

**MONITORING AND
SUPERVISION OF
PIE AND SCHEDULE
FUND AUDITORS**

REGISTRATION AND RECOGNITION

The AOB's key oversight activities such as registration, inspection and enforcement are aimed at promoting high quality audit practices. The AOB encourages that audit firms build capacity and have in place quality framework which enables quality audits to be performed consistently.

The AOB's oversight activities are targeted to:

- Enforce the AOB's Registration Conditions that promotes quality and capacity;
- Drive quality audit practices through inspection and remediation efforts; and
- Set the tone for quality through enforcement actions.

The AOB registers and recognises 40 audit firms and 369 registered and recognised individual auditors.

Table 1 below provides the breakdown of the number of PIE and schedule funds clients of these registered and recognised auditors.

TABLE 1

Registered and recognised auditors as at 31 December 2022

Profile of audit firms	No. of audit firms	No. of individual auditors	No. of PIE audit clients	% of total PLCs market capitalisation	No. of schedule funds audit clients	% of total NAV
Registered audit firms						
Partnership with 10 and more audit partners	10	249	995	96.44	1,272	98.56
Partnerships with 5 - 9 audit partners	14	71	153	2.60	21	1.31
Partnerships with fewer than 5 audit partners	12	37	75	0.83	20	0.13
Sub Total	36	357	1,223	99.87	1,313	100.00
Recognised foreign audit firms	4	12	5	0.13	-	-
TOTAL	40	369	1,228	100.00	1,313	100.00

Chart 1 tabulates the number of registered audit firms and individual auditors for the past five years. The number of registered audit firms has decreased from 49 in 2018 to 36 in 2022. The sharp decrease in the number of audit firms was due to the AOB's condition of registrations introduced in August 2018. The AOB tightened the conditions of registration in 2019 to improve and strengthen the audit firm's internal capacity and governance. The registration conditions provided an avenue for the audit firms to restructure their practices to be better equipped to audit PIEs and schedule funds.

The number of registered individual auditors has steadily been increasing since 2019 as audit firms have been building capacity.

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

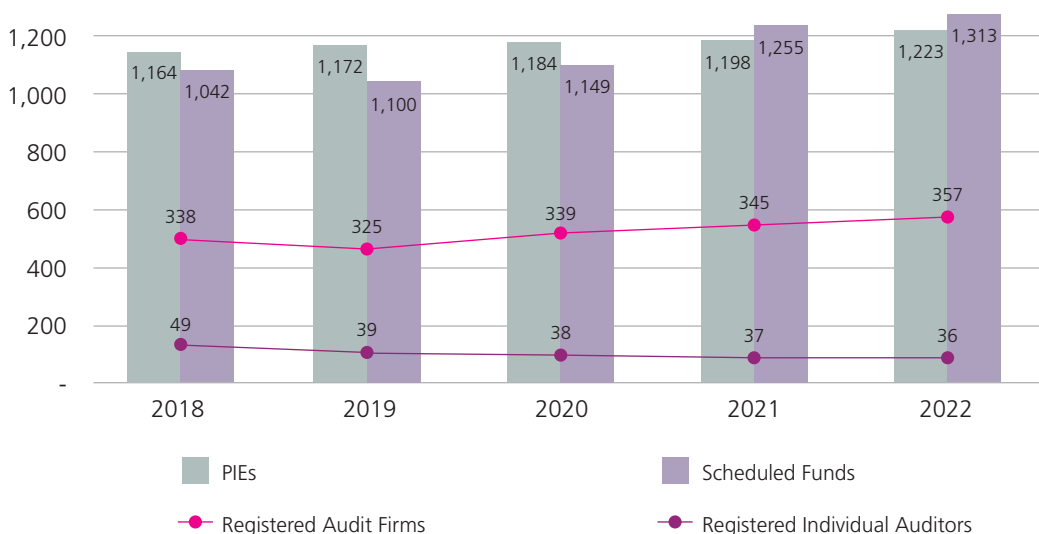
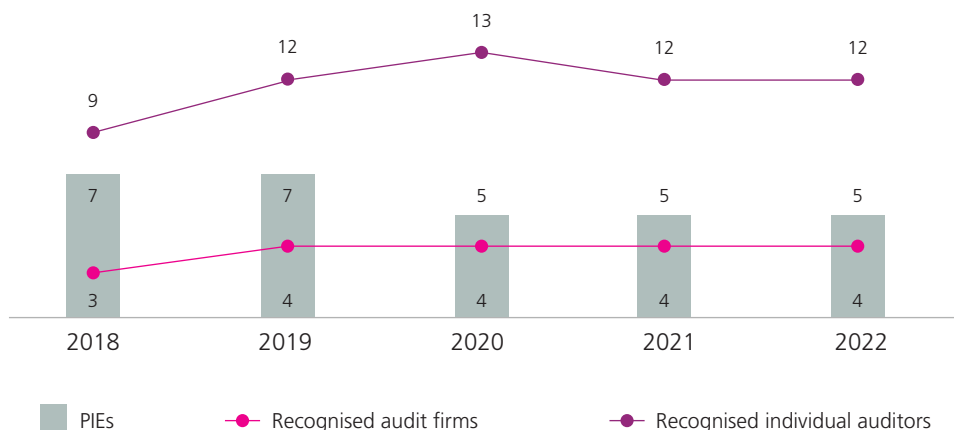


Chart 2 tabulates the number of recognised audit firms and individual auditors for the past five years. Over the years, the number of recognised audit firms and individual auditors have remained steady at four recognised firms and 12 individual auditors.

The recognised audit firms are from Singapore, Hong Kong and the UK. Recognised audit firms must be an internationally affiliated network firm, with effective technical support and robust quality control from its network firm.

The AOB relies on the oversight frameworks of the recognised auditors' home jurisdictions to determine whether they are fit and proper to audit PIEs. Part of this is ensuring that the audit firms comply with international quality control, auditing, ethical and other assurance standards, and that they are subjected to regular inspection by their home audit regulators.

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



PIE CLIENTS' MOVEMENTS

Throughout 2022, an additional of two AOB registered audit firms with a total of 162 PIE clients met the criteria of Major Audit Firms. At present, Major Audit Firms in Malaysia consist of eight AOB registered audit firms which collectively audit 95.3% of the total market capitalisation of PLCs in Malaysia. Throughout 2022, there were new additions to the PIE client lists of the registered audit firms. Also, there were PLCs that were delisted and PIEs that were no longer considered PIEs.

As shown in Table 2 below, PIE audit clients continued to move from Major Audit Firms to Other Audit Firms in 2022. The AOB viewed the trends positively as the movement would dilute the market concentration in the audit industry.

While the AOB views this trend positively, Other Audit Firms are reminded to build up their respective firms' human resources capacity from time to time to so as to uphold their audit quality. Other Audit Firms should keep abreast with the developments in the capital market. This is to ensure that the audit firms have the capable and competent resources to perform quality audits.

TABLE 2

Clients' movement among registered and recognised audit firms during year 2022

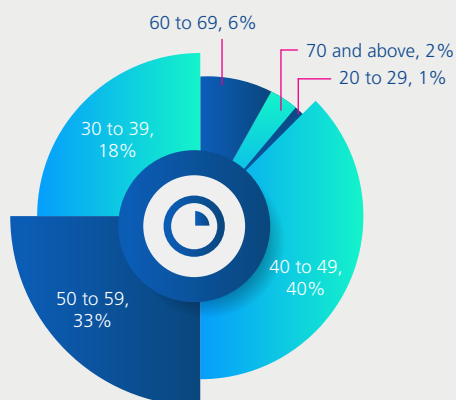
Firm Size	As at 1 Jan 2022	Change in audit firm profile	New PIEs	PLCs delisted and PIEs removed	No. of PIEs incoming from		No. of PIEs outgoing to		As at 31 Dec 2022
					Major Audit Firms	Other Audit Firms	Major Audit Firms	Other Audit Firms	
Major Audit Firms	734	162	32	(10)	-	9	-	(23)	904
Other Audit Firms	464	(162)	9	(6)	23	-	(9)	-	319
Foreign	5	-	-	-	-	-	-	-	5
Total	1,203	-	41	(16)	23	9	(9)	(23)	1,228

AGE PROFILE OF AOB REGISTERED AND RECOGNISED INDIVIDUAL AUDITORS

In 2017, the AOB highlighted the need for audit firms to consider the continuity and sustainability of its audit practice. Succession planning is important to minimise disruption to the practice and allow for a smooth exit and transition of the retiring partners. Audit firms must continuously recruit new talent, develop, mentor and groom their team members for management and leadership roles.

CHART 3

Age profile of registered individual auditors as at 31 December 2022



Based on data in 2022, 41% (2017: 42%) of registered individual auditors are of the age of 50 years and above. Within this group, 20% (2017: 36%) are of the age of 60 years and above. The oldest registered individual auditor is 79 years old. It is encouraging to note that the group with the age of 40 years and below has increased to 19% (2017: 11%), indicating an increase in the number of younger talent in the profession.

INSPECTION OF AUDIT FIRMS AND INDIVIDUAL AUDITORS

In accordance with Section 31V(1) of Part IIIA of the SCMA, the AOB conducts inspections on auditors of PIEs and schedule funds with the objective to promote high quality audits and reliable audited financial statements.

Inspections conducted by the AOB comprise Firm and Engagement level reviews.

A Firm level review focuses on the review of an audit firm's quality control systems and practices as well as the degree of compliance with the requirements of *International Standard on Quality Management 1 (ISQM 1)*



An Engagement level review seeks to assess the degree of compliance by auditors with the relevant auditing and ethical standards including whether sufficient and appropriate audit evidence have been obtained in relation to the audit reports of PIEs and schedule funds.

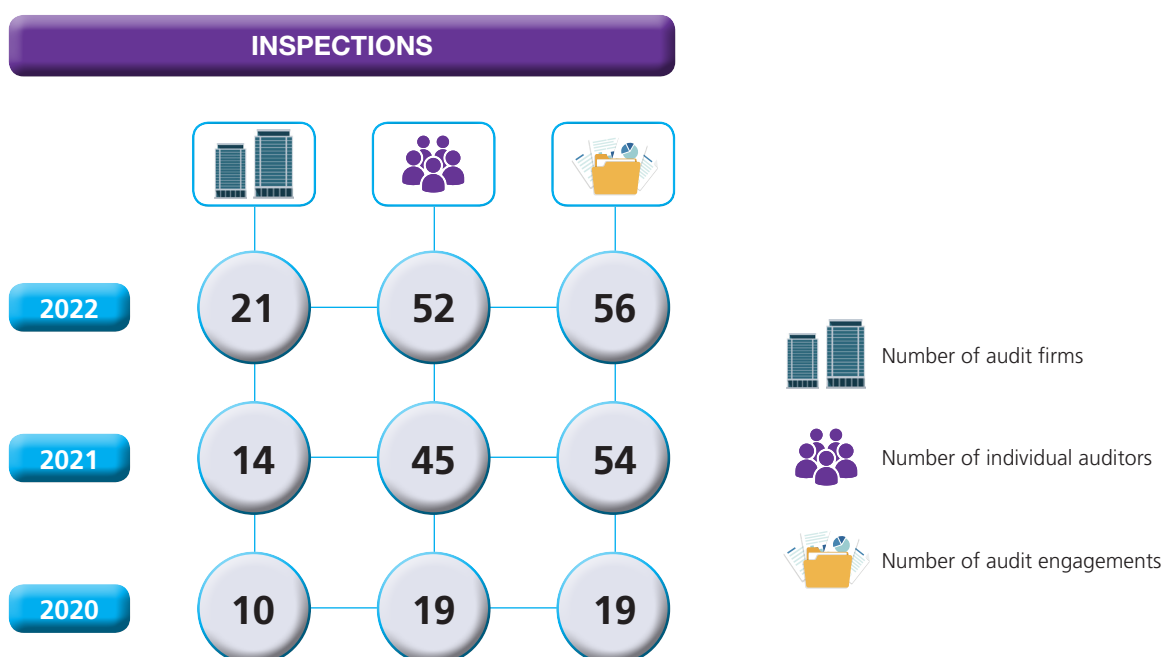
In 2022, the AOB inspected 21 Audit Firms covering 52 individual auditors for 56 audit engagements.

Each year, the AOB conducts inspections on all firms that have more than 50 PIE audit clients with a total market capitalisation of the PIE audit clients of above RM15.0 billion. These eight Major Audit Firms (2021: six Major Audit Firms) collectively audited PLCs that represented 73.5% of the total number of PLCs and 95.3% of the total market capitalisation of PLCs in Malaysia.

The AOB adopts a risk-based approach in selecting other audit firms for inspection under its monitoring programme. The AOB takes into consideration various factors such as:

- Size of the audit firm (including a firm's degree of investment in audit quality);
- Number of registered audit partners with the AOB;
- Results of the auditors' internal and external monitoring reviews;
- Number of PIE and schedule fund clients;
- Market capitalisation of and complexity of the audit firm's audit clients; and
- Financial performance of those clients particularly where there are indicators of potential financial manipulation and/or liquidity concerns.

The AOB also conducted a number of targeted inspections to respond to emerging risks in a timely manner.



At the conclusion of every inspection, the AOB assesses the severity of findings arising from each engagement review. All findings are expected to be remediated by the audit firms within a timeline agreed with the AOB regardless of whether subsequent enforcement action is taken on the individual auditor or his/her firm.

The AOB emphasises the importance of identifying the actual root causes when putting in place a remedial action plan. It is essential that the remediation plan is holistic, relevant, and viable to ensure that any shortfall or weaknesses in audit quality are appropriately and promptly rectified to ensure high quality and reliable audited financial statements of PIEs and schedule funds.

More in-depth information on the inspection programme, including common inspection findings, results of thematic reviews, trends analysis and remediation efforts taken by inspected audit firms will be made available separately in the 2022 AOB AIR.

2022 INSPECTION HIGHLIGHTS

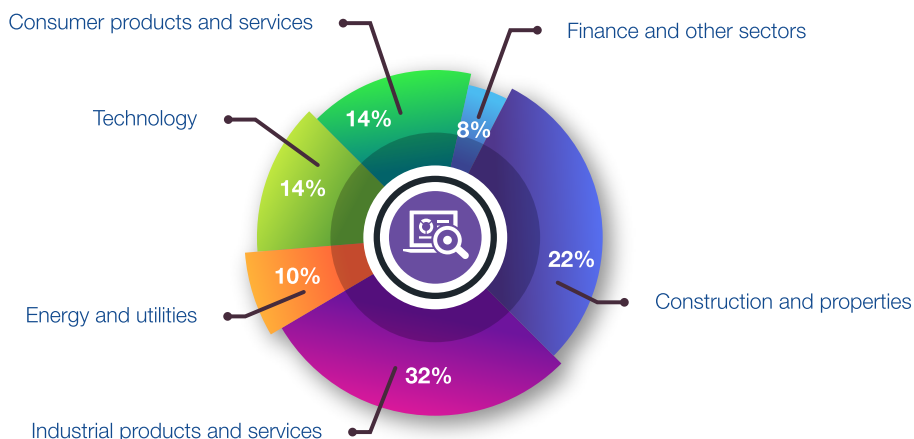
Risk-based approach taken by the AOB in the planning and engagement selection for its inspections and monitoring programmes



Actions taken in 2022 included:

- Imposition of specific remediation measures to incorporate or revise the relevant audit procedures
- Enforcement actions by the AOB pursuant to Section 31Z of the SCMA
- Refer the cases of PLCs to other SC line departments

INDUSTRIES COVERED BY THE AOB'S INSPECTION IN 2022

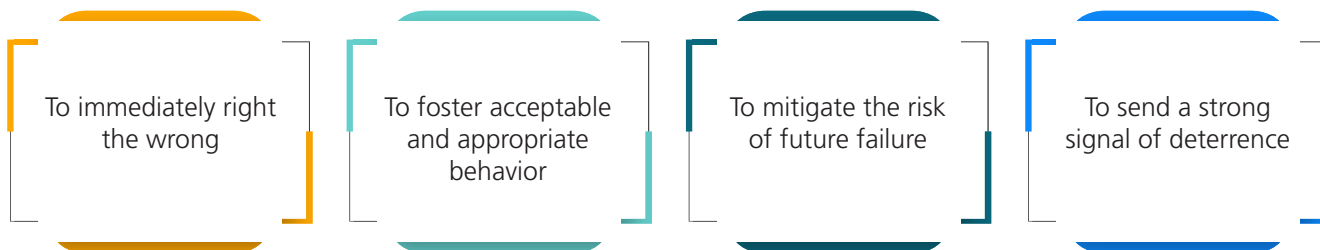


ENFORCEMENT ON AUDIT FIRMS AND INDIVIDUAL AUDITORS

Achieving the desired outcome

The AOB continued to focus its efforts in taking enforcement actions that instil good behaviour and achieve high level of compliance among the AOB’s registrants.

The desired outcomes that the AOB intends to achieve include:



Proportionality of enforcement action

In determining the type of actions to be imposed, the AOB ensures that enforcement actions are commensurate with the nature and severity of the breach. The AOB would impose stricter actions in cases of multiple instances of failures to perform audit procedures. Other considerations include the conduct of the auditors, previous regulatory record and impact on the capital market.

Nature and severity of breach	Conduct of the auditors	Previous regulatory record	Impact on the capital market
<ul style="list-style-type: none"> Breaches were pervasive and involved failures in many key areas. Breaches involve or reveal serious weaknesses in management systems or internal controls or processes of the firm. Breaches of relevant laws and regulations. Breaches of ethical standards. Contravention is deliberate. Person in breach had benefitted from the breach financially or otherwise. Breaches contributed to the commission of financial crime. 	<ul style="list-style-type: none"> Failure to exercise due care, diligence and professional behaviour. Contravention is deliberate. Person in breach had benefitted from the breach financially or otherwise. Breaches contributed to the commission of financial crime. 	<ul style="list-style-type: none"> Have been sanctioned for non-complying with regulations, guidelines and any other applicable laws. Disciplinary proceedings or actions taken by any relevant regulatory authority in or outside Malaysia. 	<ul style="list-style-type: none"> Breach affected a large number of PIE or schedule fund audit. Breach caused significant loss to PIE or schedule fund and the investors. Breach has impact on the basis of the audit opinion. Breach had an impact on the reliability of the audited financial statements. Breach had impact on the market capitalisation of the PIE or the NAV of the schedule fund.

Mitigating consideration

Enforcement proceedings typically involved long gestation periods before the matter is concluded. The AOB is mindful that for its enforcement actions to be an effective deterrence and mitigate the risk to the capital market, enforcement proceedings need to be completed in a timely manner.

The AOB recognises and considers the auditors efforts in mitigating any non-compliances of the relevant standards which contribute to an early and more timely resolution of the matter. In this aspect, the AOB takes into account the level of co-operation provided by the auditors which include providing a prompt response to the AOB’s requests for information, voluntarily providing information to assist the inspection/enforcement team and self-reporting of any non-compliances. In addition, the AOB favourably views the proactiveness of the auditors in taking actions to remediate, limit and mitigate potential and actual cases of non-compliance.

ENFORCEMENT ACTIONS IN 2022

Sanctions imposed

In 2022, the AOB took six enforcement actions, as shown in Figure 1. The AOB prohibited five audit partners and one audit firm from auditing and accepting PIEs and schedule funds as audit clients for one year. In addition to the prohibition, the AOB also imposed monetary fines on the audit partners and audit firm totalling RM383,500.

Three of the audit partners were sanctioned for failure to comply with the relevant ISA when performing audit of a PIE as the engagement partner. Meanwhile, two other audit partners were sanctioned for failure to perform their role as the Engagement Quality Control Reviewer (EQCR). The AOB views this seriously and reiterates the crucial role of the EQCR in safeguarding the integrity of audit quality and control process.

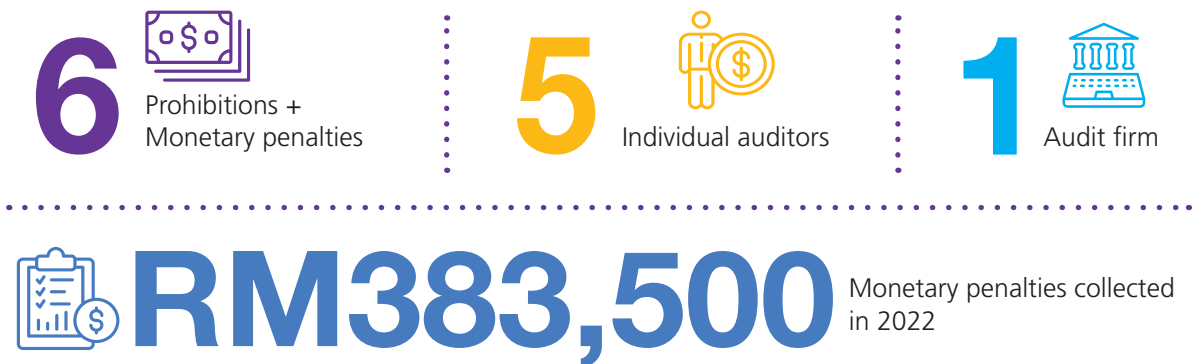
The audit firm was sanctioned for failure to comply with the relevant requirements of *International Standards on Quality Control 1* (ISQC 1). In particular, the firm had failed to ensure that its quality control monitoring system operated effectively, resulting in its failure to detect the audit deficiencies found in the audits of the PIE clients.

The AOB wants to stress the importance of the audit firm’s quality control systems and practices and its compliance with the requirements of ISQC 1. The AOB would not hesitate to take actions against the firm for any weaknesses in the quality control systems and non-compliances to the ISQC 1 and the *International Standard on Quality Management 1* (ISQM 1) (from 15 December 2022 onwards).

The AOB’s actions against the auditors were taken after the due process accorded to them, including the opportunity for them to appeal to the SC against the AOB’s decisions.

FIGURE 1

Enforcement actions taken in 2022



Read more on the AOB’s enforcement actions <https://www.sc.com.my/aob/aobs-sanctions>

Cases under inquiry and concluded

The number of outstanding cases as at 31 December 2022 is shown in Table 3. Details on the movement of enforcement cases since 2018 are shown in Table 4.

TABLE 3

Number of outstanding cases as at 31 December 2022

Cases brought forward from 2021	2
New cases referred to Enforcement in 2022	4
Cases completed in 2022	2
Outstanding cases as at 31 December 2022	4

TABLE 4

Number of cases completed since 2018

Year	No. of referrals for enforcement proceedings	No. of cases completed prior to 2022	No. of cases completed in 2022	No. of outstanding cases as at 31 December 2022
2018	8	8	-	-
2019	4	4	-	-
2020	5	4	1	-
2021	1	-	1	-
2022	4	-	-	4

THE AOB'S ENFORCEMENT OBSERVATIONS



Audit evidence

- Non-existent, incomplete or inadequate documentation in the audit file to support the audit procedures performed, assumptions made and conclusions reached.



Auditor's independence

- The auditor did not have full control over the trade receivables confirmation process where requests were made and received through their clients.
- Over reliance on information provided by the clients without performing further audit procedures.
- Failure to perform audit procedures to verify reliability of information provided by the clients.



Overseas audit

- Lack of understanding and knowledge in performing audits in foreign jurisdictions.
- Not familiar with the laws, regulations and reporting requirements of foreign jurisdictions.



EQCR role

- Failure to sufficiently review the selected audit documentation relating to significant judgements and risk areas of the engagement as well as the basis of the conclusions.
- Absence of a robust review by the EQCR partner affect the oversight and governance over the audit partners in carrying out audited financial statements of PIE or schedule funds.



Professional scepticism

- Accepting clients' explanation without corroborating audit evidence.
- Failure to critically assess audit evidence for potential material misstatement(s).

JUDICIAL REVIEWS

Auditors aggrieved with the AOB's decision can appeal to the SC, and if not satisfied, they may have legal recourse. In 2022, the SC was involved in three judicial reviews brought by audit firm, Afrizan Tarmili Khairul Azhar (AFTAAS) and its audit partners. These judicial reviews involved challenges to the AOB's powers in enforcing its rules and regulations and the manner in which the AOB conducted its enforcement proceedings.

In a landmark decision, the Federal Court, on 17 August 2022, unanimously ruled in favour of the SC and dismissed the application for leave to appeal by AFTAAS and three of its partners against the AOB's decisions to impose enforcement sanctions against the audit firm and its partners. The Federal Court's decision reflects the seriousness of the breaches and reinforces the robustness of the AOB's enforcement framework.

The SC also obtained favourable decisions in the High Court in two other judicial review applications brought by AFTAAS and its partner. The High Court had struck out the judicial review application to challenge the effective date of the prohibition imposed on AFTAAS and its partners on 29 June 2022.

In another judicial review application brought by AFTAAS's partner against the AOB's imposition of addition criteria of registration, the High Court again ruled in favour of the SC and dismissed the judicial review application. AFTAAS's partner has since appealed to the Court of Appeal against the High Court's decision.

Judicial review applications against the AOB's decisions as at 31 December 2022

Judicial Review	Brief Description	Outcomes
Between AFTAAS and three of its partners and the SC	Challenges against the AOB's powers and the manner in which the AOB conducts its enforcement proceedings.	<ul style="list-style-type: none"> The Federal Court had on 17 August 2022, unanimously ruled in favour of the SC and dismissed the application of leave to appeal by AFTAAS and its partners against the AOB's decisions to impose sanctions against AFTAAS and its partners.
Between AFTAAS and its partner and the SC	Challenges against the AOB's notification to AFTAAS and its partners on the effective date of prohibition.	<ul style="list-style-type: none"> The High Court has on 29 June 2022 struck out the judicial review application. On 28 July 2022, AFTAAS and its partner has filed an appeal to the Court of Appeal against the High Court's decision. AFTAAS and its partner had on 14 November 2022 withdrawn their Appeal to the Court of Appeal against the High Court's decision.
Between Datuk Mohd Afrizan Husain and the SC	Challenges against the AOB's Criteria for Registration.	<ul style="list-style-type: none"> The High Court had dismissed Datuk Mohd Afrizan's judicial review application on 18 August 2021. Datuk Mohd Afrizan had filed an appeal at Court of Appeal on 23 August 2021.

Read more on the update of the judicial reviews <https://www.sc.com.my/aob/aobs-sanctions>