

Examining the Effectiveness Of Regulators In Supervising The Conduct Of Auditors

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The term 'auditor' originates from the expression auditor, which in Latin, it means 'to listen'. Nonetheless, when scrutinising the duties and obligations of auditors, it reveals that they do not merely listen. They also examine and report to the company, on its accounts. Moreover, the scope of these duties and obligations has amplified over recent years. This is due to the changes in the corporate landscape which encompasses the business world. On the other hand, significant judgments have been laid down by the courts across jurisdictions with regards to auditors' duties and obligations. It began with the historic English decision of Re Kingston Cotton Mill Co (No 2) [1896] 2 Ch 673 where Lopes LJ stated that "...auditors are watchdogs but not bloodhound..." to the ingenious statement of Cardozo CJ in the American decision of Ultramares Corporation v Touche (1931) 174 NE 441 that to hold auditors liable results to a case of "...liability of an indeterminate amount for an indeterminate time to an indeterminate class..." In the midst of these legal propositions, it is pertinent to determine the effectiveness of the regulatory bodies namely the Companies Commission of Malaysia, Securities Commission and Central Bank of Malaysia and the proposed independent body in monitoring, supervising and regulating the conduct of auditors. This is important in view of the various scandals involving auditors that have occurred in Malaysia. Moreover, shareholders and stakeholder have placed much reliance on the regulators in protecting their rights and interests. Nonetheless, the findings show that the relevant regulatory bodies namely the Companies Commission of Malaysia, Securities Commission and Central Bank of Malaysia is still far from carrying out their role effectively. Thus, they should be more effective in ensuring, accountable auditors.

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1. Introduction

This study explores the effectiveness of the relevant regulatory bodies and the proposed independent body in monitoring, supervising and regulating the conduct of auditors.

2. Companies Commission Of Malaysia (Ccm)

The CCM was established by the enactment of the Companies Commissions of Malaysia Act 2001 (CCMA). The functions and powers of the CCM are provided in Part III of the CCMA. S. 17 of the CCMA provides for the functions of CCM namely to ensure that the corporate laws are administered and enforced. In fact, the approach taken by CCM is a balanced enforcement (New Straits Times, 2009). Thus, the CCM does not only carry out administrative functions but it also has the powers to bring wrongdoers to trial. In order to do so, S. 18 of the CCMA provides that CCM shall have the power to do all things necessary for the performance of its functions. Thus, CCM has the power to institute proceedings against any person who has contravened the Companies Act 1965. The following table provides information on the number of companies that have been formed in Malaysia.

Table 1: Number of Companies Registered in Malaysia

	LOCAL COMPANIES	FOREIGN COMPANIES	Total Number of Companies
Up to 31 st December 2007	795, 353	4232	799, 585
2008			
Q1	10, 557	8	10, 565
Grand Total	805, 910	4, 2420	810, 150

Since by virtue of S. 174(1) of 'the Companies Act', it is a requirement to appoint an auditor in every company, it means that the 810, 150 companies do have auditors appointed. Thus, CCM have the powers to monitor the conduct of these auditors. If at any point of time, CCM believes that there has been a contravention of 'the Companies Act', it should bring an action. In its enforcement functions, one of the sections is Corporate Account Management Section. Within the section, there is an "Auditing Monitoring Unit". This unit monitors auditors who have been licensed by the Ministry of Finance Malaysia. The unit will monitor based on the offences that have been committed under the Companies Act 1965. In addition, this unit is also responsible for registering new audit firms and the subsequent monitoring of audit firms throughout Malaysia that are registered at the CCM.

In ensuring that the enforcement is effective, CCM has an Investigative Division which will carry out investigations on complaints that have been made to the division. The Complaints Section is responsible to accept record and act on complaints concerning both businesses and companies from company officers, shareholders, business owners, business partners or the public regarding any breaches under the Companies Act 1965. The particular unit which is responsible for the conduct of auditors is Financial and Fraud Section. Thus, the point to be noted is that the division will not carry out investigation unless there has been a complaint made against an auditor. If there is a complaint and after investigation, the matter warrants further action, the division will recommend the necessary action to be taken by the enforcement team. The division gives full support to the prosecution in the interests of shareholders and stakeholders.

If investigation shows that there is evidence of contravention of 'the Companies Act' the Legal Services will then bring an action against the auditors. The prosecution team will register the case in the court. Notably, the provisions which are relevant to the conduct of auditors which an action could be brought by CCM are namely S. 174(8), S. 174(8A), S. 175, S. 364, S. 364A, S. 366 and S. 368 of 'the Companies Act' which lays down the duties of auditors. The following table provides information on the number cases being carried out by CCM

Table 2: Breakdown of Number of Complaints, Investigations and Prosecutions

2007	Number of Complaints Received	452
	Number of Investigations Carried Out	153
	Number of Prosecutions	96

It should be noted that none of the complaints, investigations or prosecutions in the year 2007 involved auditors. This is so although there have been many scandals involving auditors in Malaysia. Thus, although provisions have been made to empower CCM to bring action, the powers have not been used despite cases involving auditors' breach of duties

3. Securities Commission (Sc)

SC was established in 1993 by virtue of the Securities Commission Act 1993 (SCA). The functions of the SC are laid down in S. 15 of the SCA. The functions are to ensure that the provisions of the securities laws are complied with and to take all reasonable measures to maintain the confidence of investors in the securities markets by ensuring adequate protection for such investors. In order to carry out the functions, SC has been given powers as provided in S. 16 of the SCA. It has been reported (New Straits Times, 2010) that since the introduction of S. 128(1) of the CMA which concerns the auditors' right to whistle-blow, SC

has received over 40 reports. The reports were made by the auditors of public listed companies.

The SC has the power to carry out enforcement and investigation. This is provided in Part V of the SCA. These powers are relevant in relation to S. 136 of the CMSA which provides a penalty for destroying, concealing or altering books or sending books or property out of Malaysia. A case in point is Tan Kam Sang, who is the accountant of Kiara Emas Asia Industries Bhd (KEAIB) and Ravandran a/l Thangaveloo, who was a partner of Messrs Arthur Andersen & Co, were charged for furnishing false information to the Securities Commission. A provision relevant to this discussion is S. 177 of 'the CMSA', which provides that a person shall not make false or misleading statements in a material particular which is likely to induce the sale or purchase of securities or is likely to affect the market price of the securities. A case in point is Deloitte KassimChan (Deloitte), who has been publicly reprimanded by SC for their failure to discharge due diligence responsibilities for the restructuring of Ocean Capital Berhad.

Another provision which is relevant is as regards to takeovers and mergers. Where there has been a proposal submitted to the SC pursuant to S. 212 of 'the CMSA', if a statement made is false or misleading; submit or cause to be submitted any statement from which there is material omission; or engage in or aid or abet conduct that he knows to be misleading or deceptive or is likely to mislead or deceive the SC, the person commits an offence under S. 214 of 'the CMSA'. Another provision relevant to the discussion is S. 369(b)(B) of 'the CMSA' which provides that it is an offence to furnish false reports to SC regarding the affairs of a related corporation. A case in point is Yue Chi Kin, for abetting United U-Li Corporation Berhad in submitting false information to Bursa. Yue Chi Kin was charged under S. 122B(b)(bb) read together with S. 122C(c) of the Securities Industry Act 1983 which is similar to S. 369(b)(B) and S. 370 of 'the CMSA'. The following table provides information on the number of criminal actions taken against auditors.

Table 3: Number of Criminal Actions Taken Against Auditors

YEAR	NUMBER OF CASES
2004	3
2009	1

The above table only provides information for the year 2004 and 2009. Nevertheless, there have been scandals involving auditors in other years especially the year 2007 and 2008. The SC should also look into those matters. A point to be noted is that the SC is more proactive compared to the CCM regarding offences committed by auditors. It cannot be said that the auditors have only committed an offence against the CMSA and not 'the Companies Act'.

4. Bank Negara Malaysia (Bnm)

BNM was established by the enactment of Central Bank of Malaysia Act 1958 (CBMA). It is an Act to provide for the establishment, administration, powers and duties of BNM. By virtue of S. 16A of the CBMA, BNM has power to report on suspected offence by any person for an offence committed. In view of that BNM has the power to give information of such commission to the police, the affected banking institution or the relevant body. Hence, the relevant body includes MIA, MICPA, CCM and SC. Thus, BNM by itself does not have the power to bring an action against the auditors for breach of BAFIA. It is important for BNM to exercise this role especially due to S. 40(15) of BAFIA which imposes a duty on auditors in the banking sector to report to BNM for any fraud or dishonesty. Nonetheless, it should be noted that the role of BNM is only confined to auditors who audit banking and financial institutions. The following table provides information on the breakdown on the type of banks and financial institutions in Malaysia.

Table 4: Number and Types of Banks in Malaysia

COMMERCIAL BANKS	22
ISLAMIC BANKS	17
INTERNATIONAL ISLAMIC BANK	2
INVESTMENT BANK	15
TOTAL NUMBER	56

Considering there are 56 banks and financial institutions in total, it is imperative that BNM exercises its role of reporting offence against BAFIA to the relevant bodies at the appropriate time. This will enable MIA, MICPA, CCM or SC to take the necessary action. It should be noted that MIA, CCM and SC does not have the power to bring an action against the auditors for breach of BAFIA unless there is also a breach of the By-Laws, 'the Companies Act' or the CMSA respectively. Hence, BNM must work hand in hand with MIA, MICPA, CCM and SC. This will ensure that the banking and financial sector is well guarded and protected.

5. Public Company Accounting Oversight Board (Pcaob)

A proposal has been made to form a special body to regulate auditors. The idea was raised by the former Prime Minister, Datuk Seri [as he then was] Abdullah Ahmad Badawi during his budget speech for 2008. This was also recommended by the Corporate Law Reform Committee (CLRC). It should be noted that the concept of an independent body to monitor and supervise auditors is globally recognized. This can be seen in countries such as the US, UK, Australia, Singapore, Canada and Germany. Furthermore, there is a need to have such a

body since there have been an increasing number of scandals involving auditors such as Ocean Capital Bhd, Megan Media Bhd, Transmile Bhd, Oilcorp Bhd.

Such a body will increase the confidence among existing individual shareholders, prospective shareholders, directors, employees, creditors, guarantors, companies wishing to exercise takeovers and mergers, trustees, regulatory bodies, government, professional bodies and members of the public on auditors. Furthermore, it is also to ensure that auditors do not commit carelessness, negligence, errors and discrepancies in the future. This body will come under the auspices of the SC. Hence, it is the SC which is working out the details of the framework governing the body. Nonetheless, it is important that the AOB will not have overlapping powers with MIA, MICPA, SC and CCM. However, it has been reported that if a particular auditor has been investigated by PCAOB, MIA will not interfere (New Straits Times, 2008). This shows that there is a certain degree of overlap between AOB and MIA.

The draft bill *i.e.* Audit Bill for the establishment of PCAOB will be tabled in March 2009 (New Straits Times, 2008). Later it was reported that the Audit Bill has been delayed to June 2009 (New Straits Times, 2009). The PCAOB was later known as Audit Oversight Board (AOB). The AOB will comprise seven members including a full-time executive chairman (New Straits Times, 2008). Only two of the members will be from the accounting profession. The rest of the members will be prominent individuals of high integrity. The CLRC has recommended that the members of the AOB should comprise of members of the regulators, investor associations and industry associations. This is to ensure that the body is independent from those it is regulating (New Straits Times, 2009).

This will also ensure that the interests of the existing individual shareholders, prospective shareholders, directors, employees, creditors, guarantors, companies wishing to exercise takeovers and mergers, trustees, regulatory bodies, government, professional bodies and members of the public are properly represented. It will also remove any element of biasness of the relevant accounting bodies towards its own profession. It will also instill confidence among the shareholders and stakeholders on the AOB. The AOB will be fully funded. According to Bursa, the members must be full-time (New Straits Times, 2007). This is important because in that case the members will be more committed. Most importantly, the AOB must be independent from those it is regulating. Otherwise it will not be able to carry out its functions effectively. In that case, the AOB will have the powers to punish errant auditors.

The AOB will perform regular and rigorous inspection on auditors which audit public-listed companies and public-interest companies such as banks and financial institutions. This means that those auditors which audit public companies which are not listed and private companies will not be supervised. This is so regardless of the size of the company. This should not be the case. This is because there have been situations where public listed companies have

gone private. Thus, in such a case the auditors will not be regulated. Rightfully, all auditors should be regulated regardless of the type of companies.

Furthermore, it begs the question as to how regular will the inspection be. It is still unclear whether the inspection will be done before the auditors prepare their report or after the report is prepared. It has been said that the inspection will be rigorous. If only two of the AOB members are accountants, it is questionable as to the degree of rigorousness of the inspection. This is because one must have the knowledge and experience of accounting and auditing to carry out such functions. The benchmark of whether a particular auditor has carried out his duties properly will be the auditing standards which have been set by MIA. Therefore, AOB must be in agreement with the standards set by MIA. This is to ensure that a uniform approach is adopted by both the bodies. Otherwise, this can cause a lot of confusion among the auditors.

It has been said that the process taken by MIA and MICPA in taking action against auditors is long-winded and not effective. Thus, there is a need to form AOB. Essentially, if the time taken by such bodies is long-winded, their processes must be looked into to determine where the time could be shortened. If their powers are not effective, then their powers should be increased. It does not necessarily mean that if a new body is formed, the time taken will be shorter and the powers will be effective. The issue is not the time. The issue is whether there is a keen desire to bring the wrongdoers to the forefront and make them accountable for their actions.

An issue to be concerned of is to whom is AOB answerable or accountable to for its duties and responsibilities. This is crucial otherwise AOB may take its functions lightly. Then it will be a case of creating a white elephant. Thus, the formation of AOB is not necessarily the key answer to address the scandals involving auditors. The regulatory bodies such as CCM, SC and BNM have to be proactive in dealing with scandals involving auditors. It is insufficient that scandals involving auditors are reported in the media. Action should be taken against errant auditors. On the other hand, MIA and MICPA should not take a laid-back approach in dealing with auditors in the light of the government's intention of forming the AOB. On the other hand the auditing profession should not view the formation of AOB as an axe over their head. This is because the formation is timely and necessary. The auditing profession should not be smeared with a bad reputation just because there are few bad apples.

6. Conclusion

The relevant professional accounting bodies such as MIA and MICPA do take much initiative to issue appropriate standards and guidelines. Nonetheless, they are not in tandem with international standards. Thus, this will not attract key shareholders and stakeholders into the country. On the other hand, the By-Laws which are meant to govern auditors are not fully effective as can be seen on the

issue concerning non-audit services. Thus, the relevant regulatory bodies such as CCM, SC and BNM should be more vigilant on the conduct of the auditors. On the other hand the relevant professional accounting bodies such as MIA and MICPA must take a more proactive role in regulating the conduct of the auditors. Their role should not be introverted to the members of their profession. They must bear in mind the interests of the shareholders and stakeholders.

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