



Suruhanjaya Sekuriti
Securities Commission
Malaysia

**Audit Oversight Board
Annual Report 2013**

Cover:

A bridge connects two bodies of land separated by a large mass of water. In the case of audit, the audit report connects investors with financial statements. Building a bridge involves complex engineering, similar to the challenge of having quality audit where it requires collaboration and co-operation among all stakeholders.

Photo credit: Seri Wawasan Bridge, Putrajaya by Mohammad Aminullah Basir, SC Alumni

AUDIT OVERSIGHT BOARD

Securities Commission Malaysia

Suite 8-6 Level 8 Wisma UOA Damansara II 6 Jalan Semantan Damansara Heights 50490 Kuala Lumpur

Tel +603 2091 0666 **Fax** +603 2091 0600 **Website** www.sc.com.my

The cut-off date for the data included in this report was 31 December 2013.

MISSION STATEMENT

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

TABLE OF CONTENTS

Executive Chairman’s Message	v
Overview of the AOB’s Strategies	ix
PART ONE	
SUPPORT ADOPTION AND IMPLEMENTATION OF STANDARDS	1
• Recognition by the European Commission of the Malaysian Audit Oversight System	2
• Involvement in the Development and Implementation of Standards and Regulations	2
• Global Initiatives in Reforming the Audit Market and Practices	5
PART TWO	
PROMOTE HIGH QUALITY AUDIT PRACTICES	9
Registration Activities	10
• Registration of Audit Firms and Individual Auditors	10
• Recognition of Foreign Audit Firms and Individual Auditors	11
• Registration Fee for Audit Firms Undergoing Merger Activities	11
• Review of Compliance with Partner Rotation and EQCR Requirements	11
• Engagements with Audit Firms	12
Inspection Activities	14
• Introduction	14
• Summary of Activities	14
• Focus Group Discussion – Building Capacity to Support Audit Quality	16
• Overview of Findings	18
• Key Observations from Firm Level Review and Engagement Review Findings of Major Audit Firms	18
• Key Observations from Firm Level Review and Engagement Review Findings of Other Audit Firms	20
• Remediation	26
• Conclusion	27
Enforcement Activities	29
• Introduction	29
• Overview of the Findings and Cases	29
2014 Outlook	32
• 2014 Inspection Focus	32

PART THREE

INFLUENCE THE FINANCIAL REPORTING ECOSYSTEM AND LEVERAGE ON STAKEHOLDERS' SUPPORT 33

- The Financial Reporting Ecosystem and Quality of Financial Reporting 34
- ASEAN Audit Regulators Group Activities 34
- Continued Participation in IFIAR 35
- Participation in Other International Events 36
- Engaging the Accounting Profession and Leadership of Audit Firms 36
- Promoting High Quality Financial Reporting Practices 37
- Enhancing Communication with Other Stakeholders 37
- Strengthening Relationship with Other Regulators 38
- Supporting Accounting Education 38
- Committee to Strengthen the Accountancy Profession (CSAP) 38

PART FOUR

ASSESSMENT OF PERFORMANCE AND EFFECTIVENESS 41

- Introduction 42
- 2013 Performance Review 42
- Outcome of the Academic Research Report – Elements of Market Confidence in Audit Market Services: An Evaluation of Stakeholders' Expectations in Malaysia 43

PART FIVE

STATEMENT ON GOVERNANCE 47

- Members of the Audit Oversight Board 48
- Meeting Attendance 51
- Responsibilities of the Board 51
- Meeting Procedures 51
- Registration Committee 51
- Organisation Structure 52

PART SIX

FINANCIAL STATEMENTS AND OTHERS 53

- Financial Statements of the Audit Oversight Board 54
- Acronyms and Abbreviations 69
- Definitions 71

Executive Chairman's Message

It gives me great pleasure to report on the progress and outcomes of the Audit Oversight Board (AOB)'s activities for 2013.

AOB's oversight focus

While the quality of financial reporting in Malaysia is influenced by many stakeholders, audit firms have the primary role of ensuring they are structured in a way which ensures the quality of their audit remains respectable and provides confidence to other stakeholders who rely on their work. Our focus in 2013 was on activities which reinforced best practices within audit firms while at the same time encouraging them to enhance their quality control framework and ensuring controls were effectively deployed to yield quality audit.

Among the key elements of quality control which were given attention were tone set by leadership of audit firms, consistency of performance of partners within an audit network and the effectiveness of the internal monitoring systems deployed by audit firms. This theme has been our focus across all our audit oversight activities.

Audit firms which intend to register with the AOB are now required to demonstrate their compliance with the whole requirements of the International Standards on Quality Control 1: Quality Controls for Other Assurance and Related Services Engagements (ISQC1) at the point of application. In addition to this, we also engaged other audit firms which were not scoped in for our inspection. This enabled the AOB to clarify its expectations and for the firms to share their plans and challenges in



complying with ISQC1. While firms had demonstrated progress in this area, our engagements revealed that many smaller audit firms are struggling to have the quality control elements as required by ISQC1 to be effectively deployed and operationalised.

Internal monitoring processes of audit firms were given particular emphasis during our audit inspections. This was to enable the AOB to have a better picture of their scope, implementation and effectiveness. Based on our findings, we believe audit firms need to enhance this component of their quality control procedures to ensure better effectiveness.

While Major Audit Firms normally have matured technical consultation processes, with the support of their global networks, firms other than this category may not have similar capabilities. Any gap in the understanding of accounting, auditing and ethical standards would influence the quality of their audit work. We believe the accountancy profession in Malaysia should consider this issue seriously and provide support to these firms to ensure these technical requirements are met. This does not necessarily mean that firms would be able to use the smallness of the sizes to avail themselves from maintaining high technical standards in their work.

Root cause analysis a pre-condition for effective remediation

There are various reasons for the audit deficiencies noted by the AOB. Audit firms need to identify the actual root causes to understand the factors that underlie the inspection findings. This will in turn help these firms develop remedial action plans that are more sustainable and would minimise the recurrence of the deficiencies.

For the Major Audit Firms, the top potential root causes to audit deficiencies are lack of resources due to continuous high attrition rate, amount of involvement and insufficient supervision and direction by engagement partners, failure of the firms' monitoring control mechanism to surface relevant issues and lack of application of professional scepticism in evaluating audit evidence.

For the Other Audit Firms, the potential major root causes involve weak messages on audit quality by their leadership, lack of understanding of the business of audit clients, inadequate technical competencies in both accounting and auditing, insufficient technical support to safeguard audit quality which includes consultation process and internal monitoring reviews, lack of application of professional scepticism in evaluating audit evidence; insufficient involvement, supervision and direction by engagement partners and ineffective Engagement Quality Control Reviewer (EQCR).

More honest and holistic approaches in identifying root causes and devising appropriate remediation plans to address the actual drivers of the deficiencies would strengthen audit firms' system of quality control, and position audit firms in better footings.

Developments in the Malaysian auditing market

We noted that audit fees have been on the increasing trend since 2010. The audit fees charged by the top 10 audit firms went up by 6% and 9% respectively in 2011 and 2012. This, however, was

compensated by the increase in salary cost of 18% and 13% within the same period.

Availability and quality of talents remained the key challenges cited by audit firms. As our economy continues to grow, the demand for accountants has been growing with similar pace, which affected the recruitment of staff at audit firms. We foresee this as a trend that will not change in the near future.

The number of audit firms registered with the AOB was fewer at 53 in 2013 compared to 67 in 2012. However, the number of registered individual auditors increased from 293 to 302 in 2013. The larger firms have increased the numbers of partners in line with their workload, an issue which the AOB had raised in previous years.

To facilitate mergers of smaller audit firms, the AOB provided some concession to reduce the registration cost to the firms involved in the exercise.

Global development in reforming audit market and practices

There were several major developments in reforming the audit market and practices particularly in Europe and the United States in 2013.

While the United Kingdom Competition Commission (UK CC) investigating competition levels in the statutory audit market had decided against mandatory rotation of audit firms and further restrictions on audit firms providing non-audit services, it mandated the UK Financial Times of London Stock Exchange (FTSE) 350 to put their audit contract out to tender at least once every 10 years, with no "comply or explain" option.

In the US on the other hand, the US House of Representatives approved a bipartisan bill amending the *Sarbanes-Oxley Act of 2002* to prohibit the Public Company Accounting Oversight Board (PCAOB) from requiring public companies to use specific auditors or requiring the use of different auditors on a rotation basis.

In Europe, the framework of the European Union (EU) audit reform had been agreed where audit firms of public-interest entities (PIEs) will be required to rotate every 10 years, after which EU member states may allow the auditor or audit firm to continue audit of the same PIEs up to the maximum duration of 20 years, where a public tendering will be conducted. For a joint audit, a maximum duration of 24 years may be allowed by the EU member states.

The International Accounting and Assurance Standards Board (IAASB) Consultation Paper on 'A Framework for Audit Quality' was issued in January 2013 with the intention to raise awareness of the key elements of audit quality, to encourage key stakeholders to explore ways to improve audit quality, and to facilitate greater dialogue among key stakeholders on the topic. The IAASB proposed framework explores a number of elements of audit quality which are believed to be able to influence the likelihood of quality audit being consistently performed.

The PCAOB has their similar project, with a longer-term goal of tracking such measures with respect to domestic global network firms and reporting collective measures over time. It proposes a framework comprising three basic segments, i.e. audit inputs, processes, and results. The proposed framework acknowledges that external pressures, such as rapid environmental change and pressures for growth and profit, influences audit quality, and that quality activities and results can occur at several levels, including the engagement team, office or region, affiliate firm and global firm levels.

The AOB continues to monitor these developments and where necessary will consider whether some of these changes would benefit our market. We will continue to address concerns such as independence of auditors through our operations.

Equivalent recognition by the European Union

The European Commission (EC) issued a decision in June 2013 recognising the Malaysian public

oversight, quality assurance, investigation and penalty systems for auditors and audit entities as equivalent to those of Member states of the EU.

With this recognition, EU auditor regulators and the AOB may conclude co-operative agreements with a view to relying on each other's work on the supervision of auditors and audit firms. Such firms registered with the AOB in Malaysia will be able to provide auditing services to EU-based companies without additional regulation.

Enforcing standards

While the AOB has always been focusing on working with audit firms to enhance their performance, we would not hesitate to take enforcement actions against serious deficiencies and breach of ethical conducts which will affect confidence on the audited financial statements in Malaysia.

The AOB took enforcement actions against six auditors in 2013. They mainly failed to comply with the requirements of auditing standards in the performance of their audit which affected the basis of their audit judgements. There were also auditors who failed to comply with independence requirements in discharging their duties as auditors.

Continued co-operation with stakeholders

Given the complexity of the financial reporting ecosystem which extends beyond our borders, the AOB co-operated with many stakeholders in Malaysia and abroad in performing its functions.

We continue to benefit from our involvement in the International Forum of Independent Audit Regulators (IFIAR). Our participation has enabled us to be aware of the latest progress in the global audit oversight activities. The network that we have built over the years with other audit regulators has enabled the AOB to obtain the necessary information, knowhow and in some cases co-operation in our audit oversight work.

At the ASEAN level, we hosted the 2nd ASEAN Audit Regulators Group (AARG) Inspection Workshop from 14–16 January 2013. The Accounting and Corporate Regulatory Authority (ACRA) of Singapore and the Securities and Exchange Commission of Thailand (SEC Thailand), the two other members of AARG, participated in the workshop together with regulators from Cambodia, Indonesia, Laos, Vietnam, Hong Kong and Japan.

The second meeting of the AARG was held in Singapore in May 2013 where audit regulators from Malaysia, Singapore and Thailand continued to exchange views on their oversight activities, development in accounting profession and quality indicators. In conjunction with the meeting, the AARG held a dialogue with the leadership of the Big Four Audit Firms from Malaysia, Singapore and Thailand as part of the annual engagement at the ASEAN level to discuss development and effectiveness of the remediation measures to address quality issues.

Closing

Our progress made during the year was made possible with the support and assistance from our fellow regulators, professional accountancy bodies and other stakeholders. Given that we have a common stake in the quality and reliability of audited financial statements, such co-operation and support would continue to be important, moving forward. I wish to thank all of them.

I am privileged to have the counsel and guidance of my fellow AOB members. This has enabled the AOB to progress further in achieving its mission.

Finally, I would like to recognise the dedication and commitment of the staff of the AOB who have been the pillar of our performance.



Nik Mohd Hasyudeen Yusoff

OVERVIEW OF THE AOB'S STRATEGIES

The AOB aims to achieve the following desired outcomes:

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

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 strategic framework has four strategic themes, which are:

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

Support adoption and implementation of standards

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

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

Promote high quality audit practices

Our key oversight activities such as registration, inspection and inquiry are aimed at ensuring audit firms and individual auditors are committed to delivering high quality independent audits while achieving their business objectives. Towards this, 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
- Set the tone for quality through enforcement actions.

Influence financial reporting ecosystem

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

Leverage on stakeholders' support

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

PART ONE

Support Adoption and Implementation of Standards

RECOGNITION BY THE EUROPEAN COMMISSION OF THE MALAYSIAN AUDIT OVERSIGHT SYSTEM

The European Commission (EC) issued a decision in June 2013 recognising the Malaysian public oversight, quality assurance, investigation and penalty systems for auditors and audit entities as equivalent to those of Member states of the European Union (EU). This decision is based on assessments conducted by the EC with the assistance of the European Group of Auditors' Oversight Bodies (EAOB).

With this positive recognition, EU auditor regulators and the AOB may conclude co-operative agreements with a view of relying on each other's work on the supervision of auditors and audit firms. This acknowledgment validates Malaysia's on-going efforts in warranting independent audit oversight over PIEs, consequently attesting to the country's regulatory framework for auditors as being on par with international standards and best practices.

It is anticipated that many audit firms registered with the AOB in Malaysia will benefit from this recognition as it would enable them to provide auditing services to EU-based companies without additional regulation.

INVOLVEMENT IN THE DEVELOPMENT AND IMPLEMENTATION OF STANDARDS AND REGULATIONS

As in previous years, the AOB has continued to participate as an observer in meetings held by the Auditing and Assurance Standards Board (AASB) and the Ethics Standards Board (ESB) of the Malaysian Institute of Accountants (MIA). These avenues have paved the way for AOB to gain deeper insights into the perception of the profession on specific and emerging issues. It has also provided the AOB with opportunities to articulate its views on these matters.

Auditing and assurance

Key activities of the AASB in 2013 include–

- Adoption, withdrawal and implementation of IAASB pronouncements in Malaysia which included the adoption of ISA 610 (Revised 2013) *Using the Work of Internal Auditors*;
- Issuance of the Frequently Asked Questions (FAQs) on the Recommended Practice Guide No. 11 *Auditor's Report on Financial Statements Prepared in Accordance with the Malaysian Financial Reporting Standards (MFRS) Framework*;
- Issuance of the Recommended Practice Guide No. 4 (Revised) *Example of Independent Auditor's Reports*; and
- Issuance of the Recommended Practice Guide No. 5 (Revised) *Guidance for Auditors on Engagements to Report on the Statement on Risk Management and Internal Control Included in the Annual Report*.

Laying the foundation for the auditor's report of the future

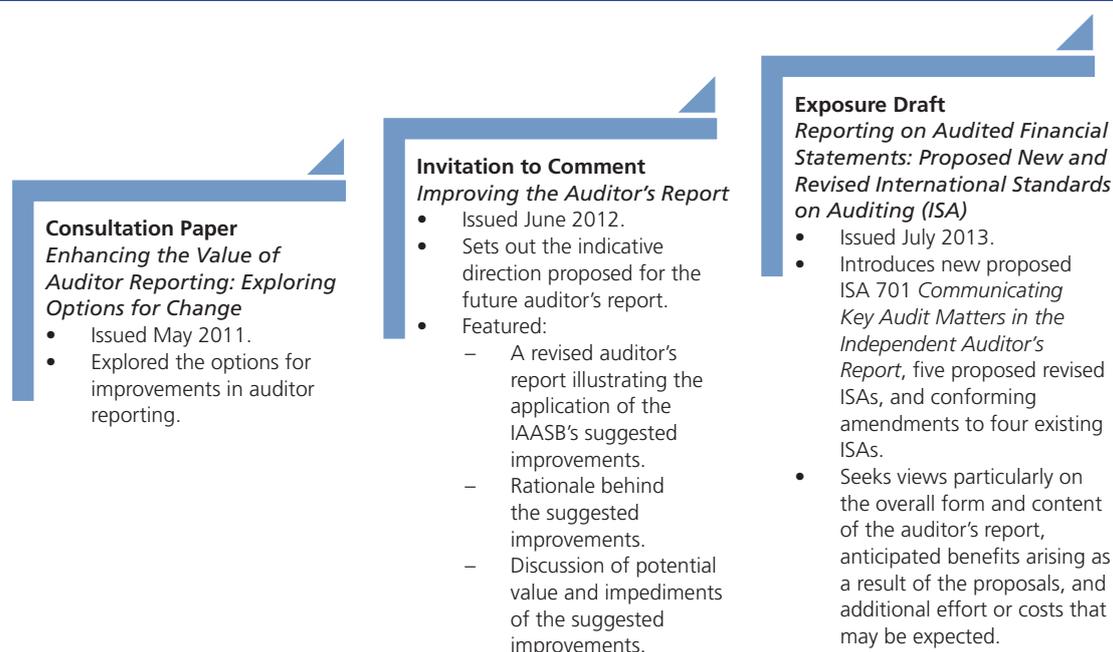
It is widely acknowledged that the auditor's report is the key deliverable addressing the output of the audit process. In the wake of the global financial crisis, there have been multiple calls for a more informative auditor's report, particularly for more relevant information to be provided based on the audit that is performed.

In response to these calls from investors, analysts, and other users of audited financial statements, the IAASB had issued three consultative documents, as depicted in the following Diagram 1.

The exposure draft, a culmination of the feedback received from the issuance of the earlier consultation paper and invitation to comment, contains the

Diagram 1

Consultative documents issued by IAASB



following proposed new and revised International Standards on Auditing (ISAs):

- Proposed ISA 700 (Revised) *Forming an Opinion and Reporting on Financial Statements*;
- Proposed ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*;
- Proposed ISA 260 (Revised) *Communication with Those Charged with Governance*;
- Proposed ISA 570 (Revised) *Going Concern*;
- Proposed ISA 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report*;
- Proposed ISA 706 (Revised) *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*; and
- Proposed Conforming Amendments to Other ISAs.

The key enhancements to the auditor's report, as proposed in the exposure draft, include—

- Prominent placement of the auditor's opinion and basis of opinion paragraphs;
- Reporting on "Key Audit Matters", i.e. matters that, in the auditor's judgement, were of most significance in the audit of the current period financial statements;
- Reporting on "Going Concern", including a conclusion on the appropriateness of management's use of the going concern basis of accounting in preparing the financial statements, as well as a statement that neither the management or the auditor can guarantee the entity's ability to continue as a going concern;
- Reporting on "Other Information" (briefly addressed later in Part One of this annual report);
- Explicit statements that:

- The auditor is independent of the audited entity; and
- The auditor has fulfilled other relevant ethical responsibilities (with disclosures of sources of those requirements);
- Disclosure of the name of the engagement partner, with a “harm’s way exemption”; and
- Improved descriptions of auditor’s responsibilities and key features of audit, whereby certain components may be relocated to an appendix in the auditor’s report, or reference made to such description on a website of an appropriate authority.

The AOB supports the on-going efforts by the IAASB in improving auditor reporting, and welcomes the overall proposed form and content of the proposed auditor’s report. The proposed enhancements set out in the exposure draft are anticipated to increase the relevance of auditor reports while providing stakeholders with more information and a better understanding regarding the audit on which the reports are issued. The greater transparency advocated in these proposed amendments are also anticipated to assist significantly in narrowing the current expectation gap.

The AOB, in its annual report in 2012, had agreed that whilst auditors should say more regarding the work performed, sufficiency and appropriateness of audit evidence obtained, key judgements made and the overall conclusion of the audit, auditors should not be required to report on matters which are within the purview of those charged with governance. The AOB is thus pleased to note this is reflected in the proposed illustrative examples, which have been considerably refined and are consequently, more relevant and aligned towards being an auditor’s commentary rather than a management commentary.

However, with the introduction of the proposed enhancements to the auditor’s report, the AOB continues to caution against the inclination towards boilerplate disclosure in order to ensure continued

relevance of the proposed enhancements, in particular that of the newly introduced “key audit matters” section, so as to have the desired impact on stakeholders. There is also a need for auditors to manage the information to be included in the auditor’s report in order to ensure that the content remains at a reasonable volume without compromising the communicative value of those disclosures.

Reporting on ‘Other Information’

The IAASB has undertaken a project to revise the ISA 720 *The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements* to evolve the requirements so that they remain sufficient and relevant in the context of today’s financial reporting environment, while not extending the scope of the auditor’s opinion to cover the other information.

The ensuing proposed ISA 720 (Revised) *The Auditor’s Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor’s Report Thereon* issued in November 2012 recognises the significant changes in financial reporting over the last two decades regarding the information issued in connection with an entity’s financial statements and the evolution in the manner in which such information is disseminated and communicated to stakeholders.

Essentially, the scope of the proposed ISA 720 (Revised) will encompass other information in documents containing and accompanying audited financial statements and the auditor’s report thereon. In addition, the proposed ISA 720 (Revised) clarifies and enhances the scope and focus of auditor efforts on ‘other information’ to include the concept of initial release.

The auditor will be required to read and consider the other information in light of the understanding of the entity and its environment the auditor has acquired during the course of the audit, and to respond appropriately when the auditor identifies a potential material inconsistency in the other

information or a material misstatement in the audited financial statements.

Generally, the AOB welcomes the proposed principles-based approach, and is in agreement with broadening the scope of the proposed ISA 720 (Revised) to include documents that accompany the audited financial statements and the auditor's report. The AOB is also of the view that the concept of 'initial release' which may differ from the date the financial statements are issued as defined in ISA 560 *Subsequent Events* is clear and understandable. However, the AOB believes that the interpretation of other information, in particular with regard to the qualitative aspects of such interpretation, contains the element of subjectivity which may inadvertently lead to inconsistency of practice among auditors.

With regard to the proposed amendments to the auditor's responsibilities towards the other information, the AOB is further concerned that the element of subjectivity involved may negatively influence the scope of audit procedures covered by the auditor. These amendments may also contribute towards further confusion in relation to stakeholders' overall understanding of the auditor's responsibilities, resulting in widening the expectation gap between the auditors and readers of the auditor's report.

Notwithstanding that the IAASB had stated in its explanatory memorandum that likely costs and benefits of alternative approaches had been considered, the AOB cautions that the likelihood incremental in the costs – which may include the increase in underlying risk to the auditor as a result of assuming additional responsibility – should not outweigh the benefits or the overall quality and enhanced value from the proposed ISA 720 (Revised).

Ethics

With regard to the ESB, the following changes to the International Ethics Standards Board for Accountants (IESBA) *Code of Ethics for Professional Accountants* have been adopted and incorporated into the MIA By-Laws (On Professional Ethics, Conduct and Practice) in 2013:

- Changes to the *Code of Ethics for Professional Accountants* Related to Provisions Addressing a Breach of a Requirement of the Code;
- Changes to the *Code of Ethics for Professional Accountants* Addressing Conflicts of Interest;
- Change to the Definition of "Engagement Team" in the *Code of Ethics for Professional Accountants*; and
- Changes to the Definition of 'Those Charged with Governance'.

During 2013, as part of the monitoring exercise on partner rotation, the AOB also discovered that there were ambiguous interpretations of the MIA By-Laws by various auditors with respect to the partner rotation requirements¹. An explanation was sought from MIA and following this, the MIA issued a circular on 17 April 2013 to clarify that the partner rotation requirement applies to an 'individual', and not to the firm.

GLOBAL INITIATIVES IN REFORMING THE AUDIT MARKET AND PRACTICES

In 2013, the AOB continued to monitor global efforts in reforming the audit market towards achieving better quality. Developments have been particularly noted with regard to the mandatory

¹ Section 290.151 of MIA's By-Laws (On Professional Ethics, Conduct and Practice) requires that an individual shall not be a key audit partner for more than five years in respect of the audit of any PIE. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the said client for two years.

rotation of audit firms, mandatory tendering of audit contracts and prohibition of audit firms from providing non-audit services to audit clients, as well as audit quality.

Mandatory rotation of audit firms, tendering of audit contracts and restrictions in the provision of non-audit services

An overview of the developments in various jurisdictions with regard to the mandatory rotation of audit firms and/or tendering of audit contracts, as well as restrictions in the provision of non-audit services are as follows:

- **United Kingdom**

Amendments to the *UK Corporate Governance Code* by the Financial Reporting Council (FRC) in 2012 had required the FTSE 350 companies to put their external audit contracts out to tender at least every 10 years, whereby an explanation was required if they failed to do so. These amendments were part of efforts taken to ensure a high-quality and effective audit.

In July 2013, the UK CC investigating competition levels in the statutory audit market decided against mandatory rotation of audit firms and further restrictions on audit firms providing non-audit services.

The final decision by the UK CC in October 2013 mandated the UK FTSE 350 to put their audit contract out to tender at least once every 10 years, with no 'comply or explain' option. The UK CC had emphasised that no company will be able to delay beyond 10 years, and opined that many companies would benefit from going out to tender more frequently at every five years.

- **United States of America**

In July 2013, the US House of Representatives approved a bipartisan bill amending the *Sarbanes-Oxley Act of 2002* to prohibit the

Public Company Accounting Oversight Board (PCAOB) from requiring public companies to use specific auditors or requiring the use of different auditors on a rotating basis.

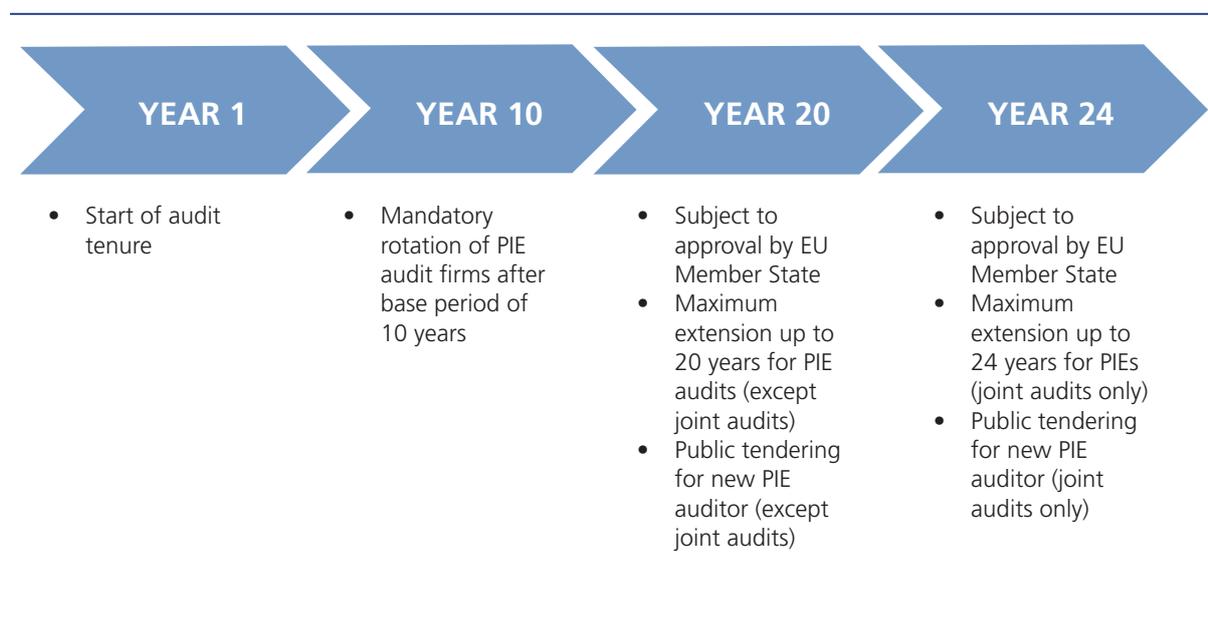
The bill is particularly intended to clarify that the US is not headed towards the adoption of a mandatory firm rotation requirement, which was apparently misconstrued with the continued consideration of the PCAOB Concept Release No. 2011-006 on *Auditor Independence and Audit Firm Rotation* issued in August 2011.

- **European Union**

In December 2013, the Committee of Permanent Representatives (COREPER) approved the agreement between the Lithuanian presidency of the Council of the EU and the European Parliament on the framework of the EU audit reform, the key elements of which are as follows:

- (i) The supervision of auditors in the EU will be led by the Committee of European Auditing Oversight Bodies (CEAOB), using the experience of the European Securities and Markets Authority (ESMA) in the sphere of international co-operation between EU member states and third countries;
- (ii) Audit firms of PIEs will be required to rotate every 10 years, after which EU member states may allow the auditor or audit firm to continue audit of the same PIEs up to the maximum duration of 20 years, where a public tendering will be conducted. For a joint audit, a maximum duration of 24 years may be allowed by the EU member states. This is depicted in Diagram 2;
- (iii) Fees generated from non-audit services rendered to an audit client will be capped at 70% of the audit fee; and
- (iv) Audit firms will be strictly prohibited from providing certain non-audit

Diagram 2

EU Proposed Mandatory Rotation Timeline for PIE Audit Firms

services to audit clients, in particular tax advice and services linked to the financial and investment strategy of the audited PIEs. However, EU member states will have the right to allow some tax and valuations services to be provided if these services are immaterial and have no direct effect on the audited financial statements.

The proposals detailed in the preliminary agreement are subject to formal approval in the Competitiveness Council of the EU and a plenary vote in the European Parliament.

Measuring audit quality

Recent events and financial conditions have accentuated the significance and the role of credible, high-quality financial reporting in all sectors of the world economy, including the capital markets, small companies, not-for-profit and government organisations. Simultaneously, this underscores the need for continual improvement to audit quality.

The IAASB has embarked on the development of a framework that identifies the factors that contribute to audit quality at the engagement, audit firm and national levels. The IAASB Consultation Paper on a Framework for Audit Quality issued in January 2013 was intended to raise awareness of the key elements of audit quality, to encourage key stakeholders to explore ways to improve audit quality, and to facilitate greater dialogue among key stakeholders on the topic. The IAASB proposed framework explores a number of elements of audit quality which include inputs, outputs, interactions and contextual factors. These elements influence the likelihood of quality audit being consistently performed. The IAASB proposed framework also demonstrates the importance of appropriate interactions among stakeholders and of various contextual factors.

In November 2012, the PCAOB also earmarked a project to develop audit quality indicators as a priority project for 2013. The PCAOB, with a longer-term goal of tracking such measures with respect to domestic global network firms and reporting collective measures over time, proposed a framework comprising three basic segments, i.e.

audit inputs, processes, and results. The proposed framework acknowledges that external pressures, such as rapid environmental change and pressures for growth and profit, influences audit quality, and that quality activities and results can occur at several levels, including the engagement team, office or region, affiliate firm and global firm levels.

At the same time, the Center for Audit Quality (CAQ), which is affiliated with the American Institute of Certified Public Accountants (AICPA), was involved in a project to look at the definition, indicators, and measurements of audit quality. In line with this project, the CAQ has developed a resource to highlight some possible important

elements of audit quality which include the following:

- Firm leadership and tone at the top;
- Independence, objectivity and scepticism;
- Audit process, methodology and performance;
- Professional development and competency;
- Monitoring; and
- Firm organisation and structure.

As in previous years, the AOB will continue to monitor such international developments and accordingly, determine the necessary course of action to be taken.

PART TWO

Promote High Quality Audit Practices

Registration Activities

REGISTRATION OF AUDIT FIRMS AND INDIVIDUAL AUDITORS

The AOB continued to influence audit practices through its audit oversight activities primarily through its registration, inspection and enforcement functions. It is envisaged that the main outcome is for the audit firms to build capacity and quality framework which enable quality audits to be performed consistently.

In this pursuit, AOB consistently reminds the audit firms to comply with the applicable international auditing and quality control standards adopted by the accountancy profession in Malaysia. Firms to be registered with the AOB are required to demonstrate their ability to comply with the relevant quality control and auditing standards.

The number of registered audit firms and individual auditors reduced in 2013 as several audit firms

Table 1

Registration of audit firms and individual auditors as at 31 December 2013

Profile of audit firms	No. of audit firms	No. of individual auditors	No. of PIEs audited	% of market capitalisation
Partnerships with more than 10 partners	8	178	931	95.57
Partnerships with 5 – 10 partners	6	30	84	0.54
Partnerships with 2 – 4 partners	36	91	145	3.88
Sole proprietors	3	3	6	0.01
TOTAL	53	302	1,166	100.0

Table 2

Registration statistics: Comparison between 2013 and 2012

Profile of audit firms	No. of audit firms (2013)	No. of audit firms (2012)	No. of individual auditors (2013)	No. of individual auditors (2012)
Partnerships with more than 10 partners	8	6	178	144
Partnerships with 5 – 10 partners	6	9	30	44
Partnerships with 2 – 4 partners	36	43	91	96
Sole proprietors	3	9	3	9
TOTAL	53	67	302	293

exited the market while others consolidated their practices. However, the concentration of clients remained with the top 14 audit firms which collectively audit 1,015 PIEs covering 96.1% of the market capitalisation of public-listed companies (PLCs) in Malaysia.

For the year under review, the AOB did not reject any application for registration.

RECOGNITION OF FOREIGN AUDIT FIRMS AND INDIVIDUAL AUDITORS

As at 31 December 2013, the AOB recognised 16 foreign individual auditors from seven foreign audit firms who audited six foreign incorporated companies which are listed on Bursa Malaysia.

The AOB placed reliance on the oversight frameworks of the foreign auditors' home countries when considering their recognition.

Among the considerations taken into account by the AOB were whether these audit firms were required to comply with international auditing and quality control standards or whether they were subjected to regular inspection by their home regulators. During the year, the AOB further required the foreign auditors to disclose specific findings from the inspection carried out by their home audit regulators.

REGISTRATION FEE FOR AUDIT FIRMS UNDERGOING MERGER ACTIVITIES

In enhancing capacity and to improve audit quality, AOB notes a changing trend that several audit firms

may consider merging. This involves the creation of a new entity which will assume the consolidated business of the audit firms involved. In such a case, individual auditors who are partners of audit firms undergoing merger process are required to pay multiple registration fees.

To support capacity building of audit firms, the AOB has provided a concession to individual auditors who are partners of audit firms undergoing merger based on certain criteria. The individual auditors will be considered as single individual auditors for the purposes of the collection of registration fees for a period to be determined by the AOB. This will reduce the cost to be incurred by them during the transition period.

REVIEW OF COMPLIANCE WITH PARTNER ROTATION AND EQCR REQUIREMENTS

Compliance with partner rotation and EQCR requirements are among the fundamental principles in ensuring that independence of auditors and audit quality are maintained. The AOB vigilantly monitors the audit firms' compliance with partner rotation rules to ensure any possible breach of the rule is rectified at the early stage.

In 2013, the AOB issued warning letters to four audit firms which did not comply with the partner rotation requirement. The number of warning letters issued in relation to non-compliance of partner rotation rule reduced from 2012. The AOB reminded the audit firms that it will not hesitate to take stern action against the firms and its partners should the breach not be rectified. The AOB believes that the audit firms are more

Table 3

Profile of the foreign audit firms recognised by the AOB

Jurisdiction	No. of audit firms		No. of individual auditors		No. of PIEs audited	
	2013	2012	2013	2012	2013	2012
Singapore	5	4	12	10	4	5
Hong Kong	1	1	2	2	1	1
UK	1	1	2	2	1	1
TOTAL	7	6	16	14	6	7

aware of the requirement as consistent communications are in place to ensure compliance is met.

The audit firms had subsequently rectified the non-compliance either by registering a new partner under the firm or not seeking reappointment as the auditor of the PIEs concerned. Other registered partners from other registered audit firms were also engaged to act as EQCR to ensure that none of the partners breach the partner rotation requirement.

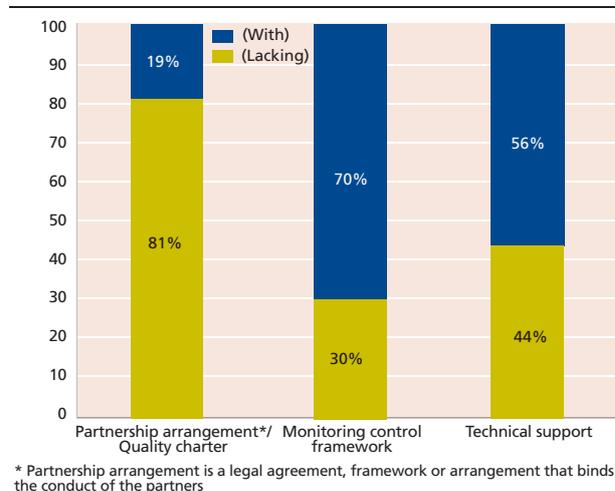
The AOB continued to monitor the firm’s appointment of EQCR for the PIEs. The standard requires an EQCR to be an individual with sufficient and appropriate experience and authority to act as an audit engagement partner for all PIEs audits, to be of equal standing with the engagement partner. The AOB continues to emphasise that the EQCR must be a registered partner with AOB. During the year, the AOB identified six audit firms which were not able to comply with the EQCR requirement and they have given their commitment to rectify the situation within the most reasonable practicable period.

ENGAGEMENTS WITH AUDIT FIRMS

Apart from the regular monitoring on the compliance with partner rotation and EQCR requirements, the AOB engaged with 27 registered audit firms prior to the renewal of their registration which were not subject to inspection during the year. The main objectives of the engagements were to gain an understanding of the firms’ business strategy, audit quality framework and challenges thereon. During the engagements, the AOB shared its expectations of the firm’s commitment in ensuring quality audit work and that the audit firm invests in the relevant infrastructure and training to support delivery of quality audit work.

Chart 1 shows that 81 % of the audit firms indicated that they did not currently have an established partnership arrangement or quality charter in place. The AOB views that it is essential for audit firms to have a structured partnership arrangement which should bind the conduct of the partners to ensure

Chart 1
Observations from the engagement with the audit firms not yet inspected



* Partnership arrangement is a legal agreement, framework or arrangement that binds the conduct of the partners

Source: AOB

that the partners are cognisant of their professional duties and the consequences of not discharging their professional duties in compliance with the auditing and ethical standards, and the relevant applicable laws and regulations.

The AOB requires all audit firms to have a monitoring control framework to conform with the requirements of the ISQC1 and ensure the emphasis on audit quality internally. From the engagement with audit firms, approximately 70% of the audit firms indicated that they have the framework in place and the remaining was in the process of setting up. The AOB views this crucial as the situation should not be prolonged any further. For those audit firms that already have in place the control monitoring framework, it is important to ensure the effectiveness in detecting non-compliance issue.

Technical support is viewed as one of the important factors that influences quality audit. Without proper understanding and application of the accounting and auditing standards, this may impair the delivery of quality audit work. From the data collected, approximately 56% of the audit firms indicated that they have the technical support either internally, by the network firms or externally as provided by professional bodies. The AOB reminds the audit firms of the importance of having

the right resources to support a quality technical team.

The AOB supports the commitment of audit firms to continually strive to improve their audit practices. It is also important to ensure timeliness of ensuring all elements of IQSC1 are in place and operates effectively.

Common challenges shared by the audit firms

During the engagements, the audit firms further shared challenges faced in their practices. These include lack of resources due to challenges in getting quality graduates, retention of staff, robust development in accounting standards, training fatigue, and higher compliance and salary costs.

The AOB acknowledges that one of the main challenges is the increase in salary costs. In this

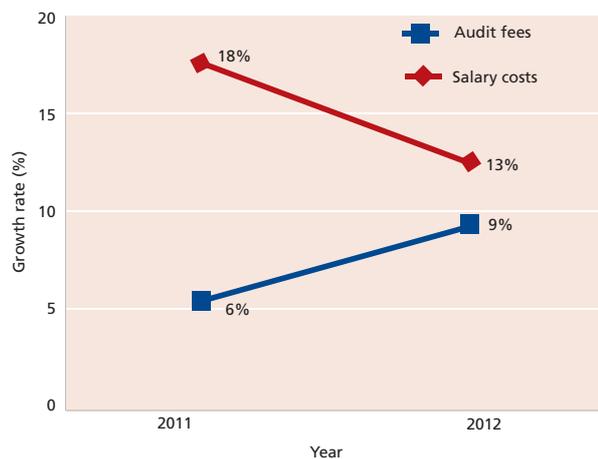
respect, the AOB further gathered statistics on audit fees in comparison to the increase in salary costs from the top 10 audit firms which audit PIEs in Malaysia.

Chart 2 shows the growth rates for the top 10 audit firms in Malaysia in terms of statutory audit fee and salary costs. While the audit fees had increased from 6% to 9% in 2011 and 2012 respectively, the salary costs remained higher than the audit fees at 18% and 13% for both years.

Chart 3 depicts the aggregated total revenue generated from audit fees and salary costs for the top 10 audit firms in Malaysia for 2010, 2011 and 2012.

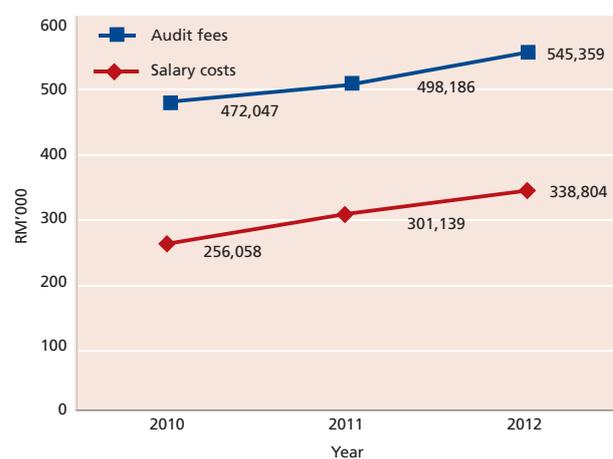
In conclusion, the data supports the feedback of continuous increase in salary costs which is at a rate higher compared to the growth in audit fees. This is one of the main challenges for the audit firms in the long term.

Chart 2
Growth rates in audit fees and salary costs for top 10 audit firms in Malaysia



Source: AOB

Chart 3
Total audit fees vs salary costs of top 10 audit firms in Malaysia



Source: AOB

Inspection Activities

INTRODUCTION

In achieving its mission to foster high quality independent auditing that promotes confidence in the quality and reliability of the financial statements of PIEs in Malaysia, the AOB conducts inspections on the auditors of PIEs in accordance with section 31V(1) of Part IIIA of the *Securities Commission Act 1993* (SCA). An inspection includes the assessment of the degree of compliance by the auditors with the auditing and ethical standards applicable in Malaysia, including the quality of the audit reports prepared by the auditors relating to the audited financial statements of the PIEs.

As a consequence to inspection observations, the audit firms and auditors are required to identify the root causes of the observations in order to carry out appropriate remedial actions that would enhance audit quality.

SUMMARY OF ACTIVITIES

The AOB conducts regular inspections annually on audit firms which have more than 10 partners and audit more than 40 PIEs with a total market capitalisation of above RM15 billion (collectively referred to as "the Major Audit Firms"). In 2013, six audit firms were identified in this category which audit approximately 94% of the PIEs listed on the stock exchange, by market capitalisation.

On the other hand, regular inspections on mid-tier audit firms and sole proprietors (the Other Audit Firms) are completed within a pre-determined inspection cycle. During the year, the AOB

conducted regular inspections on five Other Audit Firms, two of which were mid-tier audit firms previously inspected in 2011. In total, the AOB conducted regular inspections on 11 audit firms which audit over 95% of the market capitalisation of PLCs and over 80% of the total number of PIEs.

The regular inspections comprised the following:

- An assessment of the audit firms' emphasis on audit quality focusing on–
 - The firms' overall quality control and compliance with International Standards on Quality Control 1: Quality Controls for Other Assurance and Related Services Engagements (ISQC1) and the MIA By-Laws; and
 - The firms' self-governance and monitoring mechanisms relating to audit quality
- The review of the work of the firms' auditors on selected audit engagements of PIEs for compliance with the ISA; and
- Follow-up of remediation plans from previous inspection visit(s).

During the year, focus group discussions were held with selected audit firms to obtain feedback from different staff levels on topics relating to various aspects of ISQC1 to encourage capacity building and drive messages on audit quality.

Selection of audit engagements for inspection takes into consideration specific industries and their

respective areas of concern in addition to selecting engagements based on size. The AOB's selection consideration included the following thematic focus:

- Audit engagements of insurance PIEs focusing on valuation of financial assets, insurance contract liabilities and revenue recognition involving IT audit;
- Audit engagements of property development and construction PIEs focusing on the areas involving estimation and judgement; and
- Audit engagements involving the work of component auditors not audited by the audit firm under inspection.

The AOB also conducted a special inspection to respond to certain concerns over the quality and reliability of the audited financial statements of a PIE.

To be more effective in its regulation in promoting improvement in audit quality on a more sustainable manner, the AOB finds it important that the audit industry's capabilities and accountabilities need to be further strengthened through more intense engagements and discussions. Accordingly, in addition to its regular and special inspections,

the AOB actively engaged with audit firms throughout the year, either individually or collectively.

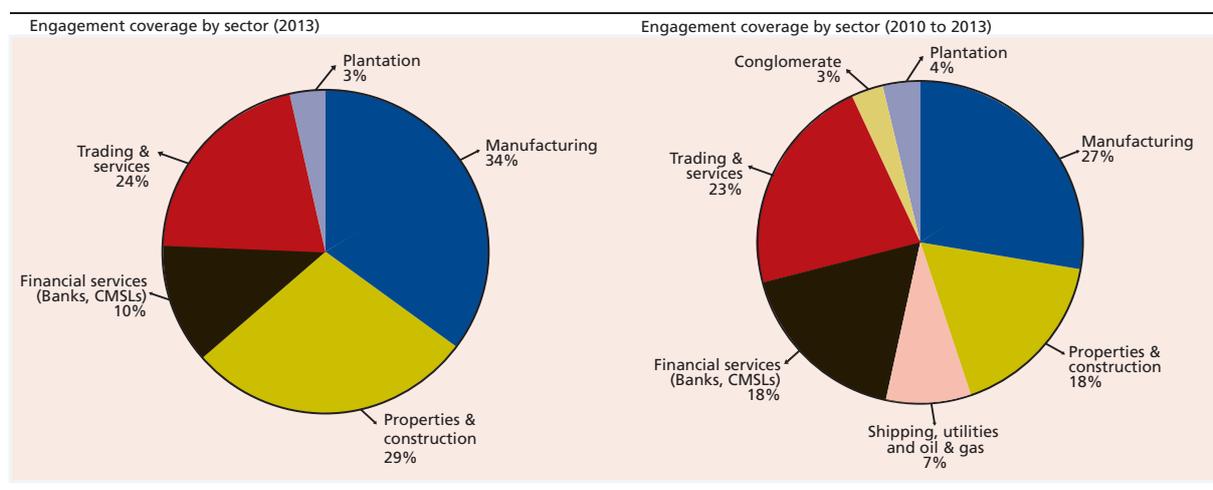
Table 4
Inspection coverage in 2013

	Major Audit Firms	Other Audit Firms	Total
No. of firms inspected	6	6*	12
No. of individual partner inspected	14	25	39
No. of audit engagement inspected	13	25	38

*includes one special inspection

For the individual firm engagements, there will be in-depth discussions on specific matters relating to the individual firm's business strategy, internal governance, efforts on capacity building, remediation progress on past inspection findings and audit challenges. During these discussions, the AOB will provide feedback and set expectations on the audit firms to ensure that the firms have the capacity and technical competencies to accept and audit PIEs without any compromise to audit quality.

Chart 4
An analysis by sector of the audit engagements inspected in 2013 and to date



In relation to the collective engagements, forums and dialogues were held with the audit firms either directly or through the accounting profession. Such dialogues are targeted on generic issues affecting the audit firms. The AOB conducted/participated the following forums and dialogues in 2013:

- 14 January – A forum with the leadership from the large and mid-tier audit firms, regulators and academicians to discuss issues relating to the audit committee’s role in influencing audit quality, fraud and its influence on the confidence of financial reporting and talent management in accounting firms. Findings from a joint research between the AOB and the Association of Chartered Certified Accountants (ACCA) titled ‘Optimising Talent in Accounting Firms’ was launched;
- 6 May – Participated in a dialogue organised by Accounting and Corporate Regulatory Authority (ACRA) between AARG with the regional leadership of the Big Four firms to discuss on IFIAR Global Survey and AARG’s inspection findings results as well as the

firms’ internal/network review results;

- 20 August – A dialogue session with ACCA Public Practice Committee on the inspection findings reported in AOB’s 2012 Annual Report; and
- 19 November – A dialogue session with the Other Audit Firms where AOB shared its inspection observations in relation to ISQC 1 as well as audit engagement reviews and expectations moving forward. In relation to the audit engagement deficiencies, specific focus was placed on accounting and auditing technical understanding and applications through case studies. The dialogue also served as an avenue for the Other Audit Firms to provide feedback on challenges faced by the audit firms in the industry.

FOCUS GROUP DISCUSSION – BUILDING CAPACITY TO SUPPORT AUDIT QUALITY

The AOB is cognisant of the fact that talent is a critical success factor to achieve high quality audit

AOB’s International Engagements

During the year, the AOB continued to exchange experiences with other international audit regulators through the 7th International Forum of Independent Audit Regulators (IFIAR) Inspection Workshop held in Zurich, Switzerland and the 2nd AARG Inspection Workshop (the AARG Workshop) hosted by the AOB held in Kuala Lumpur from 14 to 16 January 2013. These inspection workshops enable AOB’s inspection officers to keep abreast with current emerging issues across various jurisdictions and ensure inspection techniques applied remain relevant and consistent among the audit regulators in dealing with those emerging issues. The ACRA of Singapore and the SEC Thailand the two other members of AARG, participated in the 3-day AARG Workshop together with regulators from Cambodia, Indonesia, Laos, Vietnam, Hong Kong and Japan where information and ideas relating to practical issues on inspection were shared.

The AARG Workshop highlighted several areas requiring closer engagement with the audit firms. They included the following:

- Emphasis for audit firms to perform more robust root cause analysis to enable them to develop effective remediation plans. This is in view of recurring findings which indicated that the firms’ existing remediation plans may not be sufficiently effective; and
- Emphasis on firms’ self-governance and monitoring mechanisms and encouraging EQCR accountability to improve audit quality.

within the auditing profession. However, talent recruitment and retention continues to be cited by the profession as one of the key challenges faced. Capacity building through talent recruitment, development and retention remains an area of focus in AOB's engagement with the firms.

The AOB has obtained feedback from audit staff that may be useful for firms to acknowledge in their efforts to enhance capacity building. Apart from the collaboration with ACCA in September

2012 to conduct an online survey that covered nine larger accounting firms identified by the AOB, it conducted focus group discussions with audit staff from seven large firms comprising 40 audit managers, 39 audit seniors and 39 audit associates during its regular inspections in 2013.

The focus group discussions covered areas relating to capacity building and the feedback given by the audit staff was well received by the leadership of the firms. A summary of the feedback is as follows:

AREAS OF DISCUSSION	AUDIT STAFF FEEDBACK
ASPIRATIONS TO BECOME AN AUDIT PARTNER	<ul style="list-style-type: none"> • Only 10% of the audit staff aspire to become an audit partner mainly due to the following reasons: <ul style="list-style-type: none"> – Audit has become too challenging, imposes higher risk and responsibilities for an audit partner to undertake; and – Audit firms are viewed as a training ground and a stepping stone to the commercial sector, where the working hours are seen to be more manageable.
TRAINING	<ul style="list-style-type: none"> • Audit staff found the internal trainings conducted by the firms to be relevant and sufficient. • Classroom and on-the-job trainings are preferred over web-based learning as they allow for two-way communication between staff and trainers. • Audit staff also found the use of case studies and sharing of practical experiences by partners and managers to be effective in facilitating the learning process.
EVALUATION OF STAFF PERFORMANCE	<ul style="list-style-type: none"> • Audit staff want more frequent and timely performance feedback from their supervisors/appraisers. • Ongoing informal feedback is also seen by staff to be beneficial to facilitate the progress throughout the year. • Some audit staff suggested for a 360-degree anonymous feedback system to provide feedback on their supervisor.
BALANCING BETWEEN ADMINISTRATIVE TASKS AND AUDIT WORK	<ul style="list-style-type: none"> • Suggestions were made by some audit managers that certain administrative tasks should be assigned to administrative staff to relieve them of their heavy workload and to allow them to focus their time on supervising audit engagements and discharging their professional duties.
STAFF PERCEPTION ON THEIR CONTRIBUTION	<ul style="list-style-type: none"> • There appears to be an expectation gap where most staff believe that their contribution to the audit firms was high but may not be viewed to the same extent by the audit firms. • Creating an environment to boost staff morale by appreciating their efforts to motivate them in their work performance to support audit quality.
INITIATIVES FOR TALENT RETENTION SHARED BY THE STAFF	<p>Key initiatives to help promote talent retention and reduce staff attrition:</p> <ul style="list-style-type: none"> • Improve work-life balance by reducing workload, increasing headcount and ensuring deadlines are reasonably managed by the partners; • Competitive salary and better benefits; and • Strengthening the recruitment process to ensure new hires have the required competency and the right attitude to do the job.

OVERVIEW OF FINDINGS

Although there was a slight reduction in the number of significant deficiencies observed across the Major Audit Firms, it remains a challenge for them to ensure consistency of performance across the engagement partners within the firms in view of recurring deficiencies identified during the inspections. Efforts on self-governance framework and monitoring control procedures were enhanced however the effectiveness of such controls remains to be a discussion point with the firms.

While the AOB noted that the two mid-tier firms which were re-inspected had made significant efforts in improving audit quality, the findings from the inspections suggested that the impact of these efforts lacked effectiveness.

From the review of engagement files, the ability of the auditor to apply professional scepticism and to evaluate sufficient appropriate audit evidence remains a challenge.

In 2013, the AOB's inspections of previously not inspected Other Audit Firms indicated that gaps in the system of quality control policies and procedures and the application of such policies and procedures were prevalent in these firms, although there was a slight improvement compared to 2012 results. The review of engagement files revealed a number of areas where significant deficiencies were identified.

KEY OBSERVATIONS FROM FIRM LEVEL REVIEW AND ENGAGEMENT REVIEW FINDINGS OF MAJOR AUDIT FIRMS

Strong tone from the top paramount to drive audit quality

Strong leadership sets the tone for professional conduct among fellow partners which in turn creates a culture to maintain consistent quality in the performance of audit engagements within the firm. Quality audit is heavily dependent on all members of the audit engagement team to play

their respective roles effectively. In some situations, the AOB had observed positive correlation between the strength of the tone from the top where swift and decisive action taken on individual audit partners who have not complied with the firm's quality requirements and placing the right resources on an audit engagement, resulted in improved quality in engagement performance.

Apart from rigorous communication to drive quality messages and enhancements to audit methodology to facilitate the audit engagement team, the AOB also observed efforts by the Major Audit Firms to place greater emphasis on human resource through better utilisation of resources and increasing remuneration package to attract and retain talent.

The AOB continued to observe the movements of audit clients from one audit firm to another. Audit firms considering the acceptance of prospective audit clients are reminded to observe and apply appropriate client acceptance due process, in particular understanding the audit client and its implication of audit risks.

The AOB acknowledges that the issue of talent retention and balancing of partners' workload continues to be a key challenge to the audit firms. Whilst efforts are taken to address the issue, audit firms are reminded to ensure business considerations do not override audit quality.

Rigour of firms' monitoring of system of quality control to ensure consistency of quality practices within the firm

Although the Major Audit Firms have established monitoring control review function performed internally within the firm or by their network firms, the AOB's review of engagement files which were subjected to the firms' own monitoring control review indicated that the monitoring control review performed by some Major Audit Firms lacked sufficient rigour. There were instances where the

firm's engagement reviewers had failed to identify significant deficiencies which were highlighted by the AOB arising from its inspection. These shortcomings may be attributed to:

- Insufficient time being allocated for the review, hence it may not have been performed with sufficient depth and instead focused on breadth; and
- Gaps in the scoping of the review by the firms which focuses on compliance with firm's audit methodology in form and consequently, may have overlooked the substance of certain key aspects which were the AOB's focus in its inspection of engagements.

Consistency of performance is a key success factor in maintaining audit quality. Accordingly, the AOB continues to emphasise the importance of having an effective monitoring system of quality control policies and procedures that tracks and measures the extent of consistency of quality practices within the firm and to avoid recurring deficiencies.

Engagement performance through adequate involvement of key audit partners

Engagement partner

The AOB continues to observe a gap in the consistency of engagement performance among engagement partners within the audit firms. Despite efforts taken by the firms to communicate AOB's findings to all their partners, the number of recurring inspection findings that the AOB encountered seem to suggest that the level of supervision by some engagement partners was lacking. A number of engagement partners relied heavily on their next-in-line to supervise and perform review of audit engagements. Directions from the partners were unclear and the next-in-line was not sufficiently experienced, hence audit quality suffered.

From statistics compiled by the AOB of inspected engagements, recorded time spent by the engagement partners relative to the engagement team ranges from 1.10% to 9.66%. The lack of a partner's involvement on audit engagements may be attributed to heavy partner workload. Whilst firms have made some progress to rebalance partners' workload, more may need to be done as several partners are still struggling to find sufficient time to properly supervise their audit engagements.

There is a close correlation between the level of partner's involvement in the audit and the quality of the audit engagements. Firms are reminded to continually assess partners' workload and to ensure that they are able to spend sufficient time to provide proper supervision and review to ensure quality audit work.

Engagement Quality Control Review (EQCR)

The EQCR plays an important role in audit quality by providing an independent and objective evaluation of the key judgement areas, particularly in high-risk areas and assessment of whether the related audit procedures and documentation support the conclusions reached. In this area, the AOB is encouraged with the move by the Major Audit Firms to emphasise the importance of EQCR in safeguarding audit quality by increasing their accountability. Examples are as follows:

- EQCR involvement made into Key Performance Indicator (KPI) for partners;
- Evaluating the implications of monitoring control review or AOB's inspection findings to an EQCR's performance appraisal; and
- Reiterate that EQCR's involvement is not only limited to key judgements areas brought to their attention by the engagement team, however they have to play the role of an objective and effective quality control reviewer.

Professional scepticism

The AOB observed that the Major Audit Firms have continued to take the initiatives to reinforce the importance of exercising professional scepticism in the conduct of their audit work. The initiatives observed include more regular trainings and structured communications and reminders on professional scepticism.

Notwithstanding the efforts, the AOB's inspection continued to reveal audit deficiencies in. There was one common area where some auditors failed to demonstrate professional scepticism, when the engagement team did not to identify or evaluate the risk of management override of controls despite the existence of specific factors giving rise to such risk. This is an important risk assessment procedure as it sets the expectation of whether there is a need to extend audit procedures to mitigate the risk of management override of controls.

Identifying and evaluating the risk of management override of controls is an important risk assessment procedure that can directly impact the entire audit strategy, particularly in the areas involving management's estimates and judgements.

Evaluation of audit evidence

In 2012, the AOB observed numerous discrepancies or conflicting evidences within the audit working papers were not further assessed by the auditors. The AOB also observed instances where the audit evidences were internally generated documents. In 2013, the AOB continued to observe the above findings, albeit the frequency had reduced.

There is a continuous need for auditors to critically analyse audit evidence and maintain vigilance to ensure reliable evidence is obtained and audit quality is not adversely affected, given the effects of the emerging concerns on fraud risks and business practices.

KEY OBSERVATIONS FROM FIRM LEVEL REVIEW AND ENGAGEMENT REVIEW FINDINGS OF OTHER AUDIT FIRMS

Setting the right tone from the top

Despite being highlighted in prior years, the AOB continued to observe firms that do not measure, monitor and reward audit quality at partner level. This is an observation which is more prevalent with sole proprietors and partnerships that are formed out of informal mutual alliance. The AOB will continue to work closely with such firms in this area as it is important for them to demonstrate the leadership's emphasis on audit quality and incentive to foster quality oriented culture.

Setting the tone from the top is crucial to ensure audit quality as there is clear correlation between the two as observed from AOB's past inspections.

Independence and ethics

The AOB's inspections in 2013 revealed instances where the firm's independence compliance system and processes were not effective. This is evidenced through the AOB's identification of breaches to the MIA By-Laws on five-year partner rotation rule. The AOB had warned these firms where some had immediately rectified the situations while others have proposed remedial actions.

Compliance with the independence ethical requirements reflects auditor's ability to uphold integrity, objectivity and professional behaviour, which is fundamental in performing an audit. This will continue to be an area of AOB's focus for future inspections.

Rigour in the client acceptance process

The acceptance and continuance of client process is pertinent as it provides an assessment on a

prospective audit client, whether to accept the engagement based on risks, capacity, competence and audit fee. In 2013, the AOB continued to observe movement of audit clients from the Major Audit Firms to the Other Audit Firms. In this respect, the Other Audit Firms are reminded to apply sufficient rigour in their acceptance evaluation process as there may be underlying risks or issues which may not be communicated in the professional clearance letter from the predecessor auditor for various reasons.

Firms in their efforts to grow revenue should not offer lower audit fees than the predecessor auditor to secure the business without due consideration of the actual costs and audit risks involved to carry out a quality audit.

Monitoring quality control policies and procedures

The AOB's inspections revealed shortcomings in the monitoring of quality control policies and procedures of the Other Audit Firms. The AOB's review of engagement files which was subjected to the firms' own internal monitoring control review indicated that the monitoring control review performed lacked sufficient robustness and rigour. Firms should address the shortcomings through the following:

- Establish proper internal monitoring process that is adequately resourced with technically sound and dedicated personnel; and
- Internal monitoring review over engagement performance should be conducted with sufficient breadth and depth. The engagement reviews should be based on substance of the issues with focus on areas that affect sufficiency of audit procedures and audit evidence and issues that may have impact on basis of audit opinion rather than on compliance and administrative type of issues.

Firm should ensure that its monitoring processes are appropriately designed and implemented effectively as they would be critical in providing reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.

Human resource

While Other Audit Firms in general are gradually recognising the importance of investing in talent development initiatives, the AOB noted that firms are sceptical in making heavy investment in this area, citing challenges in talent retention as the main reason. Relevance is drawn from the recommendations in the report titled 'Optimising Talent in Accounting Firms', which was a result of a survey jointly conducted by the ACCA and the AOB. Included in the report are the following recommendations for firms to increase their value proposition in talent recruitment and retention:

- Increase awareness of the value of audit to stakeholders which will lead to reduced pressure on audit fee;
- Enhance clarity over partnership admission criteria, with the view of making available partnership opportunity;
- Promote efficiency in the audit by having partners and senior staff involved in the audit engagement at the early stage;
- Implement comprehensive structured training to accelerate staff learning curve. Training should comprise both technical and soft skills training; and
- Influence client behaviour to improve their accounting practices and responsibilities over preparation of financial reports and supporting documents.

Engagement performance

While the AOB is encouraged with its 2013 inspection visits which have shown that the overall climate towards audit quality is moving in the right direction, the Other Audit Firms do require more improvement and in some instances, the improvement necessary is significant.

The Other Audit Firms are reminded to raise their professional scepticism in performing their audit work. This includes questioning the reliability of audit evidence and to evaluate sufficient appropriate audit evidence.

In 2013, the AOB observed a high number of significant deficiencies in the following audit areas:

- Assets impairment;
- Estimates;
- Revenue recognition;
- Sampling; and
- Presentation and disclosure.

Assets impairment and estimates

The common pitfalls noted from AOB's 2013 inspections are as follows:

- Indicators of impairment were not identified and addressed;
- Assets such as goodwill and intangible assets with indefinite useful lives were not subjected to annual impairment assessment;
- Lack of verification and challenge of management's assumptions used in their cash flow projections, and consequently, no basis to support management's conclusion;
- Inappropriate determination of the assets' recoverable amount and incorrect comparison of the recoverable amount against its carrying amount;
- Undue reliance of and lack of professional scepticism on management representations;

- No audit procedure to obtain understanding of the PIE's process and controls on accounting estimates;
- The management's process and basis/assumptions to support estimated costs and allocation of common costs were not evaluated; and
- Data used by management to support estimations were not verified.

In relation to the above, the AOB reiterates the need for the auditors to critically evaluate the value-in-use cash flows prepared by management by professionally challenging the key assumptions used such as the forecasted sales volume, selling prices, cost and discount rate based on the prevailing economic climate, rather than finding justifications to support the management's assumptions. Where necessary, the auditors should stress test on those value-in-use computations, including performing adequate sensitivity analysis.

To be able to effectively evaluate and challenge management's basis and assumptions used in determining an asset's value-in-use, the auditor must possess a thorough understanding of the PIE's business and the industry of which the PIE operates.

Revenue recognition

The common pitfalls noted from AOB's 2013 inspections are as follows:

- Failure to evaluate the different nature of revenue sources;
- Shortcomings in testing cut-off assertion;
- Substantive analytical procedure not performed in accordance with ISA requirements; and
- Performing test of details based on reports not tested for reliability or accuracy.

In relation to the first two points above, the AOB observed the tendency of the Other Audit Firms to apply standard 'template' audit procedures despite the fact that the amount and timing of revenue recognition can be affected by various factors such as the nature of revenue, return policy, payment terms and delivery arrangements among others. In this respect, rigorous planning and risk assessment procedures to understand and identify such potential factors are crucial in customising and determining the appropriate nature, timing and extent of audit procedures to obtain sufficient appropriate audit evidence.

Despite the highlights in its previous years' annual report on the shortcomings in auditors performing substantive analytical review as their primary audit procedures to obtain audit evidence, the AOB continued to observe that many of the Other Audit Firms have performed the substantive analytical review in the form of variance analysis which is limited to comparing current year figures with the prior year. There was no documented evidence within the audit files that the following requirements of ISA 520 were met:

- Determination on the suitability of particular substantive analytical procedures;
- Evaluation on the reliability of data used to set expectation;
- Setting of expectations; and
- Setting of threshold for investigating differences.

A good substantive analytical review depends on many factors including the availability of reliable data specific to the PIE and the industry of which the PIE operates, adequate knowledge and experience to set expectations with sufficient precision and ability to investigate identified differences. Accordingly, the auditors must first evaluate all these factors and if any of these could not be met, substantive analytical review may not be appropriate.

Sampling

The common pitfalls noted from AOB's 2013 inspections are as follows:

- Untested population;
- Inappropriate basis of sampling; and
- Exceptions from test samples were not identified and properly evaluated.

The objective of the audit, when using audit sampling, is to obtain sufficient appropriate audit evidence to support the audit conclusion about the population from which the sample is selected. However, when determining the samples to be selected for testing, certain Other Audit Firms did not consider the particular characteristic of the population from which samples are drawn that may indicate a higher risk of material misstatements to meet the test objectives.

In addition to the above, the AOB continued to observe the tendency of certain firms to select items based on monetary threshold based on the materiality set for the audit engagement, where the results of such specific item testing cannot be used to project to the remaining untested population. In the absence of other substantive testing or relevant test of controls, the auditor would not have obtained sufficient appropriate audit evidence.

Audit firms should be mindful when selecting specific items for testing. In particular, when assessing the untested population, the materiality threshold set for the audit engagement should be applied instead of using the percentage of samples coverage over the population as a justification that no further samples or other audit procedures are required to be performed to address the untested population.

Presentation and disclosure

The common pitfalls noted from AOB's 2013 inspections are as follows:

- Non-compliance with relevant Financial Reporting Standard (FRS) disclosure requirements; and
- Key presentation and disclosure items in the audited financial statements were not

verified and evaluated, leading to incorrect presentation and disclosure.

The AOB observed the lack of audit procedures performed by certain Other Audit Firms when addressing the presentation and disclosure assertion of certain key account balances or class of transactions. This includes insufficient rigour to challenge the PIE's basis of classification of certain account balances, an example where certain bank borrowings were classified as long term liabilities instead of current liabilities despite the terms of the bank borrowings clearly indicated that they are current liabilities as required by the relevant approved accounting standard. In areas where the substance of events surrounding the bank borrowings was complex, the auditor should consult to support the audit conclusion.

Audit firms are reminded that while the presentation and disclosure of financial statements is the management's responsibility, there are specific ISA requirements that require the auditors to perform the necessary audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework.

Thematic reviews (Covers both Major Audit Firms and Other Audit Firms)

Consistent with previous years, the AOB continued to carry out thematic reviews as part of its 2013 regular inspections, recognising there could be potential audit challenges across the thematic issues that may require the involvement of other stakeholders apart from the audit firms and auditors to achieve an effective resolution. Three areas of thematic reviews were conducted as follows:

- Insurance industry, specifically focused on conventional life policies;
- Group audit arrangements; and

- Property development and construction industry.

Insurance

Due to the specialised nature of insurance audits, there are only a handful of audit partners from the larger network firms that have the expertise to conduct audits of insurance companies. This may pose the risk of not having enough talent within the auditing industry to cope with the workload of such audits. From AOB's engagement with the leadership of these audit firms, it was noted that the firms have taken succession planning measures through the identification of staff to be internally groomed and be put in the pipeline to be made an insurance audit partner. However, retention of such talent remains a challenge to the audit firms given the attractiveness and marketability of this specialised skill in the insurance industry as well as threat from other audit firms, especially outside Malaysia.

In auditing revenue for insurance companies which comprises new premiums and renewal premiums based the companies' accounting policies, a common observation identified from AOB's 2013 inspection is the lack of audit procedures to verify if renewal premium revenue was recognised in accordance with the companies' accounting policies.

Key challenges:

- As talent retention is already a key challenge to audit firms, this challenge may intensify for retention of talents in a specialised industry. Hence, it is important that the audit firms continue to closely monitor their succession planning.
- The audit firms currently do not have a team of actuaries locally due to shortage of actuarial expertise within Malaysia. Therefore, the audit firms have to tap for such support from their network member firms.

Group audit arrangements

Compared to previous years, the AOB noted that firms have put in considerable effort in enhancing their involvement in the work of the auditors of components not audited by them. As a result, the frequency of the identified findings in the following areas in 2012 had significantly reduced in 2013:

- Limitations in the scoping process;
- Consistency in the application of work done based on the threshold set;
- Primary auditors were not diligent in following up with the component auditors on their reporting deliverables; and
- Tendency to rely on the work performed by the component auditors particularly when those component auditors were from the Major Audit Firm.

When determining whether a component is a significant component, firms are reminded to look beyond the quantitative factors and take into account, qualitative factors underlying the component which may pose a significant risk of material misstatement due to specific nature and circumstances.

The AOB also noted greater diligence being applied by the audit firms to perform review of the component auditors' audit working papers. Where such reviews indicated shortcomings particularly in the key audit areas, the audit firm has performed additional procedures to address the remaining audit risks. There were also instances when the assessment of the component auditors' professional competence put to question on their quality and capability, the audit firm has opted to perform the audit of the component directly.

Key challenges:

- Auditing components with a different financial year end may result in audit inefficiency as co-operation from the component auditors may not be forthcoming and the audit firm would need to perform additional audit procedures to address the intervening period.
- Auditing components residing in certain jurisdictions are becoming more difficult as the relevant authorities are enforcing more stringent requirements that would impose greater barrier to assess and retain information of PIEs and the audit working papers of component auditors in those countries.

Property development and construction

As the nature of business in this industry involves a great amount of judgement in determining the amount of revenue to be recognised and the completeness of property development or construction cost, this would pose various areas of challenge to the audit. The areas where deficiencies have been identified from AOB's 2013 inspections were as follows:

- Lack of understanding of the management's process and controls on accounting estimates and budgeting process;
- Lack of verification and challenge of management's basis in estimating cost to completion and allocation of common cost;
- Insufficient audit procedures performed in the assessment of budgets and costs to identify foreseeable losses, liquidated ascertained damages, and potential cost overruns; and
- Non-compliance with the accounting and disclosure requirements of FRS 111, Construction Contracts and FRS 201, Property Development Activities.

REMEDIATION

Overall progress

The results from AOB's inspection visits over the years have shown that the most audit firms are moving gradually in the right direction to raise the overall standard of auditing in Malaysia.

The AOB observed that consistent with previous years, the key areas of remediation undertaken by the firms in 2013 include the following:

- Strengthening the governance structure and tightening audit quality improvement plan;
 - Enhancement to performance evaluation of partners and staff with more audit quality focused KPIs;
 - Enhancement to monitoring control framework;
 - More structured trainings on technical subjects and relevant changes to audit manual, policies and procedures;
 - Tightening the approach to professional scepticism, including training and regular reminders and communication;
 - Rebalancing partner's portfolio; and
 - Enhancement to the role of engagement quality control reviewer, including making this a performance evaluation criterion that will impact remuneration.
- Understanding of management's processes and controls relating to accounting estimates and consequently, the audit of accounting estimates particularly relating to property development activities in the area of review of project budget, revenue and provisioning and allocation of cost;
 - Sampling and untested population;
 - Impairment testing of assets;
 - Audit of components in relation to Group audit;
 - Fraud risk inquiry;
 - Revenue cut-off procedures;
 - Substantive analytical procedures;
 - Follow up on confirmation procedures; and
 - Identification and evaluation of risk of management override of controls.

The above recurring observations raise the question as to whether the firm's monitoring procedures are sufficiently robust and effective in designing and implementing remediation plans that directly address the actual root causes to the audit deficiencies. The Major Audit Firms have been required to put in place the relevant measures on a timely basis to prevent recurring deficiencies. For two Major Audit Firms and the two mid-tier firms, they were further required to include the appropriate performance measures to assess the effectiveness of their remedial measures.

Recurring findings

Whilst on overall, there is positive progression in the remediation of AOB's inspection findings given the efforts taken by the firms, there remain gaps where the results of AOB's 2013 inspection on engagement reviews of the Major Audit Firms and two mid-tier firms revealed recurring findings in the following areas, among others:

- Going concern assessment;

Root Causes

The AOB believes that there are various reasons for the audit deficiencies and hence the firms are reminded of the importance to acknowledge the actual root causes and develop a robust root cause analysis as it provides a clearer understanding of the factors that underlie the inspection findings. This will in turn help the firms in developing remedial action plans that are more sustainable and would minimise recurrence, if not eliminate.

As consistency of performance and efforts across the firms and individual auditors remains a challenge, this will be an aspect that the AOB would closely monitor with the firms. The AOB emphasises that the consistency of performance among the individual auditors is of importance as while a firm may have quality control policies and procedures in place, if an individual auditor of the firm fails to comply, it may reflect the effectiveness of the firm's governance of its policies and procedures.

Based on the AOB's analysis, the following are the top potential root causes to audit deficiencies:

Major Firms

- Lack of resources due to continuous high attrition rate;
- Lack of timely involvement and insufficient supervision and direction by the engagement partners;
- Lack of engagement partners' due care in discharging their professional duties;
- Failure of the firm's monitoring control mechanism to surface relevant issues; and
- Lack of application of professional scepticism and judgement in evaluating audit evidence.

Other Audit Firms

- Lack of efforts by the firm's leadership in driving the message about audit quality;
- Lack of understanding of the business of audit clients;
- Mechanical approach in fulfilling training needs and not understanding the impact of the application of standards;
- Lack of technical competencies, both accounting and auditing;
- Lack of technical support to safeguard audit quality, which includes consultation process and internal monitoring reviews;

- Lack of application of professional scepticism and judgement in evaluating audit evidence;
- Lack of timely involvement and insufficient supervision and direction by the engagement partner; and
- Ineffective EQCR.

CONCLUSION

In 2013, the AOB observed encouraging results from the Major Audit Firms in enhancing audit quality through strengthening of their leadership messages on audit quality and self-governance framework. However, such observations vary among the Major Audit Firms. The AOB observed that some firms responded swiftly and decisively on action to be taken on partners when audit quality was compromised. Such tone from the top drove strong messages on its seriousness to uphold audit quality and promote good partner's behaviour by taking the necessary measures on partners who failed to perform their duties with due care and diligence.

Nevertheless, consistency of engagement performance among engagement partners remained a challenge for the Major Audit Firms. There is a need to realign internal monitoring control framework to focus and cover sufficient depth rather than just compliance nature for such reviews to be effective in identifying weaknesses with the firm's system of quality controls and engagement performance.

For the Other Audit Firms, there continues to be a need for the firm's leadership to implement various measures to safeguard audit quality and to foster quality oriented culture. A number of Other Audit Firms still need to make significant improvement. This includes making necessary investment in infrastructure and technical competence to support audit quality. Possessing the relevant technical competence is fundamental in the audit of an engagement. Hence, partners and engagement team members are required to continuously upgrade their technical knowledge and effectively apply them in their audit execution. The Other Audit Firms are constantly reminded of the

requirement to establish monitoring control review function and ensure the effectiveness of such function to assist in safeguarding audit quality.

In striking the balance between business needs and professional obligations, audit firms are constantly reminded of the potential conflict between the two. They need to apply due care in the acceptance and evaluation process as prospective clients may carry with them some risks that, if not well managed, can result in negative repercussions to the firms.

The AOB acknowledges the challenges faced by the auditing profession especially in building capacity. Audit firms should be innovative in formulating measures that work in their circumstances in order to build capacity. While there may be a tendency for audit firms to focus their efforts on talent recruitment and retention to address shortages of audit staff, audit firms should not lose sight on the importance of talent development as audit staff who are technically sound in accounting and auditing matters are fundamental to achieve audit quality. The audit firms are constantly reminded that audit quality is a team effort.

As the AOB has observed recurring deficiencies identified from prior inspections, audit firms are reminded to critically and objectively identify actual root causes that have given rise to the deficiencies in order to design appropriate remedial actions that will minimise recurring deficiencies. Further, firms should consider establishing a framework for

timely follow-up and assessment over the effectiveness of implemented remedial plans. This would include verification of the engagement files for the subsequent audit to ensure remediation of deficiencies identified from external and internal reviews previously are actually implemented other than relying on verbal representation from the engagement team.

Moving forward, the AOB will continue with its efforts to engage with the audit firms in discussion about drivers of audit quality which include understanding the root-cause analysis, remediation effectiveness and sustainable action plans. AOB will continue to share and encourage good practices among audit firms and collaborate with the audit firms to achieve the intended outcome.

“Generally there have been encouraging results from the Major Audit Firms in their effort to safeguard audit quality. Some ingredients of good quality audit firms which we observed include strong governance process where swift and decisive actions were taken on individual auditors who compromised audit quality, making the necessary investments in infrastructure to support audit quality and building technical capacity, and exercising due care when accepting client to manage potential risk arising from any negative repercussions associated to the client.”

Enforcement Activities

INTRODUCTION

High quality financial reporting practices by PIEs coupled with high quality audit practices can be an effective market differentiator, helping Malaysian businesses attract capital and potential investors.

In the pursuit of promoting confidence in the quality and reliability of audited financial statements and maintaining a credible form of public assurance in the auditing profession, the AOB Board has been given the responsibility to conduct inquiries and impose appropriate sanctions against auditors and audit firms for non-compliance with auditing and ethical standards.

The AOB's enforcement philosophy is to balance the principle of proportionality, efficiency and achieving the desired outcome in considering the sanction imposed on any individual and/or audit firm. The AOB also takes into account the nature and seriousness of the offence, previous regulatory record and any other mitigating factors. Depending on the deterrent effect the AOB plans to achieve, the sanctions could include among others reprimand, relevant professional education to be undertaken by the person concerned, prohibition from accepting any PIEs as its clients for a period not exceeding 12 months, prohibition from auditing any PIEs for a period not exceeding 12 months or permanently and imposition of monetary penalty not exceeding RM500,000.

Regulatory decisions made by AOB are made on an objective and impartial basis, without conflicts of interest, bias or improper influence.

In undertaking the inquiry process, AOB is mindful of the concept of fairness wherein the relevant party inquired is given numerous opportunities to clarify both in person and through written representation on issues raised and present relevant information and documents.

Typically, as a consequence of the inspection findings or oversight activities, the AOB Board, may if it deems appropriate, propose the imposition of any sanctions on the audit firm or auditor.

OVERVIEW OF THE FINDINGS AND CASES

Although Malaysia has a robust auditing framework and professional standards which are internationally benchmarked, there is room for improvements in respect of the application and compliance of these standards and a need for the auditors and audit firms to move towards compliance in substance rather than form.

While professional standards prescribe minimum level of quality in the delivery of audit assurance services, self-discipline by audit firms and market discipline is needed to ensure delivery of quality audit services.

For example, the MIA By-Laws clearly states that professional accountants need to use professional judgement in applying the principles of the MIA By-Laws wherein they need to identify the threats to compliance with the fundamental principles, evaluate the significance of the threat and apply

safeguards to eliminate the threats to an acceptable level. The AOB observed that auditors do not comprehend the spirit of the MIA By-Laws and compliance is still very much in form. It also observed that certain auditors demonstrated lack of professional scepticism and independence in the

conduct of their audit.

In 2013, the AOB took enforcement action against six auditors. The summary of the actions taken for the year under review is as follows:

No.	Nature of misconduct	Parties involved	Brief description of misconduct	Action taken	Date of action
1.	Breach the AOB's registration condition imposed under section 31O(4) of the SCA 1993.	Tan Chin Huat Partner of STYL Associates who was the engagement partner in the audit of a PIE for the financial year ended 31 December 2010.	Failure to comply with certain requirements of ISA in discharging his professional duties in the performance of an audit of the PIE.	Reprimand	19 August 2013
2.	Breach the AOB's registration condition imposed under section 31O(4) of the SCA 1993.	Yeo Eng Hui Partner of STYL Associates who was the engagement partner in the audit of a PIE for the financial year ended 31 December 2010.	Failure to comply with certain requirements of ISA in discharging his professional duties in the performance of an audit of the PIE.	Reprimand	
3.	Breach the AOB's registration condition imposed under section 31O(4) of the SCA 1993.	Wong Shan Ty Partner of Ong & Wong who was the engagement partner in the audit of a PIE for the financial year ended 30 September 2011.	Failure to comply with certain requirements of ISA in discharging her professional duties in the performance of an audit of the PIE.	Reprimand <ul style="list-style-type: none"> On 13 September 2013, Wong Shan Ty appealed to the SC pursuant to section 31ZB of the SCA, against the above decision made by the AOB. On 31 October 2013, the SC decided to reject the appeal. 	
4.	Breach the AOB's registration condition imposed under section 31O(4) of the SCA 1993.	Cheah Choong Keong Partner of C.K. Cheah & Co. who was the engagement partner in the audit of a PIE for the financial year ended 30 September 2011.	(i) Failure to comply with certain requirements of ISA in discharging his professional duties in the performance of an audit of the PIE; and (ii) Failure to comply with certain requirements of the MIA By-Laws which relate to independence of an auditor in discharging his professional duties.	(i) Reprimand; and (ii) Penalty of RM5,000. <ul style="list-style-type: none"> On 12 September 2013, Cheah Choong Keong appealed to the SC pursuant to section 31ZB of the SCA, against the above decision made by the AOB. On 31 October 2013, the SC decided to reject the appeal. 	

No.	Nature of misconduct	Parties involved	Brief description of misconduct	Action taken	Date of action
5.	Breach the AOB's registration condition imposed under section 31O(4) of the SCA 1993.	Dr Abd Halim Husin Partner of Wong Weng Foo & Co. who was the engagement partner in the audit of a PIE for the financial year ended 30 June 2011.	Failure to comply with certain requirements of ISA in discharging his professional duties in the performance of an audit of the PIE.	Reprimand	28 August 2013
6.	Breach the AOB's registration condition imposed under section 31O(4) of the SCA 1993.	Mohd Neezal Md Noordin Partner of AljeffriDean who was the engagement partner in the audit of a PIE for the financial year ended 31 March 2011.	(i) Failure to comply with certain requirements of ISA in discharging his professional duties in the performance of an audit of the PIE; and (ii) Failure to comply with certain requirements of the MIA By-Laws which relate to independence of an auditor in discharging his professional duties.	(i) Reprimand; and (ii) Penalty of RM10,000.	

2014 Outlook

2014 INSPECTION FOCUS

The following are the identified focus areas for 2014:

- Business practices and self-governance;
- Compliance with ethical requirements;
- Assessment of monitoring policies and procedures;
- Audit of accounting estimates including estimated fair value and related disclosures; and
- Group audit arrangements with respect to the application of MFRS.

Other high risk areas requiring heightened scepticism and professional judgement will also be the AOB's focus areas.

In its efforts to be kept abreast with the current economic environment, emerging issues and changes to the accounting standards on audit quality, the AOB will interact with domestic and international regulators and other stakeholders in the financial reporting ecosystem. The AOB will also continue to hold dialogues with audit firms.

The AOB will also focus on the following areas:

- Requiring audit firms to enhance their process in identifying root causes of audit deficiencies in order to design effective remediation plans;
- Enhancement of technical competency in accounting and auditing among the Other Audit Firms;
- Setting expectation on the audit firms' leadership to drive changes in partner's behaviour that will enhance the professional conduct to mitigate risk of audit failure;
- Further enhancement in capacity building, training and infrastructure to improve audit quality;
- Continuous engagement with broader range of stakeholders in the financial reporting ecosystem; and
- Co-operation among independent audit regulators to enhance consistency, effectiveness and efficiency in inspection, which includes continuous involvement in IFIAR and ASEAN Regulators meetings and inspection workshops.

PART THREE

Influence the Financial Reporting Ecosystem and Leverage on Stakeholders' Support

THE FINANCIAL REPORTING ECOSYSTEM AND QUALITY OF FINANCIAL REPORTING

In shaping high quality financial reporting ecosystem in Malaysia, the roles played by the relevant parties are critical. Recognising this, the AOB proactively undertakes activities to communicate more strategically with key stakeholders. The AOB participated in events to share insights and promote quality practices which support the sustainable improvement in financial reporting and audit quality. Stakeholders included the accounting profession, audit firms, regulators, directors and academicians.

ASEAN AUDIT REGULATORS GROUP ACTIVITIES

The AOB hosted the 2nd AARG Inspection Workshop (the AARG Workshop) from 14–16 January 2013. The ACRA of Singapore and the SEC of Thailand, the two other members of AARG, participated in the AARG workshop together with regulators from Cambodia, Indonesia, Laos, Vietnam, Hong Kong and Japan.

The AARG Workshop was preceded by a half-day forum on 14 January attended by the leadership from the large and mid-tier audit firms, regulators

and academicians. The forum discussed issues relating to the audit committee's role in influencing audit quality, fraud and its influence on the confidence of financial reporting and talent management in accounting firms.

On the topic of talent management, the findings from a joint research between the AOB and ACCA titled 'Optimising Talent in Accounting Firms', was launched at the forum.

The 3-day AARG Workshop provided members and fellow regulators from the region the opportunity to exchange information and ideas regarding practical issues related to inspection techniques, observations and experiences.

The AARG Workshop highlighted several areas requiring closer engagement with the audit firms. They included the following:

- Emphasis for audit firms to perform more robust root cause analysis to enable them to develop effective remediation plans. This is in view of recurring findings which indicate that the Firms' existing remediation plans may not be sufficiently effective; and
- Emphasis on firms' self-governance and monitoring mechanisms and encouraging EQCR accountability to improve audit quality.



During the 2nd AARG Inspection Workshop, participants shared their experiences and best practices in regulating audit and promoting the audit quality. Participants also discussed on the evolution of the inspection process in their respective jurisdiction and the enforcement framework and subsequent actions taken.

The AARG Workshop has contributed to greater consistency across the region's audit regulators and facilitated timely discussion of regional issues that have an impact on regulation of the audit profession. Through the sharing of experiences and processes, regulators are also kept abreast of developments and practices which are useful to raise the standard of audit quality in the region.

The AARG first began meeting informally in 2010 and had its first formal meeting in January 2011. The objectives were to share best practice in audit regulation and inspections, engagement jointly on common issues with audit firms regionally to promote improvement in audit quality and encourage the development of independent audit oversight among other ASEAN countries.

The second AARG meeting was held in Singapore in May 2013. Audit regulators from Malaysia, Singapore and Thailand continued to exchange views on their oversight activities, development in the accounting profession and quality indicators.

In conjunction with the meeting, the AARG held a dialogue with the leadership of the Big Four Audit Firms from Malaysia, Singapore and Thailand as part of the annual engagement at the ASEAN level to discuss development and effectiveness of the remediation measures to address quality issues.

The meeting discussed the IFIAR Global Survey and AARG's Inspection Findings as well as the firms' internal and network review result.

Apart from this dialogue session the AOB attended the ASEAN Capital Market Symposium hosted by the International Federation of Accountants (IFAC) and Institute of Certified Public Accountants of Singapore (ICPAS) in Singapore.

The AOB Executive Chairman participated as a panelist in the session on "A Strong Financial Reporting Infrastructure: Vital for a Growing Economy and Strong Capital Market" whilst the General Manager and Head of the AOB was a panelist in the session on "Independent Oversight of Auditors".

The ASEAN Capital Markets Symposium 2013 raised awareness of the importance to regional capital markets of auditor oversight and promoted consistent audit quality in the ASEAN region.

At the side lines of the symposium, a dialogue was also held between the AARG and representatives of the Global Public Policy Committee (GPPC) in Singapore. Among the issues discussed were the ASEAN perspective on talent attraction and retention, the findings of AARG's Inspection and how the findings can be stacked against IFIAR, Audit Quality Drives and the Individual Firms Issues.

In 2013, AARG visited the Indonesian audit regulators, welcoming them as the latest member of IFIAR and discussed audit matters relating to the ASEAN market.

The AOB also participated in the ACRA Public Accountants Conference in August 2013 which was held in Singapore.

CONTINUED PARTICIPATION IN IFIAR

The IFIAR's membership has grown to 46 since its establishment on 15 September 2006 and AOB, continues to benefit from the sharing of the global audit development and practical experience of independent audit regulatory activity.

In 2013, the AOB attended the plenary meeting of IFIAR which were held in Noordwijk, Netherlands. The semi-annual plenary meetings of IFIAR were moved into an annual plenary session during the year. Among the issues discussed were:

- IFIAR Charter, membership issues, and work plan;

- audit policy developments;
- current market conditions and findings of recent inspections;
- quality issues and measures with the GPPC; and
- engagement with stakeholders such as IFAC, and other regulatory groups which include International Organization of Securities Commissions (IOSCO), Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS).

Subsequent to the IFIAR Plenary meeting, the AOB was identified to host the IFIAR 8th Inspection Workshop from 10 – 12 March 2014 in Kuala Lumpur.

The IFIAR Inspection Workshop is a closed-door event and is designed to encourage sharing of knowledge and practical experiences among independent audit regulators of IFIAR member countries. In 2013, two inspection officers of AOB participated in the event which was held in Zurich, Switzerland.

The 7th IFIAR's Inspection Workshop was organised to share experiences internationally of inspections framework, work program, current macroeconomic situation and overview of the results of a survey conducted by the IFIAR on request of the FSB in relation to the findings from IFIAR Members' inspections.

Specific topics and policy discussions from the IFIAR GPPC Working Group include professional scepticism, revenue recognition, group audits and engagement quality control review.

This workshop involved various sharing across jurisdictions on updates in regulatory inspection activities such as inspections of bank audits, use of IT-Experts, risk-based inspection approach, audit of goodwill impairment, quality of audit evidence, monitoring system on quality control policies and procedures and evaluation of firms' action plans.

PARTICIPATION IN OTHER INTERNATIONAL EVENTS

The AOB Executive Chairman was one of the panelists at the Asia-Pacific Financial Market Development Symposium which was organised by the Australian Government. The symposium was organised to develop concrete ideas on the structure, participation and future activities of the Forum, and how these activities can be co-ordinated with other ongoing regional initiatives. The symposium brought together private sector leaders and regulators in the financial services industry from the Asia-Pacific region.

The AOB Executive Chairman also participated as one of the panelists in the breakfast session on the "Regional Financial Policy and Regulatory Initiatives: What Needs to be Addressed, What is Being Addressed, Where are the Gaps and Opportunities for Collaboration". This session discussed the existing processes aimed at developing Asia-Pacific financial markets, including those being progressed through ASEAN and ASEAN+3, with the aim of identifying lessons learnt from those processes and potential gaps.

ENGAGING THE ACCOUNTING PROFESSION AND LEADERSHIP OF AUDIT FIRMS

Strengthening the accounting and auditing profession needs to be supported by continuous engagement with relevant authorities. The AOB believes that regular engagements with the stakeholders and leadership of audit firms will continue to enhance quality audit work.

In 2013, the AOB had two dialogue sessions with the small and medium registered audit firms to discuss specific inspection findings, root cause analysis, remediation plan, industry issues and practical challenges such as talent retention and keeping abreast with the relevant standards to support audit quality work. Specific focus was placed on the accounting and auditing technical understanding and applications through case studies and suggestions to address challenges facing the profession.

PROMOTING HIGH QUALITY FINANCIAL REPORTING PRACTICES

The AOB was involved in several external events to share views and thoughts which included conferences, seminars, conventions, symposiums, talks and forums, organised by various relevant stakeholders such as MIA, Malaysian Institute of Corporate Governance (MICG), ACCA, Malaysian Institute of Certified Public Accountants (MICPA), Institute of Chartered Accountants in Australia (ICAA), Certified Public Accountant (CPA) Australia, Institute of Bankers Malaysia (IBBM) and Securities Industry Development Corporation (SIDC).

The AOB participated in the following events which included:

- MIA Conference 2013
- Audit Committee Conference 2013 organised by the MIA
- National Accounting Educators Symposium (NAES) 2013 organised by the MIA
- Audit Committee Seminar 2013 organised by the MICG
- Forum on the value of quality audit organised by the MIA and ACCA
- ICAA-MICPA Audit Forum – “Quality Control in Practice”
- CPA Congress 2013 organised by the CPA Australia
- 2013 Asian-Pacific Association of Banking Institutes (APABI) Conference organised by the IBBM
- SC-ACCA Roundtable on the “Re-Assessing the Value of Current Corporate Reporting and Views on Integrated Reporting”
- 14th Emerging Markets Programme (EMP) organised by the SIDC.

ENHANCING COMMUNICATION WITH OTHER STAKEHOLDERS

In an attempt to address the high attrition and turnover rates in accounting firms, ACCA and the AOB jointly conducted a survey to determine the state of audit talent in Malaysia.

The result of the report, entitled ‘Optimising Talent in Accounting Firms’, was launched on 15 January 2013 at the AARG Forum. The survey was conducted in the last quarter of 2012 and revealed that an overwhelming majority (86%) of external auditors surveyed enjoy the nature of their work. They appreciate that a career in external audit provides abundant career opportunities, and that the progression path is generally predictable up to the senior management level.

The survey further found that opportunities to earn diversified experience, high future earning potential and job security were ranked high as key retention factors. Employees also appreciate the availability of diverse, structured and on-the-job learning opportunities. This reinforces the prevalent view that working in an accounting firm provides an excellent foundation to a professional career in finance and accounting industry.

The survey subsequently recommended action plans to be adopted by firms for talent recruitment and retention. The proposals suggested ideas such as for firms to create an engaging and open culture where employees are confident to surface issues relating to their well-being and career satisfaction; create a more conducive working environment to support female staff so larger number are inclined to stay and encouraged to aim for partnership; increase awareness of the value of audit to stakeholders which will lead to the reduce pressure on audit fee.

On 20 August 2013, the AOB organised a dialogue with the ACCA Public Practice Committee (PPC) following the release of the 2012 AOB Annual Report. PPC posed several questions based on the AOB Annual Report findings. While most of the questions were broad based and focused on the findings, they were related to AOB's inspection findings and enforcement actions.

The Accounting and Auditing Committee of SC (AAC) together with Malaysian Accounting Standards Board (MASB) held a roundtable on International Financial Reporting Standards (IFRS) 10, Consolidated Financial Statement on 10 October 2013.

The session provided an overview and various illustrations on the new single control model introduced by MFRS 10; focusing on the common application issues as well as areas that required significant judgement. Representatives from MASB, AOB and the relevant line departments in the SC attended the session.

STRENGTHENING RELATIONSHIP WITH OTHER REGULATORS

The AOB can best fulfil its mandate by enhancing its collaboration with other regulators, particularly, Bank Negara Malaysia (BNM), and the Companies Commission of Malaysia (CCM). The collaboration entails broader discussions on policy matters and feedback on areas which influence quality financial reporting practices.

In pursuing this, the SC including the AOB proactively engaged CCM during the year and provided comments on the Companies Bill which is the fundamental framework that influences the capital market.

The AOB continued to engage Bursa Malaysia on the issue of foreign auditors who audit financial statements of foreign corporations listed on the bourse, performance of auditors and the role of the directors and audit committee in ensuring quality financial reporting.

The initiative for collaboration between the AOB and other regulators is an effort to reduce differences in regulators' approaches, minimise duplication of effort towards effective regulation and increase effectiveness of regulatory activities in supervising the financial reporting and auditing.

SUPPORTING ACCOUNTING EDUCATION

Accounting education is one of the major factors that brings about high quality financial reporting. The AOB believes that continuous support to the accounting education is important to ensure that the programmes offered in the learning institutions remains relevant and applicable in the business environment.

In 2013, the AOB participated in the following events in bridging the gap between the accounting education and practice:

- Malaysian Accounting Students Convention 2013 organised by the University of Malaya (UM);
- Sunway TES ACCA Platinum Train-The Trainers Conference 2013; and
- Talk and Strengthening the Accountancy Profession Event organised by UM.

COMMITTEE TO STRENGTHEN THE ACCOUNTANCY PROFESSION

The establishment of the Committee to Strengthen the Accounting Profession (CSAP) was in relation to the findings of the *Report on Observance of Standards and Codes – Accounting and Auditing* (ROSC AA) issued by the World Bank in 2012. The AOB Executive Chairman was appointed as the CSAP's Chairman and the AOB is the Secretariat of CSAP.

The CSAP was set up to formulate and recommend strategies and measures to strengthen the accountancy profession and to improve the

contribution of the profession in enhancing the competitiveness of the country in line with the government's transformation agenda.

In developing the strategies, CSAP considered, among others, the future demand for accountants in Malaysia, accountancy education and training as well as regulatory issues including the

governance of the accountancy profession.

CSAP also organised several roundtables and dialogues with the audit firms, professional accountancy bodies, academicians, PLCs and financial institutions to brief them on the background of the CSAP, data requirements and CSAP's approaches.

PART FOUR

Assessment of Performance and Effectiveness

INTRODUCTION

The AOB Board approved a new strategic framework which incorporated a three-year outlook of the market and regulatory landscape.

The strategic framework links its service areas to the outcomes envisaged by the mission. While the core services such as registration and inspection are ongoing oversight activities, focus areas have been identified after considering the operating environment, developments in financial reporting and auditing, regulatory changes as well as global development in audit regulation to achieve the outcomes which are in line with the mission. During the year, the following five strategic outcomes were further refined:

- Confidence in audited financial statements;
- Audit opinion based on sufficient and appropriate evidence;

- Externalisation of professional values and ethics;
- Resourceful and capable audit practices; and
- High quality financial reporting practices by the PIE.

At the beginning of each year, the AOB Board considers and approves the proposal from management on the annual operational plan including areas that the AOB would focus on in performing its audit oversight function. The progress of the oversight activities would be reported to the AOB Board on a quarterly basis. A review of performance is performed in the middle of the year.

The outcomes and progress achieved in relation to the focus areas of the AOB in 2013 indicate that the AOB continued to achieve its regulatory mandate and mission in line with the overall aim of its strategic framework.

2013 PERFORMANCE REVIEW

AOB STRATEGIC OUTCOMES	ACTIVITIES	PERFORMANCE ASSESSMENT
Confidence in audited financial statements	<ul style="list-style-type: none"> • Participation in public events to send key messages on audit quality to key stakeholders. AOB participated in 19 local and international events. • Commissioned an academic research to assess the market impact of the establishment of AOB. 	<ul style="list-style-type: none"> • Created awareness among key stakeholders on the importance of audit oversight in the capital market. • Research findings noted positive feedback from stakeholders. • Auditors are more inclined to emphasise material issue in their audit report.
Audit opinion based on sufficient and appropriate evidence	<ul style="list-style-type: none"> • There were 11 audit firms inspected under the regular inspection. • A special inspection was conducted to respond to market events which could influence the confidence in financial reporting. 	<ul style="list-style-type: none"> • There was no major audit failure reported during the year among the companies with large market capitalisation. • Enforcement actions against six auditors for failure to comply with professional standards.
Externalisation of professional values and ethics	<ul style="list-style-type: none"> • AOB continued to monitor audit rotation requirement which is fundamental principle to ensure auditor independence. • Audit firms need to comply with professional ethics in substance and not wholly be comfortable with compliance in form. 	<ul style="list-style-type: none"> • Four warning letters were sent to audit firms that did not comply with this requirement and these firms are undertaking the relevant measures to address the issue.

AOB STRATEGIC OUTCOMES	ACTIVITIES	PERFORMANCE ASSESSMENT
Resourceful and capable audit practices	<ul style="list-style-type: none"> Engagement with audit firms during the renewal of registration to ensure audit firms have in place the firms' quality control framework. Firms are required to identify root causes of the deficiencies identified by AOB during inspection and are at various stages of progress. Focused group interviews were conducted during the year to drive messages on capacity building. Support the implementation of auditing standards, involved in local standard setting board and provide comments on two exposure drafts to IAASB during the year. 	<ul style="list-style-type: none"> There were 12 registration conditions imposed on audit firms and auditors during the year whilst six auditors were subjected to specific remediation measures. Remediation progress is at various stages of implementation. There were 19 remediation plans approved during the year. Technical competence is fundamental in carrying out an audit of an engagement. The firms are required to invest in the right training and infrastructure to support the development of technical competence. Talent remained to be a critical challenge for audit firms in ensuring quality of their work. This is attributed to the workload demands and competitive offers from other industries and overseas.
High quality financial reporting practices by PIE	<ul style="list-style-type: none"> Participation in events to engage directors and member of audit committees to remind them of their role in enhancing the quality of financial reporting of PIEs. Drive messages on investment in talents and relevant infrastructure to support effectiveness and high quality financial reporting functions. 	<ul style="list-style-type: none"> Dialogues with key stakeholders revealed the need for PIE to invest in the development of talent in ensuring high quality financial reporting.

OUTCOME OF THE ACADEMIC RESEARCH REPORT – ELEMENTS OF MARKET CONFIDENCE IN AUDIT MARKET SERVICES: AN EVALUATION OF STAKEHOLDERS' EXPECTATIONS IN MALAYSIA

Key conclusions and recommendations

The objective of the academic report is to provide evidence on the impact of the AOB on various stakeholder groups in Malaysia and evaluating their expectations towards AOB's functions. This is the first independent study conducted in 2012 to obtain feedback and explore the perception of the stakeholders towards the AOB.

The key conclusions from this project are:

Overall impact of the presence of the AOB

- There was general agreement that the AOB's existence is extremely beneficial to the whole ecosystem. At the time of reporting, as it is still in its early years, stakeholders expect the AOB to continuously improve its efforts to raise expectations, requirements and eventually the quality of audits performed in PIEs.

The impact of the AOB and its inspection report

- The establishment of the AOB is an effective means of monitoring quality of audit performance and enhancing confidence of the users on audited financial statements.
- Interviewees generally perceived independent inspection body could enhance audit quality by enhancing quality of documentation and evidence, and appropriate behaviour of the external auditors.
- The important role of the AOB to ensure 'sound' quality control within audit firms through compliance with the ISQC 1.
- The existence of independent inspection report undoubtedly has enhanced the stakeholders' confidence on level of audit quality in practice.
- The auditors voiced significant concern in respect to detrimental effect of independent audit inspection on auditors' professional judgement and nature of an audit that may impair audit quality.
- Greater transparency report is demanded by other key stakeholders such as the investors that provide more information about standing of audit quality between the audit firms.

Strengthening the process and procedures for inspection

- All respondents acknowledge a high degree of professionalism practised by the inspection teams. This requires continuous professional development within the AOB to constantly upgrade the internal capabilities.

Interactions between stakeholders in the audit and external auditors

- Interactions between the AOB and the auditors of PIEs are common. However, auditors wish for increased support from the AOB in providing them with more details on the inspection findings which could be used as training material to enhance the audit quality.

The role of professional bodies and regulators

- Majority of the respondents feel that the MIA should take a lead role, for monitoring the quality of accountants as preparers of the financial statement firm reporting.
- Professional bodies see themselves in a more supporting role, encouraging high quality reporting and high quality audit to be performed by their members.

The Way Forward – Recommendations

The following are several recommendations for AOB to consider:

- Proactive engagement with institutional investors to create better awareness of AOB;
- Greater sharing of inspection findings to enhance usage of reports to improve overall audit quality;
- Develop a stronger link with MIA to enhance collaborative efforts to strengthen the accountancy profession; and
- Greater transparency in inspection scope of report.

Engagement with Institutional Investor

The AOB should engage proactively with the institutional investors. More importantly, institutional investors should be made aware of the reports produced by the AOB and how such reports could benefit their investment decision making process. This could result in greater appreciation of mutual needs and lead to better understanding of the scope, functions and contributions of the AOB in enhancing the confidence of investors in Malaysia.

Greater sharing of inspection findings

The AOB may consider sharing the inspection findings with a wider audience in an effort to promote continuous improvement in the overall audit quality. For the audit firms, sharing could be in the form of development of training materials that they can use in their training programmes for the junior auditors. Similarly, the inspection findings could be shared with universities and academics in developing case study materials for accounting and auditing curriculum at both undergraduate and postgraduate level students in Malaysia.

Develop a stronger link with MIA

Majority of the interviewees mentioned lack of effective direction and monitoring from MIA, an umbrella body for accounting professionals in Malaysia. With better engagement and more collaborative efforts, both parties could form an effective and useful co-operation towards a stronger accountancy profession in Malaysia.

Inspection scope and report

There are calls for greater transparency in the audit inspection report so that the intended users of the report would better informed. While many of our respondents are unsure whether the Malaysian market is ready for this high level of transparency, it is timely that more details are being published in a stand-alone report or in the mainstream media.

The AOB should consider extending their scope of monitoring that includes audit firms for unlisted companies and preparers of the financial statements. This is seen by the stakeholders as paramount to strengthening the governance structure of PIE firms in generating a higher quality and more reliable financial statements.

PART FIVE

Statement on Governance

MEMBERS OF THE AUDIT OVERSIGHT BOARD



NIK MOHD HASYUDEEN YUSOFF

Nik Hasyudeen is the Executive Chairman of the AOB and an Executive Director of the SC.

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

Nik was the former President of the MIA and also the former Vice-President of the ASEAN Federation of Accountants. He had also served on the MASB and the Listing Committee of Bursa Malaysia. He holds a bachelor's degree in Business from Curtin University of Technology and is a Fellow of CPA Australia.

GOH CHING YIN

Goh Ching Yin is the Executive Director for Strategy and Development; and Market Oversight of the SC.

Helming two portfolios, Goh is responsible for strategy and research, market development, economics and risk management under the Strategy and Development division. His team conceptualises and formulates capital market strategy, products, market mechanisms and the SC's business plan; providing policy analysis of key issues and input to the Government on wider issues affecting the capital market and broader economy. The team also identifies and manages macro risks to the SC's regulatory objectives, and provides oversight on initiatives to develop private equity, venture capital, derivatives and multi-lateral arrangements.

For Market Oversight, he is responsible for regulatory oversight and market surveillance on the stock exchange, bond market development and surveillance; and licensing and authorisation of capital market licensees. His team also oversees the credit rating agencies and bond pricing agency.

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





DATO' GUMURI HUSSAIN

Dato' Gumuri is a Fellow of the Institute of Chartered Accountants in England and Wales, member of the MIA and the MICPA. He is also a Commission member of the SC.

He is the immediate past Chairman of SME Bank and held that post from 2005 to 2013. He was also the Managing Director and Chief Executive Officer of Penerbangan Malaysia Bhd from 2002 to 2004. Prior to this, he was a Senior Partner and Deputy Chairman of Governance Board of PricewaterhouseCoopers Malaysia. He has served as the Non-Executive Director of Bank Industri & Teknologi Malaysia Bhd, Malaysia Airlines System Bhd, Sabah Bank Bhd and Rangkaian Hotel Seri Malaysia Bhd.

DATUK NOR SHAMSIAH MOHD YUNUS

Datuk Nor Shamsiah Yunus is currently the Deputy Governor in BNM. She is responsible for the supervision division that supervises commercial banks (conventional and Islamic banks), investment banks, insurance companies (conventional and takaful) and development financial institutions. She also oversees the Strategic Human Capital Management and the corporate shared services function. She is also responsible for the department on enforcement and combating abuses in the financial system. She sits as one of the members at the BNM Board of Directors. She is also a member of the Monetary Policy Committee, Financial Stability Policy Committee and Joint Policy Committee.

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





CHEONG KEE FONG

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

He was previously a member of the Company Law Reform Committee established by the CCM and a member of the Finance Committee on Corporate Governance Working Group II on Corporate Governance in Malaysia. Cheong Kee Fong was also a member of Financial Reporting Foundation from 1997–2001, CCM and its Audit Committee from 2002–2005.

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

CHOK KWEE BEE

Chok Kwee Bee is the Managing Director of Teak Capital Sdn Bhd, a venture capital management company managing a technology fund under the Malaysia Venture Capital Management Bhd (MAVCAP) Outsource Partner Program.

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

Kwee Bee is currently a member of the Malaysian Venture Capital Development Council (MVCDC). She also sits on the board of Hong Leong Bank Bhd and several portfolio companies. She was previously a member of the SC Capital Market Advisory Council, member of the Exchange Committee of Labuan International Financial Exchange and also a past Chairman of the Malaysian Venture Capital and Private Equity Association (MVCA).



DATO' MOHD NAIM DARUWISH

Dato' Mohd Naim Daruwish is the Chief Executive Officer of the CCM.

Dato' Mohd Naim graduated with a LLB (Hons) degree from the University of Malaya. He started off his career as a Legal Officer with the Legal Department of Bank Pertanian Malaysia in April 1984 before being appointed as Magistrate in 1985 and later as a Senior Magistrate.

He was then appointed as the Manager and later as the Senior Manager of the Prosecution/Litigation Division, Legal Department of the Employees Provident Fund (EPF), Kuala Lumpur. Among the positions held by him in EPF were the General Manager of the Enforcement Department, the Senior General Manager of Legal Department and the Senior General Manager of the Contribution Department.

He is also a board member of Labuan Financial Services Authority (Labuan FSA).



MEETING ATTENDANCE

In 2013, the AOB held seven Board meetings. The attendance by the Board members is stated in the table below:

Board member	Number of meetings attended
Nik Mohd Hasyudeen Yusoff	7/7
Dato' Gumuri Hussain	3/7
Datuk Nor Shamsiah Mohd Yunos	5/7
Goh Ching Yin	7/7
Chok Kwee Bee	5/7
Cheong Kee Fong	6/7
Dato' Mohd Naim Daruwish	3/7

RESPONSIBILITIES OF THE BOARD

The Board is responsible in assisting the AOB in discharging its functions under the SCA. The responsibilities include:

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

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

MEETING PROCEDURES

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

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

REGISTRATION COMMITTEE

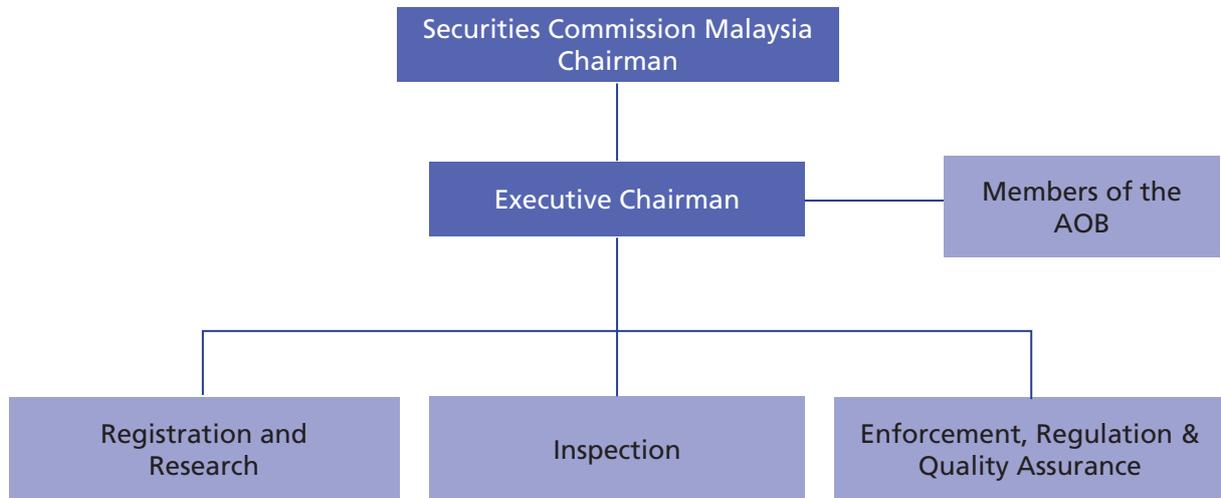
Section 31EA of the SCA provides that the AOB may establish such committees as it considers necessary or expedient to assist in the performance of its responsibilities as specified under section 31E(1) of the SCA.

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

The members of the Registration Committee are:

- Nik Mohd Hasyudeen Yusoff
- Goh Ching Yin

ORGANISATION STRUCTURE



PART SIX

Financial Statements and Others

Audit Oversight Board

Financial statements for the year ended 31 December 2013

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2013

	Note	2013 RM	2012 RM
Assets			
Current assets			
Other receivables	4	80,850	80,850
Cash and cash equivalents	5	828,350	910,532
Total assets		<u>909,200</u>	<u>991,382</u>
Reserves			
Fund from the SC	6	9,000,000	6,000,000
Accumulated deficit	7	(8,120,800)	(5,071,724)
Total reserves		<u>879,200</u>	<u>928,276</u>
Current liabilities			
Other payables and accruals	8	30,000	63,106
Total liabilities		<u>30,000</u>	<u>63,106</u>
Total reserves and liabilities		<u>909,200</u>	<u>991,382</u>

The notes set out on pages 58 to 65 are an integral part of these financial statements.



Datuk Ranjit Ajit Singh
Chairman
Securities Commission Malaysia



Nik Mohd Hasyudeen Yusoff
Executive Chairman
Audit Oversight Board

Date: 28 January 2014

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2013**

	Note	2013 RM	2012 RM
Income			
Registration fee		1,885,177	1,615,029
Finance income from fixed deposits	9	65,730	56,364
Other operating income		15,000	5,000
		<u>1,965,907</u>	<u>1,676,393</u>
Operating expenditure			
Administrative expenses	10	(5,014,983)	(4,372,508)
		<u>(3,049,076)</u>	<u>(2,696,115)</u>
Deficit before tax		(3,049,076)	(2,696,115)
Tax expense	13	–	–
Deficit for the year / Total comprehensive expense for the year		<u>(3,049,076)</u>	<u>(2,696,115)</u>

The notes set out on pages 58 to 65 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 RM	2012 RM
Cash flows from operating activities			
Loss before tax		(3,049,076)	(2,696,115)
<i>Adjustment for:</i>			
Finance income		(65,730)	(56,364)
		<hr/>	<hr/>
Operating loss before changes in working capital		(3,114,806)	(2,752,479)
Change in other payables and accruals		(33,106)	(560,120)
		<hr/>	<hr/>
Net cash used in operating activities		(3,147,912)	(3,312,599)
		-----	-----
Cash flows from investing activities			
Finance income		65,730	105,799
Restricted deposit		(15,000)	(5,000)
		<hr/>	<hr/>
Net cash from investing activities		50,730	100,799
		-----	-----
Cash flows from financing activity			
Fund received from the SC		3,000,000	1,000,000
		<hr/>	<hr/>
Net cash from financing activity		3,000,000	1,000,000
		-----	-----
Net decrease in cash and cash equivalents		(97,182)	(2,211,800)
Cash and cash equivalents at 1 January		905,532	3,117,332
		<hr/>	<hr/>
Cash and cash equivalents at 31 December		808,350	905,532
		<hr/>	<hr/>
Cash and cash equivalents comprise:			
Cash and bank balances	5	328,350	400,684
Deposits placed with a licensed bank	5	500,000	509,848
		<hr/>	<hr/>
		828,350	910,532
Less: Restricted deposits		(20,000)	(5,000)
		<hr/>	<hr/>
		808,350	905,532
		<hr/>	<hr/>

The notes set out on pages 58 to 65 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. General

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

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

To facilitate the abovementioned purposes, a fund known as the AOB Fund was established under section 31H of the SCA. The AOB Fund is administered by the SC. The SC provides administrative and accounting support to the AOB Fund and the accounts are kept separately from the accounts of the SC in accordance with section 31L(5) of the SCA. 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 with the 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 2014

- Amendments to MFRS 10, *Consolidated Financial Statements: Investment Entities*
- Amendments to MFRS 12, *Disclosure of Interests in Other Entities: Investment Entities*
- Amendments to MFRS 127, *Separate Financial Statements (2011): Investment Entities*
- Amendments to MFRS 132, *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*
- Amendments to MFRS 136, *Impairment of Assets – Recoverable Amount Disclosures for Non-Financial Assets*
- Amendments to MFRS 139, *Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting*
- IC Interpretation 21, *Levies*

MFRSs, Interpretations and amendments effective for annual periods beginning on or after 1 January 2015

- MFRS 9, *Financial Instruments (2009)*
- MFRS 9, *Financial Instruments (2010)*
- Amendments to MFRS 7, *Financial Instruments: Disclosures – Mandatory Effective Date of MFRS 9 and Transition Disclosures*

The AOB plans to apply the above mentioned standards, amendments and interpretations that are applicable and effective from the annual period beginning on 1 January 2014 and 1 January 2015 respectively.

The initial application of the abovementioned standards, amendments and interpretations are not expected to have any material financial impacts to the financial statements of the AOB except as mentioned below:

MFRS 9, *Financial Instruments*

MFRS 9 replaces the guidance in MFRS 139, *Financial Instruments: Recognition and Measurement* on the classification and measurement of financial assets.

(b) Basis of measurement

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

(c) Functional and presentation currency

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

(d) Use of estimates and judgements

The preparation of 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

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

(i) Initial recognition and measurement

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

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

(ii) Financial instrument categories and subsequent measurement

The AOB categorises financial instruments as follows:

*Financial assets**Loans and receivables*

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

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

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

Financial liabilities

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

(iii) Derecognition

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

extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit or loss.

(b) 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 3 months or less. 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

Registration fees

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

Finance income

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

4. Other receivables

	2013 RM	2012 RM
Deposits	80,850	80,850
	<u> </u>	<u> </u>

5. Cash and cash equivalents

	2013 RM	2012 RM
Cash and bank balances	328,350	400,684
Deposits placed with a licensed bank	500,000	509,848
	<u>828,350</u>	<u>910,532</u>

The deposits placed with a licensed bank earned interest income at the rate of 3% per annum (2012: 3% per annum).

Included in deposits placed with a licensed bank is RM20,000 (2012: RM5,000) 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 which is under common control by the Government of Malaysia (a party that has direct or indirect significant influence on the AOB).

6. Fund from the Securities Commission Malaysia

	2013 RM	2012 RM
Cash contribution from: SC	9,000,000	6,000,000
	<u>9,000,000</u>	<u>6,000,000</u>

7. Accumulated deficit

	RM
As at 1 January 2012	(2,375,609)
Loss for the year	(2,696,115)
As at 31 December 2012	(5,071,724)
Loss for the year	(3,049,076)
As at 31 December 2013	<u>(8,120,800)</u>

8. Other payables and accruals

	2013 RM	2012 RM
Accruals	30,000	63,106
	<u>30,000</u>	<u>63,106</u>

9. Finance income

	2013 RM	2012 RM
Interest income of financial assets that are not at fair value through profit or loss	65,730	56,364
	<u>65,730</u>	<u>56,364</u>

10. Administrative expenses

	2013 RM	2012 RM
The administrative expenses consist of:		
Auditors' remuneration:		
– Audit services	20,000	20,000
– Other services	–	10,000
Honorarium payment	56,688	13,325
Non-executive members' allowance	87,000	102,500
Other miscellaneous charges	290,364	319,367
Rental of premises	311,286	325,296
Staff costs	4,249,645	3,582,020
	5,014,983	4,372,508
	5,014,983	4,372,508

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) Other financial liabilities measured at amortised cost (OL).

	Carrying amount RM	L&R RM	OL RM
2013			
Financial assets			
Other receivables	80,850	80,850	–
Cash and cash equivalents	828,350	828,350	–
	909,200	909,200	–
	909,200	909,200	–
Financial liability			
Other payables and accruals	(30,000)	–	(30,000)
	(30,000)	–	(30,000)
	(30,000)	–	(30,000)
2012			
Financial assets			
Other receivables	80,850	80,850	–
Cash and cash equivalents	910,532	910,532	–
	991,382	991,382	–
	991,382	991,382	–
Financial liability			
Other payables and accruals	(63,106)	–	(63,106)
	(63,106)	–	(63,106)
	(63,106)	–	(63,106)

11.2 Gains arising from financial instrument

	2013 RM	2012 RM
Gains on:		
Loan and receivables	65,730	56,364
	<u>65,730</u>	<u>56,364</u>

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 to mitigate the effects of fluctuations in cash flows.

Maturity analysis

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

	Carrying amount RM	Contractual cash flow RM	Under 1 year RM
2013			
Financial liability			
Other payables and accruals	30,000	30,000	30,000
	<u>30,000</u>	<u>30,000</u>	<u>30,000</u>
2012			
Financial liability			
Other payables and accruals	63,106	63,106	63,106
	<u>63,106</u>	<u>63,106</u>	<u>63,106</u>

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:

	2013 RM	2012 RM
Fixed rate instruments		
Financial assets	500,000	509,848
	<u>500,000</u>	<u>509,848</u>

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

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

12. Fund management

	2013 RM	2012 RM
Fund from the SC	9,000,000	6,000,000
Accumulated deficit	(8,120,800)	(5,071,724)
	<u>879,200</u>	<u>928,276</u>

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

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 2013 were authorised by the SC for issuance and signed by the Chairman of the SC and Executive Chairman of AOB on 28 January 2014.

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 54 to 65 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 28 January 2014.



.....
Vignaswaran A/L Kandiah

Before me:



INDEPENDENT AUDITORS' REPORT TO THE AUDIT OVERSIGHT BOARD

Report on the Financial Statements

We have audited the financial statements of the Audit Oversight Board (AOB), which comprise the statement of financial position as at 31 December 2013, and the statements of profit or loss and other comprehensive income, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages 54 to 65.

Commission Members' Responsibility for the Financial Statements

The Commission Members of the Securities Commission Malaysia (Commission) are responsible for the preparation of financial statements so as to give a true and fair view in accordance with Malaysian Financial Reporting Standards and with the 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 that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the AOB as of 31 December 2013 and of its financial performance and cash flows for the year then ended in accordance with Malaysian Financial Reporting Standards and with the International Financial Reporting Standards.

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
Firm Number: AF 0758
Chartered Accountants



Peter Ho Kok Wai
Approval Number: 1745/12/15(J)
Chartered Accountants

Petaling Jaya, Malaysia

Date: 28 January 2014

ACRONYMS AND ABBREVIATIONS

AARG	ASEAN Audit Regulators Group
AASB	Auditing and Assurance Standard Board
ACCA	Association of Chartered Certified Accountants
ACRA	Accounting and Corporate Regulatory Authority of Singapore
AICPA	American Institute of Certified Public Accountants
AOB	Audit Oversight Board
APABI	Asian-Pacific Association of Banking Institutes
ASEAN	Association of Southeast Asian Nations
BCBS	Basel Committee on Banking Supervision
BNM	Bank Negara Malaysia
CAQ	Centre for Audit Quality
CCM	Companies Commission of Malaysia
CEAOB	Committee of European Auditing Oversight Bodies
COREPER	Committee of Permanent Representatives
CPA	Certified Public Accountant
CSAP	Committee to Strengthen the Accountancy Profession
EC	European Commission
EGAOB	European Group of Auditors' Oversight Bodies
EMP	Emerging Markets Programme
EPF	Employees Provident Fund
EQCR	Engagement Quality Control Reviewer
ESB	Ethics Standards Board
ESMA	European Securities and Market Authority
EU	European Union
FAQ	Frequently Asked Question
FRC	Financial Reporting Council
FRS	Financial Reporting Standard
FSB	Financial Stability Board
FTSE	Financial Times of the London Stock Exchange
GPPC	Global Public Policy Committee
IAASB	International Accounting and Assurance Standard Board
IBBM	Institute of Bankers Malaysia
ICPAS	Institute of Certified Public Accountants of Singapore
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions

ISA	International Standards on Auditing
ISQC 1	International Standards on Quality Control 1: Quality Controls for Other Assurance and Related Services Engagements
KPI	Key Performance Indicator
Labuan FSA	Labuan Financial Services Authority
MACC	Malaysia Anti – Corruption Commission
MASB	Malaysian Accounting Standards Board
MAVCAP	Malaysia Venture Capital Management Bhd
MFRS	Malaysian Financial Reporting Standards
MIA	Malaysia Institute of Accountants
MICG	Malaysian Institute of Corporate Governance
MICPA	Malaysian Institute of Certified Public Accountants
MOF	Ministry of Finance
MVCA	Malaysian Venture Capital and Private Equity Association
MVCDC	Malaysian Venture Capital Development Council
PCAOB	Public Company Accounting Oversight Board
PIE	Public-interest entity
PLC	Public-listed company
PPC	Public Practice Committee
ROSC AA	Report on Observance of Standards and Codes - Accounting and Auditing
SC	Securities Commission Malaysia
SCA	<i>Securities Commission Act 1993</i>
SIDC	Securities Industry Development Corporation
UK	United Kingdom
UK CC	UK Competition Commission
US	United States of America

DEFINITIONS

Auditor	An individual auditor or audit firm who is registered under section 310 of the <i>Securities Commission Act 1993</i> as an auditor of a PIE.
Big Four Audit Firms	Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers.
Major Audit Firms	Audit firms with more than 10 partners and audit more than 40 PIEs with a total market capitalisation of above RM15 billion.
Other Audit Firms	Mid-tier audit firms and sole proprietors.
Public-interest entity	An entity meeting the following definition: <ul style="list-style-type: none"> (a) A PLC or a corporation listed on the stock exchange (b) A licensed institution licensed under the <i>Banking and Financial Institutions Act 1989</i> (c) An insurance company licensed under the <i>Insurance Act 1996</i> (d) A takaful operator registered under the <i>Takaful Act 1984</i> (e) An Islamic bank licensed under the <i>Islamic Banking Act 1983</i> (f) A developmental financial institution prescribed under the <i>Development Financial Institutions Act 2002</i> (g) A holder of Capital Markets Services Licence for the carrying on of the regulated activities of dealing in securities, dealing in derivatives and fund management; and (h) Any other person as the Minister may, by order published in the <i>Gazette</i>, prescribe.