



The Observer

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❖ Exceptionally low cost of the internal audit function – a concern

In the past few years, MSWG has been raising questions at AGMs on the exceptionally low cost spent by PLCs on their internal audit (IA) function. MSWG considers a cost of below RM24,000 per annum as exceptionally low.

During the last year, a few of the PLCs queried have stated that the low IA cost was due to less or no audit work performed during the year because of movement controls arising from the COVID-19 pandemic.

Meanwhile, most of the other PLCs replied that they felt that the cost was reasonable, and that the scope covered by the internal audit function was sufficient to ensure that internal control systems were adequate and effective.

Some of the other reasons provided for the low IA cost include:

- The management and CEO were also undertaking necessary steps to ensure internal control procedures are being followed.
- The Audit Committee was receiving assurance from the management that risk management and internal control systems were adequate and effective.
- The reduction was due to cost cutting measures due to difficult times.

Unreasonable reasons for low cost

The reasons provided by the PLCs for the low cost incurred for their IA function does not hold water.

One of the reasons given was that management and CEO were also undertaking necessary steps to ensure that the internal control procedures were being followed. Another was that the Audit Committee was receiving assurance from the management that risk management and internal control systems were adequate and effective.

In both these instances, the Audit Committee was relying on management for assurance on management when it should be relying on someone independent of

management for that assurance – only an independent IA function, correctly positioned, can provide such independent assurance.

Internal audit provides assurance on management – it does not make sense to ask management to provide assurance on itself – this is an obvious conflict of interest.

Another common reason given for the low IA cost was that it was due to cost-cutting exercises due to difficult times. The IA function should not just be regarded as any other 'cost centre' that can be downsized during difficult times. It is exactly in such difficult times that there should be a robust IA function. It appears that some companies maintain an IA function just to 'tick the box' to say that they have complied with the listing requirement to have an IA function.

Findings of the MSWG-ASEAN CG Scorecard 2020 assessment

The findings of the MSWG-ASEAN CG Scorecard 2020 assessment revealed that 158 PLCs had exceptionally low IA costs of RM24,000 per annum (or equivalent to RM2,000 per month) or less. The lowest cost incurred for the IA function was RM1,752 per annum (2019: RM1,488).

The bottom 5 PLCs with IA cost of RM6,000 per annum or below are: -

No	Company	IA cost (RM)	Revenue (RM)	Net Profit/(Loss) (RM)
1	Inch Kenneth Kajang Rubber Public Ltd Co. *	1,752	14,214,000	(6,910,000)
2	SMTrack Berhad	4,000	1,698,113	(1,773,606)
3	Kuchai Development Bhd *	5,500	6,880,079	2,240,930
4	Top Builders Capital Berhad *	6,000	199,536,000	(159,546,000)
5	Inix Technologies Holdings Berhad	6,000	8,049,105	(3,359,542)

* PLCs not monitored by MSWG

All the 5 PLCs listed above had outsourced their internal audit functions.

The finding of the MSWG-ASEAN scorecard assessment revealed that out of the 158 PLCs with IA cost of less than RM24,000 per year, 154 of them relied on outsourced service providers for their IA functions.

An IA cost of RM1,752 per year for a PLC with more than RM10 million revenue and RM6,000 for a PLC with almost RM200 million revenue should spark concerns on the adequacy of the scope of work and the effectiveness of the IA function. For that matter, even the 158 PLCs which had IA cost of RM24,000 per annum or less should also be viewed with concern.

The role & function of internal audit

The IA function is considered as one of the four cornerstones of good corporate governance – the other three being the board, the management and external audit. IA is considered important enough to be mandated by the listing requirements.

Chapter 15, Paragraph 15.27 of the Main Market Listing Requirements (MMLR) requires a listed issuer to establish an IA function that reports directly to the audit committee. The plans and scope of the IA function are determined by the audit committee of the PLC. As such, the role, the function, and the scope of the IA function could vary among PLCs.

IA provides independent assurance to the board, through the audit committee, that all is well when it comes to risk management, control processes and governance structures and processes of organisations. Business organisations are susceptible to fraud and all kinds of wrong. As such an effective IA function is essential to safeguard the interest of the shareholders and other stakeholders.

Internal audit – the unregulated function

Unlike the external auditors of PLCs, who are regulated by the AOB, (and the Malaysian Institute of Accountants), under the purview of the SC, the internal auditors are unregulated.

There is the Institute of Internal Auditors Malaysia, but it is not mandatory for an internal auditor, or for the head of an internal audit function, to be a member of that Institute. The unregulated nature of IA could be a reason for the low cost of the IA function. All things being equal, the lower the cost the lesser the quality, the competence and effectiveness. That which is unregulated tends to fall into disarray. Important professions are always regulated. With regulations, there is higher quality and more accountability.

It is well and good to realise the importance of IA and make it mandatory for listed companies. If the IA function is indeed that important enough to be acknowledged as a mandatory requirement under the listing requirements, then, surely, it is important enough to be regulated – just like any other profession worth its salt.

Devanesan Evanson
Chief Executive Officer

MSWG AGM/EGM Weekly Watch 4 – 8 October 2021

For this week, the following are the AGMs/EGMs of companies which are in the Minority Shareholders Watch Group's (MSWG) watch list.

The summary of points of interest is highlighted here, while the details of the questions to the companies can be obtained via MSWG's website at www.mswg.org.my.

Date & Time	Company	Quick-Take
04.10.21 (Mon) 08.00 am	Ageson Bhd (AGM)	The Group posted a PBT of RM31.71 million for FY2021 as compared to PBT of RM41.10 million mainly due to higher cost of sales incurred of which the increase was in tandem with the growth in revenue

		contributed from the construction segment.
07.10.21 (Thur) 10.00 am	Bermaz Auto Bhd (AGM)	<p>Bermaz's revenue increased by 30% y-o-y to RM2.29 billion (2020: RM1.76 billion) mainly due to higher vehicle sales volume from domestic operations which was a result of the economic stimulus package under Penjana and aggressive promotional campaigns introduced by the Group.</p> <p>However, its performance was partly offset by lower vehicles sales volume from the Philippines operations.</p> <p>Nevertheless, its PBT increased by 28% to RM168.9 million (2020: RM132.0 million). With the ongoing COVID-19 pandemic, the performance of the Group will remain challenging as COVID-19 pandemic may still impact the Group's overall performance in FY2022.</p>
07.10.21 (Thur) 11.00 am	Analabs Resources Bhd (AGM)	<p>Analabs almost posted a better year-on-year financial performance with a 6% increase in revenue and 125% jump in net profit.</p> <p>The better performance was driven by higher sales from the manufacturing, formulation and sale of resin, chemicals and building materials segment. Meanwhile, the bottomline was boosted by improved manufacturing efficiency, rationalisation and containment of operating overheads.</p>

One of the points of interest to be raised:

Company	Points/Issues to Be Raised
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Ageson Bhd (AGM)	<p>The total fee for the outsourced internal audit function of the Company during the FYE2021 was RM10,841.97 (Page 44 of Annual Report 2021).</p> <p>Given that the fee is rather small (at RM903.50 per month), how does the audit committee assure itself that there would be adequate coverage and an effective audit function? What are the areas covered by the internal audit function? How many internal audit reports were issued during the said period?</p>
Bermaz Auto Bhd (AGM)	<p>Bermaz recorded an improvement in revenue of 43.2% to RM2.12 billion (2020: RM1.48 billion) largely due to higher sales volume for the domestic operations which was mainly attributed to the positive impact from the sales tax exemption introduced by the Government for CKD and CBU vehicles (page 18 of Annual Report 2021 ("AR2021")).</p> <p>With the extension of the sales tax exemption to 31 December 2021 coming to an end, what will be the key catalysts to drive the Group's car sales for the financial year 2022 and going forward?</p>
Analabs Resources Bhd (AGM)	<p>Analabs' total loans and borrowings had increased by 45% to RM70.96 million from RM48.98 million a year ago (page 53, Statements of Financial Position, AR2021). The increase was mainly due to the increase in margin trading and onshore foreign currency loan.</p> <p>Should some of the quoted investments be liquidated to reduce Analabs' total loans and borrowings? (Note: "Other Investments" which primarily consists of quoted investment had increased to RM154.97 million in FY2021 from RM103.01 million the year before).</p>

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DISCLOSURE OF INTERESTS

•With regard to the companies mentioned, MSWG holds a minimum number of shares in all these companies covered in this newsletter.

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