

PART



**FOSTERING HIGH QUALITY
INDEPENDENT AUDITING
IN THE CAPITAL MARKET**



INTRODUCTION

The Audit Oversight Board (AOB) was established pursuant to the *Securities Commission Malaysia Act 1993* (SCMA). It supports the Securities Commission Malaysia by regulating auditors of public-interest entities (PIEs) and schedule funds to promote investor protection as well as confidence in the quality and reliability of audited financial statements of PIEs and schedule funds.

The AOB’s regulatory oversight is primarily exercised through its core work:

- Registration and recognition;
- Inspecting the audits of PIEs and schedule funds; and
- Enforcement of ethical and auditing standards.

The AOB has adopted a strategic plan which links its core work and activities to achieve its mission. The AOB continues to strengthen its focus on risk-based inspections and take enforcement actions against auditors for

non-compliance with the auditing and/or ethical standards.

The efforts in fostering high quality audit require all stakeholders to play their roles effectively. In this respect, the AOB continues to promote improvement in audit quality and emphasis was placed on effective communication and collaboration with stakeholders through initiatives such as organising engagement sessions with audit committees and managements of PIEs, regulators and auditors.

Highlights of activities in 2019, in line with the strategic themes, are presented in the following sections.



STRENGTHENING THE FOCUS ON RISK-BASED INSPECTIONS

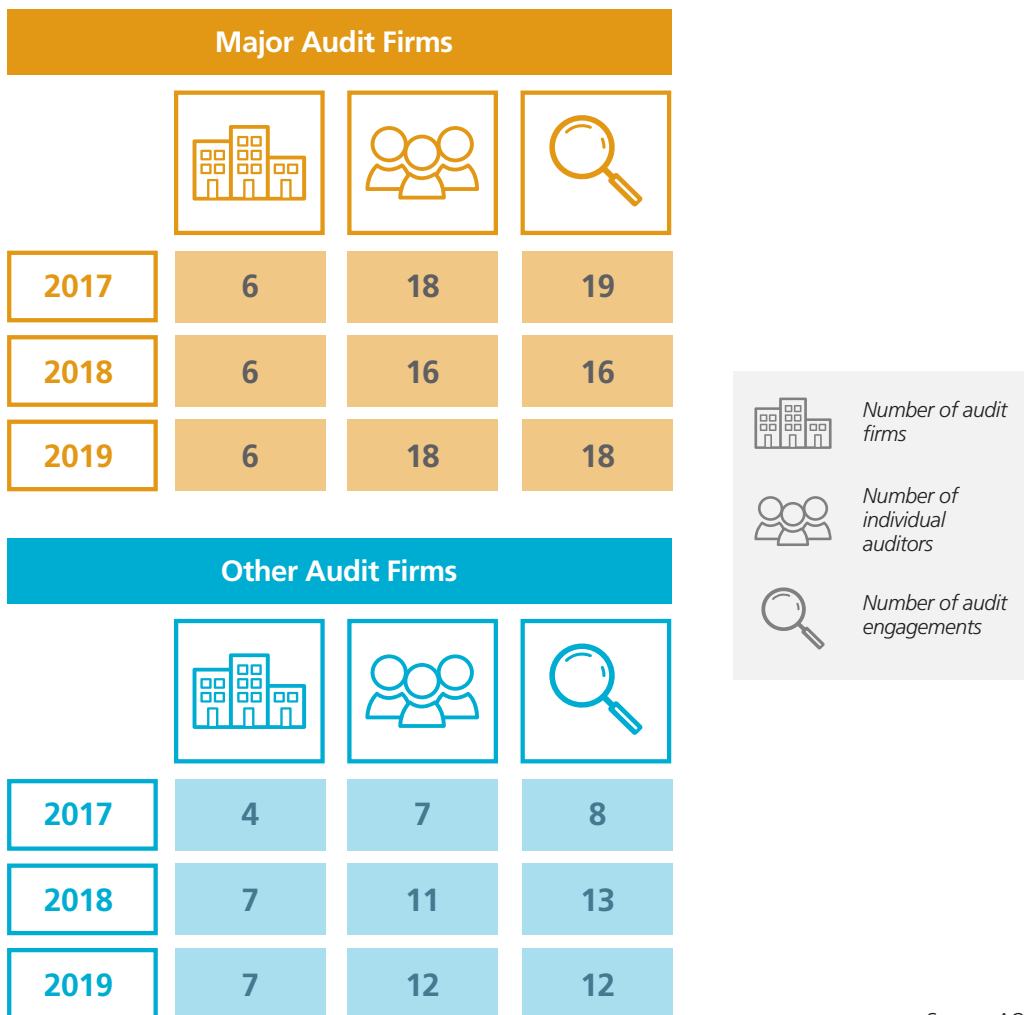
The AOB conducts regular inspections on auditors of PIEs and schedule funds to promote high quality audits and reliable audited financial statements.

In developing and carrying out its inspection programme, the AOB adopts a risk-based approach that takes into consideration the impact of an audit failure on the capital market

and public confidence. The AOB's inspection programme also incorporates thematic reviews on potential areas of concern that require the AOB's immediate attention.

Further details on the inspection programme, including common inspection findings, results of thematic reviews, trends analysis and remediation efforts taken by inspected audit firms will be presented separately in the *2019 AOB Annual Inspection Report (AIR)*.

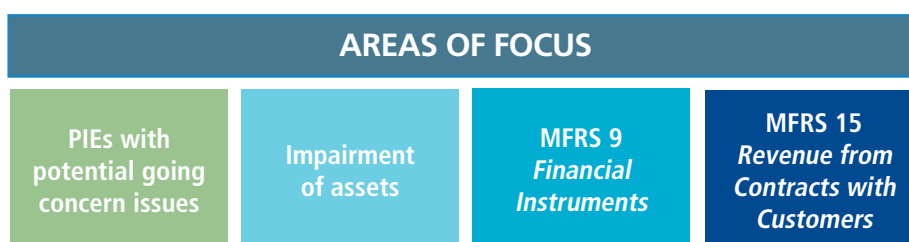
INSPECTION COVERAGE 2019



Source: AOB

Inspection Highlights 2019

- Regular inspections were conducted focusing on the following economic trends, market concerns and developments in audit, accounting and regulatory areas:



Source: AOB

- Increased coverage on the inspections of audit engagements of financial institutions in view of the adoption of *Malaysian Financial Reporting Standards (MFRS) 9 Financial Instruments*.
- Conducted a number of special inspections to respond to emerging risks in a timely manner.
- Actions taken in 2019 included:
 - Imposed conditions on certain inspected audit firms and individual auditors (including Engagement Quality Control Reviewer (EQCR) partners) as interim measures where significant concerns on audit quality were established;
 - Imposed specific remediation measures on certain inspected audit firms and individual auditors;
 - Referrals of certain inspected audit firms and individual auditors, including EQCR partners, to the Enforcement Department due to the severity of inspection findings; and
 - Sharing of inspection findings with relevant PIEs where significant concerns on audit quality were established and needed to be addressed immediately by the PIE.
- With the issuance of the *2018 AOB Annual Inspection Report*, the AOB strongly encourages the Board of Directors and their Audit Committees (ACs) to gain an understanding and discuss the inspection findings as well as trends with their respective auditors to ensure that risk areas specific to their entities are adequately addressed. To ensure that the ACs have the information shared in the *Annual Inspection Report*, the AOB distributed the report to all public-listed companies (PLCs) to facilitate and enhance the communication and engagement between the Board of Directors and/or the ACs and their auditors.

ANNUAL TRANSPARENCY REPORTING

To promote accountability among audit firms and uphold audit quality, the AOB introduced the Annual Transparency Reporting for audit firms who have more than 50 PIE audit clients and the total market capitalisation of the audit firms' PIE clients must be above RM10 billion. Commencing in the year 2020, audit firms are required to disclose, its legal and governance structure, measures taken to uphold audit quality and manage risks, and information on their measurement of indicators for audit quality in their transparency report. This will provide board and shareholders with relevant information for considerations in the evaluation and appointment of auditors.

FOCUSED AND IMPACTFUL ENFORCEMENT OUTCOME

The AOB registrants are required to comply with the relevant requirements of the approved auditing standards in Malaysia, namely, the *International Standards on Auditing* and the *Malaysian Institute of Accountants' (MIA) By-Laws on Professional Ethics, Conduct and Practice (MIA By-Laws)*, and relevant laws and regulations.

The AOB continues to send strong signals to its registrants and stakeholders that non-compliance with auditing and ethical standards will be viewed seriously and proportionate action will be taken where necessary. In 2019, the AOB's actions ranged from a revocation of registration to prohibitions and monetary penalties.

The AOB adopts a strategic enforcement approach where the principles of proportionality, efficiency and AOB's desired outcomes are considered before a sanction is imposed on an auditor. To determine the type of sanction that will be imposed for any contravention or breach, the AOB takes into account the nature and seriousness of the offence, previous regulatory records and other mitigating factors.

The AOB has robust internal processes to ensure that enforcement actions are proportionate with the breach and are aligned to its objectives in safeguarding the capital market from the risks of audit failure and improving the quality of audits of PIEs and schedule funds.

The AOB takes cognisance that prohibitions to accept and audit PIE and schedule fund clients have a financial and business impact on the firms, thus it is an enforcement tool that is not wielded lightly, which reflects the severity of the breaches.

ENFORCEMENT HIGHLIGHTS IN 2019



Revoked the registration of an individual auditor for breaching the key audit partner rotation requirement of the MIA By-Laws and prohibited a firm from increasing its PIE and schedule funds clients as well as imposed a monetary penalty. The firm was also required to provide an undertaking to the AOB that it will assess and build capacity within the firm.



Prohibited firms and engagement partners from accepting as clients and auditing the financial statements of PIEs and schedule funds for 12 months for issues such as multiple instances of breaches to the requirements of the *International Standards on Auditing (ISAs)*, recurring findings and evidence of capacity and capability issues.



Prohibited engagement quality control reviewers from accepting as clients and auditing financial statement of PIEs and schedule funds for 12 months for failing to effectively carry out their oversight responsibilities.



Monetary penalties imposed on firms and engagement partners for audit failures.

Source: AOB

Depending on the issues that need to be addressed including capacity versus capability issues, the AOB has the power and discretion to vary the type and period of the prohibitions. For example, firms can be allowed to maintain existing clients but are prohibited from accepting new clients, or firms can be prohibited from accepting and auditing any clients.

The AOB also continues to stress the importance of EQCR partner's in the quality control of an audit. It has taken enforcement actions against EQCR partners who have failed to effectively carry out their oversight responsibilities. Actions against EQCR partners were only taken in cases where significant failures were identified during the course of audit that should have been identified and addressed by any reasonably experienced EQCR partner.

Auditors aggrieved with the AOB's decision can appeal to the SC, and if not satisfied, they may have legal recourse. In 2019, firms and auditors who have been sanctioned have initiated judicial reviews and other legal proceedings against the SC and the AOB for enforcement actions taken. These matters are currently pending hearing in the Courts.

The AOB has always been mindful of the impact of its actions on the reputation and professional lives of auditors. As such, it ensures that the enforcement processes are robust and can withstand any challenges. The AOB also holds strongly to the principles of natural justice and accords the auditors numerous opportunities to defend their position and present their case.

NUMBER OF CASES AND A RANGE OF ACTIONS TAKEN IN 2019

REVOCATED

 **1** INDIVIDUAL AUDITOR

REPRIMANDED

 **1** INDIVIDUAL AUDITOR

PROHIBITED

 **3** AUDIT FIRMS  **5** INDIVIDUAL AUDITORS

PENALTIES IMPOSED ON

 **3** INDIVIDUAL AUDITORS

TOTAL AMOUNT OF PENALTIES IMPOSED IN YEAR 2019

 **RM1,312,000**

Source: AOB

As an overview of the AOB's enforcement case management, the table below shows referrals received, completed as well as outstanding cases as at 31 December 2019.

CASE MANAGEMENT: NUMBER OF REFERRALS, COMPLETED AND OUTSTANDING CASES FOR THE RELEVANT YEARS

Year	No. of Referral for Enforcement Proceedings	No. of Cases Completed Prior to 2019	No. of Cases Completed in 2019	No. of Outstanding Cases as at 31 Dec 2019
2016	4	1	3	-
2017	1	-	-	1*
2018	16	10	6	-
2019	12	-	4	8

* The matter is still outstanding due to the discovery of additional facts which warrants the expansion of scope of the enforcement proceedings.

Source: AOB

EFFECTIVE COMMUNICATION AND COLLABORATION WITH STAKEHOLDERS

The AOB expands its past efforts to encourage the improvement of the quality of financial reporting through engagement with a wide variety of stakeholders in Malaysia, the region and globally.



DIRECTORS AND MANAGEMENT

Two sessions were held with ACs to share the AOB's observations through its inspection and how the ACs may play a role in supporting the audit process and improving audit quality. In these sessions, the Association of Chartered Certified Accountants (ACCA) and the Malaysian Accounting Standards Board (MASB) were also invited to share their insights.

The AOB also participated in a roundtable discussion organised by the ACCA with audit practitioners and non-practitioners alike, on closing the expectation gap in audit, which is one of the most cited current challenges for the audit profession.



REGULATOR

The AOB shared Malaysia's regulatory updates and insights at various International Forum of Independent Audit Regulators (IFIAR), ASEAN Audit Regulators Group (AARG), and Organisation for Economic Co-operation and Development (OECD) Asian workshops and meetings throughout the year. These events are important forums for regulators to discuss best practices and common problems, and develop increased consistency in audit regulation across jurisdictions, while fostering greater collaboration between the member countries.



AUDITOR

In 2019, the AOB hosted the AARG Annual Meeting which included a conversation between regulators and regional leaders from a number of major audit firms. This provided a venue for constructive dialogue between regulators and auditors on ways to address the common challenges presented by the auditing landscape.

The AOB introduced the Transparency Reporting framework in 2019, which is intended to place an emphasis on Audit Quality Indicators (AQIs) in assessing audit quality. In formulating the framework, the AOB, together with the larger audit firms, explored how to practically present such information to the public.

KEY STAKEHOLDERS ENGAGEMENT AT A GLANCE IN 2019

MARCH



IFIAR Inspection Workshop 6 to 8 March 2019

The AOB shared Malaysia's regulatory updates and insights into the audit regulators practical experiences at the 13th IFIAR Inspection Workshop in Paris. This annual workshop was hosted by the *Haut Conseil du Commissariat aux Comptes* (H3C), designed and targeted for those involved in inspection activities.

APRIL

AARG Inspection Workshop 1 and 2 April 2019

Key highlights shared at the AARG Inspection Workshop held in Singapore were Malaysia's regulatory updates, the AOB's enforcement framework and data analytics observations as well as the *International Standards on Quality Control* (ISQC) 1 observations. The inspection workshop hosted by Singapore's Accounting and Corporate Regulatory Authority (ACRA) covered knowledge sharing and exchange of inspection experience among regulators in the region.

MAY

IFIAR Annual Plenary Meeting 30 April to 2 May 2019

The IFIAR 2019 Plenary Meeting themed "The Evolving World of Audit" was hosted by the Hellenic Accounting and Auditing Standards Oversight Board and held in Rhodes, Greece.

The discussions were on exploring current issues facing the profession and audit regulators, including lessons by regulators in managing challenges and analysing proposed changes in other jurisdictions.

JULY



AARG Annual Meeting 17 and 18 July 2019

The AOB hosted the 9th AARG Annual Meeting. Over 100 participants attended, which included ACRA Singapore, Securities and Exchange Commission (SEC) Thailand, Pusat Pembinaan Profesi Keuangan Indonesia and SEC Philippines and the regional leaders of the Global Public Policy Committee (GPPC) firms namely, BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG and PricewaterhouseCoopers.

At the AARG, best practices were shared to ensure consistency in the approach to audit regulation within the region. The AARG prides itself in the collaborative work among member countries and regular engagements with the GPPC firms in the region in improving audit quality.

The annual meeting is a platform to share ideas, suggestions, experiences and regulatory updates from the respective jurisdictions, including an introduction of the audit regulatory framework by the AARG's newest member, the SEC Philippines.

AUGUST



AOB Conversation with the Larger Audit Firms 9 August 2019

The AOB engaged eight larger audit firms to introduce the Annual Transparency Reporting for firms that audit PIEs in Malaysia.

OCTOBER



CAANZ-MICPA Audit Forum 17 October 2019

The AOB shared challenging issues currently affecting audit practitioners at the forum themed 'Future of Audit'. The Audit Forum was organised by The Malaysian Institute of Certified Public Accountants (MICPA) and the Chartered Accountants Australia and New Zealand (CAANZ).

NOVEMBER



Conversation with Audit Committees 8 and 22 November 2019

The AOB organised a Conversation with the ACs, which was attended by the ACs of PLCs. The objective of the event was to present the AOB's recent initiatives in the auditing space that will influence the ACs' role in enhancing and improving audit quality in Malaysia.



Forum on the ISQM 11 November 2019

The Forum entitled 'ISQM: Another Tsunami of Change for Auditors?' organised by the MICPA. The AOB shared the overview and expectation of the proposed *International Standard on Quality Management 1* (ISQM) of the International Auditing and Assurance Standards Board.



Closing the Expectation Gap in Audit 20 and 21 November 2019

Views highlighted by the AOB to the audit practitioners and non-practitioners at the roundtable organised by ACCA covered the expectation gap in audit particularly common inspection findings.



OECD-ASIAN Roundtable 27 and 28 November 2019

At the OECD Asian Roundtable on Corporate Governance, the AOB discussed recent achievements, challenges and future priorities in Malaysia with regards to the corporate governance framework as well as the development of accounting and auditing standards, independence of auditors and regulatory oversight. The Roundtable was organised by the OECD and hosted by the Securities and Exchange Board of India (SEBI) with financial support from the Financial Service Agency of Japan.