A GUIDE TO UNDERSTANDING AUDITING AND ASSURANCE:

MALAYSIAN LISTED COMPANIES

SEPTEMBER 2014

Acknowledging the contribution of
MALAYSIAN INSTITUTE OF ACCOUNTANTS

MALAYSIAN INSTITUTE OF ACCOUNTANTS

BE HEARD.
BE RECOGNISED.

CPA AUSTRALIA

CPA Australia Ltd ('CPA Australia') is one of the world's largest accounting bodies representing more than 150,000 members of the financial, accounting and business profession in 121 countries.

For information about CPA Australia, visit our website **cpaaustralia.com.au**

First published 2014

CPA Australia Ltd
ACN 008 392 452
Level 20, 28 Freshwater Place
Southbank Vic 3006
Australia

CONTENTS

Contributors	**4**
Foreword	**5**
A guide to understanding auditing and assurance: Malaysian listed companies	**6**
Why are audits required?	6
What does assurance mean?	6
What is an audit of financial statements?	7
What is a review of the statement on risk management and internal control?	7
Relationships in financial reporting	7
The auditor's report	8
Modified auditor's reports	9
How can you tell if the auditor's report is clean or not?	10
Does a clean auditor's report mean a clean bill of health for the company?	10
Who signs the auditor's report?	10
What is auditor independence?	10
What do auditors do?	11
What is a material misstatement?	12
What do auditors do in regard to fraud?	12
What do auditors do in regard to going concern?	12
Does the auditor sign off on the whole annual report?	13
What is audit quality?	13
Difference between internal and external audit	13
Other assurance	13
Appendix 1 – Glossary	**14**

CONTRIBUTORS

CPA Australia acknowledges the work of the External Reporting Centre of Excellence and MIA Professional Standards and Practices Division.

EXTERNAL REPORTING CENTRE OF EXCELLENCE

David Hardidge FCPA (Aust.)	Chairman
Indra Abeysekara CPA (Aust.)	
Tong-Gunn Chew FCPA (Aust.)	
Ric De Santi FCPA (Aust.)	
Thomas Egan FCPA (Aust.)	
Amir Ghandar FCPA (Aust.)	Technical Support and Lead Author
Piotr Jakubicki CPA (Aust.)	
Alan Lee CPA (Aust.)	
Jeffrey Luckins FCPA (Aust.)	
Carmen Ridley (Aust.)	
Mark Shying CPA (Aust.)	Technical Support
Julie Sinclair FCPA (Aust.)	
Ram Subramanian CPA (Aust.)	Technical Support
Eva Tsahuridu	Technical Support

MIA PROFESSIONAL STANDARDS AND PRACTICES DIVISION

Eddie Wong Koon Wai CPA (Aust.), C.A. (M)	Director
Rasmimi Ramli FCCA, C.A. (M)	Senior Manager
Shalini Balakrishnan FCCA, C.A. (M)	Manager

FOREWORD

Auditing and assurance play an essential role in the effective operation of our capital markets and the economy at large, providing confidence to current and prospective shareholders about the information disclosed by companies.

A guide to understanding auditing and assurance: Malaysian listed companies explains the value and purpose of auditing and assurance in plain language. This should assist shareholders who are not experts in auditing and assurance to better understand the messages from their company's auditor, and make use of this information in their decision making. Since first publication, the Guide has been recognised for its contribution to this essential aspect of financial literacy internationally.

The Guide has been adapted for shareholders in many parts of the world and through the dedicated contribution and collaborative input of the Malaysian Institute of Accountants (MIA) now comes suited specifically for the needs and perspective of Malaysian shareholders and the Malaysian auditing profession.

The Guide is an initiative of the External Reporting Centre of Excellence of CPA Australia and I congratulate them on their contribution to a CPA Australia publication that has an important role to play in the promotion of improved financial literacy.

Alex Malley FCPA
Chief Executive
CPA Australia Ltd

The MIA is pleased to support A guide to understanding auditing and assurance: Malaysian listed companies, which is an initiative of the External Reporting Centre of Excellence of CPA Australia and has been customized to suit the Malaysian environment in collaboration with the MIA Professional Standards and Practices Division.

For some time MIA has recognized the need to educate shareholders and other providers of capital who are not literate in financial reporting standards and the Companies Act 1965 to interpret financial statements. This Guide has been written in plain language to assist shareholders and other providers of capital without expertise in accounting to further their understanding of the important role of auditing and assurance.

We would like to express our gratitude and appreciation to CPA Australia for their initiative in the publication of this Guide. We hope this Guide will increase the knowledge and enhance financial literacy among existing and prospective shareholders.

Ho Foong Moi
Chief Executive Officer
Malaysian Institute of Accountants

A GUIDE TO UNDERSTANDING AUDITING AND ASSURANCE: MALAYSIAN LISTED COMPANIES

WHY ARE AUDITS REQUIRED?

Shareholders are often quite separate from those managing and governing the companies they own. They need a reliable and independent source of financial information on which to assess the company, and the performance of Directors. The same can be said for other stakeholders of companies, such as creditors, lenders, employees, analysts, prospective shareholders, governments and communities. Audits enhance the credibility of the information contained within the **financial statements**, so that shareholders and other stakeholders can make assessments and decisions with confidence and on a consistent basis.

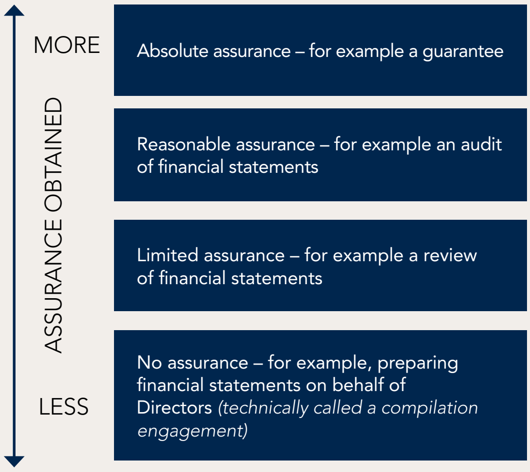
WHAT DOES ASSURANCE MEAN?

The term **assurance** refers to the expression of a conclusion that is intended to increase the confidence that users can place in a given subject matter or information. For example, an **auditor's report** is a conclusion that increases the confidence that users can place in a company's financial statements.

There are different levels of assurance, which depend on the type of work that the **assurance practitioner** performs, and these different levels also lead to different types of conclusions.

Type of assurance	For example	Nature of key work performed	Example form of conclusion
Reasonable assurance	An audit of financial statements	Detailed testing, evidence gathering and substantiation to support the conclusion.	"In our opinion, the financial statements give a true and fair view".
Limited assurance	A review of financial statements	Primarily enquiries and analysis, less detailed procedures.	"Based on our review, nothing has come to our attention that causes us to believe that these financial statements do not give a true and fair view".
No assurance	Preparing financial statements (compilation)	Preparation of the financial statements	No conclusion provided

The following diagram illustrates different levels of assurance, in some of the different activities performed by assurance practitioners:



WHAT IS AN AUDIT OF FINANCIAL STATEMENTS?

An audit of financial statements is a **reasonable assurance** engagement where the auditor provides an opinion about whether the financial statements present a **true and fair** view, and are in accordance with **accounting standards** *(and legislation where appropriate).*

Malaysian listed company full-year financial statements are required by law to be audited.

While the reasonable assurance obtained in an audit is a high level of assurance, it is not absolute assurance (a certification that the financial statements are completely correct). Obtaining absolute assurance is not possible in financial statement audits for a number of reasons, including:

- It would be impractical for the auditor to test and audit every transaction
- Financial statements involve judgements and estimates which often cannot be determined exactly, and may be contingent on future events

WHAT IS A REVIEW OF THE STATEMENT ON RISK MANAGEMENT AND INTERNAL CONTROL?

Malaysian listed companies must ensure that the auditor reviews a statement made by the board of directors with regard to the state of internal control (Statement on Risk Management and Internal Control) of the listed company and report the results to the board.

The Malaysian Institute of Accountants has issued Recommended Practice Guide 5 (Revised) to provide guidance for auditors in the performance of a limited assurance engagement to report on the Statement on Risk Management and Internal Control included in the annual report.

RELATIONSHIPS IN FINANCIAL REPORTING

The following diagram illustrates the relationship between shareholders and other stakeholders, Directors and the auditor.

In listed companies a sub-committee of the board of directors called the audit committee usually arranges the appointment of the auditor. The audit committee typically meets with the auditor throughout the year to discuss details such as scheduling, risks, financial reporting issues, the auditors findings and other matters relevant to the audit and financial statements. At the conclusion of the audit, the auditor often provides a more detailed, in-depth confidential report to the audit committee.

In Malaysia, auditors attend a listed company's Annual General Meeting and are available to answer questions from interested parties that are entitled to participate in the meeting, such as shareholders. This is a useful opportunity to clarify specific aspects of the audit.

THE AUDITOR'S REPORT

The auditor's report contains the auditor's opinion on the financial statements, in addition to a range of other information. An unmodified auditor's report effectively states the auditor believes the financial statements present a true and fair view, and are in accordance with accounting standards and relevant legislation. This is sometimes also called an "unqualified" or a "clean" audit opinion. Unmodified auditor's reports are the most common type you are likely to come across. This is in part because Directors usually addresses most of the problems or adjustments that auditors discover before the financial statements are issued.

Emphasis of matter and other matter paragraphs

In some circumstances, the auditor will include additional wording in the auditor's report directing users to information that in their view is fundamental to understanding the financial statements (called an "emphasis of matter" paragraph) or relevant to their understanding of the audit, the auditor's responsibilities or the report itself (called an "other matter paragraph").

It is important to note that an emphasis of matter or other matter paragraph is not a qualification, limitation or adverse conclusion (for these types of auditor's reports, see *Modified auditor's reports* below).

Type of paragraph	Examples
Emphasis of matter	There is a significant uncertainty as to the company's ability to continue as a going concern, which has been appropriately disclosed in the financial statements.
Other matter	The auditor's report is made solely to the members of the company and the auditor does not assume responsibility to any other person for the content of the report.

MODIFIED AUDITOR'S REPORTS

Modified auditor's reports are issued when the auditor believes the financial statements contain a **material misstatement**, or when the auditor is unable to obtain enough evidence to form an opinion. The following table sets out the different types of modified auditor's reports that may be issued in these situations.

Type of modified audit opinion	Description	Situations where this type of report may be issued	Examples
Qualified or "except for" opinion	The opinion states the financial statements present a true and fair view, and are in accordance with accounting standards *except* for the effect of a specific matter or matters. The issues are described in a separate paragraph within the report.	A qualified opinion is issued when a specific part of the financial statements contains a material misstatement or adequate evidence cannot be obtained in a specific, material area, and the rest of the financial statements are found to present a true and fair view, in accordance with accounting standards.	The auditor has a different view on the valuation of an asset than that applied by Directors in the financial statements, but the rest of the financial statements were found to be free of material misstatements.
Disclaimer of opinion	The auditor cannot reach an opinion overall on the financial statements and therefore disclaims any opinion on it.	A disclaimer of opinion is issued when the auditor cannot obtain adequate evidence to form an opinion on the financial statements overall.	The company's financial reporting information system is damaged and key data is lost, meaning adequate evidence is not available to support the disclosures in the financial statements.
Adverse opinion	The opinion states that the auditor believes the financial statements *do not* present a true and fair view, and *are not* in accordance with accounting standards.	An adverse opinion is issued when the auditor believes misstatements are so pervasive that the financial statements do not present a true and fair view, or are not in accordance with accounting standards.	The auditor believes that Directors have applied an inappropriate financial reporting framework in preparing the financial statements.

HOW CAN YOU TELL IF THE AUDITOR'S REPORT IS CLEAN OR NOT?

To determine if an auditor's report is clean or modified, you need to look at the "opinion" section. This is usually found towards the end of the auditor's report, before the auditor's name and signature. An unqualified or clean audit opinion will state that the auditor believes the financial statements present a true and fair view, and are in accordance with accounting standards and relevant legislation. A modified auditor's report will contain a qualification to that statement, a disclaimer or an adverse statement (see also "Modified auditor's reports").

It is also useful to look at the heading of the audit opinion which will state "Qualified opinion" if the opinion is qualified.

Even where there is a clean opinion, it is important to look for and pay attention to emphasis of matter or other matter paragraphs (see also page 8).

The Malaysian Institute of Accountants has issued a guide on understanding auditor's reports which includes illustrative examples and is available on their website.

DOES A CLEAN AUDITOR'S REPORT MEAN A CLEAN BILL OF HEALTH FOR THE COMPANY?

Auditor's reports are intended to increase the degree of confidence users have in the information in financial statements – not about the state of the company itself or whether it is a safe investment. An unmodified auditor's report means investors or other stakeholders can make an assessment of the company based on its financial statements, with a higher degree of confidence that the information is materially correct and unbiased.

Auditor's do perform a role in assessing the appropriateness of the going concern assumptions used by Directors in preparing the financial statements, but this cannot be taken as a conclusion on the solvency or financial health of the company (see "What do auditors do in regard to going concern?").

WHO SIGNS THE AUDITOR'S REPORT?

In Malaysia, an approved company auditor signs the auditor's report. The report is signed in the name of the firm and in his own name by the partner of the firm who is an approved company auditor. The firm number and the approved number of the partner is legibly written or printed either under or alongside the signature of the firm and the partner respectively.

The Malaysian professional ethical standards require that the auditor's report be signed by the engagement partner whose firm is appointed as auditor of the company. The engagement partner is the person responsible for the overall performance and quality of the audit engagement.

WHAT IS AUDITOR INDEPENDENCE?

An independent auditor is free from external influence or bias and is therefore able to independently form judgements and conclusions during the audit. Auditors are subject to **professional ethical standards**, including extensive requirements for auditor independence both in mind and in appearance. It is critical that auditors are not only actually independent, but also seen as independent. For example, in respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than five years.

WHAT DO AUDITORS DO?

The audit of financial statements is a systematic process designed to identify instances of material misstatement in the financial statements. Extensive **auditing standards** and legislative requirements set the framework and minimum requirements for financial statement audits.

The following diagram illustrates at a very high level what is involved in financial statement audits, and the order in which activities usually take place during the year:

Primarily performed prior to period end	Initial assessment and agreement on terms of the engagement	A key part of the initial assessment is whether the auditor will be able to meet independence and other ethical requirements.
	Understanding the company and assessing risks of material misstatement in the financial statements	Understanding the company involves an analysis of internal and external factors. The assessed risks of material misstatement form a basis for the audit procedures to be performed.
Period end, e.g. 30 June		
Primarily performed after period end	Performing procedures to address the risk of material misstatement in the financial statements	The types of procedures applied involve judgement and will vary significantly depending on the risks of material misstatement, nature of the entity.
	Finalisation and auditor's report signed (Malaysian listed companies: within 4 months of period end date)	For more on auditor reporting, see "The auditor's report".

WHAT IS A MATERIAL MISSTATEMENT?

As mentioned above, auditors are concerned with material misstatements, rather than *any* misstatement in the financial statements. Material misstatements are those that are significant enough to affect the decisions made by the users of the financial statements. This can be in terms of the quantitative or qualitative significance of misstatements.

Quantitative	The quantities or ringgit amounts in the financial statements. For example, quantitatively material misstatements could include: • Overstating revenue • Missing/not recorded liabilities • Understating expenses
Qualitative	The nature of items in the financial statements. For example, qualitatively material misstatements could include: • Not disclosing certain related party transactions • Not disclosing management's remuneration These disclosures are important in evaluating how the company has been managed, although they may be small quantitatively in comparison to the scale of the company's overall operations.

WHAT DO AUDITORS DO IN REGARD TO FRAUD?

Auditors consider the possibility that fraudulent activities can result in material misstatement in the financial statements, and take this into account in planning and performing their work. Fraud is defined in auditing standards as an:

"intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage".

An audit is not an investigation intended to uncover all instances of fraud. However it is reasonable to expect that an audit would detect instances of fraud that result in material misstatement.

WHAT DO AUDITORS DO IN REGARD TO GOING CONCERN?

The **going concern** assumption is that a company will continue in business for the foreseeable future. This assumption is adopted unless evidence indicates otherwise.

The going concern assumption has a significant impact on how a company's financial statements are presented (see "If going concern doesn't apply").

In preparing the financial statements, Directors makes an assumption as to whether it believes the company will be able to continue as a going concern. The auditor performs work to assess this assumption as part of the audit.

If going concern doesn't apply

Companies that are not a **going concern** report on a different basis from those that are – for example, assets and liabilities would be recognised at their immediate sale value/ liquidation value, rather than their value in future use.

The work of the auditor includes:

- Obtaining evidence that can be used to assess the appropriateness of Directors' assumptions in regard to going concern.
- Forming a conclusion on whether that evidence indicates any material uncertainties in the ability of the company to continue as a going concern.

The auditor's focus in this assessment is whether the company can continue as a going concern for a 12-month period from the date of signing the auditor's report.

The going concern assumption involves judgements about events taking place in the future, which are inherently uncertain. Where there is significant uncertainty in the company's ability to continue as a going concern and this has been disclosed by Directors in the financial statements, the auditor includes wording in the auditor's report to direct users to the applicable note in the financial statements.

This is called an emphasis of matter paragraph (explained further on page 7). If the auditor ultimately does not agree with Directors' assumptions in regard to going concern, the result would be a modified opinion (see "The auditor's report").

DOES THE AUDITOR SIGN OFF ON THE WHOLE ANNUAL REPORT?

The auditor's report is about the financial statements, which are usually included in the annual report. Other information within the annual report may not have been subjected to assurance (for example management discussion and analysis, or an operating review). However, the auditor does consider whether this accompanying information is consistent with the audited financial statements. So for example, the auditor would report if the profit results included in the operating review were inconsistent with those in the financial statements.

WHAT IS AUDIT QUALITY?

Audit quality is challenging to define, measure and observe as most of the valuable work auditors do happens before company financial statements are released to the public (see also "What do auditors do?"). The International Auditing and Assurance Standards Board (IAASB) has issued a *Framework for Audit Quality* which says:

> "Audit quality encompasses the key elements that create an environment which maximises the likelihood that quality audits are performed on a consistent basis."

Audit firms are ultimately responsible for performing quality audits. The IAASB's *Framework for Audit Quality* also recognises the importance of the contribution and support of regulators, audited companies and other stakeholders in achieving quality audits and reliable financial statements in the capital markets.

DIFFERENCE BETWEEN INTERNAL AND EXTERNAL AUDIT

Internal audit is an appraisal activity established within an entity and functions under the direction of the company's management and board. It is a management tool and forms part of the company's internal control structure. In general, the main focus of an internal audit is to evaluate the adequacy and effectiveness of the company's internal control.

Conversely, an external audit is undertaken by an auditor who is independent from the entity and has been appointed to express an opinion on the financial statements or other specified accountability matter. External auditors act and report in accordance with their mandates, which may be dictated by legislation, regulation or established in a contract.

OTHER ASSURANCE

Assurance is also applicable in a wide and expanding range of other areas aside from financial statements. Some examples include:

- Compliance with regulations
- Sustainability reports
- Greenhouse gas emission statements
- Prospectuses
- Performance audits

A wide group of stakeholders increasingly need credible information in regard to the performance and impact of companies in these areas.

APPENDIX 1 – GLOSSARY

Accounting standards: Mandatory standards applied in preparing financial statements. In Malaysia, these standards are issued by the Malaysian Accounting Standards Board.

Assurance: The expression of a conclusion that is intended to increase the confidence of users in subject matter or information (see also "What does assurance mean?").

Assurance practitioner: A professional assurance services provider.

Auditor's report: The final report that sets out the auditor's opinion (see also "The auditor's report".

Auditing and assurance standards: Mandatory standards applied by assurance practitioners in audits, reviews and other assurance engagements. In Malaysia these standards are issued by the Malaysian Institute of Accountants.

Financial statements: Four primary financial statements for the current and comparative financial period (statement of comprehensive income, statement of financial position, statement of changes in equity, and cash flow statement), plus the notes to the financial statements. See also, "A guide to understanding annual reports: Malaysian listed companies"available on CPA Australia's website and the Malaysian Institute of Accountants website.

Going concern: An enterprise that is expected to continue in business for the foreseeable future, taken to be a 12 month period for the purpose of auditor going concern assessments. (see also "What do auditors do in regard to going concern?").

Limited assurance: A level of assurance that is meaningful, but lower than reasonable assurance (see also "What does assurance mean?").

Material misstatement: An inaccuracy or omission from the financial statements that is significant enough to affect the decisions made by users of the financial statements.

Professional ethical standards: The ethical standards applicable to the accounting profession, including those applicable to assurance practitioners. In Malaysia, these standards are issued by the Malaysian Institute of Accountants.

Reasonable assurance: A high but not absolute level of assurance (see also "What does assurance mean?").

True and fair: Presenting an unbiased picture of a company's financial performance and position in the financial statements.

CPAH1112_09.14