

RECOMMENDED PRACTICE GUIDE

Auditor's Reports - Companies Act, 1965

COMMENTARY

The requirements of an audit of bodies incorporated under the Companies Act, 1965 (hereby referred to as the Act) are set out in Part (VI) of the Act and the power and duties of auditors as to reports on accounts are set out in Section 174 of the Act.

Section 174(1) of the Act requires the auditors to report to the members on the accounts required to be laid before the company in general meeting. The contents of the auditor's report are set out in Section 174(2) of the Act.

Foreign Companies

Foreign companies although not incorporated under the Act are required to keep accounting and other records in Malaysia that are sufficient to explain the transactions and financial position of the foreign company that relate to its operations in Malaysia. The records must be audited by a person approved under Section 8 of the Act. *Ref: Section 336A, Companies Act, 1965*

Auditors

An individual is allowed to undertake audits pursuant to the Companies Act, 1965 only if he has been granted approval by the Minister of Finance. An approved company auditor is defined in Section 4 of the Companies Act, 1965 and provisions for audits under the name of a firm and a partnership are set out in Sections 9(4) and 9(7) respectively. *Ref: Section 8, Companies Act, 1965*

As such all reports required to be signed by an auditor pursuant to the Act must be made by an approved company auditor in Malaysia.

Reporting Framework

Audits of companies are governed by the following:

- (i) Provisions of the Act;
- (ii) Conditions laid down by the Minister of Finance in the issuance of the audit licence;
- (iii) Promulgations of the Malaysian Institute of Accountants such as the Approved Standards on Auditing and the By-Laws (On Professional Conduct and Ethics); and
- (iv) Applicable approved accounting standards issued pursuant to the Financial Reporting Act, 1997.

Accounts

The Act defines ‘accounts’ as consisting of profit and loss account, balance sheet and includes notes or statements required by the Act (other than auditor's reports or directors' reports) and attached or intended to be read with profit and loss accounts or balance sheets.

Ref: Section 4, Companies Act, 1965

Financial statements, are defined in Malaysian Accounting Standards Board (MASB) Standard 1 on ‘Presentation of Financial Statements’ as including the following components:

Ref: MASB 1, Paragraph 8

- (i) Balance sheet;
- (ii) Income statement;
- (iii) A statement showing either: -
 - (a) all changes in equity; or
 - (b) changes in equity other than those arising from capital transactions with owners and distribution to owners.
- (iv) Cash flow statement; and
- (v) Accounting policies and explanatory notes.

These are the same components defined as the term ‘accounts’ in the Act. Although the definition in the Act does not include ‘Cash Flow Statement’ as a statement required by the Act, the Ninth Schedule of the Act requires that a ‘Statement of Changes in Financial Position’ be annexed to every profit and loss account and balance sheet.

*Ref: MASB 1, Paragraph 90
MASB 5 - Cash Flow Statement*

As both definitions in MASB and the Act refer to the same components, the reference to accounts and financial statements are synonymous.

An auditor's report is issued in conjunction with the requirements of the Act and other legislations, as appropriate, such as the Housing Developers (Control and Licensing) Act, 1966, Co-operative Societies Act, 1963, Banking and Financial Institutions Act, 1989 and the Insurance Act, 1996. Under such circumstances members should consider whether non-compliance with these legislations would materially affect the financial statements.

‘Consideration of Laws and Regulations in an Audit of Financial Statements’ requires that the audit should be planned to enable the auditor to determine the effects of non-compliance (if any), and the material amounts and disclosures required in the financial statements. The auditor may be required to disclose this non-compliance to the relevant authorities. The duty of confidentiality can be overridden by legislation or the courts of law. However, consideration must be given to the auditor's responsibility to public interest. In all such cases, legal advice should be obtained.

Ref: AI 250

In addition, there are occasions when an auditor may be called

upon to express an opinion on financial statements or certain elements of a set of financial statements prepared for other purposes.

This Guide serves as guidance for the preparation of audit reports pursuant to Section 174 of the Act.

The basic principles and procedures set out shall apply and be adapted where necessary to cases where an auditor expresses opinion on certain elements of a set of financial statements prepared for purposes other than the annual requirements.

Registers refer to those required to be kept under the Act and exclude other records and journals, which are commonly referred to as registers. *Ref: Section 11, Companies Act, 1965*

The New Form of Audit Report

Whilst Section 174(2) of the Act sets down the requirements for the contents of the auditor's report, it does not set out the prescribed form.

The most significant changes in the new form are in the requirement to describe the management and auditor's responsibilities, the nature of the audit and the work that the auditor has performed. These clarifications will alleviate users misconception about the role and responsibility of the auditor, and the extent of assurance that an audit work provides. The following are basic elements of the auditor's report set, some of which is already part of the current requirements for auditor's report: -

- (i) **Title** - Report of the Auditors *Ref: AI 700 - The Auditor's Report on Financial Statements*
- (ii) **Addressee** - Members (shareholders) of the Company
- (iii) **Introduction** - Role and responsibility of the Directors and the Auditor.

- (a) This identifies the financial statements being audited including the date of and period covered. Financial statements are frequently accompanied by supplementary information and a Chairman's statement in the Annual Report. These are not specifically required to be audited or reported upon and the auditor's report on the financial statements should indicate this clearly. The usual manner is to identify the statements included in the auditor's report by referring to the pages of these financial statements being reported on. However, members attention is drawn to the requirements of AI 720 in arriving at their opinion, which requires that there should be no

Ref: AI 720 - Other Information in Documents Containing

material inconsistencies or material misstatement of facts; *Auditing Financial Statements*

- (b) It states that the preparation of the financial statements are the responsibility of the company's directors; and
- (c) It states that the responsibility of the auditor is to express an opinion on the financial statements.

(iv) **Scope**

It covers all the requirements set out in the approved standards on auditing issued by MIA. A statement that the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement should also be included.

It should also describe the audit as including: -

- (a) Examining, on a test basis, evidence to support the financial statements amounts and disclosures;
- (b) Assessing the accounting principles used in the preparation of the financial statements;
- (c) Assessing the significant estimates made by management in the preparation of the financial statements; and
- (d) Evaluating the overall financial statements presentation.

The report should include a statement by the auditor that the audit provides a reasonable basis for the opinion above.

(v) **Reporting**

This sets out the reporting responsibility of the auditor and the requirements pursuant to Section 174(2) of Act (the Audit Opinion).

(vi) **Name(s) and Signature(s) of Signing Auditor(s)**

Auditor's signature, name and licence number.

(vii) **Name and Address of Auditing Firm**

Audit firm's name, number and address should be stated. It is also the practice for some companies to provide a separate

listing of the companies auditors and their addresses. Where the address is shown as an attachment, it need not be disclosed in the audit report.

(viii) **Date of the Report**

All reports must be dated and should not be earlier than the date the financial statements are approved by the Board of Directors and the relevant statutory declarations as required by the Act.

*Ref: AI 560 -
Subsequent Events
AI 580 - Management
Representations*

Audit Opinion

Audit reports must be clear and concise. An unqualified report must not contain any reservation or important explanation, which may be construed as a qualification, and cast doubts on the reliability of the audited financial statements and be written in an affirmative language.

An unqualified opinion is given when the auditor is satisfied in all material respects with the matters required to be reported upon.

Accounting Requirement

Accounting and other records are required to be kept by the company pursuant to Section 167(1) of the Act to enable true and fair accounts to be prepared from time to time and to be kept in such manner as to enable them to be properly audited.

True and fair is not defined. It is generally accepted that accounts which are prepared in accordance with generally accepted accounting principles, which includes the consistent application of accounting policies, applicable approved accounting standards and the requirements of the Ninth Schedule and the provisions of the Act, which provide adequate disclosure of information relevant to the proper understanding of the financial statements, would give a true and fair view.

The Companies Act, 1965, amended by the Companies (Amendment) Act, 1998 includes a provision to require a company to apply approved accounting standards in the preparation of accounts. It also provides that where any conflict or inconsistency arises between the provisions of an applicable approved accounting standard and a provision in the Ninth Schedule in their respective applications to the accounts or consolidated accounts of a company, the provision of the applicable approved accounting standards shall prevail.

*Ref: Section 166A -
Compliance with
Approved Accounting
Standards*

There are, however, occasions where compliance with an

Ref: Section 166A(4),

applicable approved accounting standard may be misleading or would not give a true and fair view. Under such circumstances the directors are not required to comply with the applicable approved accounting standards.

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However, the directors have to:

- (i) disclose by way of a notes to the accounts their reason for not preparing the accounts or consolidated accounts in accordance with the approved accounting standard; and
- (ii) give particulars in the note of the quantified financial effect in the accounts or consolidated accounts if the relevant approved accounting standard was complied with.

The Act requires the profit and loss account and balance sheet to be audited before they are laid before the company at its annual general meeting.

Ref: Section 169(1), (3), (4), Companies Act, 1965

Section 174(1) of the Act requires an auditor to report to the members on the accounts required to be laid before the company in general meeting. Accounts include the statement of changes in financial position and as such, this statement should also be audited.

Reporting Responsibilities

The reporting responsibility pursuant to Section 174(2) of the Act, requires the auditor to state the following matter in his report to members of the company: -

- (a) Whether the accounts and, if the company is a holding company for which consolidated accounts are prepared, the consolidated accounts are in his opinion properly drawn up: -
 - (i) so as to give a true and fair view of the matters required by Section 169 to be dealt with in the accounts and, if there are consolidated accounts, in the consolidated accounts;
 - (ii) in accordance with the provisions of this Act so as to give a true and fair view of the company's affairs; and
 - (iii) in accordance with the applicable approved accounting standards; and
- (aa) If in his opinion the accounts, and where applicable the consolidated accounts, have not been drawn up in accordance with a particular applicable approved accounting

standard: -

- (i) whether in his opinion the accounts or consolidated accounts, as the case may be, would, if drawn up in accordance with that approved accounting standard, have given a true and fair view of the matters required by Section 169 to be dealt with in the accounts or consolidated accounts;
 - (ii) if in his opinion the accounts or consolidated accounts, as the case may be, would not, if so drawn up, have given a true and fair view of those matters; his reasons for holding that opinion;
 - (iii) if the directors have given the particulars of the quantified financial effect under Section 166A(5), his opinion concerning the particulars; and
 - (iv) in a case to which neither subparagraph (ii) nor (iii) applies, particulars of the quantified financial effect on the accounts or consolidated accounts of the failure to so draw up the accounts or consolidated accounts, as the case may be;
- (b) whether the accounting and other records and the registers required by this Act to be kept by the company and, if it is a holding company, by the subsidiaries other than those of which he has not acted as auditor have been, in his opinion, properly kept in accordance with the provisions of this Act.
- (c) in the case of consolidated accounts: -
- (i) the names of the subsidiaries (if any) of which he has not acted as auditor;
 - (ii) whether he has considered the accounts and auditor's reports of all subsidiaries of which he has not acted as auditor, being accounts that are included (whether separately or consolidated with other accounts) in the consolidated accounts;
 - (iii) whether he is satisfied that the accounts of the subsidiaries that are consolidated with other accounts are in form and content appropriate and proper for the purposes of the preparation of the consolidated accounts, and whether he has received satisfactory information and explanations as required by him for those purposes; and

- (iv) whether the auditor's report on the accounts of any subsidiary was made subject to any qualification (other than a qualification that is not material in relation to the consolidated accounts), or included any comment made under subsection (3), and, if so, particulars of the qualification or comment;
- (d) any defect or irregularity in the accounts or consolidated accounts and any matter not set out in the accounts or consolidated accounts without regard to which a true and fair view of the matters dealt with by the accounts or consolidated accounts would not be obtained; and
- (e) if he is not satisfied as to any matter referred to in paragraph (a), (b), or (c), his reasons for not being so satisfied.

If the auditor is unable to report affirmatively in respect of (a), (b), or (c) above, he must say so, giving rise to a qualified report.

In addition the auditor is required by Subsection (3) of Section 174 to form an opinion on the following matters: -

- (a) whether he has obtained all the information and explanations that he required;
- (b) whether proper accounting and other records (including registers) have been kept by the company as required by this Act;
- (c) whether the returns received from branch offices of the company are adequate; and
- (d) whether the procedures and methods used by a holding company or a subsidiary in arriving at the amount taken into any consolidated accounts were appropriate to the circumstances of the consolidation;

and he shall state in his report particulars of any deficiency, failure or shortcoming in respect of any matter referred to in this subsection.

This report is to be made on the basis of exception reporting i.e. the auditor only makes reference to the circumstances if he is not satisfied with his conclusion.

Both MASB 1 and Paragraph 4 of the Ninth Schedule provide that the cash flow statement is a component of the financial statements. As such, pursuant to MASB 5 and Section 166A of the Act, it has

to be reported accordingly.

(A) Compliance with the provisions of the Act - Section 174 (8)

"If an auditor, in the course of the performance of his duties as auditor of a company, is satisfied that: -

- (a) there has been a breach or non-observance of any of the provisions of this Act; and
- (b) the circumstances are such that in his opinion the matter has not been or will not be adequately dealt with by comment in his report on the accounts or consolidated accounts or by bringing the matter to the notice of the directors of the company or, if the company is a subsidiary, of the directors of its holding company,

he shall forthwith report the matter in writing to the Registrar."

Clarification has been obtained from the Registrar of Companies on the scope of Section 174(8) of the Ac, in particular the term 'in the course of the performance of his duties as auditor of a company'.

The Registrar has confirmed that in his opinion this section applies to all breaches of the Act noted by the auditor in the course of his audit. Thus, all breaches encountered in an audit, whether relating to the accounts, accounting records or other aspects of the Act, will have to be reported to the Registrar if the auditor feels the alternative actions referred to in Section 174(8)(b) are inadequate to deal with the matter.

This would also include the Directors' Report although it is not part of the accounts that is reported upon by the auditors.

Therefore, in his judgement on whether to report a breach or non-observance of provisions of the Act to the Registrar, the auditor should: -

- (a) consider the evidence of a breach or non-observance and be satisfied that a breach or non-observance has actually occurred; and
- (b) form an opinion on whether in the circumstances of a particular case the matter has been or will be adequately dealt with in the manner prescribed in Section 174(8)(b) other than by reporting to the Registrar.

The onus of reporting to the Registrar in such circumstances has no legal limit as regards to the breach or non-observance and the decision lies entirely with the reporting auditor.

The reporting requirement makes reference to consolidated accounts but this is not defined in the Act. Group or group accounts are also not expressly defined in the Act. The Ninth Schedule to the Act, however, only refers to the holding company and its subsidiary companies.

On the other hand, MASB defines a group as a parent and all its subsidiaries. It also states that a parent is an enterprise that has one or more subsidiaries. Consolidated financial statements are financial statements of a group presented as that of a single enterprise.

Ref: MASB 11 - Consolidated Financial Statement and Investment in Subsidiaries

The reporting auditor is appointed pursuant to Section 172 of the Act. The appointment is for the company and not for the group.

Subsidiaries for which the auditor of the holding company has not acted as auditor, would include those audited by a firm whose constituent partners are different from those of the firm auditing the holding company and audit firms which are not registered in Malaysia pursuant to the Act and the Accountants Act, 1967.

The concept of whether an audit is not material and pervasive or otherwise does not operate in respect of Section 174(2)(b), as it is specific in that accounting and other records and their registers are either kept in accordance with the Act or otherwise. Thus, unless the records are unavailable for the same reason, the auditor's duties clearly require either an adverse or an unqualified opinion to be reported.

A disclaimer of opinion in respect of accounting and other records is appropriate when the auditor has not had satisfactory access to those records. This would normally lead to a general disclaimer on the financial statements.

(B) Exempt Private Companies

Every company is required to file an Annual Return in the prescribed form as set out in the Eighth Schedule of the Act and to file with the accounts of the company. The accounts are required to be laid before the annual general meeting held on the date to which the return is made up to.

However, an exempt private company may choose not to file the

accounts with the Registrar. When accounts are not filed, an Exempt Private Company Certificate confirming its status should be attached to the Annual Return. This is to be signed by a director, the company secretary and the auditor.

In addition, the auditors are required pursuant to Section 165A of the Act to state: -

- (a) whether the company has in his opinion kept proper accounting records and other books during the period covered by those accounts;
- (b) whether the accounts have been audited in accordance with this Act;
- (c) whether the auditor's report on the accounts was made subject to any qualification, or included any comment made under Section 174(3), and, if so, particulars of the qualification or comment; and
- (d) whether as at the date to which the profit and loss account has been made up, the company appeared to have been able to meet its liabilities as and when they fall due.

(C) Foreign Companies

Section 336 of the Act states that the provisions of the Act apply to foreign companies operations in Malaysia. The auditor shall be required to report on these operations pursuant to Section 174 of the Act.

(D) Financial Institutions

When the accounts or Directors' Report of a financial institution incorporate modifications and exceptions as determined by the Bank Negara in accordance with the Act, is necessary for the auditor to state this fact in his report.

*Ref: Section 169(19),
Companies Act, 1965*

The form of the accounts and the auditor's report is set out in GP8 issued by the Bank Negara Malaysia.

(E) Insurance Companies

The auditor's report to members on the accounts of insurance companies should comply with the requirements of the Act. In addition, the auditor is required to report in accordance with the provision to the Fourth Schedule of the Insurance Act, 1996 on the accounts lodged with the Director-General of Insurance.

*Ref: Section 2(1) of
Part I*

If the accounts presented to members (shareholders) are prepared in the form prescribed by the Insurance Act, 1996 as provided in Section 169(18) of the Companies Act 1965, the report of the auditor should include a statement to this effect.

The form of the accounts and the auditor's report is set out in GP I5 issued by the Bank Negara Malaysia.