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1MDB: The Audit Firms' Questions

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Abstract

The 1Malaysia Development Berhad (1MDB) has had three auditors since it started its operation several years ago. The issues of interest are related to the subject matter of auditor switching and the audit failure allegations made against its two latter auditors: KPMG and Deloitte. When it concerns Deloitte, it was accused of hiding 1MDB's insolvency. As for the KPMG, it was accused of failing to expose the allegedly suspicious transactions between 1MDB and its joint venture partner Petrosaudi International Limited (PSI) to the relevant authorities. As for the auditor switching from KPMG to Deloitte, questions arose on the reasons for and its timing.

Keywords: 1MDB, Deloitte, KPMG, audit failure allegations, auditor switching

1. Introduction

There are two questions involving the audit firms of the 1MDB. One is concerned with the allegations against the audit firms of Deloitte and KPMG for the yearly statutory audit. The other is related to auditor switching. When it concerns the former, the issue involves the possibility of audit failures. This is discussed next.

2. The Allegations Against…

Deloitte – Hiding 1MDB's Insolvency? It was in early 2015 that reports came out stating that the 1MDB was suffering from a major liquidity crisis as it had not yet been able to repay a RM2 billion loan which was due since the end of November 2014. The loan had since been extended at least twice to January 31, 2015 but it was still struggling to secure the necessary funds to repay the loan. If the company was unable to repay its loan by February 18, 2015, the relevant lending banks had to declare the loan officially in default. If that took place, then the remaining balance of 1MDB's debts which was in excess of RM40 billion would immediately be in default. Such an eventuality would be a devastating outcome not just for 1MDB, but for the creditworthiness of the Malaysian Government which guaranteed explicitly and implicitly at least RM16 billion of these debts. The impact on the local financial system would then be equally severe. At the end, the loan was paid out – with media reporting that the local billionaire Ananda Krishnan was the white knight rescuing the company in distress. (**Note**: Details of all this and more may be found in the companion case that come with the title 1MDB: The Financial Accounting's Question of Going Concern which constitute one of the case studies for the first series of case studies on 1MDB by yours truly.)

While the drama unfolded, Deloitte was confronted with the question as to whether it had dutifully and diligently performed its fiduciary duty when auditing 1MDB (Fuentes, 2015a). It was because the 1MDB was signed off on 3 November 2014 as a healthy going concern but had missed its first deadline to repay an RM2 billion in less than a month later! In other words, should not the company's accounts be given instead a qualified audit report or at the very least the unqualified audit report with an emphasis of matter?

Specifically, Tony Pua, who is Democratic Action Party (DAP) National Publicity Secretary and MP for Petaling Jaya Utara, raised the question of where had all the cash gone when for the financial year ending March 2014, 1MDB had in its balance sheet a total of RM3.85 billion in "Cash and Bank Balances" (Fuentes, 2015a). Pua had also pointed out that Deloitte which had signed off the accounts on 3 November 2014 had even taken into account 1MDB's proposed redemption of its investment of US$1.1 billion (RM3.9 billion) in the Cayman Islands which would improve the company's liquidity in the short term. All in all, argued Pua, given the "Cash and Bank Balances" and the Cayman's redemption, 1MDB should not be suffering from any cash flow shortage to repay a relatively small RM2 billion loan.

From Pua came the allegation that there may be an outright fraud committed by Deloitte. As he put it, Deloitte signed off 1MDB's 2013 and 2014 accounts without qualification. This could take place with Deloitte abetting 1MDB in producing their "unqualified" accounts. In this regard, he was quoted to say: “Such complicity would not be the first as we have seen how the world’s largest auditing firm, Arthur Andersen, collapsed overnight over their role in the multi-billion dollar Enron financial scandal in the United States.” Alternatively, there could well be the case of an audit failure committed by the audit firm. Specifically, Deloitte had been negligent as proven by the fact that the 1MDB had failed to produce the necessary funds to repay a RM2 billion loan at the end of November 2014 - despite the fact that auditors signing off the accounts in the first week of the same month! As he put it: “Surely a firm facing such imminent crisis should never have had their accounts signed off without even an ‘emphasis of matter’.”

Having said all this, Pua in another news report a few months later was said to have claimed that there might not be the case of an outright fraud or negligence on the part of Deloitte (Fernandez, 2015). Instead, it might very well be the case of the management of 1MDB having misled the audit firm! How could this happen? Well, in an earlier news report (FMT Reporters, 2015a), the following was mentioned coming from Pua: “If not for the promised receivable of US$1.23 billion, 1MDB would not have passed the ‘liquidity risk’ test as the Company is expected to fully repay a RM2 billion outstanding loan by the end of November 2014.”

In another news report filed by *Malaysiakini*, such promise was clearly mentioned (Pua, 2015): “1MDB had promised their auditors, Deloitte Malaysia, that the balance will be redeemed and received by the end of November 2014. However, the amount remains outstanding despite 1MDB’s cashflow problems in repaying a RM2 billion debt which was due on 30 November 2014.” And, it should be worth pointing out that *Malaysiakini* in that very news report had stated the following next: (**Editor’s note**: 1MDB in a statement yesterday said it has redeemed in full the RM8.24 billion it invested in the Cayman Islands.) (Emphasis already around.)

[But, do note that early the next month, the *Malaysiakini* had also reported the following (“Conflicting claims on 1MDB’s”, 2015):

> Bank Negara must investigate the status of 1Malaysia Development Bhd's (1MDB) RM3 billion placed in the Cayman Islands following the latest twist in the repatriation of the funds. PKR vice-president Rafizi Ramli said a report in Singapore's *The Business Times* today that the money will not be repatriated from the Cayman Islands contradicts 1MDB's former claims that it has been returned in full. In the said article, 1MDB boss Arul Kanda Kandasamy was reported saying he has "no plans" to repatriate the funds as they will be used to service interest payments on its US dollar debts. "This contradicts 1MDB's earlier statement that confirmed that the money has been returned (to Malaysia)," said Rafizi in a statement today. He said this warranted serious attention and "immediate action" from the Finance Ministry and Bank Negara. "I have repeatedly urged Bank Negara to confirm if the funds have really been returned or not. "The 1MDB CEO's statement today not only shows its investment (in the Caymans) is problematic, but worse, it gives an impression that the 1MDB management is not transparent and is hiding things from the people," he said.

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Also, it should be worth mentioning what came out in the *Singapore Business Times* approximately a month later (Gabriel, 2015):

> Amid allegations of improprieties levelled against 1Malaysia Development Bhd (1MDB) over its business dealings, which have triggered a high-level probe into its books, the Malaysian government has extended a nearly RM1 billion (S$373 million) loan to the debt-ridden firm. The Business Times understands that the loan was provided by the Ministry of Finance, 1MDB's shareholder, to deal with the firm's cash flow woes as it is saddled with huge interest payments. The firm has racked up debts of some RM42 billion with worries of a potential default weighing on Malaysia's sovereign rating and currency. When contacted, a spokesman of 1MDB declined comment.

As it turned out, it was all true. Check out the following which came out in *The Malaysian Insider* in the middle of March 2015 ("1MDB will haunt capital", 2015):

> On March 12, Second Finance Minister Datuk Ahmad Husni Hanadzlah told Parliament that Putrajaya had extended funds to the company a day after the Singapore Business Times reported that Putrajaya had "loaned" money to 1MDB. Two days later, Astro Awani quoted Ahmad Husni as saying RM600 million of the standby credit had been used. On the same day as Husni's announcement in Parliament, 1MDB president and group executive president Arul Kanda Kandasamy said in a statement the RM950 million was a loan to 1MDB by Putrajaya "on commercial terms". The contradictory terms led PKR secretary-general Rafizi Ramli to call it a bailout to ease 1MDB's immediate cash flow woes.]

All in all, the 1MDB management appeared to have given their word to the auditor that money would surely flow in at the time that it was needed leading to Deloitte Malaysia letting them off the hook with the remark that it was unable to verify for certain the valuation as disclosed in the financial reports. Indeed, in one of the news story referred to above, it was mentioned that for the 1MDB accounts for March 2013 and 2014, Deloitte had in fact highlighted 26 per cent of the 1MDB assets or RM13.4 billion as nothing more than the so called "Level 3" assets (Fernandez, 2015). As Pua put it on this kind of assets, they are where the fair value measurements are derived from valuation techniques that include inputs that are not based on observable market data (unobservable inputs). In other words, argued Pua, Deloitte had put on record that they were unable to vouch for the veracity and accuracy of the numbers supplied by the 1MDB management!

KPMG – Colluding with PetroSaudi and 1MDB? It is notable that KPMG served as auditor for 1MDB from 2010 to 2012, before it was replaced with Deloitte. It was in late February 2015 that Pua had urged the KPMG to explain its failure to expose the allegedly suspicious transactions between 1MDB and its then joint venture partner Petrosaudi International Limited (PSI) ("Pua calls for immediate audit", 2015). In particular, he claimed that the audit firm was responsible in reporting such matters to the relevant authorities, such as the police or even the Malaysian Anti-Corruption Commission (MACC). And, its failure to do so had provided the picture that it was abetting 1MDB in covering up the "Petrosaudi scam". The news portal the *Free Malaysia Today* had reported this whole thing on the possible collusion between KPMG and 1MDB in the following clear cut manner (FMT Reporters, 2015b):

> Pua also said that under international auditing standards, KPMG was obliged "to maintain professional skepticism" throughout an audit. It ought to assess the risks of material misstatements, and identify business transactions which may have been entered into for the purpose of fraudulent financial reporting or to conceal misappropriation of assets.

Saying that the public expects auditors to fulfil their responsibilities proficiently, he added, "Auditors must balance competing interests to perform their role and provide public service. If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity."

"In this case, unless they were convinced after a thorough audit process that there has been no suspicious element of fraud or the misappropriation of direct or indirect Government funds, the Auditors are obligated to report the matter to the relevant authorities, such as the Police or even the Malaysian Anti-Corruption Commission (MACC)," he asserted.

As the story goes, KPMG was the auditor of 1MDB's 2010 accounts, which happened to be the state investment company's very first set of financial reports. Hence, the reporting period includes the time from when the joint venture was signed in September 2009, and when it was terminated in March 2010. It is notable that the signing of the joint venture agreement had led the 1MDB to pay US$1 billion to the PSI's subsidiary, 1MDB PetroSaudi, despite its lack of a tangible track record ("DAP lawmaker slams audit", 2015).

And, it is also notable that PSI had created the shell company, 1MDB PetroSaudi, from scratch on September 18, 2009, just 10 days before its subsidiary received US$1 billion from 1MDB. Documents on whistle-blower website *Sarawak Report* showed that four days after 1MDB PetroSaudi was created, PSI signed an agreement saying the subsidiary owed it US$700 million. Next, on September 29, 1MDB bought 40% of new shares in 1MDB PetroSaudi and injected RM1 billion in cash. On the following day, US$700 million was taken out of 1MDB PetroSaudi and given to PSI and the PSI had next channeled it out to a company allegedly owned by Low, called Good Star Limited. All in all, it could very well be alleged that the 1MDB PetroSaudi joint venture company's US$700 million loan repayment to PetroSaudi in 2009 was a front to profit Low and/or those he associated with.

Pua said that these details were not reported in 1MDB's very first set of financial reports for the financial year ended in March 2010 as the joint venture was terminated 6 months later in March 31, 2010, which happened to be the last day of the financial reports. And, with the agreement termination taking place, the US$1 billion investment was later revalued to US$1.2 billion, sold back to PSI, "converted into Murabaha notes (an Islamic loan)," and then loaned back to 1MDB Petrosaudi Limited! As Pua had pointed out ("DAP lawmaker slams audit", 2015):

> I raised the question earlier as to whether conversion of shares to loan was in actual fact a cover-up of the JV scam. By converting it into a loan to the Petrosaudi, 1MDB was then

> able to avoid reporting the key salient details of the JV agreement in the 2010 Financial Report. The action of 1MDB raises strong suspicions of hanky-panky because if 1MDB decided that the venture with Petrosaudi was not working out, why didn't it just withdraw its US$1.2 billion investment in full?

In another news report that appears to be more crystal clear, Pua was said to have questioned why 1MDB did not just withdraw the entire US$1.2 billion investment in full if the joint venture had failed or if it did not believe in the business model anymore (FMT Reporters, 2015b). Next, he was quoted to say: "Why did it still lend money to the venture given that it would have no control of the funds?"

In the final analysis, Pua suggested that 1MDB's secret joint venture with Petrosaudi International Limited (PSI), entered into in 2009, raised "strong suspicions of hanky-panky" involving "a highly elaborate scam to siphon money from 1MDB" (FMT Reporters, 2015b). And, the KPMG would have had complete access to the agreement and would have vetted the relevant transactions including the US$700 million (RM2.5 billion) transferred from 1MDB to PetroSaudi ("DAP lawmaker slams audit", 2015). Next, he was quoted to say:

> The question must therefore be asked if the auditors for 1MDB, KPMG Chartered Accountants, who signed off the accounts on October 4, 2010, abetted 1MDB in covering up the above PetroSaudi scam…The failure to red flag the above transactions meant that the 1MDB auditors would have failed in their duty to protect the interests of the government and the Malaysian public at large.

In the following month, another exposé took place related to the KPMG audit of 1MDB for the year ended March 2010 which it had signed off on October 4 the same year (Ng, 2015a). As mentioned earlier, 1MDB entered into a joint venture with PetroSaudi Holdings (Cayman) Limited, a wholly owned subsidiary of PSI on September 28, 2009 but the collaboration was terminated six months later. The termination had led to the 1MDB's US$1 billion investment converted into US$1.2 billion Murabaha notes, or an Islamic loan, on March 31, 2010 after selling 40% of its stake in the JV. The loan went back to 1MDB PetroSaudi Limited.

However, the emails (leaked by *Sarawak Report*) dated July 23 and September 8, 2010 had specifically referred to the "Murabaha financing agreement dated June 14, 2010 between 1MDB and 1MDB PetroSaudi Limited, a JV company formed between 1MDB and PSI." So, said Pua: "This meant if the Murabaha loan agreement was only signed on June 14, 2010, why is it 1MDB financial statements for March 2010 already claimed that the 1MDB shares in the JV has been converted into Murabaha notes on the last day of the financial year at March 31, 2010?" [It should be worth noting that in another news report later in the month it was mentioned that email correspondences had clearly showed that the drafts for all the various documents including the SSA itself were still being worked on by 1MDB's lawyers Brian Chia of Wong & Partners throughout April and May 2010 (Fuentes, 2015b). Said Pua: "An email dated 9 June 2010 from PetroSaudi's lawyer, Thomas Merrifield to PetroSaudi's Tim Buckland, even pointed to the fact that 1MDB's two Board resolutions for the above transaction were signed only after 25 May 2010."]

He next said that these emails had raised suspicion that the entire share conversion exercise by 1MDB in the JV into a loan was an afterthought well past the March 2010 financial year. And, it was done with the backdating of the deal as disclosed in the 2010 financial statements in order to suppress information! Apparently, the backdating of the Murabaha conversion was needed since 1MDB would now no longer be required to reveal mind boggling details of the earlier JV with PetroSaudi in its 2010 financial statements since only the latest deal needed to be highlighted. Such details included the fact that the JV had included controversial transactions such as 1MDB Petrosaudi Ltd "agreeing" that it owed PetroSaudi US$700 million (RM2.559 billion) in advances and later paying the amount to nominee Good Star Ltd, a company controlled by Jho Low.

In the final analysis, the fact that KPMG’s audit report was dated October 4, 2010 which was well past all that which had taken place signified the auditor’s complicity in the entire joint venture termination and the subsequent conversion of shares to Murabaha notes. As Pua had put it as what this would mean (Ng, 2015a): “The apparent attempt to hide these information from the financial statements and the failure to red flag the above transactions meant that KPMG would have failed in its duty to protect the interests of the government and the Malaysian public at large.”

Next, Pua had suggested the following for the KPMG to do: “To protect the integrity and independence of the international chartered accountants, KPMG must declare its role in the Petrosaudi scandal, and if there has been omission and negligence, intentional or otherwise, in its audit of 1MDB.” And in the news report filed by *Malaysiakini*, he was quoted to say the following too (Aw, 2015): “Failure to do so would necessitate an investigation into its conduct by the Malaysian Institute of Accountants (MIA), as the statutory body established under the Accountants Act, 1967, to regulate the accountancy profession.”

As far as Pua was concerned, what happened was quite significant. This can be discerned from what appeared in another news report published later in the month where Pua was quoted to say (“KPMG has failed Malaysians”, 2015): “Because they help 1MDB cover up the shocking embezzlement in the 1MDB PetroSaudi JV, 1MDB was allowed to continue its wanton acts by lending even more cash to PetroSaudi. Consequently, 1MDB accumulated a monster RM42 billion in debt over the next four years. Clearly, KPMG has failed Malaysians.”

Finally, it is most interesting to note too that related to this matter of apparent collusion among some parties to perpetrate fraud in the 1MDB, Pua had asked for the very first auditor of 1MDB – Ernst & Young - to come forward with information. Noted the news portal the *Free Malaysia Today* (FMT Reporters, 2015c):

> Pua had called for Ernst & Young, 1MDB’s previous auditors, to shed more light. Sarawak Report questioned Ernst & Young’s role, saying: “Did they make any report about their concerns and if not, why not?” when they abruptly ended their association with 1MDB during the very first audit, making way to KPMG, amid speculation that they had been unwilling to approve the accounts.

Before the delineation in the very next section of what more coming from Pua as far as the audit firms KPMG and Ernst & Young were concerned, it should be worth noting that what was stated earlier on KPMG's colluding with 1MDB in trying to hide the various transactions surrounding the joint venture between 1MDB and PSI was not all that KPMG had been accused of committing. In the news portal *The Malaysian Insider*, related to the KPMG, it was mentioned that the *Sarawak Report* had said the day before that evidence showed "unacceptable and unethical practices", which included actively conspiring to back date documents referred to in the audit report, as well as intervening to retrospectively alter agreements which had been previously signed by the 1MDB ("KPMG has failed Malaysians", 2015).

Also, in that very same news report, Pua was said to have cited an email dated May 22, 2010 between 1MDB's Chief Investment Officer Nik Kamil and PetroSaudi CEO Patrick Mahoney on relevant transaction documents, which was published in *Sarawak Report*. The email allegedly states:

> Letter of Agreement to purchase shares – all okay, except Auditors want a change in clause 5.9. Conceptually, they say that they will only clear the audit if the 'proportionate reduce [sic] in guarantee' is satisfied by either a 'proportionate conversion of the shares' or payment in 'cash'. Attached is the draft which they had proposed which I have not sent to our lawyers as it is better that you deal with it.

3. Pua's Filing Report with the Malaysian Institute of Accountants (MIA)

It was at the end of March 2015 that Pua lodged a complaint with the MIA in the hope that appropriate action would be taken against the auditors involved upon a full investigation by the regulating body (FMT Reporters, 2015d). He alleged that KPMG and Ernst & Young had failed to report to the relevant authorities the "highly dubious and fraudulent" transactions regarding 1MDB in regard to its PetroSaudi International deal. This, he said, had resulted in 1MDB being able to maintain a façade of financial strength and viability, despite accumulating RM41.9 billion debts as of March 31 last year.

It is notable however that the bulk of Pua's complaint was against KPMG, which he alleged had intentionally or negligently failed to conduct sufficient due diligence and audit of 1MDB when signing off the accounts within a month of taking over from the 1MDB's first auditor the Ernst & Young (Ng, 2015b). In a *Free Malaysia Today* news report, it was specifically mentioned that Pua had handed over to the MIA a detailed complaint of six allegations, all of which involved the KPMG (FMT Reporters, 2015d).

In that very news report, Pua was said to have mentioned that the parties concerned had taken steps to ensure there was no disclosure made in the 1MDB financial statements on the joint venture by converting the 1MDB shares into an Islamic loan to PetroSaudi and by stating out in the financial statements that the conversion had taken place on March 31, 2010 when in actual fact the conversion had taken place much later in September of the same year. Apparently, the aim of doing these things was to avoid reporting two very important pieces of information: the disappearance of what supposedly to be PetroSaudi's share of USD1.5

billion in the joint venture and the siphoning off of USD700 million invested by 1MDB in the joint venture when the amount was taken out from the joint venture to be deposited into an account owned by Good Star Limited.

Finally, in regard to one of the allegations thrown against KPMG, the news report mentioned that there was the suspicion that the firm had "intentionally, and/or negligently failed to conduct sufficient and necessary due diligence and audit of 1MDB as the firm signed off the accounts for 1MDB within a month after taking over responsibility for the accounts." Pua was quoted to have said: "1MDB was involved in very material transactions worth billions of ringgits. How come the accounts of a company transacting billions of ringgit can be signed off within one month by the auditors?" Related to this, Pua had also pointed out that the KPMG should have conducted its audit with extra care since the previous auditor Ernst & Young had just resigned under dubious circumstances

4. KPMG's Local and International Reactions to the Complicit Accusation in 1MDB 2010 Audit

The accusations thrown at the KPMG which revolve upon the idea that it had helped to cover up suspicious dealings related to the 1MDB and PSI joint venture had led to what appear to be the expected responses coming from both local and international offices of the audit firm. In general, the responses appear not to make anything clearer. One can even say that these responses are just as mind boggling as the related transactions taking place over the joint venture between 1MDB and PSI.

In summary, in regard to the latter, there was in total at least three bizarre transactions taking place in the so called joint venture between 1MDB and PSI (Fuentes, 2015b). First, the investment of USD1 billion (RM3.5 billion) by 1MDB for 40 percent of new shares in PSI subsidiary the 1MDB Petrosaudi Limited took place even though it had a dubious existing debt of USD700 million. Second, in a matter of several days after the money was sent from Kuala Lumpur to the subsidiary's bank account, 70 percent of it left for the bank account of another company allegedly owned by Jho Low. Third, the supposed USD1.5 billion asset injection by PetroSaudi into the joint venture was mere empty words.

At the end, none of these and other (possible) harrowing details of the JV agreement got the chance to appear in the 1MDB's very first set of financial reports for the financial year that ended in March 2010. This was because the JV was terminated six months later in 31 March 2010, very coincidentally on the very last day of the financial reports. In its place, on what supposedly 31 March 2010, the 1MDB entered into a Share Sale Letter Agreement ("SSA") to dispose of its investment in the JV for a consideration of USD1.2 billion made payable to 1MDB through an issuance of notes receivable. There is a need to emphasize on the word "supposedly" for the truth of the matter was that the share sale and notes receivables were never signed or created on the 31 March 2010. Instead, the Murabaha loan notes were signed only on 14 June 2010!

At the end of March 2015, the response came from the local office of the KPMG in the form of email that it sent to the news portal *Malaysiakini* (Zikri, 2015). It said:

> KPMG Malaysia was appointed as auditors for 1MDB in September 2010. KPMG Malaysia was the auditor for the financial years ended 31 March 2010 to 31 March 2012. The audit of 1MDB was conducted in accordance with international standards on auditing. KPMG will cooperate with the relevant Malaysian authorities investigating this matter. Due to continuing client confidentiality obligations, KPMG is unable to comment further at this point in time.

As for the KPMG's head office, it was the *Sarawak Report* which reported that a Sydney-based Malaysian financial journalist Ganesh Sahathevan had sought answers from KPMG International's Global Chairman John Veihmeyer as to the allegations (Zikri, 2015). Specifically, Sahathevan had asked whether KPMG Global had been aware of any of the transactions relating to 1MDB outlined in the *Sarawak Report*'s expose. And, the following was the reply (FMT Reporters, 2015e).

KPMG International is a Swiss Cooperative. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to bind or obligate any member firm. KPMG International does not have any relationship with, or connection to, 1MDB.

It is interesting to note that another news portal, *The Malaysian Insider*, had reported remarks supposedly coming from an officer to the KPMG International head John Veihmeyer. Said the news portal (Ng, 2015b):

> Sarawak Report had reported that Tom Wethered, the general counsel for KPMG International Cooperative global chairman John Veihmeyer, said that the corporate headquarters had no involvement in the matter, because the KPMG network represented nothing more than a "'Swiss Cooperative' of happy Helvetic brand sharers". He had said that no one at the headquarters was responsible for what their fellow franchise holders were up to, and they were just there to help and advise when required.

What to make of this response? Check out the following coming from the news portal *Free Malaysia Today* (FMT Reporters, 2015e):

> The answer received, unfortunately, has put paid to assumptions that KPMG's 'global network' can be relied upon to ensure accountability… The suggestion is that KPMG International is a franchise sans accountability. The question begging to be asked is what KPMG actually means when it says that 1MDB's audit is conducted "in accordance with international standards".

From another news portal the *Malaysiakini*, the following was mentioned coming from the *Sarawak Report* (Zikri, 2015):

> Malaysians and others, who had assumed that accreditation by KPMG represented some form of guarantee of high standards; quality control; centralised monitoring and disciplinary process to ensure high standards of accountancy practice must therefore

> stand disappointed. Name bearers get to carry the brand, but without any form of accountability whatsoever… Were it to be more widely recognised that KPMG Global exerts so little quality control over its branches, the reputation on which this ‘cooperative' relies might very well lose a lot of its luster.

5. The Switching of 1MDB’s Auditor from KPMG to Deloitte…

It was in the second half of February 2014 that *Kinibiz* came out with a report containing a couple of eye popping items (Kinibiz, 2014). First, it mentioned the fact that the 1MDB had yet to file its 2013 accounts with the Companies Commission of Malaysia (CCM) – when accounts’ submission was last made on Dec 28, 2012 for the financial year ending March 2012. In this regard, Pua was quoted to say:

> It is both shocking and suspicious that an multi-billion ringgit entity 100% owned by the Ministry of Finance has failed to produce its audited financial statements after nearly a year [overdue]. The directors of 1MDB have clearly run afoul of the Companies Act 1965 by failing to hold the company’s annual general meetings, file its annual returns to the Registrar of Companies together with their audited financial report within the specified time period.

Next, the news report mentioned the fact that there was the “sudden resignation” of 1MDB’s external auditor the KPMG. And, at the end of it, it mentioned the following coming from Pua as what appeared to the be the reason for KPMG to resign all of a sudden: “Most urgently, 1MDB must remove any doubts that the resignation of an internationally reputable auditor is due to an unverifiable US$2.32 billion (RM7.67 billion) parked at an anonymous ‘segregated portfolio fund’ in the highly secretive Cayman Islands, which is better known as a tax haven for global money launderers.” Note that the amount US$2.32 billion in Cayman Islands was the amount (supposedly?) paid to the 1MDB after the loans that it handed to the 1MDB-PetroSaudi joint venture was prematurely terminated and redeemed in the latter part of 2012. As Pua put it:

> Through a series of complicated financial engineering in the latter part of 2012, the loan was prematurely terminated and redeemed. However, the repayment of US$2.32 billion (RM7.93 billion) was made in a perplexing manner in a ‘segregated investment portfolio’ based in the Cayman Islands. To date no one has been able to verify with any certainty who the investment portfolio manager is, the fund’s performance or for that matter, if the money actually exists.

On the very next day after the news report had come out, the 1MDB issued a press release (Jacob, 2014). It mentioned among others that the switch from KPMG to Deloitte for the 2013 financial statements was “a mutual agreement” and that it was “in line with best market practice where companies decide on its current or future auditors after considering all aspects, including but not limited to conflict of interests and other considerations.” In response, Tony Pua had this to say (Jacob, 2014):

> 1MDB could not be more wrong, or we could perhaps forgive its management of attempting to make light of a very bad situation. There is no “best practice” in this

world which says that it is perfectly normal to suddenly change auditors long after the accounts were overdue. Had the change been made well before the end of 1MDB financial year Mar 2013, there would have been little for us to question the company. However, when the accounts are significantly delayed by nearly a year, and the auditor quits before it gets finalised, then surely every rakyat has the right to ask for an honest explanation. For example, why couldn't the change of auditors be done only for the Mar 2014 accounts?

All in all, when it concerns Deloitte, its 1MDB unqualified audit report dated some time in November 2014 was concerned with the accounting period that ended in March 2014. But, about a month after the audit report was issued, the 1MDB began to face the problems of paying its debts. Hence, the question to raise: could Deloitte be accused of failing to detect the problem of insolvency faced by the company?

And, when it concerns KPMG and Ernst & Young, was there the case of theirs failing to do their job in reporting what appears to be fraudulent activities in 1MDB to the authorities? And, as far as for the KPMG in particular, had it done wrong in having the share conversion of the joint venture described in the financial statements as taking place a few months earlier than its actual date? Finally, should not Malaysia now make it mandatory (like in the case of the United States for listed companies) for its companies to file reports with the authorities on reason(s) for their switching of auditors?

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