



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

External Auditor

BNM/RH/GL 018-4	Prudential Financial Policy Department Islamic Banking and Takaful Department	External Auditor
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PART A OVERVIEW

1. Introduction

Policy objective

1.1. Bank Negara Malaysia (the Bank) places reliance on quality audit services to complement its conduct of supervision of financial institutions so as to foster safety and soundness. The Bank, therefore, maintains a deep interest in the quality with which an external auditor performs the audit of a financial institution. The assurance of a properly conducted audit serves to provide an independent view of the financial statement's reliability, which becomes more important in light of the increasing scope of management's judgment permitted under the financial reporting standards adopted in Malaysia.

Scope of policy

1.2. This policy document outlines the qualifications of an external auditor to be appointed by a financial institution and sets out the Bank's requirements regarding the terms of an audit engagement, application procedures and reporting obligations to be observed by a financial institution.

2. Applicability

2.1. This policy document is applicable to:

- i. a financial institution;
- ii. an auditor appointed under section 67(1) of the Financial Services Act 2013 (FSA); and
- iii. an auditor appointed under section 76(1) of the Islamic Financial Services Act 2013 (IFSA).

3. Legal provision

3.1. The requirements in this policy document are specified pursuant to:

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- i. section 47(1), section 67, section 115, section 143(2) and section 266 of the FSA; and
- ii. section 57(1), section 76, section 127, section 155(2) and section 277 of the IFSA.

4. Effective date

- 4.1. This policy document comes into effect on 1 January 2015 and is applicable to the appointment of an auditor for financial years beginning on and after 1 January 2015.

5. Interpretation

- 5.1. The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA and IFSA unless otherwise defined in this policy document.

- 5.2. For the purpose of this policy document:

“**S**” denotes a standard, requirement or specification that must be complied with. Failure to comply may result in one or more enforcement actions;

“**G**” denotes guidance which may consist of such information, advice or recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted;

“**auditor**” has the same meaning assigned to it in section 31A of the Securities Commission Act 1993;

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“**board**” means the board of directors, which may be assisted by the board audit committee¹;

“**financial institution**” means a licensed person and a financial holding company approved by the Bank²;

“**licensed person**” means a licensed person under the FSA and the IFSA but excludes a licensed international Islamic bank³.

6. Policy document superseded

- 6.1. The following policy document and supervisory letter are superseded when this policy document comes into effect in accordance with paragraph 4.1:
- i. Policy document on *External Auditor* issued on 28 June 2013; and
 - ii. The Bank’s letter on *Supervisory Expectations on Audit Committee Pertaining to the Appointment/Re-appointment of External Auditor* issued in July 2012.

¹ While the board is primarily responsible for conducting the assessments on the auditor, the board may delegate the assessment of the auditor’s compliance to the board audit committee.

² Pursuant to section 112 of the FSA or section 124 of the IFSA.

³ In respect of a licensed international Islamic bank, the requirements on external auditor are as set out in paragraphs 10.3 and 10.4 of the *Guidelines on International Islamic Bank*.

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PART B REGULATORY REQUIREMENTS

7. Criteria for the appointment of an auditor

- S** 7.1. Pursuant to section 67(1) of the FSA or section 76(1) of the IFSA, as the case may be, an auditor appointed by a financial institution shall meet the qualification criteria set out in paragraph 7.3 and shall continue to meet the criteria throughout the audit engagement. In this regard, the board shall obtain, review and independently verify through reasonable means all relevant information necessary to support its assessment of the auditor's compliance with the criteria specified under paragraphs 7.3 to 7.5
- S** 7.2. If during the course of an audit engagement period, the auditor no longer fulfills any of the qualification criteria or requirements specified in this policy document, the financial institution shall immediately notify the Bank in writing of that fact and the reasons for not meeting the qualification criteria or requirements.
- S** 7.3. The qualification criteria of an auditor are as follows:
- i. he is registered as an auditor of a public interest entity with the Audit Oversight Board;
 - ii. he must not have been convicted of any offence under the FSA, the IFSA or the Companies Act 1965, or of any offence under any written law involving fraud or dishonesty;
 - iii. he shall have the necessary skills, knowledge and appropriate experience to perform the audit of the financial institution with professional competence and due care in accordance with the approved auditing standards⁴ and applicable regulatory and legal requirements;
 - iv. he shall not have relationships with, or interests in, including an interest in shares of, the financial institution or any of its related⁵ entities that are

⁴ Refers to the Malaysian Approved Standards on Auditing (MASA) issued by the Malaysian Institute of Accountants (MIA).

⁵ Refers to section 6 of the Companies Act 1965.

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likely to impair his objectivity or independence, and which cannot be reduced to an acceptable level through the application of appropriate safeguards;

- v. he shall not have any record of disciplinary actions taken against him for unprofessional conduct by the MIA where the decision for such disciplinary action has not been reversed by the Disciplinary Appeal Board of the MIA; and
- vi. he must not have served as an engagement partner for a continuous period of more than five years with the same financial institution. An auditor who has been rotated off the audit of a financial institution may resume the role as engagement partner only after a lapse of five years from the last audit engagement with that financial institution.

S 7.4. The board shall ensure that members of the audit engagement team involved in making key decisions on significant matters with respect to the audit of the financial statements meet the qualification criteria in paragraphs 7.3(ii) to 7.3(v).

S 7.5. Where non-audit services are provided to the financial institution by an auditor, the board shall ensure that the provision of such service does not impair, either in fact or appearance, the auditor's objectivity, judgment or independence.

S 7.6. Where the board relies on attestations provided by an auditor on matters covered in paragraphs 7.3 and 7.4, reasonable steps must be taken to establish the veracity of the attestations. At the minimum, the board shall:

- i. consider information available from public or independent sources which are relevant to the professional conduct of the auditor;
- ii. consider the auditor's conduct and performance in past assurance engagements with the financial institution; and
- iii. be satisfied that appropriate measures have been taken by the auditor to prevent the recurrence of past audit lapses that have been observed, including but not limited to, delays in the issuance of audit reports and

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inadequate audit procedures resulting in the failure to detect material errors or control deficiencies.

8. Terms of an audit engagement

- S** 8.1. The board shall review the terms of an audit engagement prior to confirming an engagement. The agreed terms shall be documented in an audit engagement letter.
- S** 8.2. The terms of an audit engagement shall at the minimum address the following:
- i. objective of the audit;
 - ii. scope of an audit engagement;
 - iii. agreement on the audit plan;
 - iv. responsibilities of the engagement and concurring partners;
 - v. reports to be prepared by the auditor, including the Auditor's Report and recommendations for improving internal controls;
 - vi. timing of the audit and audit fees;
 - vii. use of experts in certain aspects of the audit; and
 - viii. other significant arrangements in relation to the audit, including responsibilities of the auditor with regard to any change to members of the engagement team during the audit.
- S** 8.3. For the reappointment of an auditor, the existing terms of the audit engagement shall be confirmed for each reporting period and appropriate modifications made as necessary to reflect any material changes in the financial institution which have a bearing on the audit engagement.

Scope of an audit engagement

- S** 8.4. The scope of the audit engagement shall be determined having regard to all activities of a financial institution where the financial reporting risks are material. A financial institution shall take into account any significant changes during the reporting period which may have contributed to an increased risk

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inherent in the financial institution's internal controls over financial reporting processes, the accuracy of its recording of transactions, and ability to comply with financial reporting standards.

- G** 8.5. Changes that are relevant to a determination under paragraph 8.4 may include business combinations, significant changes in operating structures, processes or key management personnel, the implementation of new reporting standards or regulatory requirements and major systems changes or upgrades.
- S** 8.6. The scope of the audit engagement shall also include recommendations to the management for improving internal controls to ensure fair presentation of the financial statements.
- S** 8.7. The detailed audit programme and audit plan must *at least* include specific procedures to test the financial institution's internal controls over financial reporting in relation to the loan/financing portfolio, investment portfolio and insurance/takaful liabilities, as the case may be. These procedures shall include a review and validation of the management's processes for determining the adequacy of provisions for loan/financing impairments, adequacy of reserves for insurance/takaful liabilities and values ascribed to financial instruments. The procedures shall be adequate to enable the auditor to form a view as to whether the management's processes are based on a comprehensive, adequately documented and consistently applied analysis of the financial institution's loan/financing portfolio, investment portfolio and insurance/takaful liabilities.
- S** 8.8. In areas identified as being of high risk or particular concern in any particular financial year(s) having regard to matters covered under paragraphs 8.4 and 8.5, the audit programme and audit plan shall address any additional and specific procedures needed to address these areas.

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Responsibilities of the engagement and concurring partners

- S** 8.9. An engagement partner and a concurring partner shall be identified for each audit engagement.
- G** 8.10. The engagement partner is responsible for the performance of the audit engagement and the auditors' report issued. The concurring partner is responsible for objectively evaluating, before the audit report is issued, the significant judgments made by the engagement team and conclusions reached in formulating the report.
- S** 8.11. The terms of the audit engagement shall state the responsibilities of the engagement partner to:
- i. direct, supervise and perform the audit in compliance with the Malaysian Approved Standards on Auditing and the audit firm's internal quality control procedures throughout the audit engagement;
 - ii. ensure that the engagement team collectively has the appropriate capabilities, competence and time to devote to the audit of the financial institution. This shall include relevant audit experience of the team in the financial industry; and
 - iii. ensure that the auditors' report, including any opinions expressed and emphases of matter, is reliable based on sufficient audit evidence and is not misleading in any material respect.
- S** 8.12. The terms of the audit engagement shall also establish that it is the responsibility of the concurring partner to form an objective assessment, based on an appropriate review of selected audit working papers, of:
- i. significant risks identified by the engagement team during the audit and the appropriateness of the team's responses to those risks;
 - ii. whether the audit evidence obtained is sufficient to support the significant judgments made and conclusions reached by the engagement team;
 - iii. whether differences of opinion with the management or other contentious matters were appropriately dealt with; and

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iv. matters which should be communicated to management and where applicable, the Bank or other regulatory authority.

S 8.13. The board shall take appropriate step to satisfy itself that the concurring partner can reasonably commit the necessary time to carry out the required review of audit documentation to support the assessment required under paragraph 8.12.

S 8.14. Where the auditor expects or intends to use the work of an external expert to obtain sufficient audit evidence to support the audit, the terms of the audit engagement shall provide that the use of experts does not diminish the auditor's responsibility for the audit reports issued and opinions expressed.

Reliance and accountability for the Auditors' Report

S 8.15. A financial institution shall inform its auditor that the Bank may rely on the auditors' review and report as input to the Bank's supervisory plans under the risk-based approach to supervision, and its ongoing assessments of the safety and soundness of the financial institution.

S 8.16. A financial institution shall not accept any terms of an audit engagement under which the financial institution agrees to indemnify the auditor against claims made by third parties, release the auditor from liability for claims or potential claims that might be brought by the financial institution against the auditor, or limit the remedies available to the financial institution for professional misconduct.

Audit fees

G 8.17. The board should ensure that audit fees are commensurate with the scope of the audit and accountability assumed by an auditor, taking into account the required skills, knowledge and the allocation of time and resources needed to complete the audit assignment in accordance with the requirements set out in this policy document.

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PART C REGULATORY PROCESS

9. Application procedures

- S** 9.1. A financial institution is required to submit an application to the Bank for approval prior to appointing an auditor for each financial year no later than two months before the annual general meeting at which the resolution to appoint the auditor will be tabled.
- S** 9.2. An application to the Bank shall be made using the format as set out in Appendix 1 and shall be addressed to Pengarah, Jabatan Penyeliaan Konglomerat Kewangan or Jabatan Penyeliaan Perbankan or Jabatan Penyeliaan Insurans dan Takaful, as applicable.
- S** 9.3. An application shall not be submitted to the Bank unless the board is reasonably satisfied that the requirements specified in this policy document have been, or will be, met. The financial institution shall maintain adequate documentation to support the board's assessments against the requirements of this policy document.

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APPENDICES

Appendix 1 Application form for appointment of an auditor

1. Name of financial institution :
2. Appointment for financial year ending : *[e.g. 30 Jun 20x4]*
3. Proposed date of Annual General Meeting :
4. Particulars of the Audit Firm

Name	
Firm No.	
Address	

New appointment Reappointment

If new appointment, please state reason(s) for change of audit firm

5. Particulars of engagement and concurring partners

	Engagement partner	Concurring partner
Name		
Audit Licence No.		
NRIC No.		
Contact No.		
E-mail		

Engagement partner since *[financial year]*

New appointment Reappointment

If new appointment, please state reason(s) for the change of engagement partner

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Concurring partner since *[financial year]*

New appointment

Reappointment

If new appointment, please state reason(s) for the change of concurring partner

Where the engagement partner or the concurring partner were involved in the rendering of any advisory services to the financial institution or its related⁶ entities in the last two financial years, please provide a list of advisory services rendered and the name of the institutions which the services are rendered to.

6. Particulars of registration with the Audit Oversight Board

	Engagement partner	Concurring partner
Reference number		
Expiry date		
Details and reasons of conditions imposed, if any		

7. Particulars of the man-days for both engagement partner and concurring partner for the previous year

	Man-days
Engagement Partner	
Concurring Partner	

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8. Particulars of fees and non-audit services provided by the audit firm for the last two financial years

Type	RM		Nature of non-audit services
	[e.g. 30/6/X1]	[e.g. 30/6/X2]	
Audit fee			
Regulatory related ⁶ fees			
Non-audit fee			
Total			

9. Additional information to be enclosed with application:

- Detailed assessment⁷ by the board or board audit committee, as the case may be
- Curriculum vitae of the engagement and concurring partners
- Extract of board minutes endorsing the proposed appointment/reappointment of the engagement partner, concurring partner and audit firm
- Statutory declaration by the engagement partner⁸
- List of public interest entities⁹ audited by the engagement partner in the last two years¹⁰, prior to the date of statutory declaration
- List of public interest entities audited by the concurring partner in the last two years

Date :

Name and Signature
Chief Executive Officer/
Company Secretary

⁶ E.g. services provided arising from additional requirements by BNM or PIDM

⁷ The assessment must include areas as set out in Appendix 2.

⁸ Format as set out in Appendix 3.

⁹ For this purpose, public interest entities means public listed companies, conventional and Islamic banking institutions, development financial institutions, insurers and takaful operators regulated by Bank Negara Malaysia or Securities Commission of Malaysia.

¹⁰ For reappointment of the same engagement partner, disclosure is only needed for audit engagement since the last statutory declaration.

Appendix 2 Principal areas of assessment of an auditor

Area of assessment		Scope of assessment
Performance	Level of knowledge, capabilities, experience and quality of previous work	<ul style="list-style-type: none"> ▪ Years of experience of engagement partner in the audit of financial institutions ▪ Adequacy of man-days spent by the engagement and concurring partners ▪ Effectiveness of the concurring partner in conducting reviews and supporting the engagement partner's assessment
	Level of engagement with the board	<ul style="list-style-type: none"> ▪ Ability of engagement partner to provide independent views during discussions with the board ▪ Adequacy of frequency of updates to the board on the quality of reporting, including the applicability of new and significant accounting standards
	Ability to provide constructive observation, implications and recommendation in areas which require improvement	<ul style="list-style-type: none"> ▪ Effectiveness of the audit recommendations in addressing weaknesses observed during previous audits, particularly on internal controls relevant to financial reporting process
	Appropriateness of audit approach and the effectiveness of audit planning	<ul style="list-style-type: none"> ▪ Adequacy of audit scope ▪ The audit firm's plan towards ensuring staff continuity in the audit of a financial institution
	Ability to perform the audit work within the agreed duration given	<ul style="list-style-type: none"> ▪ Ability to meet audit deadlines ▪ Timeliness in responding

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Area of assessment		Scope of assessment
		to audit issues
Independence and objectivity	Non-audit services rendered by auditor does not impede independence	<ul style="list-style-type: none"> ▪ Whether the board has taken into consideration the level of knowledge, capabilities, experience and potential conflict of interest of the audit firm before the firm is appointed to provide the non-audit services ▪ The level of involvement by engagement and concurring partners in advisory services in the last two years
	Auditor demonstrates unbiased stance when interpreting the standards/policy adopted by a financial institution	<ul style="list-style-type: none"> ▪ Level of participation of, and professional skepticism exercised by, the engagement partner, in particular when there are differences in interpretation or views with management

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Appendix 3 Statutory declaration by the engagement partner

STATUTORY DECLARATION BY ENGAGEMENT PARTNER OF AUDIT FIRM

I, *[name of engagement partner (Audit Licence Number)]*, of *[name of audit firm (Firm's Number)]*, *[NRIC No.]*, being the partner primarily responsible for the audit engagement, do solemnly and sincerely declare that:

- A. I am registered as an auditor with the Audit Oversight Board.
- B. I am not disqualified under the provisions of the Companies Act 1965 from being appointed as an auditor for *[name of institution]*
- C. I have not been convicted of any offence under the Financial Services Act 2013, the Islamic Financial Services Act 2013 or the Companies Act 1965, or of any offence under any written law involving fraud or dishonesty.
- D. I have no relationships with, or interests in, including an interest in shares of, *[name of financial institution]* or any of its related entities that are likely to impair my objectivity or independence, and which cannot be reduced to an acceptable level through the application of appropriate safeguards.
- E. I have no record of disciplinary actions taken against me for unprofessional conduct by the Malaysian Institute of Accountants (MIA) where the decision for such disciplinary action has not been reversed by the Disciplinary Appeal Board of the MIA.
- F. The information submitted together with the Application Form for Appointment of Auditor on public interest entities audited by me as engagement partner in the last two years/since the last statutory declaration (*delete whichever is not applicable*) prior to the date of this statutory declaration is true and complete.

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 ABOVE NAMED

AT _____

IN THE STATE OF _____

THIS DAY OF _____ 20_____

Before me:

(Signature of Sessions Court Judge,
Magistrate or Commissioner of Oaths)

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Appendix 4 Frequently asked questions¹¹

Scope of Audit Engagements

1. Is the auditor of a financial institution expected to extend the normal scope of a statutory audit engagement in order to meet the requirements specified under paragraph 8?

No, the matters dealt with under paragraph 8 does not extend the normal scope of a statutory audit which is carried out by an external auditor in accordance with Malaysian Approved Standards on Auditing (MASA) issued by the MIA and applicable regulatory and legal requirements. In particular, references to the auditor's review of the financial institution's financial reporting processes and internal control environment, and recommendations to be made to management for improving internal controls are consistent with the auditing procedures required to be carried out in the normal course of a financial statement audit pursuant to MASA, and does not impose an expectation on an auditor to undertake additional procedures outside the normal course of a financial statement audit. Hence, the auditor is not expected to express a separate opinion in the audit report on management's financial reporting processes and internal controls.

A financial institution may refer to MASA issued by MIA for a better appreciation of the expectations of an auditor performing financial statement audit, including the following:

- ISQC 1: Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Service Engagements
- AI 315: Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
- AI 1006: Audits of the Financial Statements of Banks

¹¹ This section addresses the interpretation queries likely to be faced by a financial institution in implementing the requirements in this policy document.

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Chronological Sequence of Events

2. Should a financial institution submit the engagement letter together with the application letter?

No, the information required by the Bank to process the application for appointment of auditors is outlined in paragraph 9 (i.e. Appendix 1 together with the additional information required therein). Paragraph 9.3 provides for situations where some of the requirements would only be met after the auditor is appointed (e.g. detailed audit plan). This would not preclude a financial institution from submitting an application for the appointment of the auditor to the Bank, as long as the Board is satisfied that those requirements will be met in due course prior to the commencement of the audit.