THE ROLE OF AUDITORS IN THE BANKING SECTOR

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Abstract
The term ‘auditor’ originates from the expression ‘auditor’, which in Latin it means ‘to listen’. Nonetheless scrutinizing the duties of auditors reveals that they do not merely listen. They examine companies’ accounts and submit reports. Moreover these duties have augmented over recent years due to changing corporate atmosphere enveloping the business world including banking sector. Thus this study reassesses auditors’ duties as there are specific laws governing auditors in the banking sector. The study examines whether the laws are adequate in ensuring that auditors are effective watchdogs. A comparative study is also carried out to investigate auditors’ duties in non-banking sector. Essentially corporate law must ensure the interests of all stakeholders are well balanced with the challenging role of auditors.

Keywords: Auditors; Duties; Banking sector.

JEL Classification Codes: G20.

1. Introduction
This study attempts to examine the current state of law governing auditors’ role in the banking sector. It will unearth whether comprehensible legal principles have been developed by case law and statutory provisions are adequate, in specifically dealing with issues governing auditors’ duties and obligations. Essentially, the study raises the underlying problems governing auditors’ duties and obligations. The study then proceeds to raise significant issues as to whether auditors are able to play their role as effective watchdogs for the purposes of the legitimate interests of stockholders and stakeholders.

2. Background of study
There is a need to clarify the rules pertaining to the duties and obligations of auditors due to the spate of financial scandals (Tomasic, 1992). At the Malaysian forefront there are cases such as Transmile Group Bhd, Ocean Capital Bhd, Megan Media Holdings Bhd, Southern Bank Bhd (SBB) and Bank Bumiputra Malaysia Bhd. The last two cases are directly related to auditors as regards to the banking sector. Financial scandals have always been one of the major reasons for reforms in the company law (Lee, 2002). Nevertheless it should not be a case of learning the wrong lesson from those financial scandals (Deakin and Konzelmann, 2004). Otherwise the financial scandals will recur time and again. Fundamentally financial scandals prove to show that auditors have fallen below expected standards. Observably if a company were to fail within certain months after being audited, the auditors are blamed for conducting an inferior audit (Dopuch, 1988). Therefore the most common question asked whenever there has been a financial scandal is, where the auditors were (Reilly, 2006). Nonetheless a distinction should be made between audit failures and business failures. In the former situation, the blame should be attached to auditors whereas in the latter situation, there are external factors attached and therefore the auditors should not be blamed in absolute terms.

3. Definition and meaning
In Latin, the term ‘auditor’ means ‘listening’ (Bidin, 2001). This suggests that an auditor is dependent on the information provided by the relevant personnel in a particular company, in order to prepare an auditor’s report on the company’s accounts. Consequently, this means that the information provided in the auditor’s

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report depends on the accuracy, genuineness and truth of the information provided by the relevant key personnel.

However, in contemporary corporate atmosphere, the understanding and usage of the term auditor as described in the preceding paragraph, is not appropriate. This is because an auditor is in a unique position as he is required to examine financial documents and information (Sin, 1990). He has to verify the company’s accounts in detail. He is there to watch, observe and report on the company’s financial affairs. Thus audit has been defined as “a skilled examination of such books, accounts and vouchers as will enable the auditor to verify the balance sheet of a company” (Masel, 1989). Furthermore although there will be reliance and dependence on the information provided by the relevant personnel, being an expert, an auditor is required to use his own professional judgment and skill. He is trained professionally to audit the company’s accounts independently. Therefore the duties and obligations of an auditor is more than just merely listening. Notably this is the duties and obligations of an auditor in most countries (Normanton, 1966).

Nevertheless the term ‘auditor’ is not defined in the Banking and Financial Institutions Act 1989 (BAFIA) or the Companies Act 1965 (CA 1965). On the other hand, S. 2 BAFIA provides that an “approved company auditor has the meaning assigned thereto by the CA 1965. The term “approved company auditor” is defined in S. 4(1) CA 1965 which reads “a person approved as such by the Minister under S. 8 CA 1965 whose approval has not been revoked.” This definition is inadequate as it does not define who an auditor is. If the term auditor was defined, this will be a precursor to the better understanding of the role of auditors. In the absence of a comprehensive definition of the term auditor in BAFIA and CA 1965, its meaning will be left to individual’s interpretations and understanding of an auditor’s role. Consequently the interpretations and understanding will differ from one person to another person. In some cases, the interpretations and understanding may be vague. This should be particularly avoided since there are various persons or bodies such as existing members, prospective members, directors, audit committees, employees, creditors, companies wishing to exercise mergers and acquisitions, trustees of debenture-holders, members of the public, regulatory bodies, professional bodies who have an interest in this matter. As a result this will also mean that there will be differing expectations from those persons or bodies as regards to an auditor’s role (Hian and E-Sah, 1998). Consequently there will be an expectation gap between what is expected by those persons or bodies and what is actually delivered by an auditor (Liggio, 1974). It should be noted that since terms such as contributory, director, officer, official receiver and promoter are defined in the interpretation provision of S. 4(1) CA 1965 and terms such as business associate, chief executive, depositer and director in the interpretation provision of S. 2(1) BAFIA the legislature should also include the meaning of the term auditor either in CA 1965 and/or BAFIA. Hence this will give a comprehensive and uniform understanding of term auditor.

3. Duties and obligations
In the year 1967, Raja Azlan Shah presiding in the High Court of Malaya (as His Highness then was) in Mooney and Ors v Peat, Marwick, Mitchell and Co and Anor, expounded the law that an auditor owes his duties to members of a company collectively. The pronouncement was based on S. 174(1) CA 1965 which requires an auditor to report on a company’s financial affairs to the members at the company’s general meeting. It should be noted that this provision is similar to S. 40(11)(c) BAFIA which requires an auditor to submit a report to the members of the licensed institution. The above decision was a good opportunity for the court to establish intricate issues governing an auditor’s duties and obligations. Nevertheless, the court did not aver whether an auditor owes any duties to ensure that the contents of the auditor’s report were correct. Moreover, no proposition was made as to the obligations in the event the contents of the auditor’s report were found to be incorrect. Additionally, the court did not address the scope of an auditor’s duties and obligations in relation to existing individual members, prospective individual members, directors, audit committees, employees, creditors, companies wishing to exercise mergers and acquisitions, trustees of debenture holders, regulatory bodies, professional bodies and members of the public.

Thirty four years later, the High Court in Teoh Peng Phee v Wan and Co (2001), acknowledged that an auditor owes a moral duty to an individual member, to report any wrongdoings by the company’s
management. It is welcoming to note that the court recognized the interests of an individual member unlike Mooney’s case which decided in the interests of the members collectively. Nonetheless, the concern is whether if he fails to do so, he could be liable to an individual member. Furthermore, it is ambiguous what the court meant by ‘moral duty’. Undoubtedly moral duty is not akin to legal duty. Thus it will not entitle a member to bring an action against an auditor as moral duty is not based on legal duty. It is also ambiguous what the basis is for the court to use the term ‘moral duty’ as opposed to ‘legal duty’. Moreover, the court did not review the cases from United Kingdom, Australia or New Zealand to ensure that the legal position governing an auditor’s duties and obligations are clearer. Thus it shows that there have not been any cases decided by the Malaysian courts which laid down, comprehensive principles of law in relation to an auditor’s duties and obligations. Most importantly there are also no legal actions brought in tort against an auditor unlike the legal position in United Kingdom, Australia and New Zealand (Katter, 1998). In the above mentioned countries, there are adequate cases dealing with an auditor’s duties and obligations (Giles, 2002). It should be noted that the above decisions were based on the CA 1965. There were no decisions based on BAFIA.

It should be noted that in order for auditors to carry out their statutory duties and obligations effectively, they must be familiar with BAFIA and the CA. Particularly, CA 1965 is a statutory attempt to outline what the auditor’s report should contain (Singh, 1976). On the other hand, to date, BAFIA has been amended three times. However the provision, which governs auditors’ appointment and duties i.e. S. 40 BAFIA, was left untouched. Fundamentally, the provision does not provide that a duty is owed by auditors to any persons or bodies. Consequently, it does not provide that obligations are attached on auditors in the event duties are breached. Nevertheless, the provision imposes certain duties on an auditor for the purposes of auditing banking and finance company’s accounts. This shows that the legislature plays the role of minimum intervention in relation to an auditor’s duties and obligations. Thus the provision is inadequate in dealing with the rights and interests of existing individual members, prospective individual members, directors, audit committees, employees, creditors, companies wishing to exercise mergers and acquisitions, trustees of debenture holders, regulatory bodies, professional bodies and members of the public. The current legal position of an auditor is uncertain if requisite legal steps are not taken and this is indispensable so that auditors could carry out their duties and obligations in accordance with the legal requirements. This is particularly crucial since there have been much legal developments in relation to auditors’ duties and obligations in other countries i.e. United States of America, United Kingdom, Australia and New Zealand since the case of Enron, WorldCom, HIH Insurance, Pan-El, Parmalat, Tyco and Adelphia. As a result, public perception of an auditor has fallen drastically. It was found that 44% of insurance claims were for audit work (Blue, 1990). This shows that there is an increasing trend of an auditor being made liable. On the other hand, it should not come to a phase where audit services are being restricted due to the increasing risk of litigation (Kinney, 1994). Thus if the situation is not addressed, it is foreseeable that there will be more corporate collapses. Self-regulation is not the panacea for such problems (Nussbaum, 2002). Thus the duties and obligations of an auditor should be solely left to the professional body governing the auditors i.e. the Malaysian Institute of Accountants (MIA).

4. Duty to report
There is an asymmetry of information between the management of a company and its members (Morse, Marshall, Morris and Crabb, 1999). This is because the management has full information of the company’s financial affairs as opposed to the members. The management can influence how the financial information is collected, presented and released (Riley, 1994). In some cases the management may issue bias financial information (Watts and Zimmerman, 1983). Therefore there is a need to strike an appropriate balance so that the relationship between the management and the members is symmetrical. This is where the role of an auditor becomes pivotal as he is under a duty to report on a company’s financial affairs to the members. The auditor must be in complete control of the financial information to be collected, presented and released. Fundamentally he must report the truth without fear or favour. He must bear in mind that he should act in the best interests of all the persons and bodies concerned and not for their own interests. In that case the members will have full knowledge on how the management has managed the company’s financial affairs. Therefore although it is the management’s duty to prepare the financial documents, it is the auditor’s duty to interpret and verify them. Hence in the event financial irregularities crop up, usually, auditors are blamed
and not the management of the company (Giles, 2002). This is because the perception has always been that an auditor’s duty to report includes reporting on the financial irregularities.

Furthermore it is not provided as to when the auditor’s report should be submitted for the purposes of deliberation during the annual general meeting. S. 170(1) CA 1965 only provides that the auditor’s report must be furnished to the directors of the company in time to enable them to attach it to the annual report. In Syarikat Takaful Bhd, the audit was done in September 2006. However, just before the annual general meeting held on November 29 2006, the auditor KPMG Desa Megat and Co modified the report (NST, November, 2006). This occurred because the CA is silent as to when the auditor’s report must be furnished. Thus this enables an auditor to modify the report at the eleventh hour. It should be noted that BAFIA is also silent as to when the auditor’s report must be furnished.

S. 40(15) BAFIA provides that in carrying out auditing duties, if an auditor discovers that there has been a contravention of the Act, they are bound to report to Bank Negara Malaysia (BNM). This shows that an auditor performs a watchdog function (Hanrahan, Ramsay, Stapledon, Nariman and Bidin, 2002). Furthermore the provision also shows that auditing a company’s accounts is not simply an internal matter as it involves the regulatory body i.e. BNM. Nonetheless, the predicament is the standard expected of auditors on this matter. This is because it is unclear whether it is based on what the auditor believes or whether the auditor could have reasonably discovered it. The provision reads “...if an auditor...is satisfied...” Thus the provision suggests that it is based on what the auditor believes i.e. it is worded subjectively. This means that the duty to report to BNM does not arise if the auditor does not consider that there has been any breach. This does not impose any duty on an auditor since the duty is determined by the auditor himself. The provision should have imposed a duty along objective standards. The provision should have read “…where an auditor...ought to have known that there has been a breach ...” In that case an objective standard is introduced. The standard will be determined on what reasonable and competent auditors would have known in the given circumstances.

Additionally the provision concerns a contravention of BAFIA or any other law related to fraud or dishonesty. The provision is criminal in nature. Thus the issue is whether the auditor should be satisfied on the balance of probabilities or beyond reasonable doubt. Essentially the degree of satisfaction should increase with the gravity of the imputation the auditor is making (Pound, 1994). Furthermore an auditor is required to have knowledge of whether there was any contravention of any other law related to fraud or dishonesty. This includes CA 1965 and Securities Industry Act 1983 which are reasonable. Nonetheless there are other laws such as the Penal Code, Money Laundering Act, etc which are related to fraud and dishonesty too. If an auditor is required to have knowledge of such laws, this will unnecessarily expand the duties expected of him. Consequently he will have to have a sound knowledge of the law. An auditor is not legally qualified and trained to carry out such duties. It is submitted that this is an unrealistic expectation of an auditor.

5. Duty to give true and fair view

S. 40(12) BAFIA must be read together with S. 174 CA 1965. The provision provides that an auditor is required to give his opinion as to whether the accounts of the licensed institution show a true and fair view of its affairs. However, BAFIA does not define the term ‘true and fair view’ in its interpretative section of S. 2(1) of BAFIA. Furthermore it is not defined in the interpretative section of S. 4(1) CA 1965. The term ‘true and fair view’ has remained intact since its inception in 1989. Neither, have any of the Malaysian courts defined it. This is so although the term is a legal concept (Woon, 1997). Thus it is unclear what the term really means in law and in the context of auditing.

Thus the concern is whether the courts or the auditing profession should determine the meaning and ambit of the legal concept. Notably the concept is an abstraction or philosophical concept expressed in simple English (CCH, 1990). Hence it is not difficult to understand the meaning of the concept. However, when the concept is applied to a certain set of circumstances, it can raise problems since it is an abstract concept and intangible in nature. Additionally there will be an assessment on the question of degree as it involves opinions and views. Fundamentally opinions and views cannot be used as a basis to certify the accuracy of the accounts and the reliability of the company’s financial health. Thus the standard of responsibility and care in carrying out the duty to give a true and fair view is not exacting enough. Hence, the duty to give a
true and fair view cannot be confined to mere mathematical accuracy but must also extend to a fair presentation of both the financial position and the results of the business.

A further concern is the manner the concept of true and fair view is formulated. It is also not provided in the provisions the extent of work which is necessary before an auditor can reach an opinion of true and fair view. Moreover reasonable businessmen and auditors may differ over the degree of accuracy or comprehensiveness of the practice in determining what is ‘true and fair view’. Sometimes there may be differences over the method to adopt in order to give a ‘true and fair view’. In such a case there is more than one ‘true and fair view’ of the same financial position. Thus the concern is the correct method and whether there is a correct method or a single universal correct method. These matters must be resolved to give a better meaning to the concept of ‘true and fair view’. Most importantly, the issue is whether the concept of true and fair view will be accurate and reflect the reality of a company’s financial standing (Leow, 1991). It is a trite fact, that in order for an auditor to give ‘true and fair view’ of the company’s affairs he must be competent (Davies and Prentice, 1997). Nevertheless an auditor’s report is based on opinion. Although ‘true and fair view’ is based on opinion, the duty to give a true and fair view is more than just forming an opinion. Thus an auditor must be competent enough to give a sound professional opinion.

On the other hand, the application of the concept concerns business practices. Therefore, the meaning and ambit of the concept were left to the professional judgment of the auditing profession assisted by the standards and guidelines laid down by MIA. An auditor is guided by the auditing standards and guidelines as laid down by the auditing profession as to what should be reported. Nonetheless the concept cannot solely be based on the interpretation of the auditing profession. This is because when the concept is being applied, it must be agreeable to the courts since it is a legal concept. In some cases the courts may not agree to the ambit and scope of the duties and obligations as laid down by the profession. It can be seen that there is a conflict between what the legal minds perceive of an auditor’s duties and obligations as opposed to what the auditing profession perceive of an auditor’s duties and obligations. Thus the legal minds and the auditing minds must put their minds together to lay down a clear meaning and scope of the concept of ‘true and fair view’.

It is not the auditors’ duty to consider whether the business of the organisation is prudently or imprudently conducted (Anandarajah, 2001). Nonetheless it is the duty of the auditor to report as to the company’s ability to continue as a going concern (Guy and Sullivan, 1988). Stockholders and stakeholders do not just look at the auditor’s report on the institution’s financial information. They are concerned whether the institution is financially sound. Thus if the auditor opines that there will be a business failure, this should be addressed by the auditor. In such a case the auditor’s report serves as an early warning to the stockholders and stakeholders. Although it cannot be predicted whether business will be a success or a failure, financial statements will enable stockholders and stakeholders to draw valid conclusions about an institution’s future prospects.

Observably this is a growing expectation from the stockholders and stakeholders. This is because over 50% of cases involving an auditor in the US arose from business failure (Palmrose, 1987). Thus where an auditor gives his views on an institution’s going concern, it means that he is also giving a forecast on the institution’s future. There has also been a suggestion requiring an auditor to give his views on the company’s forecast (Liggio, 1973). Nonetheless it may defeat the purpose of having similar types of opinion reports by persons other than an auditor.

6. Duty to detect fraud
The duties and obligations of an auditor should involve more than just merely forming an opinion as to the trust and fairness of a company’s financial statements i.e. the duty to detect and report fraud to the management (Arjunan and Low, 1995). Additionally, the auditor should disclose the nature and effects of the fraud to the members of the company. Nevertheless if fraud is committed by the management, it is difficult to imagine how the auditor will be report the matter to the management. It will be easy in cases where the fraud is committed by the members. However, in most cases it is the management who may have committed the fraud as they are entrusted with the company’s funds and the power to make decisions on behalf of the company.
S. 40(15) BAFIA provides that an auditor of a banking and financial institution is under a duty to report any criminal offences involving fraud to BNM. In Deputy Secretary v. S.N. Das Gupta (1956) an auditor of a banking company failed to verify the cash balance claimed by the management and the actual cash in hand turned out to be much less than was shown in the books. Hence this is a case where the auditor has failed to detect fraud although he was required to do so by virtue of the banking legislations in India.

The concept of ‘true and fair view’ no longer acts as a yardstick for an auditor to check the accounts of banking and financial institutions since there is a duty to detect fraud reposed on an auditor. Observably the duty to detect fraud is of a higher duty compared to the duty to report on the institution’s accounts. This is because the duty to detect fraud is result oriented whereas the duty to report on the institution’s accounts is process oriented. It should be noted that the duty to detect fraud is imposed on an auditor in the banking sector but not in other sectors. This is because there is no similar provision to S. 40(15) BAFIA in the CA 1965. Perhaps the justification is that fraud is seen as considerably serious in the banking sector as opposed to other sectors.

Essentially fraud is a crime. Thus the auditor must report the matter to the relevant authorities. He should not merely report the matter to BNM as required by S. 40(15) BAFIA. Stockholders and stakeholders have a right to know what has happened in the institution i.e. including the commission of fraud. Thus the provision should read that fraud should be reported to the members of the institution.

7. Duty to take further steps
An institution may have its internal system of detecting deficiency, failures or shortcomings. Nevertheless an auditor should employ his own tests of determining whether the internal system is reliable and effective. If the auditor opines that the internal system is unreliable he must and should make further inquiries i.e. he should be under a duty to take further steps. This is because the institution has appointed him as an auditor, to report on whether there are any deficiencies, failures or shortcomings. Thus the tests employed by the auditor must adequately be capable of unfolding any deficiencies, failures or shortcomings. Additionally if in the course of auditing, an auditor uncovered certain wrongdoings which reasonably require them to take further steps, the auditor should be responsible in taking the steps. The auditor must decide what should the steps be and how would the steps further assist him unfold further wrongdoings by the management. The problem is what steps the auditors should take. A more difficult issue is when the steps should be taken. Clearly different auditors will have different views as to the step to be taken and the period of time it should be taken.

It should be noted that the duty to take further steps is not imposed by BAFIA or the CA 1965. However support can be found in Re Kingston Cotton Mill Co (No 2)(1896) that if there is anything calculated to excite suspicion, an auditor should probe it to the bottom. In the event the auditor fails to do so, his conduct must be looked into. Since he is responsible in auditing the institution’s accounts, he should be accountable if he fails to take any steps or took the wrong steps. It was rightly pointed out by Moffit J in Pacific Acceptance Corp Ltd v Forsyth (1970) that failure to take further steps amount to breach of duty. In Leeds Estate Building and Investment Co v Shepherd (1887), the auditor was held liable for not further investigating the source for declaring dividends in the company.

He should also assess whether the assertions made by the management are appropriate. If they are not effective the auditor should communicate this to the management of the institution. The auditor then must ensure that the management addresses the problems (Clifton, 1994).

A further issue is that in some instances, after the auditors’ report has been laid at the general meeting, the management found deficiencies, failures or shortcomings in the financial reports. In such a case the auditor should be notified. The auditor should then consider whether the deficiencies, failures or shortcomings are material. If they are, the auditor must then take the further step of notifying the management, members and BNM. Currently BAFIA does not make any provision for requiring the auditor to do so. Thus there is no duty attached to the auditor to do so. The auditor will not feel obliged to take any further steps on this matter. Therefore BAFIA should be amended imposing such a duty on the auditors.
8. Duty to maintain confidentiality

An auditor is under a duty to maintain confidentiality. This is owed to the institution. He must treat any information and trade secrets acquired in the course of auditing as private and confidential as stressed by the court in Morton v Arbuckle (No2)(1919). He is not authorized to divulge the information. Nonetheless in some situation he has no choice but to disclose the facts which may harm the institution (Abbott, 1982). Thus the concern is how do determine whether the auditor has breached his duty to maintain confidentiality.

Furthermore difficulties arise in cases where the auditor treats certain information as confidential at the expense of the members of the institution. Members are only provided information at the institution’s annual general meeting. Thus the duty to maintain confidentiality has been misused. There must be clear guidelines as to what falls under the purview of confidentiality on one hand and members’ right to information on the other hand. A further concern is whether the auditor is obliged to report to third parties if there are any wrongdoings by the institution’s management. Usually an auditor is under a duty to disclose to the institution’s management of any wrongdoings. This is because the institution is the client (Kennett, 1989). Notably in the United States there is a line of cases which has introduced the duty to report wrongdoings of the institution to third parties (Causey, 1986). Nevertheless there are no cases on this point in Malaysia.

It is submitted that a new provision be included in BAFIA and/or the CA requiring an institution to report to interested third parties if there are any wrongdoings by the institution’s management. On the other hand as long as what he has disclosed is as required by BAFIA and CA 1965, he is not in breach of the duty to maintain confidentiality. Thus the statutes should be the guiding principle for the auditor, as to the information that can be disclosed which overrides the duty to maintain confidentiality. It should also be noted that currently there are no provisions in BAFIA or CA 1965 which requires an auditor to maintain confidentiality.

9. Duty to avoid conflict of interests

Provisions have been enacted in BAFIA and CA 1965 in relation to appointment, eligibility, qualification, remuneration, disqualification and removal of an auditor. The intention is to ensure that the auditor is able to conduct auditing in an impersonal, objective and professional manner. Furthermore it is also to ensure that the auditor is independent of the company. The fundamental underlying reason for such emphasis and requirement is to ensure the auditor is not in a position of conflict of interests.

However, in some cases there is possible conflict of interests despite the measures taken by the statutes. This is because in reality there is conflict of interests. This can be seen in cases where sometimes, an auditor may provide non-auditing services to the company which he is auditing. This is because some auditing firms have branched to diversified services beyond auditing since it is lucrative. In fact it has reached a point where auditing and non-auditing services have become indistinguishable (Jeppesen, 1998). It was reported that the ‘Big Four’ earn 50% of their income from management and consulting field which was only 13% in 1981 (SEC, 2000). There is also evidence that revenue from other services has been increasing (Palmrose, 1986). In such a case, the auditor has put himself in a position where there is conflict of interests. The independence of the auditors has been compromised due to the close relationship between the management and the auditors. This is because the management has decided to engage the auditors for its non-audit services. This close relationship has been termed as ‘familiarity threat’ (Hussey, 1999). Consequently the auditing standards have also been compromised. One of the reasons for the fall of Enron is due to conflict of interests by the auditor i.e. Arthur Andersen since the auditor was also providing non-audit services to the company. Thus independence of an auditor is integral to the auditor’s duties and obligations.

An auditor could only obtain the contracts for non-auditing services if he maintains a good relationship with the management. Furthermore an auditor is dependent on his clients for livelihood. Thus the auditor is under extreme pressure to ensure that his services are retained. If he qualifies the report or detected the wrongdoings of the management, it is unlikely that he will be appointed by the management in the near future. Thus the auditor may be lenient to his clients which give room to further conflict of interests. There is an innate conflict of interest on this point. An auditor should be able to carry out his duties without fear.
or favour. The existing legal framework contributes to this fear and favour. This raises concern about ensuring objectivity and independence. Furthermore it poses danger to the credibility of auditors.

BAFIA and the CA 1965 do not prohibit an auditor from providing non-audit services to the institution. Furthermore, there is no requirement in BAFIA and the CA 1965 that disclosure should be made for remuneration received for non-audit services. S. 40 BAFIA only governs an auditor’s remuneration in relation to auditing work. It can also be a case where the remuneration amount for auditing services may not be a true figure as the institution may be paying a higher amount for non-audit services since it need not be disclosed to the members. Thus it can be seen that it is possible for auditors to place themselves in a position where there is conflict of interests and yet are not in breach of BAFIA and the CA 1965.

Although the law attempts to ensure that the auditor is not too closely connected with the institution whose accounts he is auditing, the distance between the institution and the auditor could and should be further (Ussher, 1986). If an auditor is allowed to provide non-audit services, the auditor will be closely connected. Moffit J in Pacific Acceptance Corporation Ltd v Forsyth (1970) found that this conflict is real, practical and apparent that auditors must guard against this. The conflict worries stockholders and stakeholders. Therefore where there is such conflict of interests, disclosure must be made to stockholders and stakeholders. Alternatively there should be prohibition with regards to providing of non-audit services to the institution where he acts as an auditor or would be acting as an auditor. This is to ensure that the auditor is impersonal, objective, professional and independent. The Ethics Standards Board which is part of the UK accountancy regulator is of the opinion that an auditor should not provide audit and non-audit services to the same client (Parker, 2002).

A further problem with regards to the closeness between the management and the auditor is that in practice, it was found that the demarcation between the duties of the auditor and the financial reports released by the management is unclear. This is because there have been negotiations and compromises between the management and the auditors (Houghton and Jubb, 2003). Therefore the concern is where does the duty of the management end and when does the duty of the auditor begin.

A point to be also noted is the length of the auditor’s relationship with the institution (O’Sullivan and Diacon, 1999). This is because this will reflect whether the auditor is truly independent and whether there can be possible conflict of interests. Thus to ensure the auditor is truly independent and is not in conflict of interests, the auditor should be rotated every year. Thereafter there should be a gap of three years before the same auditor is engaged by the institution. This is because independence of an auditor cannot be expected out of a matter of professional ethics (Hollingsworth, White and Harden, 1998). The crux of the matter is that the auditor is appointed as a monitor and not a bonding mechanism for the management (Fan and Wong, 2005).

10. Auditors as effective watchdogs
There is a trend of expanding accountability of corporate gatekeepers (Volz and Tazian, 2006). Notably, there is an inclination towards making professionals more accountable for statements made in their professional capacities. This is in the light of the increased reliance on professional advice as well as the availability of professional indemnity insurance (Koh and Yeoh, 1999). The interests of existing individual members, directors, prospective members, audit committees, employees, creditors, companies wishing to exercise mergers and acquisitions, trustees of debt holders, regulatory bodies, professional bodies and members of the public are intensified in current times. Corporate atmosphere is dictated by the legitimate interests of persons and bodies as mentioned above. Thus their rights must be considered in shaping the law governing an auditor’s duties and obligations (Dean, 2001). Their rights and interests should not be equated with the rights and interests of the institution. Thus limiting an auditor’s duties and obligations to the institution is not satisfactory.

Most importantly, an appropriate balance must be struck between the rights and interests of the various persons and bodies on one hand and the professional responsibility of an auditor on the other hand if the auditing profession should continue to serve. Hence, the study attempts to bridge the rights and interests of the various persons and bodies and the duties and obligations of an auditor. At the same time the legal framework should not stifle an auditor’s profession to become a high-risk profession.
Additionally, good character must be maintained by an auditor throughout his career. This is because possessing academic and professional qualifications, knowledge and experience alone are insufficient. The personal make up and character of the person is also important. Observably, although ‘good character’ is a requirement to be an auditor, the concern is whether in reality it serves only a theoretical purpose. Nonetheless this should not be the case. The nature of auditing function requires substantial amount of honesty and truthfulness. In fact an auditor is under a duty to be honest (Ivamy, 1978). It should be noted that carrying out auditing involves professional skills. On the other hand, reporting what has been discovered involves honesty which is directly connected to good character. Nevertheless BAFIA and the CA 1965 do not lay down any guidelines as to what is required for an auditor to be of good character. Thus it is submitted that a significant step should be taken on this matter i.e. to educate an auditor what is ‘good character’. Good character should not only play a key role in deciding whether a person should be an ‘approved company auditor’. It should also be used as a basis to determine whether the license should be renewed. This will send a strong message to the auditing profession that the matter is not taken lightly. The auditors would begin devoting quality time in improving their ‘software’ strength. Thus it is recommended that a special body be formed to educate an auditor of what is good character.

In a matter involving Bumiputra Commerce-Holdings Bhd (BCHB), the institution is planning to bring a legal action against Deloitte Kassim Chan (DKC) over audit work on the then Southern Bank Bhd (SBB) (NST, June 2007). This is because there has been inappropriate accounting treatment on the 2005 accounts. This was found by Price-WaterhouseCoopers (PWC). DKC were inappropriately valuing certain derivative financial instruments, not writing down in full the collateral value and wrongly writing back specific provisions made on certain foreclosed properties relating to non-performing loans aged seven years and above and non-expensing of certain costs incurred. Further the net assets were overstated by RM160 million. BCHB exercised a takeover of SBB.

The above case shows that the auditor has failed in his duties and obligations. It also shows that there is a possibility that not all auditors will carry out their duties and obligations as per the requirements of BAFIA, CA 1965 and the standards and guidelines issued by MIA. It also shows that the auditor has failed to act as an effective watchdog. The concern now is what the next course of action is. There is no provision made on this matter in BAFIA. Therefore reference should be made to S. 8 CA 1965. It is unclear whether the license to the auditors will be revoked under S. 8 CA 1965. Nevertheless what is certain is that there must be stockholders and stakeholders who are affected by this. Fundamental question is whether the law is adequate in addressing the concerns of the stockholders and stakeholders.

One of the ways to counter financial scandals is to improve the quality of auditing services. Nonetheless on the other hand it was felt that the current legal, regulatory and corporate governance framework were robust and sufficient to protect the market (Yusli, 2007). This cannot be so. This is because the number of financial scandals involving an auditor is increasing. This can be seen not only in the international arena but also in the domestic front. There is a lacunae in the current legal framework as the duties and obligations reposed on an auditor is inadequate in countering financial scandals.

Therefore in conducting an audit, an auditor is now obliged to take a much stricter approach to their clients (Bourne, 1995). There is an increasing support for the view that an auditor should take on a more active role (Baxt, 1970). Thus there is a clear need to depart from the metaphor that an auditor is merely a watchdog as laid down in Re Kingston Cotton Mill Co (No 2)(1896), to formulate more exacting duties and obligations of an auditor. This can be seen in SeeBeyond Technology Corp, where the auditor as concerned about the bulk of revenue on a US$2.2 million contract signed (Thurm and Mangalindan, 2002). If this occurred before the Enron scandal the auditor’s concerns may have been ignored. However, the management took into consideration the views of the auditor due to the impact it will cause on the stockholders and stakeholders. This is because the stockholders and stakeholders highly regard the views and opinions of an auditor on an institution’s business operations. It clearly shows that the auditor was not merely examining the organisation annually but periodically.

Nonetheless the concern is what the proper scope of good auditing is (Power, 2003). This is because the gap between an auditor’s role and the stockholders and stakeholders expectations is widening (Mednick,
There is evidence of dissatisfaction among stockholders and stakeholders (Humphrey, Moizer, and Turley, 1992). An auditor is facing increased pressure from various parties to expand his duties and obligations (Giacomino, 1994).

On the other hand the concern is whether the stockholders and stakeholders have unrealistic expectations of an auditor (Cockburn, 1987). This is because the expectations can be a constantly moving target. The question to be asked is also whether the expansion of the auditor’s duties and obligations are fair to the auditor himself. Most importantly how far the auditor should go in meeting the expectations gap must be addressed (English, 1989).

Thus it is not adequate that the auditor’s report is only laid at the annual general meeting. If the purpose is to provide information to the members of the institution as to the manner the management managed the business affairs, it should not take one year for the members to have cognizance of the matter. There should be other modes where the information is disseminated given the advances of technology today i.e. information and communication technology. Information could be put on the company’s website periodically. Furthermore it will be informative to the stakeholders too. This will enable stockholders to play a pro-active role in the institution’s financial affairs. This is because they must have information that is sufficient, timely, reliable and fairly presented (Sommer, 1974). This in turn will enhance the market place. The auditor’s report which is done annually is not sufficient to meet the marketplace’s needs in a volatile and rapidly changing business environment. Nonetheless the auditor fears that there will be unwarranted reliance on them by the stockholders and stakeholders. Notably it is not a case of unwarranted reliance but it is a justified and foreseeable reliance by the stockholders and stakeholders.

11. Conclusion

The scope of BAFIA in providing for the duties and obligations of an auditor is not exhaustive per se. Furthermore the duties and obligations of the auditor cannot be determined solely by reference to what the auditing profession has in mind. An auditor must bear in mind of the expectations and needs of the stockholders and stakeholders. Stockholders and stakeholders want to strengthen their position which calls for necessary information. This is because business is getting more and more complex in this age of regionalization, internationalization and globalization. An auditor is expected to play a pivotal role in relation to an institution’s financial matters. The auditors must perform their duties properly. An audit provides a high level of assurance of an institution’s financial affairs. Essentially the role must be adequately dealt with so that the auditor is aware of his duties and obligations. Otherwise the information contained in the report would be lost or misleading. An institution is licensed to operate banking and financial operations. Hence it is important that the operations are carried out lawfully. To ensure that the institution has done this accordingly, an auditor being independent is under a duty to audit the institution. Nevertheless if the duties and obligations of an auditor are minimal, eventually the role of auditors will be insignificant. Companies can and have collapsed where the auditor failed to do proper auditing. Since such is the magnitude of the importance of an auditor, equal importance should be placed on the duties and obligations of an auditor. The duties and obligations of auditors must be expanded for the sake of capital market, stability of financial and economic sector and interests of stockholders and stakeholders (Carmichael, 1974). Higher audit quality will provide better information to investors and thus generate a more efficient investment (Balachandran, and Nagarajan, 1987). There must be a modern approach to the auditor’s duties and obligations so that auditors play a meaningful role in the banking sector.

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