



## **GUIDELINES ON EXTERNAL AUDITOR OF LABUAN FINANCIAL INSTITUTIONS**

<b>PART A</b>	<b>OVERVIEW</b> .....	<b>1</b>
1.	Introduction .....	1
2.	Applicability .....	2
3.	Legal provision .....	3
4.	Effective date .....	3
<b>PART B</b>	<b>OPERATIONAL AND REGULATORY REQUIREMENTS</b> .....	<b>4</b>
5.	Criteria for the appointment of an external auditor .....	4
6.	Terms of an audit engagement .....	6
<b>PART C</b>	<b>REGULATORY AND SUPERVISORY EXPECTATION</b> .....	<b>9</b>
7.	Engagement with Labuan FSA.....	9
<b>PART D</b>	<b>REGULATORY PROCESS</b> .....	<b>10</b>
8.	Appointment procedures.....	10
<b>APPENDICES</b> .....		<b>12</b>
Appendix 1	Application form for appointment of external auditor.....	12
Appendix 2	Principal areas of assessment of an external auditor .....	15
Appendix 3	Statutory declaration by the engagement partner.....	16

## **PART A OVERVIEW**

### **1.0 Introduction**

#### **Policy objective**

- 1.1 External auditors play a vital role in upholding market confidence in audited financial statements which can be relied upon in the course of supervisory process. Labuan Financial Services Authority (Labuan FSA) relies on the work of external auditors for the true and fair view of the financial statements and the adequacy of accounting and general controls for the production of annual financial statements. Labuan FSA maintains a deep interest in the quality of external auditor's work for effective monitoring of the licensed entities. 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 Labuan IBFC.
- 1.2 The Guidelines aims to ensure that the Labuan Financial Institutions (LFIs) only appoint external auditors who have the skills, resources and experience necessary to perform their functions effectively and in compliance with the regulatory requirements. This would complement the professional standards that are already applied to external auditors and to ensure the effectiveness of prudential supervision. It is expected that the LFIs and external auditors will continue to meet the requirements under the Guidelines on an ongoing basis.

#### **Scope of policy**

- 1.3 The Guidelines outlines the qualifications of an external auditor to be appointed by an LFI and sets out Labuan FSA's requirements regarding the terms of an audit engagement, appointment procedures, regulatory and supervisory expectation and reporting obligations to be observed by the LFI.
- 1.4 The Guidelines shall be read together with the following:
  - i. Circular and Directive on Financial Reporting Standards for Labuan Financial Institutions that clarifies on the accounting standards adopted by the LFIs; and
  - ii. Guidelines on Fit and Proper Person Requirements that sets out the requirements on the obligations of LFIs to assess and determine the fitness and propriety of relevant persons as specified by Labuan FSA.

## 2.0 Applicability

2.1 The Guidelines is applicable to:

- i. Labuan banks and Labuan investment banks licensed under Part VI of the Labuan Financial Services and Securities Act 2010 (LFSSA);
- ii. Labuan Islamic banks and Labuan Islamic investment banks licensed under Part VI of the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA);
- iii. Labuan insurers and reinsurers including Labuan captive insurance business licensed under Part VII of the LFSSA;
- iv. Labuan takaful and retakaful operators including Labuan captive takaful business licensed under Part VII of the LIFSSA;
- v. Labuan insurance broker licensed under Part VII of the LFSSA and Part VII of the LIFSSA;
- vi. Labuan trust companies including Labuan managed trust companies licensed under Part V of the LFSSA;
- vii. Labuan money-broking business licensed under Part VI of the LFSSA and Part VI of the LIFSSA;
- viii. Labuan fund manager licensed under Part III of the LFSSA and Part IV of the LIFSSA;
- ix. Labuan public funds registered under Part III of the LFSSA and Part IV of the LIFSSA;
- x. Labuan charitable foundations<sup>1</sup> registered Part IV of the Labuan Foundations Act 2010; and
- xi. Labuan Islamic charitable foundations registered under Part IX of the LIFSSA.

2.2 In addition to the abovementioned LFIs, the Guidelines shall also applicable to an external auditor appointed under Part XI of the LFSSA and Part XII of the LIFSSA.

2.3 Unless otherwise specified, the LFIs under para 2.1(i) to (xi) should be referred to as Relevant LFIs.

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<sup>1</sup> Labuan charitable foundations which solicit public monies or funds.

### **3.0 Legal Provision**

3.1 The Guidelines is issued pursuant to:

- i. section 4A of the Labuan Financial Services Authority Act 1996 (LFSAA);
- ii. section 10 of the Labuan Companies Act 1990 (LCA);
- iii. section 174 of the LFSSA; and
- iv. section 135 of the LIFSSA.

3.2 Any Relevant LFIs which fail to comply with the Guidelines may be guilty of an offence punishable under Section 36B and 36G of LFSAA.

### **4.0 Effective Date**

4.1 Save for Paragraph 5.4, all requirements of the Guidelines shall come into effect from financial year beginning on and after 1 January 2018.

4.2 The physical presence and staffing requirement of external auditor under Paragraph 5.4 shall come into effect on 1 January 2019 to provide sufficient transition period for compliance.

## PART B OPERATIONAL AND REGULATORY REQUIREMENTS

### 5.0 Criteria for the appointment of an external auditor

- 5.1 Pursuant to section 174(1) of the LFSSA and/or section 135(1) of LIFSSA, as the case may be, an external auditor appointed by a Relevant LFI shall meet the qualification criteria set out in paragraph 5.3 and shall continue to meet the criteria throughout the audit engagement. In this regard, the board<sup>2</sup> is required to obtain, review and independently verify through reasonable means all relevant information necessary to support its assessment of the external auditor's compliance with the criteria specified under paragraphs 5.3 to 5.6.
- 5.2 If during the course of an audit engagement period, the external auditor no longer fulfills any of the qualification criteria or requirements specified in this Guidelines, the Relevant LFI shall notify Labuan FSA in writing of that fact and the reasons for not meeting the qualification criteria or requirements, within seven (7) days from the date of disqualification made known to the Relevant LFI.
- 5.3 The qualification criteria of an external auditor are as follows:
- i. he shall be fit and proper person in accordance with the Guidelines on Fit and Proper Person Requirements issued by Labuan FSA;
  - ii. he must not have been convicted of any offence under the LFSSA or the LIFSSA, Labuan Companies Act 1990, the Companies Act 2016, or of any offence under any written law involving fraud or dishonesty in Malaysia or in other jurisdictions;
  - iii. he shall have the necessary skills, knowledge and appropriate experience to perform the audit of the Relevant LFI with professional competence and due care in accordance with the approved auditing standards<sup>3</sup> and applicable regulatory and legal requirements;
  - iv. he shall not have relationships with, or interests in, including an interest in shares of, the Relevant LFIs or any of its related<sup>4</sup> 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;

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<sup>2</sup> the board of directors, which may be assisted by the board audit committee. While the board is primarily responsible for conducting the assessments on the external auditor, the board may delegate the assessment of the external auditor's compliance to its Audit Committee. For the purpose of the Guidelines, in relation to Relevant LFIs of a branch status, or any other entity which does not have a board of directors, the 'board' shall refer to the Relevant LFIs' regional/head office or an equivalent person, whichever is relevant.

<sup>3</sup> refers to the Malaysian Approved Standards on Auditing (MASA) issued by the Malaysian Institute of Accountants and any other standards that are relevant in the home jurisdiction of the Relevant LFI.

<sup>4</sup> refers to Section 4 of the LCA.

- v. he shall not have any record of disciplinary actions taken against him for unprofessional conduct by the Malaysian Institute of Accountants (MIA) or any other recognised accountancy institutions where the decision for such disciplinary action has not been reversed by their disciplinary appeal board(s);
  - vi. he shall have no record of adverse comments from Securities Commission Malaysia (SC), Bank Negara Malaysia (BNM) or any other regulatory authority(s); and
  - vii. he must not have served as an engagement partner for a continuous period of more than five years with the same Relevant LFI. An external auditor who has been rotated off the audit of a Relevant LFI may resume the role as engagement partner only after a lapse of five years from the last audit engagement with that Relevant LFI.
- 5.4 An external auditor shall establish and maintain an operational office in Labuan. The office shall have a dedicated entrance from offices of other entities/companies with minimum of two qualified auditors stationed at its Labuan office. The said operational office would be used for the conduct of audit-related works and other permissible non-audit services<sup>5</sup>.
- 5.5 The board shall ensure that members of the audit engagement team involved in making key decisions on significant matters with respect to the audit of the financial statements meet the qualification criteria in paragraphs 5.3(i) to 5.3(vi).
- 5.6 Where non-audit services are provided to the Relevant LFI by an external auditor, the board shall ensure that the provision of such service does not impair the external auditor's objectivity, judgment or independence throughout the audit engagement.
- 5.7 Where the board relies on attestations provided by an external auditor on matters covered in paragraphs 5.3 and 5.5, reasonable steps must be taken to establish the validity of the attestations. At the minimum, the board shall:
- i. consider information available from public or independent sources which are relevant to the professional conduct of the external auditor;
  - ii. consider the external auditor's conduct and performance in past assurance engagements with the Relevant LFIs; and

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<sup>5</sup> may include tax-related advisory services, professional advice on transactions (e.g. a merger, acquisition or restructuring), advisory services on broad business transactions and compliance with laws and regulations.

- iii. be satisfied that appropriate measures have been taken by the external 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.

## **6.0 Terms of an audit engagement**

- 6.1 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.
- 6.2 The terms of an audit engagement shall at the minimum address the following:
  - i. objective of the audit;
  - ii. scope of an audit engagement;
  - iii. agreement on the audit plan;
  - iv. responsibilities of the engagement and concurring partners;
  - v. reports to be prepared by the external auditor, including the Auditor's Report and recommendations for improving internal controls;
  - vi. timing of the audit and audit fees;
  - vii. use of experts in certain aspects of the audit; and
  - viii. other significant arrangements in relation to the audit, including responsibilities of the external auditor with regard to any change to members of the engagement team during the audit.
- 6.3 For the reappointment of an external auditor, the existing terms of the audit engagement shall be confirmed for each reporting period and appropriate modifications made as necessary to reflect any material changes in the Relevant LFIs which have a bearing on the audit engagement.

### **Scope of an audit engagement**

- 6.4 The scope of the audit engagement shall be determined having regard to all activities of the Relevant LFI where the financial reporting risks are material. A Relevant LFI shall take into account any significant changes during the reporting period which may have contributed to an increased risk inherent in the Relevant LFIs' internal controls over financial reporting processes, the accuracy of its recording of transactions, and ability to comply with financial reporting standards.



- 6.5 Changes that are relevant to a determination under paragraph 6.4 may include significant changes in operating structures, processes or key management personnel, the implementation of new regulatory requirements or reporting standards and major systems changes or upgrades.
- 6.6 The scope of the audit engagement shall also include recommendations to the management for improving internal controls to ensure fair presentation of the financial statements.
- 6.7 The detailed audit programme and audit plan must at least include specific procedures to test the Relevant LFIs' internal controls over financial reporting in relation to the loan/financing portfolio, investment portfolio, insurance/takaful liabilities and monies held in trust, as the case may be. These procedures shall include a review and validation of the management's processes for determining the adequacy of provisions for loan/financing impairments, adequacy of reserves for insurance/takaful liabilities and values ascribed to financial instruments. The procedures shall be adequate to enable the external auditor to form a view as to whether the management's processes are based on a comprehensive, adequately documented and consistently applied analysis of the Relevant LFIs' loan/financing portfolio, investment portfolio and insurance/takaful liabilities.
- 6.8 In areas identified as being of high risk or particular concern in any particular financial year(s) having regard to matters covered under paragraphs 6.4 and 6.5, 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**

- 6.9 An engagement partner and a concurring partner shall be identified for each audit engagement.
- 6.10 The engagement partner is responsible for the performance of the audit engagement and the external auditors' report issued. The concurring partner is responsible for objectively evaluating, before the audit report is issued, the significant judgments made by the engagement team and conclusions reached in formulating the report.
- 6.11 The terms of the audit engagement shall state the responsibilities of the engagement partner to:
- i. direct, supervise and perform the audit in compliance with the approved auditing standards<sup>3</sup> 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 Relevant LFI. This shall include relevant audit experience of the team in the financial industry; and
  - iii. ensure that the external 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.
- 6.12 The terms of the audit engagement shall also establish that it is the responsibility of the concurring partner to form an objective assessment, based on an appropriate review of selected audit working papers of:
- i. significant risks identified by the engagement team during the audit and the appropriateness of the team's responses to those risks;
  - ii. whether the audit evidence obtained is sufficient to support the significant judgments made and conclusions reached by the engagement team;
  - iii. whether differences of opinion with the management or other contentious matters were appropriately dealt with; and
  - iv. matters which should be communicated to management and where applicable, Labuan FSA or other regulatory authority.
- 6.13 The board shall take appropriate step to satisfy itself that the concurring partner can reasonably commit the necessary time to carry out the required review of audit documentation to support the assessment required under paragraph 6.12.
- 6.14 Where the external auditor expects or intends to use the work of an external expert to obtain sufficient audit evidence to support the audit, the terms of the audit engagement shall provide that the use of experts does not diminish the external auditor's responsibility for the audit reports issued and opinions expressed.

### **Reliance and accountability for the Auditors' Report**

- 6.15 A Relevant LFI shall inform its external auditor that Labuan FSA may rely on the external auditors' review and report as input to Labuan FSA's supervisory plans under the risk-based approach to supervision, and its ongoing supervisory assessments of the Relevant LFI.

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

### **Audit fees**

- 6.17 The board should ensure that audit fees are commensurate with the scope of the audit and accountability assumed by an external 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 the Guidelines.

## **PART C REGULATORY AND SUPERVISORY EXPECTATION**

### **7.0 Engagement with Labuan FSA**

- 7.1 The external auditors can provide Labuan FSA with valuable insight into various aspects of a Relevant LFI's operations and management's attitude towards the application of key accounting policies, including the judgments made by, and any asset or liability valuation models adopted by, management in carrying out these policies. Conversely, external auditors may obtain helpful insights from Labuan FSA where Labuan FSA provides input(s) on specific areas of supervisory concerns.
- 7.2 In addition, effective communication should be established through one or more direct written and/or oral communication channels or a combination thereof, as dictated by the circumstances. Written communication channels may include extended audit reports on the audited financial statements, which are submitted to the Labuan FSA as and when practicable.
- 7.3 Labuan FSA may convene meetings with the external auditors for discussing the matters relating to regulatory concerns i.e. weaknesses of the Relevant LFIs' internal control systems, adequacy of provisions and compliance with statutory and prudential requirements in their audit of financial statements. This may also include auditing and accounting issues arising from the audit engagements or international developments.

- 7.4 Notwithstanding paragraph 7.2, by virtue of section 174(5) of LFSSA and section 135(4) of LIFSSA, the external auditors shall promptly communicate matters arising from the audit that may be of material significance such as contravention of the provision of LFSSA and/or LIFSSA or any irregularities that are or can be detrimental to the interest of the Relevant LFIs' stakeholders, including deviation from licensing business activities approved by Labuan FSA. Disclosures made in good faith by an external auditor to Labuan FSA on matters of material significance shall not be deemed as a breach of the external auditor's duty of confidentiality and no legal actions shall be taken against the said external auditors. In instances where Management Letter is issued by external auditors to Relevant LFIs, a copy of the duly executed Management Letter shall be extended to Labuan FSA.
- 7.5 In furtherance to this, external auditors of the Relevant LFIs are expected to have constructive working relationship and should be in constant communication with the internal auditors and Labuan FSA on areas of common interest.

## **PART D REGULATORY PROCESS**

### **8.0 Appointment procedures**

- 8.1 A Relevant LFI is required to submit an application to Labuan FSA for approval prior to appointing an external auditor for each financial year no later than two months before the annual general meeting at which the resolution to appoint the external auditor will be tabled.
- 8.2 If the external auditor disqualified and/or cease to become the external auditor of the Relevant LFIs, the Relevant LFIs must submit new application within one month after the acknowledgement of cessation notice by Labuan FSA under paragraph 5.2.
- 8.3 An application shall not be submitted to Labuan FSA unless the board is reasonably satisfied that the requirements specified in this Guidelines have been or will be met. The Relevant LFIs shall maintain adequate documentation to support the board's assessments against the requirements of this Guidelines.

8.4 An application to Labuan FSA shall be made using the format as set out in Appendix 1 and shall be addressed to the following:

Director  
Supervision and Monitoring Department  
Labuan Financial Services Authority  
Level 17, Main Office Tower  
Financial Park Complex  
Jalan Merdeka  
87000 Federal Territory of Labuan

Telephone no : 087 591200  
Fax no : 087 453442 / 087 413328  
Email : *sed@labuanfsa.gov.my*

**Labuan Financial Services Authority**  
**21 November 2017**

Appendix 1



**APPLICATION FOR APPOINTMENT OF EXTERNAL AUDITOR**

**New Appointment**

**Reappointment**

*[Part IV (b) and (c) are mandatory. Part I, II and III need to be filled up only if there are changes]*

<b>PART I : PROFILE OF LABUAN FINANCIAL INSTITUTION</b> <i>Important: All fields are mandatory and should not be left blank</i>			
a.	Name of Labuan Financial Institution		
b.	Type of Licence <i>(Please ( √ ) the appropriate box)</i>	<input type="checkbox"/>	Labuan Bank/Investment Bank <i>(Including Islamic Bank/Islamic Investment Bank)</i>
		<input type="checkbox"/>	Labuan Insurer/Reinsurer <i>(Including Labuan captives)</i>
		<input type="checkbox"/>	Labuan Insurance Broker
		<input type="checkbox"/>	Labuan Trust Companies <i>(including Managed Trust Company)</i>
		<input type="checkbox"/>	Labuan Money Broking Business
		<input type="checkbox"/>	Labuan Fund Manager
		<input type="checkbox"/>	Labuan Charitable Foundation
		<input type="checkbox"/>	Labuan Public Funds
c.	Nature of Legal Entity <i>(Please tick ( √ ) the appropriate box)</i>	<input type="checkbox"/>	Labuan Company – Subsidiary
		<input type="checkbox"/>	Foreign Labuan Company – Branch

		<input type="text"/>	Branch of Malaysian Financial Institution
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**PART II : PARTICULARS OF THE APPOINTMENT**  
*Important: All fields are mandatory and should not be left blank*

a.	Appointment for Financial Year Period (e.g. 1/1/2018 – 31/12/2018)	
b.	Proposed date of Annual General Meeting	

**PART III : PROFILE OF THE APPOINTED EXTERNAL AUDITOR**  
*Important: All fields are mandatory and should not be left blank*

a.	Name of the Audit Firm	
b.	Firm No.	
c.	Company Address	
d.	Registered with AOB, where applicable	Yes <input type="checkbox"/> No <input type="checkbox"/>
e.	Name of Engagement Partner(s) : Contact No : Email :	
f.	Name of Concurring Partner(s) : Contact No : Email :	

**PART IV : ADDITIONAL INFORMATION TO BE ENCLOSED WITH APPLICATION**

*Important: All fields are mandatory and should not be left blank*

a.	Detailed assessment <sup>6</sup> by the board or board audit committee, as the case may be	
b.	Extract of board minutes endorsing the proposed appointment/reappointment of the engagement partner, concurring partner and audit firm	
c.	Statutory declaration by the engagement partner <sup>7</sup>	
d.	Curriculum vitae of the engagement and concurring partners	
e.	Processing fees ( <i>RM300 for charitable foundations and RM1,000 for other LFIs</i> )	

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<sup>6</sup> the assessment must include areas as set out in Appendix 2.

<sup>7</sup> format as set out in Appendix 3.



## Appendix 2

### Principal areas of assessment of an external auditor

AREA OF ASSESSMENT	SCOPE OF ASSESSMENT	
<b>A. Performance</b>	1. Level of knowledge, capabilities, experience and quality of previous work	<ul style="list-style-type: none"> <li>▪ Years of experience of engagement partner in the audit of financial institutions</li> <li>▪ Adequacy of man-days spent by the engagement and concurring partners</li> <li>▪ Effectiveness of the concurring partner in conducting reviews and supporting the engagement partner's assessment</li> </ul>
	2. Level of engagement with the board	<ul style="list-style-type: none"> <li>▪ Ability of engagement partner to provide independent views during discussions with the board</li> <li>▪ Adequacy of frequency of updates to the board on the quality of reporting, including the applicability of new and significant accounting standards</li> </ul>
	3. Ability to provide constructive observation, implications and recommendation in areas which require improvement	<ul style="list-style-type: none"> <li>▪ Effectiveness of the audit recommendations in addressing weaknesses observed during previous audits, particularly on internal controls relevant to financial reporting process</li> </ul>
	4. Appropriateness of audit approach and the effectiveness of audit planning	<ul style="list-style-type: none"> <li>▪ Adequacy of audit scope</li> <li>▪ The audit firm's plan towards ensuring staff continuity in the audit of a Relevant LFI</li> </ul>
	5. Ability to perform the audit work within the agreed duration given	<ul style="list-style-type: none"> <li>▪ Ability to meet audit deadlines</li> <li>▪ Timeliness in responding to audit issues</li> </ul>
<b>B. Independence and objectivity</b>	1. Auditor demonstrates unbiased stance when interpreting the standards/policy adopted by a Relevant LFI	<ul style="list-style-type: none"> <li>▪ Level of participation of, and professional skepticism exercised by, the engagement partner, in particular when there are differences in interpretation or views with management</li> </ul>

### Appendix 3

#### STATUTORY DECLARATION BY ENGAGEMENT PARTNER OF AUDIT FIRM

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

- A. I am not disqualified under the provisions of the Companies Act 2016 and Labuan Companies Act 1990 from being appointed as an auditor for *[name of institution]*
- B. I have not been convicted of any offence under the Labuan Financial Services and Securities Act 2010, the Labuan Islamic Financial Services and Securities Act 2010, the Companies Act 2016 or the Labuan Companies Act 1990, or of any offence under any written law involving fraud or dishonesty.
- C. I have no relationships with, or interests in, including an interest in shares of, *[name of financial institution]* or any of its related entities that are likely to impair my objectivity or independence, and which cannot be reduced to an acceptable level through the application of appropriate safeguards.
- D. I have no record of disciplinary actions taken against me for unprofessional conduct by the Malaysian Institute of Accountants (MIA) or any other recognised accountancy institutions where the decision for such disciplinary action has not been reversed by their disciplinary appeal board(s);
- E. I have no record of adverse comments from Securities Commission Malaysia (SC), Bank Negara Malaysia (BNM), or any other regulatory authority(s).

**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/Commissioner for Oaths/Notary Public)