly in addressing the appropriate existence and classification of the cash and cash equivalents as of the reporting date. In some instances, the findings were in relation to fundamental procedures such as discrepancies in details included in the bank confirmations which had not been investigated further as well as verification and vouching of bank reconciliation items which were limited to relying on management's internal documents.

As observed in prior years, due to the complex nature of the types of investment products available in the existing market, AOB still observed that there is a tendency for entities to classify its investments in trust funds as part of cash and cash equivalents. This is particularly a concern when the funds were denominated in units and need to be converted to its relevant market prices as at the reporting date. In addressing the classification of the balance, it is imperative that auditors ensure that the entities' evaluation was duly supported and appropriate in accordance with the relevant accounting standards.

AOB findings observed on cash and cash equivalents areas are:

- Rights and obligations of the cash and bank balances that were not held under the PIE's name were not sufficiently addressed;
- Insufficient evaluation of the appropriateness of early cut-off practiced by PIEs to report its cash and bank balances;
- Lack of follow up procedures or insufficient alternative procedures performed to address the existence of bank balances in the absence of bank confirmations reply; and
- Insufficient evaluation of appropriate classification of investment in trust funds as cash and cash

Remediation

Overall progress

In general, firms are putting in more effort and investment to strengthen and sustain audit quality. This may explain AOB's observation that out of nine re-inspected firms in 2016, two firms recorded no recurring findings. Some improvement was noted for six firms that recorded reduced numbers of recurring finding compared to the previous inspection of those firms.

Despite the overall improvements, the remediation action plans of some firms were found to be more effective and have yielded better results than the others. In some firms where marked positive impact was observed, several key success factors below were found to drive the successful remediation (Table 10).

The key success factors demonstrated that for a remediation plan to be successful in preventing

recurrence, it needs to be holistic, specific and linked to actual underlying causes. Equally important is the need to have a robust monitoring and measurement framework to ensure the effectiveness of the remediation actions being implemented.

The ideal remediation framework goes beyond preventing recurrence of identified findings. The right framework should also ensure that issues are proactively being addressed before being identified via internal monitoring or external inspection. AOB is also consignant of the fact that remediation plans are not a 'one size fits all' and firms should develop their own remediation actions based on their own honest and thorough assessment of root causes.

Recurring findings

Similar to the observation noted in the previous year, recurring findings on engagements reviewed during the year continued to reduce on an overall

Table 10 Implementation of remediation plan – Key success factors

Results of remediation	Remediation efforts – Key success factors		
No recurring findings observed in a firm	Increased rigour in the involvement of the Technical Department, resulting in successful implementation of an enhanced quality control framework.		
Continuous reduction in the number of recurring findings in a four-year period	 Strong tone from the top in driving audit quality. A remediation plan that focused on centralisation approach to allow audit team members to focus on specific areas. Introduction of centralisation approach on certain key audit areas. Setting-up of an Audit Centralisation Team assigned to address the administrative matters of audits. 		
Overall improvements in the results of a re-inspection for an Other Audit Firm	 Implementation of a holistic remediation plan that encompassed partnership agreement, firm structure, audit methodology and quality control framework. Setting-up of a task force to monitor the progress of the remediation plan and ensure that all timelines are strictly adhered to. 		

basis. Out of five Major Audit Firms and four Other Audit Firms re-inspected, a reduction in the number of recurring findings was noted in all but one Major Audit Firm. The key recurring findings observed during the year are as follows:

- Additional or follow-up requests to thirdparty confirmations and performance of alternative procedures;
- Testing of inventory costing method;
- Presentation and disclosure;
- Sampling and untested population; and
- Documentation discipline.

The recurring findings relating to audit sampling as well as presentation and disclosure were more prevalent for the Major Audit Firms while Other Audit Firms recorded a higher number of recurring findings relating to third-party confirmations and documentation discipline.

Compared with the previous years, AOB observed that there were no longer recurring findings on application of substantive analytical procedures, impairment assessment of assets and testing of the reliability of system-generated reports.

Root causes

A good understanding on the causes of inspection findings is vital to ensure that an effective action plan can be developed to prevent future occurrence. The following are the main root causes that continue to be observed based on AOB's analysis of both Major Audit Firms and Other Audit Firms:

- Lack of technical competence of the engagement team in the execution of the audit especially on specialised industries;
- Lack of thorough understanding of industry knowledge for certain specialised industries;
- Lack of detailed assessment on appropriate application of accounting principles for certain high risk areas by the engagement team;
- Increased complexity of client's business
 Firm's existing competency and capacity which were not adequately considered in the client continuance process;
- Consistency of engagement performance of individual partners and branches;
- Ineffectiveness of engagement partner in the review process;
- Inadequate staff with sufficient level of experience; and
- Insufficient challenge by EQCR in high risk areas.

It is highly recommended that firms develop a robust root cause analysis as it provides a clearer understanding of the factors that underlined the inspection findings. It is encouraging to note that most of the Major Audit Firms are at various stages of formalising a root cause analysis framework, and efforts taken included the identification of a designated Root Cause Analysis team. This is consistent with the IFIAR initiative in encouraging the Big-Four global networks to develop formal procedures for root cause analysis.

Impact from AOB's Regulatory Activities

The following observations can be directly or indirectly attributed to AOB's activities to date:

AREAS

Firm's policies and processes

OBSERVATIONS

Changes and enhancements made at the firm as well as engagement levels attributed to stronger tone at the top to rectify AOB's inspection findings on the following areas:

- Issuance of new and/or enhanced templates, checklists and guidelines on certain specific areas of concern which include substantive audit procedures, sampling calculators as well as reliance on experts;
- Incorporation of new policies to enhance audit quality on the following areas:
 - Additional/expansion on scope of review of the EQCR which include review of AOB's past findings;
 - Review by the firm quality control department on specific industry concerns or high risk areas as well as identification of specific matters which require consultation with the firm quality control department;
 - Requirement for involvement of specialists/experts in the audits of PIE with specific risks or conditions such as IT auditors and valuers;
 - Enhancement to firm's policies on acceptance of new clients and assessment of firm's capacity to continue to serve as the PIEs' auditors for subsequent audit engagement.
- Design and implementation of more effective method in monitoring quality and consistency of engagement performance which includes introduction of new IT systems and/or incorporating project management tools in the existing audit systems for major firms.

AREAS

Firm structure

OBSERVATIONS

AOB observed instances of changes made to the firm structure to address inspection findings at the firm and/or specific engagement levels as follows:

Continuous review of partner's portfolio to achieve a sustainable ratio (total PIE and non-PIE per partner) which includes rebalancing exercise, promotion of new partners and resignation from certain PIE audits;

- Creation of a specific pool of personnel to be involved in the audit of specialised industries such as financial institutions, insurance, fund management, property development and public infrastructure; and
- Enhancement to partnership agreement to include quality-related criteria such as responsibility of engagement partner towards audit quality, performance evaluation and impact on it upon occurrence of quality breaches.

AREAS

Training structure

OBSERVATIONS

Enhancements were made to certain firm's training structure to ensure the effectiveness of the training conducted which includes periodic assessment of training effectiveness, mandatory attendance by senior audit personnel to facilitate training and experience sharing, reducing number of participants per session as well as trainings conducted by external specialist on specific risk areas.

AOB further observed that there was an increase by 22% in the total training hours recorded for a selection of firms from 2013 to 2016.

AREAS

Capacity building of the auditing industry

OBSERVATIONS

Several instances where AOB's regulatory activities had indirectly impacted a selection of firms as follows:

- Increase by 18% in the total audit staff force from 2013 to 2016; and
- Increase in the total headcount in quality control department by 10% from 2013 to 2016.

Conclusion

In general, firms are observed to demonstrate positive commitment towards improving and sustaining audit quality. The leadership of the Major Audit Firms, are seen to have set a strong tone at the top which helps to cultivate the right culture and behaviour within their respective firms. For instance, AOB noted from interviews with a sample of partners from a selection of firms that have been inspected during the year, that their firms are actively addressing various challenges through various measures which include rebalancing of partners' portfolios, talent retention efforts as well as maintaining good support structure to uphold audit quality. Further, efforts are being undertaken to formalise a root cause analysis framework in most Major Audit Firms and various remediation actions are planned and implemented to address the potential root causes for the deficiencies highlighted by AOB. The Major Audit Firms in general have also established a framework linking monitoring review results to the performance evaluation and remuneration of the partners.

These efforts were reflected in the results on inspection activities where the overall percentage on number of engagements requiring significant improvements for Major Audit Firms has reduced in 2016. Improvements were also noted in the number of recurring findings observed. Notwithstanding these improvements, AOB continued to observe findings across the elements of ISQC 1 as well as engagement findings on certain key audit areas, the latter covering both complex and complicated business transactions and arrangements as well as certain basic and fundamental areas.

AOB also observed an increase in the number of engagements requiring significant improvement for Other Audit Firms in 2016, with certain actions being taken by AOB on some firms and their partners. For two Other Audit Firms inspected for the first time, significant gaps were noted in the firms' compliance with the requirements of ISQC 1. It is crucial that the Other Audit Firms intensify firm-wide efforts to promote audit quality culture and improve on its system of quality controls including appropriate monitoring mechanism. These actions should also be taken to ensure findings, such as insufficient training on accounting and auditing, lack of linkage between performance evaluation for partners and audit quality and lack of rigour in the evaluation on the firms' system of quality controls, are no longer observed in the Other Audit Firms.

The differing audit quality between Major Audit Firms and Other Audit Firms as outlined above may also be attributed by a less than robust root cause analysis, the inconsistency in the quality of remediation plans and the level of rigour in the implementation of the remediation plan. To further drive audit quality, Other Audit Firms could start with the development of a formal root cause analysis framework that could be used for internal monitoring and AOB inspection, as well as remediation plans that are specific to the actual root causes identified.

During the year, the scope for AOB inspection reviews included a focus on certain high risk areas of the financial statements which resulted from the local and global economic change. One industry in which high risk areas were more prevalent in the current climate is the oil and gas industry. However, despite the heightened risk in this industry especially in terms of impairment of assets, it is encouraging to note that AOB observed a reduction in the percentage of findings in this area as compared to the previous years.

On the other hand, AOB is concerned that findings are still observed in relation to certain basic and fundamental procedures for cash and cash equivalents, another high risk area identified. AOB would like to stress the importance of ensuring that sufficient appropriate audit evidence is obtained for high risk areas especially in this time of continuing economic uncertainty. Heightened professional skepticism and assignment of adequate resources are more crucial in the current economic climate.

Moving forward, for 2017, AOB will continue to monitor the development of industries and areas most affected by the uncertain economic climate. AOB will also focus on other high risk areas and emerging issues, most notably the new requirement to communicate Key Audit Matters under the *New and Revised Auditor Reporting Standards*. While the enhanced auditors' reports are expected to be more informative and insightful, it will be interesting to see how this will affect firms' audit focus and strategies into the foreseeable future.

Enforcement

In 2016, AOB received notable recognition for its enforcement efforts from the ACGA's CG Watch 2016. This recognition further reinforced AOB's enforcement efforts.

Enforcement has always been a key priority for the AOB given the important role which the external auditors play in the capital market.

AOB believes that to further public's interest in the preparation of high quality audit reports, enforcement actions must have a deterrent effect and communicates a strong message that AOB will hold accountable those who breached the laws and regulations.

The deterrent effect of an enforcement regime is weakened if the key players are unaware of the expectations of the market regulator and consequences of any non-compliance. In this respect, AOB has been very transparent and has continued to engage the audit firms and auditors at various levels to stress the importance of audit quality. Over the years, AOB has consistently taken action against auditors and audit firms which includes revoking the registration of an audit firm and its partners. AOB's actions have clearly set the expectation that any breach or noncompliance with the relevant laws and regulations will be investigated and punished with robust and proportionate sanctions.

Appeals to the Securities **Commission Malaysia**

Those aggrieved by AOB's action have an avenue to appeal to SC. The appeal process by SC is

completely independent of AOB which attests the independence and robustness of the appeal process. SC, pursuant to the SCMA, has the power to affirm, reverse or substitute AOB's enforcement decisions. This year, two appeals lodged by auditors that were sanctioned by AOB were heard by SC. In both cases, the SC upheld the decision by AOB.

Legal Challenges

Apart from appealing to the SC, there have been cases where certain parties have resorted to legal recourse by way of judicial review. Decisions by AOB have been subjected to judicial review and other legal proceedings by the auditors sanctioned by AOB. AOB has always been mindful of its mandate and the impact of its actions on the reputation and professional lives of auditors. As such, AOB ensures that it adheres to a robust enforcement regime where due process is consistently observed in arriving at a fair and reasonable decision. To ensure natural justice, auditors are also given numerous opportunities to defend their position and present their case. To this end, in the past, SC has successfully defended and won all the legal actions which sought to cast doubt on AOB's processes.

The matter where an audit firm and its partners had filed a judicial review application to challenge SC's decision to dismiss their appeal against AOB's decision to revoke their registration is still ongoing.

A civil suit was also filed by an auditor sanctioned by AOB and two other plaintiffs against the SC which originated from an action taken by AOB against the auditor. The civil suit, which sought among others, for a declaration that the disclosures made by the plaintiffs in relation to the financial irregularities of a PIE constituted disclosures of improper conduct under the Whistleblower Protection Act 2010.

The plaintiffs pleaded that they were immune from any civil, criminal and disciplinary proceedings. Although SC's application to strike out the civil suit was dismissed by the High Court, SC's appeal on the High Court's decision was allowed by the Court of Appeal. The plaintiffs subsequently filed an appeal to the Federal Court but withdrew the appeal on 16 November 2016.

In arriving at a just and fair decision, AOB ensures that the processes are robust and dynamic. With this in mind, AOB will uphold and defend decisions made to the fullest.



International Development

ASEAN Audit Regulators Group (AARG) and the World Bank

The Finance Professions Supervisory Centre, Indonesia (PPPK Indonesia) hosted the 4th AARG Inspection Workshop (the AARG Workshop) in Nusa Dua, Bali in January 2016. AOB, Securities and Exchange Commission, Thailand (SEC Thailand), and Accounting and Corporate Regulatory Authority, Singapore (ACRA Singapore) participated in the AARG workshop together with regulators from Cambodia, China, Japan, Hong Kong, Laos, Philippines and Vietnam.

The three-day AARG Workshop served as a platform for AARG members and fellow regulators from the region to exchange information and ideas regarding practical issues related to inspection techniques, observations and experiences.

Other issues discussed were audit regulatory governance structures and activities, risk-based inspections, good quality initiatives and best practices implemented by audit firms to improve audit quality. The World Bank was also invited to share their experiences on the implementation of public oversight programmes in Europe.

In August 2016, the 6th Annual Meeting of the AARG was held and hosted by ACRA Singapore. Over 100 participants attended which included audit regulators of eight ASEAN countries, Hong Kong and China, as well as the regional and global leadership of the Global Public Policy Committee (GPPC) audit firms.

One of the key items on the agenda of the meeting included a session with the World Bank on collaborative efforts to further raise the standard of audit quality in ASEAN. Areas of collaboration between the AARG and World Bank include capacity building workshops and technical assistance catering to the differing capacity levels of ASEAN members.

There was also dialogue conducted between regulators and audit firms on the upcoming trends and developments in the global audit landscape which includes the use of data analytics, audit quality indicators and the *New and Revised Auditor Reporting Standards*.

AOB's involvement in AARG will further promote close collaboration with regional regulators to uphold audit quality.

International Forum of Independent Audit Regulators

The Abu Dhabi Accountability Authority organised the 10th IFIAR Inspection Workshop (Workshop) in February 2016 which was attended by AOB's inspection officers.

The three-day Workshop was designed to share knowledge and practical experience among independent audit regulators who are IFIAR members and targeted for those involved in inspection activities.

The following were some of the key issues discussed at the Workshop:

- (a) An overview of an academic research that highlights the economic impact for which inspections by independent oversight authorities have on the capital markets.
- (b) Discussion on the results of IFIAR's fourth annual global survey conducted in 2015 in relation to findings from IFIAR members' inspections.
- (c) IT audit inspections inspection approaches, common issues and data analytics.
- (d) Risk-based inspections.
- (e) Key considerations in the design and development of audit inspection regimes.

In April 2016, the AOB, together with IFIAR members met in London for the IFIAR Plenary Meeting. IFIAR holds annual Plenary Meeting, during which its members meet, discuss and decide on important matters in relation to improving audit quality, and IFIAR's governance structure and operations.

The Plenary Meeting which was organised by UK Financial Reporting Council (UK FRC), enable participants to exchange information and experiences relating to inspection of audit firms and current audit issues, and also promote collaboration between audit regulators.

At the Plenary Meeting, IFIAR members approved the establishment of IFIAR's permanent Secretariat which will be hosted by the Japanese Financial Services Agency (JFSA) and the Certified Public Accountants and Auditing Oversight Board (CPAAOB). Together with the implementation of IFIAR's new Board-led governance structure, this will significantly heighten IFIAR's organisational capabilities and increase its ability to deal with global issues on audit quality effectively and efficiently.

In conjunction with the plenary meeting, IFIAR also held the second Enforcement Working Group Workshop, which focused on two most popular topics, case identification and evidence gathering.

AOB's involvement in IFIAR's initiatives further promotes its international collaboration and consistency in regulatory activity.

European Commission Acknowledges Adequacy of AOB Requirements

In 2016, the EC recognised AOB's requirements as being comparable to that complied by its EU counterparts for the purpose of transferring audit working papers and other related documents of inspection and investigation. This will facilitate

effective co-operation and mutual reliance on each other's oversight systems.

This recognition further acknowledges that Malaysia's audit framework is on par with international best practices, with its rules pertaining to public oversight, quality assurance, investigation and penalty systems for auditors which are equivalent to that of its EU counterparts.

With this recognition, AOB is now able to establish bilateral agreements with audit oversight authorities of EU member states, deepening working relationships and contributing to the shared vision of AOB and EU audit oversight regulators in enhancing audit quality.

Report on Corporate **Governance Watch 2016** issued by the Asian Corporate **Governance Association**

In September 2016, the ACGA issued the CG Watch 2016. The report highlighted that AOB "continues to perform with detailed market assessment, a solid inspections programme and strong steps in enforcement". The recognition in this report has acknowledged the work carried out by AOB over the past few years.

Engaging Audit Firms and Other Stakeholders

The New Auditor's Report – Sharing the UK Experience

On 13 and 14 January 2016, AOB organised two half-day events on The New Auditor's Report -Sharing the UK Experience. The event featured Paul George from the Financial Reporting Council (FRC), UK.

The event was intended for directors, audit committee members of PLCs and external auditors of PIEs and schedule funds. Besides sharing the UK experience in implementing the New and Revised Auditor Reporting Standards, this event also explored the potential impact of the New and Revised Auditor Reporting Standards on affected organisations and how to manage stakeholders' expectations.

Forum on Key Audit Matters

On 14 and 15 September 2016, AOB and MIA jointly organised a two full-day Forum on Key Audit Matters. The Forum was attended by 123 participants.

The invited speaker, Dan Montgomery, Chair of Auditor Reporting Implementation Working Group of the International Auditing and Assurance Standards Board (IAASB) shared insights into the identification of Key Audit Matters (KAM) for disclosure. Through the use of case studies, the Forum explored recommended practices for describing KAM in the auditor's report and documentation requirements in dealing with such disclosures.

This was followed by a panel session which discussed the Malaysian perspective and sharing by the Malaysian firms on "dry runs" performed with audit clients. The Head of AOB was a panellist during this session.

Revenue Composition – Focus on Non-Audit Services

Audit firms at the global level generally provide three types of services – audit (assurance), tax and advisory (consulting). AOB has observed similar service lines at the Malaysian level. Chart 1 shows that the proportion of revenue generated from the Big-Four global network audit practice has been on a downward trend, in contrast with the proportion of non-audit practice revenue. At the global level, the non-audit practice is the primary revenue contributor, with a steadily increasing proportion each year. The Big-Four global network firms have been actively growing their consulting and advisory practices, fuelled by their multiple acquisitions of consulting businesses from a myriad of jurisdictions.

At the local front, audit practice is still the primary revenue contributor, although its proportion to total revenue has diminished in recent years, similar to global trends. Assuming that this persists, revenue derived from Malaysia's non-audit practice may also surpass that derived from the audit practice.

Amid concerns that the growing proportion of non-audit practice revenue may undermine the audit firm's ability to maintain independence in the audits of its PIE clients, AOB has engaged with the Major Audit Firms to understand how such threats to independence are managed. In this respect, the increase in non-audit practice revenue is largely driven by the provision of services to non-audit clients which will not pose any independence issues.

Bearing in mind that registered audit firms with 10 and more partners collectively audit 94.30% of PLCs' market capitalisation and 99.24% of total NAV in Malaysia, AOB continues to emphasise the importance of appropriate focus on audit quality on a consistent basis, regardless of the audit firm's size and whether its revenue is predominantly derived from audit practice.

AOB will continue to monitor developments both at international and local fronts, and accordingly, determine the necessary course of action to be taken.

Non-audit practice (Advisory and tax) Audit practice (Assurance) 46% 54% 2011 45% 2012 55% 2013 57% 2014 58% 42% 2015 40% 60% 2016 39%

Chart 1 Proportion of Big-Four Global Network revenue derived from audit and non-audit practices

Sources: Ernst and Young Global Review, Deloitte Global Report, KPMG International Annual Review, PricewaterhouseCoopers Global Annual Review

Promoting High Quality Financial Reporting Practices

AOB continues to engage stakeholders and actively participate in various events to promote high quality financial reporting practices.

In 2016, AOB was involved in a series of round tables, seminars and dialogues with accounting bodies, universities and other relevant agencies to influence the shaping of financial reporting practices' quality and the realibility of audited financial statements of PIEs and schedule funds.

Enhancing the Accountancy Profession

AOB was actively involved in the Committee to Strengthen the Accountancy Profession

(CSAP), tasked to formulate recommendations to strengthen the accounting profession to be submitted to the Minister of Finance. The final report was submitted to the Minister of Finance in June 2015 with a total of 15 recommendations.

The recommendations among others were premised on ways the accountancy profession can better serve the economic and societal needs given the changing economic landscape and an increasingly competitive environment. The recommendation also included ways that accountancy education and training can be enhanced to ensure that there is sufficient supply of the professional accountants possessing competencies demanded by the fast-changing marketplace.

In January 2016, Finance Minister II, then Datuk Seri Ahmad Husni Hanadzlah, gave SC the mandate to establish the Implementation Committee to implement the CSAP recommendations and to meet the intended objectives of the CSAP Report.

Pursuant to this mandate, the SC has established the CSAP Implementation Committee and appointed the members of the Implementation Committee which comprise representatives from the MIA, SC, Bank Negara Malaysia (BNM), Companies Commission of Malaysia (SSM), Accountant General's Department (AGD), the Ministry of Higher Education (MOHE), and The Malaysian Institute of Certified Public Accountants (MICPA).

The current MIA President was appointed to chair the Implementation Committee. MIA was appointed to act as the Implementation Committee Secretariat and provide the necessary secretarial and administrative support.

New and Revised Auditor Reporting Standards

In recent years, AOB has continued to focus on the *New and Revised Auditor Reporting Standards* at local and regional levels. The extensive changes introduced to auditor reporting, as outlined in Diagram 1, will have the benefit of increased transparency and enhanced informational value, including:

Enhanced communications among investors, auditors and those charged with governance (TCWG) Increased attention by management and TCWG to disclosures in financial statements Renewed focus by auditors on matters to be communicated in the auditor's report Implementation of these standards will help drive the flow of useful and relevant information to the capital market, reduce speculation and promote understanding of financial statements. This will further empower investors and help structure more relevant and meaningful discussions among stakeholders. Companies and directors would also be guided to be more vigilant in areas where shareholders show heightened interest.

Issued by the IAASB and fully adopted by the MIA, the *New and Revised Auditor Reporting Standards* are effective for audits of financial statements with financial periods ending on or after 15 December 2016.

For Malaysia, this means that the *New Auditor's Report* will make its first appearance in the annual reports of PLCs with financial years ended 31 December 2016.

Regulatory Collaboration and Support

As these standards are expected to impact the wider financial reporting ecosystem (rather than be restricted to just auditors), the Steering Committee¹ was established as a joint working effort among regulators, industry and the accounting profession. Chaired by the SC, with AOB as secretariat, Steering Committee members took co-ordinated efforts to support smooth implementation of the new and revised standards in Malaysia. These culminated in numerous activities with a variety of stakeholders at local, regional and international levels.

Steering Committee members comprise representatives from SC, BNM, Bursa Malaysia, SSM, Federation of Public Listed Companies Bhd (FPLC), Institute of Internal Auditors Malaysia (IIAM), MIA and MICPA.

In 2016, AOB continued to facilitate discussions among members of the Steering Committee. In addition to key outreach activities (highlighted in Table 1) to help build capacity and generate awareness and understanding on the impact of these standards, the co-ordinated efforts among the Steering Committee members also led to:

- Regulatory changes particularly amendments to Bursa Malaysia's listing requirements on:
 - Immediate announcement of modified audit opinion and material uncertainty related to going concern (MUGC);
 - Quarterly reports disclosure on modified audit opinion and MUGC; and

- Strengthening the role of audit committees.
- Issuance of publication, Board of Directors: Are you ready for the enhanced auditors' report?, by MIA.

Sharing of Experiences – **International and Malaysian Perspectives**

Key individuals from UK FRC and IAASB were invited to share valuable insights and practical experience on implementation challenges in early-adopting the new and revised standards to audiences in Malaysia. It was noted that the

Table 1 Key outreach activities in 2016

Activity	Stakeholders	Date
New Auditor's Report – Sharing the UK Experience	Directors of PLCsAuditors of PIEs and schedule funds	Jan 2016
The New and Revised Auditor Reporting Standards: Implications to Financial Institutions	Directors of financial institutions	Jan 2016
AARG Annual Inspection Workshop	Regional audit regulators	Jan 2016
MIA-MICPA Joint Working Group Meeting	Accounting profession	Feb 2016
CG Breakfast Series with Directors: Future of Auditor Reporting – The Game Changer for Boardroom	Directors of PLCs	Mar and Jun 2016
MIA-MICPA Joint Working Group Meeting with Bursa Malaysia	Local regulatorsAccounting profession	Mar 2016
Audit Committee Conference 2016: Panel Discussion on Heightening Governance through Significant Matters	Audit committee members of PLCs	Mar 2016
Audit Committee Seminar for the Public and Private Sectors 2016 – Improving Audit Effectiveness organised by FPLC	Audit committee members	May 2016
AARG Annual Meeting with the Audit Firms	Regional regulatorsRegional Big-Four audit firms	Aug 2016
Forum on Key Audit Matters jointly organised by AOB and MIA	Auditors of PIEs and schedule funds	Sep 2016

general market reaction in every jurisdiction who had early adopted the *New Auditor's Report* has been consistently positive.

Leaders from certain Major Audit Firms in Malaysia also shared their experiences from 'dry run' sessions in identifying and drafting KAM based on previous years' audited financial statements of PLCs. These 'dry run' sessions allowed boards of directors to better understand audit procedures that had been performed and how these support the opinion expressed by the auditor on the financial statements. Initiatives such as this will accelerate the closing of the audit expectation gap between the stakeholders and auditors.

Overall, the outreach activities garnered positive

feedback from stakeholders as these standards will enrich the value of audits and their relevance. It is encouraging that the accounting profession views this as an opportunity for increased value propositions to respective audit clients, to enable companies to differentiate the quality among audit firms and to spur competition in the auditing market place.

AOB is committed towards maintaining this positive momentum by continuing to focus on key areas and game-changers such as the *New and Revised Auditor Reporting Standards* as a means to drive innovation and greater transparency in auditor's reports as well as financial reporting by Malaysian PIEs and schedule funds.

Key Audit Matters

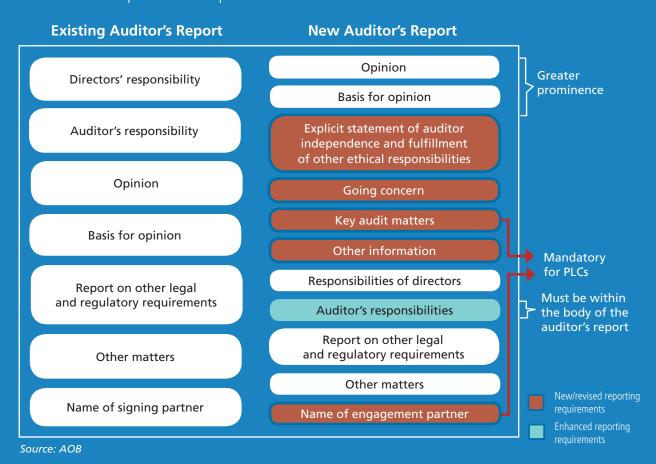
Of the various changes to the auditor's report, Key Audit Matters (KAM) received the most attention internationally. KAM was developed as part of the efforts to address the gap between information available to the market and information available to the auditor by providing some auditor insight about matters most significant to the audit to users of the financial statements.

Hence, to maximise communicative value and desired impact to stakeholders, KAM disclosures should be tailored to the entity and guided by its business model. The substance of the issues highlighted shall be the main focus, rather than only its technical aspects. Disclosures must be clear, concise, avoid ambiguity, to not overcomplicate matters, and to refrain from boilerplate disclosures or providing a mere description of audit procedures carried out.

Original information comes from the preparers while auditors are gatekeepers. With the implementation of the New and Revised Auditor Reporting Standards, preparers, senior management and directors of respective PLCs would also have to take definitive and compelling actions to elevate the quality of their respective financial reporting functions. This is in view that they will need to prepare the necessary evidence and documents to support the auditors' work and help facilitate the audit process. Audit committee oversight is equally important at this stage.

To minimise last-minute surprises, early and continuous communication among auditors, management and those charged with governance are critical for the successful implementation of these standards. Auditors are also reminded to maintain consistent delivery of value and quality regardless of the audit firm's size.

Diagram 1 The Auditor's Report – A Comparison







Rapid developments in global capital markets highlight the growing importance of safeguarding public interest. This places renewed emphasis on the importance of raising and maintaining audit quality. Standards provide a basis for mutual understanding and communications as well as enhance the quality and consistency of practice, which are integral to achieving this.

With this in mind, AOB recognises that standards development and their ensuing implementation are critical to raise the bar on audit quality. Accordingly, AOB remains committed in its participation and engagement with various stakeholders of the financial reporting ecosystem towards this end. This Part explores AOB's involvement in the standard setting arena and how certain global developments are reflected in Malaysia's local setting.

Development and Implementation of Standards and Regulations

In 2016, AOB continued to participate as an observer in meetings held by the Auditing and Assurance Standards Board (AASB) and the Ethics Standards Board (ESB) of MIA. This facilitates efforts to bridge the gap between AOB, the industry and profession in understanding different perceptions and challenges arising from current accounting and auditing issues.

This involvement has also allowed AOB to contribute its views, in particular, on areas of concern. This is in line with efforts to influence audit quality by strengthening the accounting profession through various interaction with key players in the financial reporting ecosystem. Further complementing this, AOB has shared its comments on various draft pronouncements as listed in Table 1.

Improving the structure of the IESBA Code of Ethics for professional accountants

In November 2014, the International Ethics Standards Board for Accountants (IESBA) issued a consultation paper on *Improving the Structure of the Code of Ethics for Professional Accountants* (the Code). The proposed improvements aimed to address concerns relating to the usability, adoption, implementation and enforcement of the Code.

Having considered feedback from various stakeholders, this was followed by an exposure draft, *Improving the Structure of the Code – Phase 1*, in December 2015. The exposure draft proposes restructuring of the Code while retaining its existing meaning, except in limited circumstances. Particular focus was given to avoiding inadvertent reduction of requirements or other weakening of the Code. Key changes are summarised in Diagram 1.

The AOB commends the proposed amendments for clearly distinguishing requirements from application materials. However, it is important to ensure that the enhanced structure does not inadvertently result in less prominence given to the application materials. Users need to read the application materials in context of the requirements.

Table 1 AOB comments on draft pronouncements

Comments submitted to	Draft Pronouncements
International Auditing and Assurance Standards Board (IAASB)	Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits
International Ethics Standards Board for Accountants (IESBA)	Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1
	Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client
Malaysian Institute of Accountants (MIA)	MIA Publication, Board of Directors – Are you ready for the enhanced auditors' report?

Diagram 1 Proposed key changes in restructuring the Code

Increased **prominence** of Increased clarity of responsibility Increased clarity of language application of the conceptual for compliance of firms and - simpler wording for easier framework and compliance with professional accountants understanding the fundamental principles Requirements clearly distinguished from New guide to the Code for improved navigability application material, as "R" and "A" respectively

Source: IESBA exposure draft on Improving the Structure of the Code – Phase 1

Long association of personnel with an audit or assurance client

Amid stakeholders' growing concerns on auditors' independence, both of mind and in appearance, of their audit and assurance clients, IESBA issued an exposure draft on Proposed Change to Certain Provisions of the Code Addressing the Long

Association of Personnel with an Audit or Assurance Client in August 2014. The proposals, summarised in Diagram 2, were in response to these concerns and the need to ensure that threats created by the long association of audit firm personnel with an audit client are appropriately addressed in all audit engagements. Strengthened general provisions with respect to threats created by long association.

Proposed Change to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client (August 2014)

Strengthened restrictions on types of activities that can be undertaken during the mandatory cooling-off period.

Requirement to obtain TCWG* concurrence regarding application of certain exceptions to rotation requirements.

* Those Charged With Governance

Source: IESBA exposure draft on Proposed Change to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client

Broad support was received for the proposed enhancements to the Code which allowed the conclusion of many aspects of its revised proposals. However, diversity of views and new stakeholder perspectives also indicated a need for re-exposure of certain new or revised proposals.

Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client was issued in December 2015. The proposed changes were intended to appropriately balance the public interest, stakeholder concerns regarding the need for a fresh look and considerations of global operability. Comments were sought on the length of the cooling-off period where an audit partner has served in a combination of roles during the seven-year time-on period¹. Further refinements were made to the restrictions on types of activities that can be undertaken during the mandatory cooling-off period. Regulatory safeguards set at the jurisdictional level were also considered.

AOB had no objection to the proposed changes outlined in the re-exposure draft. However, AOB reiterated that certain jurisdictions may not have sufficient resources to accommodate the extended cooling-off period from two to five and three years for the EQCR on the audit of a listed entity and PIE other than a listed entity respectively. For example, in a situation where there is a limited number of audit partners with expertise in a specialised industry, there may not be sufficient resources to perform the role of an EQCR or provide consultation should the need arise.

In January 2017, a close-off document, Changes to the Code Addressing the Long Association of Personnel with an Audit or Assurance Client, was issued. This document will be used as a basis to prepare a restructured version in accordance with the new structure and drafting conventions for the Code discussed earlier in this Part. The amendments within are effective for audits of financial statements for periods beginning on or after 15 December 2018. Certain transitional

Paragraph 290.151 of the MIA By-Laws imposes a more stringent requirement whereby the maximum time-on period is five years, in comparison to the seven years allowed in the Code.

arrangements are in place relating to the coolingoff period for engagement partners in jurisdictions where the legislative body or regulator has specified a cooling-off period of less than five consecutive years.

Once effective, partner rotation shall be applicable for all audits of PIEs. An individual shall not act as the engagement partner (EP), EQCR or any other key audit partner (KAP) role, or in a combination of these roles, for a period of more than seven cumulative years. This will be followed by the required cooling-off period, depending on the

combination of roles assumed by the individual (illustrated in Diagram 3). During the cooling-off period, consultation between the engagement team and the outgoing EP or EQCR is prohibited.

Responding to Non-Compliance with Laws and Regulations²

The AOB has been monitoring the progress of IESBA's Responding to Non-compliance with Laws and Regulations (NOCLAR) project since the first

Diagram 3 Illustrative examples – Applying partner rotation requirements in a combination of roles

Note							Year						
Note	1	2	3	4	5	6	7	8	9	10	11	12	13
(a)	•							_			_		
(b)				•	•	•	•						•
(c)	•			•	•								
(d)	•		•	•	•								•
(e)	•		•										
(f)													
 Time-on period for EP ■ Time-on period for other KAP ◆ Time-on period for EQCR ▲ Cooling-off period 													

Notes:

- Time-on period of seven cumulative years, and served as EP for four or more cumulative years. Cooling-off period shall be five consecutive years.
- Time-on period of seven cumulative years, and served as EQCR for four or more cumulative years. Cooling-off period shall be three consecutive years.
- Time-on period of seven cumulative years, served as EP/EQCR for four or more cumulative years, where individual has been EP for three or more years. Cooling-off period shall be five consecutive years.
- Time-on period of seven cumulative years, served as EP/EQCR for four or more cumulative years, where individual has been EP for less than three years. Cooling-off period shall be three consecutive years.
- Time-on period of seven cumulative years, served as EP/EQCR for less than four cumulative years, where individual has been EP for less than three cumulative years. Cooling-off period shall be two consecutive years.
- Time-on period of seven cumulative years, served as KAP. Cooling-off period shall be two consecutive years.

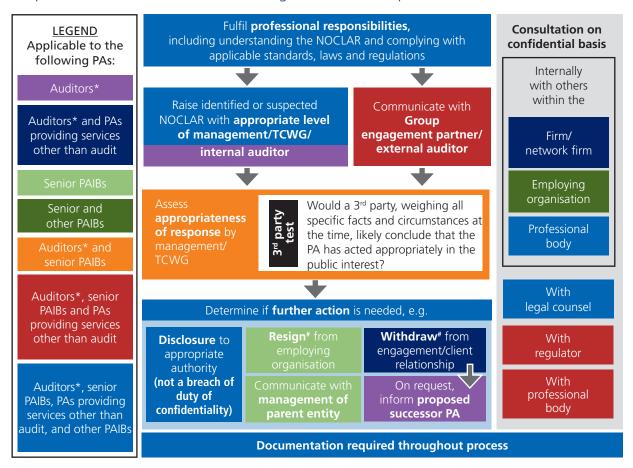
Source: IESBA Close-Off Document on Changes to the Code Addressing the Long Association of Personnel with an Audit or Assurance Client

Non-compliance with laws and regulations (NOCLAR) is any act of omission or commission, intentional or unintentional, committed by a client or employer, including by management or by others working for or under the direction of the client or employer, which is contrary to prevailing laws or regulations. NOCLAR does not include personal misconduct unrelated to the business activities of the entity - Revised IESBA Code and ISA 250 (Revised).

exposure draft on *Responding to a Suspected Illegal Act* was issued in August 2012. Incorporating feedback received from this exposure, global roundtables and various stakeholders, the re-exposure in 2015 on *Responding to Non-Compliance with Laws and Regulations* introduced a response framework to guide auditors, other professional accountants (PAs) in public practice and PAs in business (PAIBs) in deciding how best to act in the public interest when they encounter an act or suspected act of NOCLAR.

These culminated in the issuance of revised Sections 225 and 360 of the IESBA Code in July 2016, with an effective date of 15 July 2017. The finalised response framework (summarised in Diagram 4) focuses on desired outcomes in the public interest, i.e. that PAs address NOCLAR consequences with further action taken as appropriate in the public interest and on a timely basis. To facilitate this, for the first time, PAs are permitted to set aside the duty of confidentiality under the Code in order to disclose NOCLAR to appropriate authorities.

Diagram 4
Response framework when encountering identified or suspected NOCLAR



^{*} Refers to external auditor.

Source: Sections 225 and 360 of the IESBA Code on Responding to Non-Compliance with Laws and Regulations

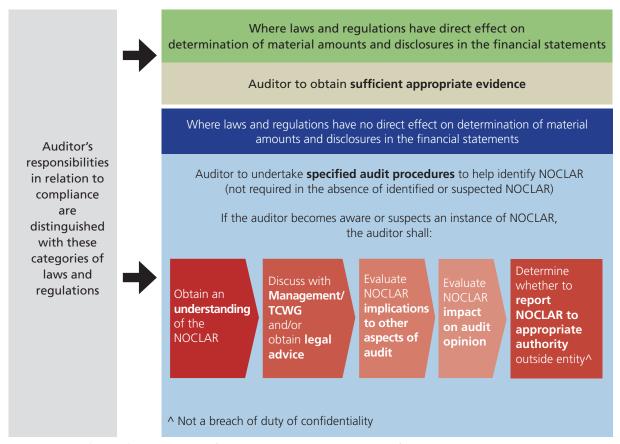
[#] Not a substitute for taking other appropriate actions under the Code.

AOB commends the new response framework for placing renewed emphasis on tone at the top while scaling responsibilities according to the capacities, influence and public expectations for respective categories of PAs. This recognises and further emphasises that all parties to the financial reporting ecosystem have an important role to play in preventing and addressing potential acts of NOCLAR.

To ensure consistency in the approach to responding to NOCLAR, IAASB issued limited amendments to ISA 250 (Revised) Consideration of Laws and Regulations in an Audit of Financial Statements in October 2016. These amendments aligned aspects of the standard related to NOCLAR to those in the revised IESBA Code, and are effective for audits of financial statements for periods beginning on or after 15 December 2017.

ISA 250 (Revised) now differentiates between two types of laws and regulations by whether they have a direct effect on the determination of material amounts and disclosures in the financial statements. This differentiation will determine the auditor's approach and audit procedures required to be performed when NOCLAR is identified or suspected (Diagram 5).

Diagram 5 Auditor's responsibilities differentiated by the effect laws and regulations have on financial statements



Source: ISA 250 (Revised) Consideration of Laws and Regulations in an Audit of Financial Statements

The responsibility of ensuring that the entity's operations are conducted in accordance with laws and regulations remains that of management, with oversight by TCWG. The auditor is not responsible for preventing NOCLAR and cannot be expected to detect NOCLAR.

Global Initiatives in Reforming the Audit Market and Practices

Enhancing Audit Quality in the Public Interest: A Focus on Professional Scepticism, Quality Control and Group Audits

In April 2016, AOB participated in a roundtable discussion on enhancing audit quality that was jointly organised by the MIA, IAASB and the Association of Chartered Certified Accountants (ACCA). It provided a platform for standard setters, regulators and the profession to share their views on key public interest issues related to professional scepticism, quality control and group audits outlined in IAASB's invitation to comment (ITC) on Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits published on 17 December 2015.

In ITC, IAASB sets out its proposals as a possible way forward to strengthen the application of professional scepticism in audits and standards addressing quality control and group audits. Input is sought from stakeholders on whether the right

issues have been identified, whether there are other issues that need to be considered, the possible causes of these issues, and necessary changes to the standards. The key proposals and considerations are outlined in Table 2.

Overall, AOB supports the commitment and efforts of IAASB towards audit quality enhancement, with current priority given to professional scepticism, quality control and group audits. These changes are timely given the rapid pace of evolving business models and technology advancements, emphasising the need to keep the ISAs fit for purpose. Relevant guidance is also essential to enable auditors to react appropriately to challenges of the evolving environment while achieving quality audits.

However, AOB emphasises that care is needed to ensure that audit quality issues arising from the application of standards are not mistaken for those arising from standard setting. There must be clear segregation between these two types of audit quality issues to effectively address the root causes of the issue at hand.

AOB recommends that any enhancements to the standard should facilitate their application and minimise divergence in practice, supported by relevant explanatory notes and guidance to clearly demonstrate the intentions behind the drafting of a particular standard. Also, while good governance, firm culture and a Quality Management Approach (QMA) may be in place, it is equally important to consider a measurable outcome to assess the effectiveness of their execution and subsequent impact on engagement performance.

or clarification is needed.

Diagram 6 Key public interest issues related to professional scepticism, quality control and group

Fostering an appropriately Reinforcing the **need for Encouraging proactive** independent and robust communication quality management challenging sceptical mindset and interactions at firm and engagement level of the auditor during the audit Exploring Focusing more on firms (including transparency Enhancing documentation networks) and their internal and external and its role in of auditor's judgements monitoring and remediation activities audit quality Keeping ISAs fit for purpose

Source: IAASB invitation to comment on Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits

Table 2 Key proposals and considerations to strengthen application of professional scepticism and standards addressing quality control and group audits

	3 1 3	
IAA	ASB key proposals and areas of focus	Key considerations
Pr	ofessional scepticism	
•	To explore what can be done to re-emphasise the important role of professional scepticism in audits of financial statements.	Factors related to the audit that can inhibit auditor's application of professional scepticism include:
•	Collaboration between IAASB, IESBA and the International Accounting Education	• Inherent cognitive bias, e.g. in the case of long-term client service relationships.
	Standards Board (IAESB) to pursue a more holistic and consistent approach to encourage	Time and resource constraints.
	a more challenging mindset of auditors.	• Environmental and contextual factors, including business environment, laws and regulations, local norms and culture in
•	To consider whether a framework should be developed and whether further guidance and/	which an auditor operates.

Documentation of professional judgements and actions provides evidence that professional scepticism was applied. It is anticipated that the New and Revised Auditor Reporting Standards (see Part 3 of this annual report) may serve to improve documentation of professional judgements made during the audit, thereby better evidencing application of professional scepticism.

Table 2 (continued)

Key proposals and considerations to strengthen application of professional scepticism and standards addressing quality control and group audits

IAASB key proposals and areas of focus

Key considerations

Quality Control

 Use of a QMA to increase focus on the importance and need for effective firm leadership, and the importance of the firm's culture and strategy.

A QMA would clarify that the firm leadership, as part of the firm's governance structure, is responsible for establishing the firm's overall culture and strategy, and thereby accountable for quality overall.

The QMA to quality control **emphasises the responsibility of firm leaders** for a more proactive, scalable and robust response to manage quality risk that would more easily adapt to a rapidly changing business environment.

Leadership by example is a key success factor for the promotion of audit quality. It is believed that tone at the top that promotes a quality-oriented internal culture will positively influence partners and audit engagement teams' behaviour and commitment to audit quality.

AOB welcomes the proposed emphasis on the responsibility of firm leaders. However, it is important to note that each firm has its own distinctive culture which drives behaviour and influences the conduct of the firm as a whole.

It is thus important that the QMA is principle-based to allow for sufficient flexibility in the implementation to achieve and maintain audit quality. The QMA must also be considered from a holistic perspective, rather than with a compliance focus, in order for it to address the substance of the quality issue.

- To address a variety of issues both at the firm and engagement level, including:
 - To clearly set out firm leadership and EP roles and responsibilities.
 - To consider whether standards need to more specifically address evolving firm and engagement team structures, e.g. shared service centres and outsourcing arrangements.
 - To consider the basis for any reliance on a firm's system of quality control, as well as reliance by a firm on network-level policies and procedures.
 - To consider whether requirements addressing policies and procedures relating to monitoring and remediation need to be strengthened, in particular to address investigation and responses to findings from external inspections.
 - To consider trends in transparency reporting at the firm and engagement level as well as whether and how the standards should or could require such reporting.
 - To consider extending the scope of engagement quality control reviews, and strengthening the roles and responsibilities of the EQCR.

Firm Governance and Leadership Responsibilities for Quality

Inclusion of firm governance as an ISQC 1 component would give more prominence to and provide more guiding principles on the accountability and responsibility of the firm leadership.

AOB wishes to highlight that the effectiveness of firm governance on audit quality is still an issue. In particular, this can be observed in the case of larger firms where governance structure is in place, but consistency and execution of the audit engagement continue to be a concern.

To certain extent, the effectiveness of firm governance could be measured based on the consistency of performance of the firm's individual partners as a result of internal or external inspection activities. This should relate back to the global and country leaderships' explanation and accountability on the performance of their network partners.

Engagement Quality Control Review

The AOB is of the view that current requirements set out in the extant ISQC 1 and ISA 220 are sufficient in addressing EQCR's responsibilities and related documentation requirements.

As such, it is recommended that any further guidance needed to address concerns raised should be incorporated into existing requirements and related application material of affected standards respectively.

AOB cautions that the development of a separate engagement quality control review standard may have the unintended consequences of diluting accountability and shifting of responsibility from EP.

Table 2 (continued)

Key proposals and considerations to strengthen application of professional scepticism and standards addressing quality control and group audits

IAASB key proposals and areas of focus

Key considerations

Group Audit

- To address concerns about the ability to effectively apply the standard to the wide variety of group structures that exists currently and will continue to evolve.
- To consider how the standard could be more flexible and whether a 'top-down' approach to designing a group audit would be more appropriate and enhance the quality of group audits.
- To address identified specific concerns relating to challenges in group audit situations, which include:
 - Acceptance and continuance of group audits, including consideration of the impact of mandatory auditor rotation where component auditors are located.
 - Access to management and information necessary for the audit.
 - Evolving group structures, including increasing use of shared service centres and sophisticated information technology systems.
 - Sufficient EP involvement when not located where majority of audit work is performed.
 - Sufficient group engagement team (GET) involvement, including in the work performed by component auditors.
 - Appropriate and effective communication between GET and component auditor.
 - Application of the concept of materiality at the component level.
 - Appropriate level of work effort of the component auditor in varying circumstances of group audits.

With regard to group audit, AOB's concerns relate to the identified risk of material misstatement.

Para 18 of ISA 330 states that irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

Para 28 of ISA 600 states that for components that are not significant components, the GET shall perform analytical procedures at a group level.

In relation to the above, AOB has found instances where there are material line items in a component which is not a significant component. The group auditor had chosen to only perform analytical procedures at the group level, which may not be sufficient to address the risk of material misstatement in a group audit

To address such situations, AOB emphasises on the need and importance of managing expectations between the group and component auditor.

Source: IAASB invitation to comment on Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits





Members of the Audit Oversight Board



From left to right: Dato' Zahrah Abd Wahab Fenner, Eugene Wong Weng Soon, Dato' Gumuri Hussain, Che Zakiah Che Din, Wong Chong Wah and Darawati Hussain



Dato' Gumuri Hussain

Appointed Executive Chairman 18 November 2016

Dato' Gumuri Hussain was a Board Member of Securities Commission Malaysia from 2006 to 2016 and Non-Executive Member of the Audit Oversight Board from 2012 to 2016.

Dato' Gumuri held numerous positions with 45 years of experience in audit, accounting, and corporate sectors. He was a Senior Partner and Deputy Chairman of the Governance Board of PricewaterhouseCoopers Malaysia, Chairman of SME Bank, Managing Director and Chief Executive Officer of Penerbangan Malaysia Bhd, Non-Executive Chairman of Sistem Televisyen Malaysia Bhd, Rangkaian Hotel Seri Malaysia Bhd, Non-Executive Director of Media Prima Bhd, Malaysian Airline System Bhd, Sabah Bank Bhd and Metrod Bhd.

Dato' Gumuri is a Fellow of the Institute of Chartered Accountants in England and Wales (ICAEW), a member of the Malaysian Institute of Accountants (MIA) and The Malaysian Institute of Certified Public Accountants (MICPA).



Eugene Wong Weng Soon

Appointed 1 March 2016

Eugene Wong Weng Soon is the Managing Director of SC and is responsible for matters relating to Corporate Finance and Investments which covers initial public offerings (IPOs), private debt issuances, collective investment schemes and take-overs. He also oversees SC's ASEAN related initiatives.

Prior to joining SC in 2009, Eugene has held positions in a merchant bank, a stockbroking company and in the audit and corporate finance divisions of international accounting firms.

He is an adviser to the Malaysian Accounting Standards Board. Eugene was the immediate past Chairman of the Ethics Standards Board of the Malaysian Institute of Accountants.

Eugene is a Fellow of the Institute of Chartered Accountants Australia and New Zealand, Fellow of CPA Australia and a member of the Malaysian Institute of Accountants. He has an Advance Diploma in Corporate Finance from ICAEW and holds a bachelor's degree in Commerce from the University of Melbourne.



Che Zakiah Che Din

Appointed 1 April 2016

Che Zakiah Che Din is currently serving with Bank Negara Malaysia (BNM) as Director of Financial Conglomerates Supervision. Prior to this, she was the Director of Development Financial Institution Regulation. She has been with the central bank for more than 33 years, focused in the area of Regulations and Supervision of Banking Institutions as well as Economics.

During the Asian financial crisis, she was seconded to MBf Finance Bhd, a company BNM assumed control. She led the team to establish the Corporate Debt Restructuring Committee (CDRC), one of three resolution agencies set up to resolve the Asian financial crisis (the others being Danaharta Bhd and Danamodal). She was also one of the key members of a working group driving the consolidation and merger of domestic banking institutions as well as the establishment of Cooperative Commission of Malaysia.

She holds a bachelor's degree in Economic (Hons) from University of Malaya.

Dato' Zahrah Abd Wahab Fenner

Appointed 3 June 2015

Dato' Zahrah Abd Wahab Fenner is the Chief Executive Officer (CEO) of the Companies Commission of Malaysia (SSM). Prior to her appointment as CEO on 1 January 2015, she was the Deputy CEO (Services), a post she held since the establishment of SSM in 2002. While serving as the DCEO (Services), her portfolio comprised the Corporate Development and Policy Division, Corporate Resource Division, Information Communication and Technology, Compliance Division, SSM Training Academy (COMTRAC) and Corporate Communications Section.

Dato' Zahrah who graduated with a Bachelor of Accounting (Hons) degree from the National University of Malaysia (UKM) is a member of the MIA and is a Chartered Accountant (CA). She is also a member of the Approval and Implementation Committee of the Iskandar Regional Development Authority (IRDA).

Dato' Zahrah was appointed as a board member for the Certification of Certified Integrity Officers which is an appointment of two years commencing from March 2015 and is also a member of the Financial Reporting Foundation (FRF). Further, Dato' Zahrah is a member of the Labuan Financial Services Authority (LFSA), member of the Board of Trustees and National Welfare Foundation of Malaysia. She was also the chairperson of the SSM Cooperative between 2011 and 2014. In 2016, Dato' Zahrah was elected as an Executive Committee member of the Corporate Registers Forum (CRF) which is an association of international corporate registries.





Wong Chong Wah

Appointed 1 April 2016

Wong Chong Wah is partner at Wong & Wong. He has over 40 years of legal experience including areas such as litigation and alternative dispute resolution, corporate and partnership law, tax, custom duties and excise, land acquisition, insurance and defamation. He is admitted to the Bar in Malaysia, Singapore and Brunei.

Wong has over 80 cases reported in the Malaysian Law Journal and other law reports. He acted as counsel for a Federal Court judge in a Constitutional Tribunal. He also appeared several times in the Privy Council as a junior counsel. He contributed to the *Malaysian Court Forms*, a Butterworths publication. He has also given lectures and contributed numerous articles on arbitration and various other subjects to legal journals.

He acts as arbitrator and counsel in arbitrations involving shareholders disputes, commercial and construction contracts. He is on the panel of arbitrators of the Kuala Lumpur Regional Centre for Arbitration and the International Chamber of Commerce Malaysia. He is also a member of the Kuala Lumpur Regional Centre for Arbitration's Panel of Adjudicators and was the sole Malaysian member of the International Court of Arbitration of the International Chamber of Commerce from 2004 to 2012.

He is named as one of the leading commercial litigators by the International Who is Who's of Commercial Litigation. He is a panel member of the Disciplinary Committee of the Bar Council and a Fellow of the Chartered Tax Institute of Malaysia. He was also a member of the listing committee of Bursa Malaysia Bhd from 2008 to 2016.

Darawati Hussain

Appointed 1 April 2016

Darawati Hussain is the Executive Director of Syalin Sdn Bhd, a family investment office. Formerly with CIMB Group, she was Director, Fund and Co-Investor Relations under the CIMB Group Strategy and Strategic Investments Division (CIMB GSSI).

She has over 20 years of experience in corporate finance, asset management and private equity, where she specialised in mergers and acquisitions, capital raising transactions and driving the initiative to set up the Shariah-compliant private equity funds. She also spent five years in London as a European equities portfolio manager for a US fund management company with asset under management (AUM) worth US\$70 billion.

Darawati is an Investment Committee member for the funds under Agensi Inovasi Malaysia and BIMB Investment Management Bhd.

She serves as an Independent Board Member of Tanah Makmur Bhd, Asiamet Education Group Bhd and Global Maritime Ventures Bhd. She is also a Director of several privatelimited companies involved in strategic crisis management communication and HSE consultancy.

Darawati was a former Chairperson of Malaysian Venture Capital and Private Equity Association (MVCA) and committee member of Malaysian Venture Capital Development Council (MVCDC) under SC and remains an active member of MVCA.

She holds a bachelors' degree in Economics and Accountancy from Durham University, UK and Master in Business Administration from London Business School, UK. She is also a Chartered Financial Analyst (CFA).



Statement on Governance

AOB is established under the auspices of SC under the SCMA to provide independent audit oversight over PIEs and schedule funds, and to ensure our regulatory framework for auditors is on par with international standards. AOB's mission is to oversee the auditors of PIEs and schedule funds, and to protect the interests of investors by promoting confidence in the quality and reliability of audited financial statements of PIEs and schedule funds. AOB's responsibilities, powers and authorities are clearly defined and transparently set out in Part IIIA of the SCMA.

About the Audit Oversight Board

The Board of SC appoints AOB members comprising an executive chairman and up to five non-executive members.

Nik Mohd Hasyudeen Yusoff retired as Executive Chairman of AOB with effect from 31 March 2016.

The Executive Chairman position of AOB is now held by Dato' Gumuri Hussain who was appointed on 18 November 2016. Four non-executive members of AOB concluded their statutory term in March 2016. They were Datuk Nor Shamsiah Mohd Yunos, Goh Ching Yin, Cheong Kee Fong and Chok Kwee Bee.

Four new members have joined the Board in 2016. They are Eugene Wong Weng Soon, Che Zakiah Che Din, Wong Chong Wah and Darawati Hussain.

A profile of AOB members is featured on pages 84 to 88.

The terms of office held by AOB members shall not exceed three years. The Executive Chairman is eligible for reappointment following the end of his three-year term, while a non-executive AOB member shall be eligible for reappointment for not more than two terms.

A person is disqualified from holding the office of AOB member if he or she is/or:

- Convicted of an offence under the law;
- Declared a bankrupt;
- Fails to attend three consecutive Board meetings of AOB without leave; and
- Not capable of discharging his or her duties.

The SCMA requires an AOB member to manage conflict of interest by disclosing his or her interest in any matter under discussion. Once the disclosure has been made, he or she:

- Shall not take part nor be present in any deliberation or decision of AOB; and
- Shall be disregarded for the purposes of constituting a quorum of AOB.

Responsibilities of the Board

The Board is responsible in assisting SC in discharging its functions under the SCMA. These responsibilities include:

- Implement policies and programmes in ensuring an effective audit oversight system in Malaysia;
- Register or recognise auditors of PIEs or schedule funds for purposes of the SCMA;
- 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 on 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 or schedule funds;
- Liaise and co-operate with oversight bodies outside Malaysia to enhance the standing of the auditing profession in Malaysia and internationally;
- Carry out inspection on person who prepares a report in relation to financial information of PIEs or schedule funds, in relation to capital market activities, as may be required to be prepared under the securities laws or guidelines issued by SC; and
- Perform such other duties or functions as AOB determines necessary or appropriate to promote high professional standards of auditors and to improve the quality of audit services provided by auditors.

AOB Meeting

Seven Board meetings were held in 2016. The quorum required is three. The attendance record is set out in Table 1.

Table 1 Attendance at Board meetings in 2016

Board member	Number of meetings attended
Nik Mohd Hasyudeen Yusoff (Retired on 30 March 2016 from the Board)) 2/2
Goh Ching Yin (Retired on 29 February 2016 from the Boa	rd) 1/1
Dato' Gumuri Hussain	6/7
Datuk Nor Shamsiah Mohd Yunos (Retired on 30 March 2016 from the Board)) 2/2
Cheong Kee Fong (Retired on 30 March 2016 from the Board)) 2/2
Chok Kwee Bee (Retired on 30 March 2016 from the Board)) 2/2
Dato' Zahrah Abd Wahab Fenner	2/7
Eugene Wong Weng Soon (Appointed to the Board on 1 March 2016)	6/6
Che Zakiah Che Din (Appointed to the Board on 1 April 2016)	4/5
Wong Chong Wah (Appointed to the Board on 1 April 2016)	5/5
Darawati Hussain (Appointed to the Board on 1 April 2016)	5/5

Committee of AOB

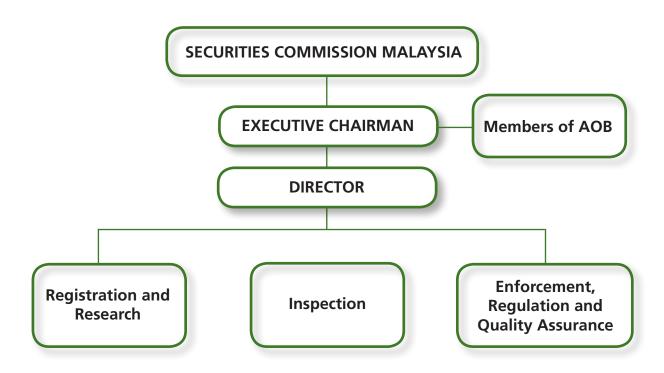
Section 31EA of the SCMA provides that AOB may establish such committees as it considers necessary or expedient to assist in the performance of its responsibilities as specified under section 31E(1) of the SCMA.

A Registration Committee was established in 2011 to determine matters regarding the approval of application for registration or recognition of auditors with AOB.

Members of the Registration Committee are:

- Nik Mohd Hasyudeen Yusoff (Retired on 30 March 2016 from the Registration Committee)
- Goh Ching Yin
 (Retired on 29 February 2016 from the Registration Committee)
- Dato' Gumuri Hussain
 (Appointed to the Registration Committee on 29 April 2016)
- Eugene Wong Weng Soon
 (Appointed to the Registration Committee on 29 April 2016)
- Dato' Zahrah Abd Wahab Fenner (Appointed to the Registration Committee on 29 April 2016)

Organisation Structure





Audit Oversight Board

Financial statements for the year ended 31 December 2016

Statement of financial position as at 31 December 2016

	Note	2016 RM	2015 RM
Assets		TAIVI	IXIVI
Current assets Other receivables Other investments Cash and cash equivalents	4 5 6	90,634 111,842 185,414	87,489 - 176,701
Total assets		387,890	264,190
Reserves and equity Funds from the Securities Commission Malaysia Accumulated deficit Total reserves and equity	7.1 7.2 7	19,016,438 (18,654,748) —	15,500,000 (15,258,510) ————————————————————————————————————
Current liabilities Other payables and accruals	8	26,200	22,700
Total liabilities	Ç	26,200	22,700
Total reserves and liabilities		387,890	264,190

The notes set out on pages 97 to 107 are an integral part of these financial statements.

Tan Sri Dato' Seri Ranjit Ajit Singh

Chairman

Securities Commission Malaysia

Date: 24 January 2017

Dato' Gumuri Hussain

Executive Chairman Audit Oversight Board

Statement of profit or loss and other comprehensive income for the year ended 31 December 2016

	Note	2016 RM	2015 RM
Income Registration fees Finance income from fixed deposits Other income	9	1,899,755 18,337 50,000	1,904,778 30,527 –
		1,968,092	1,935,305
Operating expenditure Administrative expenses	10	(5,364,330)	(5,813,835)
Deficit before tax Tax expense	13	(3,396,238)	(3,878,530)
Deficit for the year/Total comprehensive expense for the year		(3,396,238)	(3,878,530)

The notes set out on pages 97 to 107 are an integral part of these financial statements.

Statement of cash flows for the year ended 31 December 2016

Note	2016 RM	2015 RM
	(3,396,238)	(3,878,530)
	(18,337)	(30,527)
	(3,414,575) (3,145) 3,500	(3,909,057) 166 (63,586)
	(3,414,220)	(3,972,477)
	18,337 (51,842)	30,527 –
	(33,505)	30,527
	3,516,438	3,000,000
	3,516,438	3,000,000
	68,713	(941,950)
	116,701	1,058,651
	185,414	116,701
	185,414 111,842	76,701 100,000
	297,256 (111,842)	176,701 (60,000)
	185,414	116,701
	Note	(3,396,238) (18,337) (3,414,575) (3,145) 3,500 (3,414,220) (33,414,220) (33,505) 3,516,438 3,516,438 3,516,438 116,701 185,414 111,842 297,256 (111,842)

The notes set out on pages 97 to 107 are an integral part of these financial statements.

Audit Oversight Board 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 Malaysia Act 1993* (SCMA). The AOB was established for the purposes set out in Section 31B of the SCMA, 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 SCMA. 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 SCMA. The SC will continue to provide the necessary financial support to the AOB for the foreseeable future.

2. Basis of preparation

(a) Statement of compliance

The financial statements of the AOB have been prepared in accordance with Malaysian Financial Reporting Standards (MFRSs) and International Financial Reporting Standards.

The following are accounting standards, amendments and interpretations that have been issued by the Malaysian Accounting Standards Board (MASB) but have not been adopted by the AOB.

MFRSs, Interpretations and amendments effective for annual periods beginning on or after 1 January 2017

- Amendments to MFRS 107, Statement of Cash Flows Disclosure Initiative
- Amendments to MFRS 112, Income Taxes Recognition of Deferred Tax Assets for Unrealised Losses
- Amendments to MFRS 12, Disclosure of Interests in other Entities (Annual Improvements 2014-2016 Cycle)

MFRSs, Interpretations and amendments effective for annual periods beginning on or after 1 January 2018

- MFRS 9, Financial Instruments (2014)
- MFRS 15, Revenue from Contracts with Customers
- MFRS 15, Revenue from Contracts with Customers Clarifications to MFRS 15, Revenue from Contracts with Customers
- Amendments to MFRS 2, Share-based Payment Classification and Measurement of Share-based Payments Transactions
- Amendments to MFRS 4, Insurance Contracts Applying MFRS 9 Financial Instruments with MFRS 4, Insurance Contracts
- Amendments to MFRS 1, First-time Adoption of Malaysian Financial Reporting Standards (Annual Improvements 2014-2016 Cycle)
- Amendments to MFRS 128, Investments in Associates and Joint Ventures (Annual Improvements to MFRS Standards 2014-2016 Cycle)
- Amendments to MFRS 140, Investment Property Transfers of Investment Property
- IC Interpretation 22, Foreign Currency Transactions and Advance Consideration

MFRSs, Interpretations and amendments effective for annual periods beginning on or after 1 January 2019

MFRS 16, Leases

MFRSs, Interpretations and amendments effective for a date yet to be confirmed

Amendments to MFRS 10, Consolidated Financial Statements and MFRS 128, Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The AOB plans to apply the abovementioned standards, amendments and interpretations that are applicable and effective from its annual periods beginning on or after 1 January 2017, 1 January 2018 and 1 January 2019, respectively.

The initial application of the accounting standards, amendments or interpretations are not expected to have any material financial impacts to the current period and prior period financial statements of the AOB.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis other than as disclosed in Note 3.

(c) **Functional and presentation currency**

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

(d) Use of estimates and judgements

The preparation of the financial statements in conformity with MFRSs requires management to make judgements, 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 judgements 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 AOB, unless otherwise stated.

(a) Financial instruments

(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

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(c)).

Financial liabilities

All financial liabilities are subsequently measured at amortised cost.

(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 control of the asset is not retained or substantially all of the risks and rewards of ownership of the financial asset are transferred to another party. 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 the 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, 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) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances and deposits with banks which have an insignificant risk of changes in fair value with original maturities of three months or less, and are used by the AOB in the management of their short term commitments. For the purpose of the statement of cash flows, cash and cash equivalents are presented net of restricted deposits.

(c) **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.

If, in a subsequent period, the fair value of the financial asset increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, to the extent that the asset's carrying amount does not exceed what the carrying amount would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in profit or loss.

(d) Income

(i) Registration fees

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

(ii) Finance income

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

(e) Employee benefits

(i) Short-term employee benefits

Short-term employee benefit obligations in respect of salaries, annual bonuses, paid annual leave and sick leave are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid if the AOB has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) State plans

The AOB's contributions to statutory pension funds are charged to profit or loss in the financial year to which they relate. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

(f) Fair value measurement

Fair value of an asset or a liability is determined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The measurement assumes that the transaction to sell the asset or transfer the liability takes place either in the principal market or in the absence of a principal market, in the most advantageous market.

For non-financial asset, the fair value measurement takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

When measuring the fair value of an asset or a liability, the AOB uses observable market data as far as possible. Fair value are categorised into different levels in a fair value hierarchy based on the input used in the valuation technique as follows:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that the AOB can access at the measurement date.

Level 2: inputs other than quoted prices included within Level 1 that are observable for

the asset or liability, either directly or indirectly.

Level 3: unobservable inputs for the asset or liability.

The AOB recognises transfers between levels of the fair value hierarchy as of the date of the event or change in circumstances that caused the transfers.

Other receivables 4.

		2016 RM	2015 RM
	Deposits Prepayments Interest receivable	82,714 6,805 1,115	80,684 6,805 –
		90,634	87,489
5.	Other investments	2016 RM	2015 RM
	Deposits placed with a licensed bank	111,842	

Deposits placed with a licensed bank is restricted to be utilised for planning and implementing capacity building programmes in relation to the accounting and auditing profession.

6. Cash and cash equivalents

2016	2015
RM	RM
185,414	76,701
–	100,000
185,414	176,701
	185,414

Included in deposits placed with a licensed bank in the previous year was RM60,000 restricted to be utilised for planning and implementing capacity building programmes in relation to the accounting and auditing profession.

The cash and cash equivalents are placed with a licensed bank.

22,700

26,200

7.	Tota	al reserves and equity	Note	2016 RM	2015 RM
		s from the Securities Commission Malaysia mulated deficit	7.1 7.2	19,016,438 (18,654,748)	15,500,000 (15,258,510)
	Total	reserves and equity		361,690	241,490
	7.1	Funds from the Securities Commission	on Malay	sia	
				2016 RM	2015 RM
		Contribution: At the beginning of the year Additions		15,500,000 3,516,438	12,500,000 3,000,000
		At the end of the year		19,016,438	15,500,000
	7.2	Accumulated deficit		2016 RM	2015 RM
		e beginning of the year it for the year		(15,258,510) (3,396,238)	(11,379,980) (3,878,530)
	At th	e end of the year		(18,654,748)	(15,258,510)
8.	Oth	er payables and accruals		2016 RM	2015 RM

Accruals

9. Finance income from fixed deposits

9.	rinance income from fixed deposits		
		2016	2015
		RM	RM
	Interest income of financial assets that are not at fair value		
	through profit or loss	18,337	30,527
	5 .		
40			
10.	Administrative expenses		
		2016	2015
		RM	RM
	The administrative expenses consist of:		
	Auditors' remuneration	20,000	20,000
	Honorarium payment	72,502	45,076
	Non-executive members' allowance	121,500	86,000
	Other miscellaneous charges	288,570	231,144
	Rental of premises	341,278	342,018
	Staff costs	4,520,480	5,089,597
		5,364,330	5,813,835

11. Financial instruments

11.1 Categories of financial instruments

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

- (a) Loans and receivables (L&R); and
- (b) Financial liabilities measured at amortised cost (FL).

	Carrying		
	amount	L&R	FL
	RM	RM	RM
2016			
Financial assets			
Other receivables*	83,829	83,829	_
Other investments	111,842	111,842	_
Cash and cash equivalents	185,414	185,414	_
	381,085	381,085	_
Financial liabilities			
Other payables and accruals	(26,200)	-	(26,200)

Financial assets

i manciai assets			
Other receivables*	80,684	80,684	-
Cash and cash equivalents	176,701	176,701	-
	257,385	257,385	-
Financial liabilities			
Other payables and accruals	(22,700)	-	(22,700)

^{*} Excluding prepayments

11.2 Gains arising from financial instrument

	2016	2015
	RM	RM
Gains on:		
Loans and receivables	18,337	30,527

11.3 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.

11.4 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.

11.5 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 receives financial support from the SC to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when they fall due.

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
2016			
Financial liabilities			
Other payables and accruals	26,200	26,200	26,200
2015			
Financial liabilities			
Other payables and accruals	22,700	22,700	22,700

11.6 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.

11.6.1 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:

	2016	2015
	RM	RM
Fixed rate instruments		
Financial assets	111,842	100,000

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.

11.7 Fair values

The carrying amounts of cash and cash equivalents, other receivables, other payables and accruals reasonably approximate their fair values due to the relatively short-term nature of these financial instruments.

12. Fund management

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.

13. Tax expense

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.

14. Authorisation of financial statements

The financial statements for the year ended 31 December 2016 were authorised by the SC for issuance and signed by the Chairman of the SC and Executive Chairman of AOB on 24 January 2017.

Audit Oversight Board STATUTORY DECLARATION

I, Vignaswaran A/L Kandiah, the officer primarily responsible for the financial management of Audit Oversight Board, do solemnly and sincerely declare that the financial statements set out on pages 94 to 107 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 24 January 2017

Vignaswakah A/L Kandiah

Officer

Before me:

XOHD IBRAHIM)BIN YAAKOB

Unit 50-10-1, Tingkat 10 Wishaa UOA Damansara No. 50, Jalan Dungun **Bukit Damansara** 50490 Kuala Lumpur.

INDEPENDENT AUDITORS' REPORT To the Audit Oversight Board, Securities Commission Malaysia

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the Audit Oversight Board (AOB), which comprise the statement of financial position as at 31 December 2016, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, as set out on pages 94 to 107.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the AOB as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with Malaysian Financial Reporting Standards and International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with approved standards on auditing in Malaysia and International Standards on Auditing. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our auditors' report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence and Other Ethical Responsibilities

We are independent of the AOB in accordance with the By-Laws (On Professional Ethics, Conduct and Practice) of the Malaysian Institute of Accountants (By-Laws), and the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the By-Laws and the IESBA Code.

Responsibilities of Commission Members of the Securities Commission for the Financial Statements

The Commission Members of the Securities Commission Malaysia (SC) are responsible for the preparation of financial statements of the AOB that give a true and fair view in accordance with Malaysian Financial Reporting Standards and International Financial Reporting Standards. The Commission Members are also responsible for such internal control as the Commission Members determine is necessary to enable the preparation of financial statements of the AOB that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements of the AOB, the Commission Members of the SC are responsible for assessing the AOB's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Commission Members of the SC either intend to liquidate the AOB or to cease operations, or have no realistic alternative but to do so.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements of the AOB as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with approved standards on auditing in Malaysia and International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with approved standards on auditing in Malaysia and International Standards on Auditing, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements of the AOB, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the AOB.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Commission Members of the SC.
- Conclude on the appropriateness of the Commission Members' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the ability of the AOB to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements of the AOB or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the AOB to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements of the AOB, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that gives a true and fair view.

Other Matters

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

KPMG PLT

(LLP0010081-LCA & AF 0758) Chartered Accountants **Loh Kam Hian**

Approval Number: 02941/09/2018 J

Chartered Accountant

Petaling Jaya, Selangor Date: 24 January 2017

Acronyms and **Abbreviations**

AARG ASEAN Audit Regulators Group

AASB Auditing and Assurance Standards Board

Association of Chartered Certified Accountants **ACCA**

ACGA Asian Corporate Governance Association

Accounting and Corporate Authority, Singapore **ACRA Singapore AGDM** Accountant General's Department Malaysia

AOB Audit Oversight Board

Auditor Registration Application System ARAS Association of Southeast Asian Nations ASEAN

Asset under management AUM Bank Negara Malaysia BNM

CDRC Corporate Debt Restructuring Committee

CEO Chief Executive Officer CFA Chartered Financial Analyst

CIMB GSSI CIMB Group Strategy and Strategic Investments

CG Corporate governance CGU Cash generating unit

Capital Markets and Services Act 2007 **CMSA**

COMTRAC SSM Training Academy

Certified Public Accountants and Auditing Oversight Board **CPAAOB**

CPE Continuing Professional Education

CRF Corporate Registers Forum

CSAP Committee to Strengthen the Accountancy Profession

EC **European Commission** ΕP Engagement partner

Engagement Quality Control Reviewer EQCR

Ethics Standards Board ESB

European Union EU

FPLC Federation of Public Listed Companies Bhd

FRF Financial Reporting Foundation Group engagement team **GET GPPC** Global Public Policy Committee

International Auditing and Assurance Standards Board **IAASB** International Accounting Education Standards Board **IAESB ICAEW** Institute of Chartered Accountants in England and Wales

IIAM Institute of Internal Auditors Malaysia IESBA International Ethics Standards Board for Accountants

IFAC International Federation of Accountants

IFIAR International Forum of Independent Audit Regulators

IPO Initial public offering

IRDA Iskandar Regional Development Authority

ISA International Standard on Auditing

ISQC International Standard on Quality Control

ITC Invitation to Comment

JFSA Financial Services Agency of Japan

KAM Key audit matters KAP Key audit partner

LFSA Labuan Financial Services Authority
MASB Malaysian Accounting Standards Board
MFRS Malaysian Financial Reporting Standards
MIA Malaysian Institute of Accountants

MIA By-Laws By-Laws (On Professional Ethics, Conduct and Practice) of the MIA

MICPA The Malaysian Institute of Certified Public Accountants

MOHE Ministry of Higher Education

MUGC Material uncertainty related to going concern

MVCA Malaysian Venture Capital and Private Equity Association

MVCDC Malaysian Venture Capital Development Council

NAV Net asset value

NOCLAR Non-compliance with Laws and Regulations

PAs Professional accountants

PAIBs Professional accountants in business

PIE Public-interest entity
PLC Public-listed company

PPPK Indonesia Finance Professions Supervisory Centre, Indonesia

QMA Quality Management Approach
SC Securities Commission Malaysia
SCMA Securities Commission Malaysia Act 1993
SEC Thailand Securities and Exchange Commission, Thailand

SME Small and medium enterprise
SSM Companies Commission of Malaysia
TCWG Those charged with governance

The Code Code of Ethics for Professional Accountants

UK FRC UK Financial Reporting Council
UKM The National University of Malaysia

Definitions

Auditor An individual auditor or audit firm who is registered or

recognised under section 310 of the SCMA as a registered auditor or recognised auditor of a PIE or schedule fund.

addition of recognised addition of a FIE of scriedule fund.

Big-Four Audit Firms Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers.

Major Audit Firms Audit firms with more than 10 partners and audit more than

50 PIEs clients with a total market capitalisation of above RM20

billion.

Other Audit Firms Audit firms other than Major Audit Firms.

Public-interest entity Entity specified in Part 1 of Schedule 1 of the SCMA:

- (a) a PLC or a corporation listed on the stock exchange;
- (b) a bank licensed under the Financial Services Act 2013;
- (c) an insurer licensed under the Financial Services Act 2013;
- (d) a takaful operator licensed under the *Islamic Financial Services Act 2013*;
- (e) an Islamic bank licensed under the *Islamic Financial Services Act 2013*;
- (f) a person prescribed as a prescribed financial institution under section 212 of the *Financial Services Act 2013* or a person prescribed as a prescribed Islamic financial institution under section 223 of the *Islamic Financial Services Act 2013*;
- (g) a developmental financial institution prescribed under the Development Financial Institutions Act 2002;
- (h) a holder of the Capital Markets Services Licence for the carrying on of the regulated activities of dealing in securities, dealing in derivatives or fund management;
- (i) an exchange holding company approved under the securities laws;
- (j) an exchange approved under the securities laws;
- (k) a central depository approved under the securities laws;
- (l) a clearing house approved under the securities laws;
- (m) a self-regulatory organisation recognised under the

securities laws;

- (n) a private retirement scheme administrator approved under the securities laws;
- (o) a trade repository approved under the securities laws;
- (p) the Capital Market Compensation Fund Corporation;
- (q) any other person as the Minister may prescribe by order published in the *Gazette*.

Schedule fund

Fund specified in Part 2 of Schedule 1 of the SCMA:

- (a) a private retirement scheme approved by the SC under the *Capital Markets and Services Act 2007* (CMSA);
- (b) a unit trust scheme approved, authorised or recognised by the SC under the CMSA;
- (c) any other capital market funds as may be specified by the SC.

Top 10 Audit Firms

Top 10 Audit Firms based on PLC's market capitalisation in Malaysia.

