



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

External Auditor

Applicable to:

1. Prescribed development financial institutions
2. Approved auditor

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PART A OVERVIEW

1. Introduction

- 1.1 Bank Negara Malaysia (the Bank) relies on quality audit services to complement its conduct of supervision of development financial institutions (DFIs) 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 DFI. 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.
- 1.2 This policy document outlines the qualifications of an external auditor to be appointed by a DFI and sets out the Bank's requirements regarding the terms of an audit engagement, application procedures and reporting obligations to be observed by a DFI.

2. Applicability

- 2.1 This policy document is applicable to:
- (a) DFIs prescribed under the Development Financial Institutions Act 2002 (DFIA); and
 - (b) an auditor appointed under section 63(1) of the DFIA.

3. Legal provision

- 3.1 The requirements in this policy document are specified pursuant to section 41(1), section 63(1), and section 116(1) of the DFIA.
- 3.2 The guidance in this policy document is issued pursuant to section 126 of the DFIA.

4. Effective date

- 4.1 This policy document comes into effect on 1 January 2017 and is applicable to the appointment of an auditor for financial years beginning on and after 1 January 2017.

5. Interpretation

- 5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the DFIA unless otherwise defined in this document.
- 5.2 For the purpose of this policy document-

“**S**” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with.

Non-compliance may result in enforcement action.

“**G**” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted.

“**auditor**” means an auditor as defined in section 31A of the Securities Commission Act 1993 including an auditor auditing a DFI as a representative on behalf or under the direction of the Auditor General.

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

“**development financial institution**” or “**DFI**” means a development financial institution (DFI) prescribed under the Development Financial Institutions Act 2002 (DFIA).

6. Policy documents superseded

- 6.1 This policy document supersedes –
- (a) Policy document on ‘Appointment of External Auditors’ issued on 29 November 2007; and
 - (b) The Bank’s letter on ‘Supervisory Expectations on Audit Committee Pertaining to the Appointment/Re-appointment of External Auditor’ issued in May 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.

PART B REGULATORY REQUIREMENTS**7. Criteria for the appointment of an auditor**

- S** 7.1 A DFI shall only appoint an auditor who meets the qualification criteria set out in paragraph 7.3 and continues to meet the criteria throughout the audit engagement period. 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 DFI 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 not disqualified under section 64(1) of the DFIA;
 - ii. he is registered as an auditor of a public interest entity with the Audit Oversight Board;
 - iii. he must not have been convicted of any offence under the Financial Services Act 2013 or the Islamic Financial Services Act 2013;
 - iv. he shall have the necessary skills, knowledge and appropriate experience to perform the audit of the DFI with professional competence and due care in accordance with the approved auditing standards² and applicable regulatory and legal requirements;
 - v. he shall not have relationships with the DFI or any of its related³ entities, including having any direct or indirect interest in shares of the DFI's related entities, that are likely to impair his objectivity or independence, and which cannot be reduced to an acceptable level through the application of appropriate safeguards;
 - vi. he shall not have any record of disciplinary actions taken against him 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;
 - vii. he must not have served as an engagement partner for a continuous period of more than five years with the same DFI; and
 - viii. an auditor who has been rotated off the audit of a DFI may resume the role as engagement partner for that DFI only after a lapse of five years.
- S** 7.4 The board shall ensure that members of the auditor's 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).

² Refers to the Malaysian Approved Standards on Auditing (MASA) issued by the Malaysian Institute of Accountants (MIA).

³ Refers to section 6 of the Companies Act 1965 or the definition of "related corporation" in section 2 of the Co-operative Societies Act 1993, as the case may be.

- S** 7.5 Where non-audit services are provided to the DFI 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 in its auditing engagement.
- 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:
- (a) consider information available from public or independent sources which are relevant to the professional conduct of the auditor or the key members of the engagement team;
 - (b) consider the auditor's conduct and performance in past assurance engagements with the DFI; and
 - (c) 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 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 board shall ensure that the terms of an audit engagement at the minimum address the following:
- (a) objective of the audit;
 - (b) scope of an audit engagement;
 - (c) agreement on the audit plan;
 - (d) responsibilities of the engagement and concurring partners;
 - (e) reports to be prepared by the auditor, including the Auditor's Report and recommendations for improving internal controls;
 - (f) timing of the audit and audit fees;
 - (g) use of experts in certain aspects of the audit; and
 - (h) 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 board shall confirm the existing terms of the audit engagement for each reporting period and appropriate modifications made as necessary to reflect any material changes in the DFI which have a bearing on the audit engagement.

Scope of an audit engagement

- S** 8.4 The board shall ensure that the scope of the audit engagement is determined having regard to all activities of the DFI where the financial reporting risks are material. A DFI shall take into account any significant changes during the reporting period which may have contributed to an increased risk inherent in the DFI'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 under paragraph 8.4 shall also include recommendations to the management for improving internal controls to ensure fair presentation of the financial statements.
- S** 8.7 The board shall ensure that the detailed audit programme and audit plan must *at least* include specific procedures to test the DFI's internal controls over financial reporting in relation to the loan/financing portfolio and investment portfolio. These procedures shall include a review and validation of the management's processes for determining the adequacy of provisions for loan/financing impairments, 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 DFI's loan/financing portfolio and investment portfolio.
- 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.

Responsibilities of the engagement and concurring partners

- S** 8.9 The board shall identify an engagement partner and a concurring partner for each audit engagement.
- G** 8.10 In line with the responsibilities under Part VII of the DFIA, the engagement partner is responsible for the performance of the audit engagement and the auditors' report issued, while 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 board shall ensure that the terms of the audit engagement 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 DFI. 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 board shall also ensure that the terms of the audit engagement 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
 - 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 steps 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 referred to in paragraph 8.1 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 DFI 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 DFI.
- S** 8.16 A DFI shall not accept any terms of an audit engagement under which the DFI 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 DFI against the auditor, or limit the remedies available to the DFI for professional misconduct.

Audit fees

- S** 8.17 The board shall 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.

PART C REGULATORY PROCESS**9. Application procedures**

- S** 9.1 A DFI 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 Notwithstanding paragraph 9.1, where the auditor is a representative of the Auditor General, the DFI is required to submit:
- (a) firstly, an application to the Bank for approval two (2) months before the DFI commences its audit engagement with the auditor; and
 - (b) secondly, a recommendation to the Auditor General based on the assessment required in this policy document.
- S** 9.3 An application to the Bank shall be made using the format as set out in Appendix 1 including a detailed assessment of the auditor as set out in Appendix 2 and a statutory declaration made by the engagement partner as set out in Appendix 3. The complete application with supporting documents shall be addressed to Pengarah, Jabatan Penyeliaan Perbankan.
- S** 9.4 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 DFI shall maintain adequate documentation to support the board's assessments against the requirements of this policy document.

APPENDICES**Appendix 1 Application form for appointment of an auditor**

1. Name of development financial institution :
2. Appointment for financial year ending : *[e.g. 30 June 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

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 development 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	

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 ⁴			
Non-audit fee			
Total			

9. Additional information to be enclosed with application:

- Detailed assessment⁵ 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 partner⁶
- List of public interest entities⁷ audited by the engagement partner in the last two years⁸, 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

⁴ E.g. services provided arising from additional requirements by BNM or PIDM

⁵ The assessment must include areas as set out in Appendix 2.

⁶ Format as set out in Appendix 3.

⁷ 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.

⁸ 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 DFIs • 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 the DFI
	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 to audit issue

Area of assessment		Scope of assessment
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 DFI	<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

Appendix 3 Statutory declaration by the engagement partner
STATUTORY DECLARATION BY ENGAGEMENT PARTNER OF AUDIT FIRM

I, *[name of engagement partner (Audit Licence Number)]*, *[NRIC No.]*, of *[name of audit firm (Firm's Number)]*, 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 Development Financial Institutions Act 2002 or 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 or the Islamic Financial Services Act 2013.
- D. I have no relationships with, *[name of development financial institution]* or any of its related entities, including having any direct or indirect interest in shares of *[name of development financial institution]*'s 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 my last statutory declaration (*delete whichever is not applicable*) 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 ABOVENAMED

AT _____

IN THE STATE OF _____

THIS DAY OF _____ 20 _____

Before me:

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

Appendix 4 **Frequently asked questions**⁹**1. Is the auditor of a development financial institution (DFI) 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 DFI'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 DFI 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

Chronological Sequence of Events**2. Should a DFI 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 DFI 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.

⁹ This section addresses the interpretation queries likely to be faced by a development financial institution in implementing the requirements in this policy document.