

## REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) Malawi

### ACCOUNTING AND AUDITING June 21, 2007

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#### Executive Summary

The long-term vision of the Malawi Growth and Development Strategy (MGDS) is to transform Malawi from a predominately importing and consuming country into a predominately producing and exporting country. Implementation of this strategy calls for fostering private sector-led growth. Strengthening corporate financial reporting will help Malawi improve corporate sector financial transparency and thus the business environment, stimulating both local and foreign investments.

This report is based on the findings of a review of accounting and auditing standards and practices in Malawi's corporate sector. The review exercise focused mainly on the strengths and weaknesses of the institutional framework that supports the corporate financial reporting system in the country; a review of Government accounting and auditing practices is outside the scope of this report.

The Society of Accountants in Malawi (SOCAM) has adopted International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as applicable standards for corporate financial accounting and auditing in the country. However, there are various compliance gaps, mainly because of the absence of comprehensive implementation guidance and the fact that IFRS are too onerous for small and medium-size enterprises (SMEs). Overall, the corporate financial reporting regime in Malawi is weakened by out-of-date requirements for financial reporting in the Companies Act; absence of an effective oversight institution; poor technical and resource capacity of regulators; weaknesses in professional education and training; and inadequate technical capacity of the SOCAM to function as an effective professional accountancy body in line with the guidelines and various pronouncements of the International Federation of Accountants (IFAC).

This report provides policy recommendations to improve accounting and auditing practices, including strengthening enforcement mechanisms to ensure compliance with accounting and auditing requirements. The key policy recommendations include:

- Reviewing the Companies Act to provide for up-to-date requirements for financial reporting, and to ensure that there is room/flexibility to incorporate updates as they arise.
- Reviewing the Public Accountants and Auditors Act to strengthen the regulatory functions of the Malawi Accountants Board (MAB), and reorganizing MAB into an effective independent oversight institution.
- Putting in place arrangements to require public interest entities to apply IFRS for financial

reporting, and to adopt simplified financial reporting requirements for SMEs in Malawi.

- Enhancing the technical capacity of the professional accountancy body so that it can better support practitioners and institute the required international standards.
- Supporting the leading education and training institutions—Department of Accountancy in the University of Malawi and Malawi College of Accountancy—with teaching materials and faculty development, so that they can feed the market with quality graduates and can conduct research for developing the profession in line with up-to-date international practice.

The policy recommendations are based on feedback from the key in-country stakeholders. In this regard, a workshop was held in Blantyre, Malawi, on June 13, 2007—the final consultation with stakeholders in the review process. It was agreed at the conclusion of the workshop that a detailed Country Action Plan (CAP) will be developed and implemented on the basis of the report’s policy recommendations.

### ABBREVIATIONS AND ACRONYMS

ACCA	Association of Chartered Certified Accountants
BAcc	Bachelor of Accountancy
CAT	Certified Accounting Technician Scheme (ACCA)
CIMA	Chartered Institute of Management Accountants
CPD	Continuous professional development
ECSAFA	Eastern, Central and South African Federation of Accountants
GAAP	Generally accepted accounting principles
GDP	Gross domestic product
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICPAM	Institute of Certified Public Accountants in Malawi
IFAC	International Federation of Accountants
IFMIS	Integrated Financial Management Information System
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
MAB	Malawi Accountants Board
MGDS	Malawi Growth and Development Strategy
MSE	Malawi Stock Exchange
PAEC	Public Accountants Examination Council
SOCAM	Society of Accountants in Malawi

## PREFACE

Reports on the Observance of Standards and Codes (ROSC) is a joint World Bank and International Monetary Fund (IMF) initiative that helps member countries strengthen their financial systems by improving compliance with internationally recognized standards and codes. The ROSC was developed in the wake of the financial crises of the late 1990s as part of a series of measures to strengthen the international financial architecture. The global financial community considered that the implementation of internationally recognized standards and codes would provide a framework to strengthen domestic institutions, identify potential vulnerabilities, and improve transparency. Ultimately the ROSC aims to enhance countries' resilience to shocks and to better support their risk assessment and investment decisions. The ROSC involves preparation of reports in 12 key areas.<sup>1</sup>

A ROSC A&A review evaluates a country's accounting and auditing standards and practices, using as benchmarks the International Financial Reporting Standards (IFRS)<sup>2</sup> and International Standards on Auditing. It also compares the country's institutional framework that underpins the accounting and auditing practices with internationally accepted good practices. The review uses a diagnostic template developed by the World Bank to facilitate collection of data, complemented by the findings of an in-country due diligence exercise conducted by the World Bank ROSC team. Following the completion of a ROSC A&A review, the country stakeholders, assisted by World Bank staff, develop a country action plan that forms the basis for accountancy reform and development in the country.

In Malawi, the ROSC A&A exercise was carried out from February to June 2007 with active participation of the Ministry of Finance, Reserve Bank of Malawi, the Malawi Stock Exchange, the Malawi Chambers of Commerce and Industry, Malawi Investment Promotion Agency, the National Audit Office, the Registrar General, the Malawi Accountants Board, the Public Accountants Examination Council, the Society of Accountants in Malawi, audit firms, banks, insurance companies, corporate accountants and academics. This report and its policy recommendations are based on inputs from these relevant stakeholders in the country.

The Malawi ROSC A&A exercise was conducted by a World Bank team comprising M. Zubaidur Rahman, Program Manager, ROSC Accounting and Auditing Program,; Moses Wasike, Senior Financial Management Specialist; Ndungú Gathinji (International Consultant); and Evelyn Mwapasa (Local Consultant).

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<sup>1</sup> The 12 ROSC areas are data transparency; fiscal transparency; monetary and financial policy transparency; banking supervision; securities; insurance; payment systems; anti-money laundering and combating financial terrorism; corporate governance; accounting; auditing; and insolvency and creditor rights.

<sup>2</sup> Within this report IFRS refers to all standards and related interpretations issued by the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards committee (IASC). IASC-issued standards are known as International Accounting Standards (IAS). In this report, references to IFRS also include IAS.

## I. INTRODUCTION

1. This Report on the Observance of Standards and Codes (ROSC) is an assessment of the accounting and auditing practices in Malawi together with the institutional frameworks that underpin the accounting and auditing practices. The assessment has been made at the request of the Government of Malawi in the wider context of its developmental and growth challenges. The intended audiences of the report are the Malawi Government, Malawi's development partners, key stakeholders, and national and international market participants.

2. Malawi is an English-speaking former British colony, which gained independence in 1964. Malawi has a population of 13 million citizens with a per capita income of US\$160.<sup>1</sup> The economy is agro-based. Agriculture employs about 80 percent of the workforce, contributes over 80 percent of the foreign exchange earnings, and makes up about 35 percent of gross domestic product (GDP). Productivity in the agriculture sector is low.<sup>2</sup> The manufacturing sector in the country is small, contributing 12 percent of GDP;<sup>3</sup> and there is low capacity utilization across all subsectors.<sup>4</sup> Malawi is challenged to increase productivity in the agricultural sector, as well as increasing the contribution of the manufacturing sector to the economy. Malawi also faces the challenge of containing the spread and impact of HIV and AIDS. Like many other Sub-Saharan countries, Malawi's economy has been severely affected by HIV and AIDS, which has created shortages and reduced productivity of the already depleted labor force. Malawi's adult HIV prevalence in the reproductive age group of 15-49 years was 14 percent in 2005.<sup>5</sup>

3. The current Government, elected in 2004, has instituted policies aimed at curbing fiscal expenditure, tackling corruption, and propelling growth.<sup>6</sup> Despite being handicapped by a fractious parliament, the Government's policies are acknowledged to be achieving positive improvements in the macro-economic environment. Malawi qualified for debt relief under the World Bank's Heavily Indebted Poor Countries (HIPC) initiative in 2006. The business environment has improved, and there is optimism for the future.<sup>7</sup>

4. Malawi's aspirations, as articulated in the Malawi Growth and Development Strategy (MGDS) 2006 -2011, are to grow by more than 6 percent annually for the five-year period and to increase per capita income to US\$450 by the end of 2011.<sup>8</sup> Sustainable economic growth—one of the main MGDS themes—aims to achieve the country's vision of creating wealth and employment, transforming the country from a predominantly consumption-based economy to a predominantly production-based economy, and gradually

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<sup>1</sup> Malawi Growth and Development Strategy (MGDS) 2006-2011, Government of Malawi, 2006: 10.

<sup>2</sup> MGDS, 2006: 14.

<sup>3</sup> National Statistics Office.

<sup>4</sup> MGDS, 2006: 35.

<sup>5</sup> MGDS, 2006: 25.

<sup>6</sup> World Bank Country Brief, Malawi, Washington, D.C.

<sup>7</sup> The Malawi Business Survey 2006 conducted by the Malawi Confederation of the Chambers of Commerce and Industry (MCCI) rated the business environment good to very good with better expectations in the next 12 months.

<sup>8</sup> Actual growth for the year 2006 is estimated at 6.5 percent.

emerging as an industrial nation. For this purpose, Malawi is seeking to increase domestic and foreign investment in productive sectors.<sup>9</sup>

5. There are approximately 9,000 companies registered in Malawi. The Malawi Stock Exchange (MSE) was established in the year 1996. By December 2006, there were 11 MSE-listed companies; 10 of the companies are domestic and one is foreign. As of December 29, 2006, market capitalization of the MSE was US\$12 billion.<sup>10</sup> Only 5 percent of the value (US\$0.6 billion) related to domestic companies, with the balance (US\$11.4 billion) relating to Old Mutual, a South African-based foreign company. The MSE trading increased remarkably in 2006. Turnover on the Malawi Stock Exchange in 2006 was US\$14.3 million (US\$7.59 million in 2005; and US\$6.15 million in 2004).<sup>11</sup> In 2006, one company listed on the Malawi Stock Exchange; activity is increasing, with three companies in the pipeline for listing in 2007.

6. Within 9 commercial banks, Malawi has banking assets of US\$740 million.<sup>12</sup> In addition to these 9 banks, Malawi's regulated financial system, under the Reserve Bank of Malawi, includes 2 discount houses; 12 insurance companies; 1 unit trust; 5 asset management companies; 3 stock broking companies; and 1 stock exchange, the MSE. Pension funds, micro finance institutions and co-operative are outside the regulated financial system; but the ROSC team was informed that there is legislation being drafted, the Financial Services Bill 2007, that will bring these institutions into the regulated sector as well.

## II. INSTITUTIONAL FRAMEWORK

### A. Statutory Framework

7. This section briefly describes the legal principles and issues applicable with regard to accounting, auditing, and financial reporting in Malawi.

8. **The Companies Act 1984 (Cap 46:03) does not require application of International Financial Reporting Standards (IFRS)<sup>13</sup> or any other standards.** There is no requirement for applying accounting standards or generally accepted accounting principles (GAAP) in the Companies Act. The Act requires financial statements to show a true and fair view. But whether a true and fair view requires the application of IFRS has been left to the requirements of specific sector legislation or regulation. This is a

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<sup>9</sup> Potential growth sectors as identified in the MDGS include tourism (to increase from 1.8 percent GDP to 8 percent GDP by 2011), mining (to increase to at least 10 percent GDP annually from current mining and quarrying contributions of 2.3 percent GDP) and manufacturing (to increase output with growing value addition, export development, and employment creation).

<sup>10</sup> MSE Daily Market Report, December 29, 2006.

<sup>11</sup> MSE Annual Market Performance Review 2006.

<sup>12</sup> Malawi kwacha (MWK)103,681,535,000 net after 1 percent provision. Exchange rate of MWK140 = US\$1. Figures as of December 31, 2006 (Reserve Bank of Malawi).

<sup>13</sup> Within this report, IFRS refers to all standards and related interpretations issued by the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards committee (IASC). IASC issued standards are known as International Accounting Standards (IAS). In this report, references to IFRS also include International Standards on Auditing.

significant gap in this fundamental legislation. Almost all commercial institutions are regulated under the Act, which would be expected to identify either the basis of financial reporting or the institution that is charged with the responsibility of giving the necessary direction for such reporting. Although the Society of Accountants in Malawi (SOCAM) has directed that all companies in Malawi shall apply IFRS,<sup>14</sup> there is no link between SOCAM and the Companies Act. However, the Act elaborates requirements for keeping proper accounting records and preparing financial statements. These requirements are useful in ensuring an adequate base from which financial statements (whether IFRS compliant or not) can be prepared and in stipulating generally the obligation for preparing financial statements. Specific sections stipulating these requirements are as follows:

- ***S180 (2)*** requires all companies to keep proper accounting records, as necessary, to give a true and fair view of the company's affairs, to prepare proper balance sheets and profit and loss accounts in accordance with the Act, and to explain its transactions.
- ***S182*** requires directors of every company annually to have prepared and sent to every member and every debenture holder of the company a profit and loss account and balance sheet. For a company with subsidiaries at the end of the financial year, ***S185 (2)*** requires that group accounts be sent to members and debenture holders of the company together with the company's own profit and loss account and balance sheet.
- ***S185 (4)*** defines group accounts as consolidated accounts comprising (a) a consolidated profit and loss account dealing with the profit and loss of the company and all subsidiaries to be dealt with in the group accounts; and (b) a consolidated balance sheet dealing with the state of affairs of the company and those subsidiaries. However, ***S185*** allows group accounts to be prepared in a form other than as defined above if the company's directors are of the opinion that it is better for the purpose of presenting the same or equivalent information in a form that may readily be appreciated by the members and debenture holders.

8. **The Third Schedule of the Companies Act gives an outline of the contents of the accounts but the Act does not give up-to-date guidance on presentation.** The contents of the accounts as contained in the Third Schedule are quite elaborate. With continuing developments in the accounting profession, increased emphasis on more disclosure has resulted in more standardized presentations on main portions of financial statements and with the rest of the information being provided with explanatory notes. This presentation step is lacking in the Companies Act, which also does not require preparation and attachment of a cash flow statement and a statement of changes in equity.

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<sup>14</sup> The role of SOCAM in setting accounting standards is discussed in Section D.

9. **The Companies Act gives powers to the Registrar of Companies to amend some requirements on preparation of financial statements as applied by companies.**<sup>15</sup>

These provisions may be useful to smaller companies that may find the standard requirements on preparation of financial statements too onerous. However, the ROSC team did not find any evidence of these provisions being sought by preparers. In the future if the requirements for IFRS compliance are incorporated in the Act and depending on how the development of IFRS for SME works out, this flexibility may be important in responding to the needs of smaller companies.<sup>16</sup> Most of the accountants and auditors interviewed admitted that IFRS requirements are too onerous for smaller companies.

10. **Availability of financial statements is hampered by capacity constraints at the Registrar's office.** The Companies Act (Section 196) requires every public company (other than a company limited by guarantee) to file annual accounts at the Registrar's together with the annual return. This provision would ensure availability of financial statements of public companies to the general public. However, the Registrar is unable to monitor and enforce filing requirements because the filing systems are manual and cannot effectively handle the large volume of files. The ROSC team's test-search for accounts at the Registrar's office found several companies not up to date with their filing. Some were one or two years in arrears in filing accounts; in one instance the accounts filed were unsigned.

11. **The Companies Act provides for audited accounts.** This provision includes preparation of an auditors' report, appointment of auditors, qualification of auditors, ethical requirements of auditors, and issues to be addressed in the auditors' report. Together the provisions set a comprehensive legal basis for the profile of auditors, their conduct, as well as the requirement to comply with auditing standards. The specific audit provisions in the Companies Act are as follows:

- **S182** requires directors of every company annually to cause to be prepared and sent to every member and every debenture holder of the company a report by the auditors.
- **S191 (1)** requires every company, within three months after its incorporation and thereafter at every annual general meeting, to appoint auditors to hold office until the next annual general meeting.
- **S194 (1)** requires auditors of a company while in performance of their duties to act in such a manner as faithful, diligent, careful, and ordinarily skillful auditors would act in the circumstances.
- **S194 (2)** stipulates that no provision in the memorandum or articles of the company or in any contract with the company shall exempt the auditor from the

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<sup>15</sup> S183 (4) and S184 (2) allow the Registrar directors to modify the requirements of the Third Schedule for the purpose of adapting them to the circumstances of the company, as long as the modifications do not interfere with the company's obligation to give a true and fair view of the state of affairs of the company. S185 (3)b allows the Registrar to approve when group accounts need not deal with a subsidiary of a company—if the company's directors are of the opinion that it is impracticable or of no real value, or it would be too expensive, or it would be misleading or harmful, or the businesses of the holding company and subsidiary are too different.

<sup>16</sup> At the time of the ROSC consultations with stakeholder, SOCAM indicated that it was looking at developing SME Accounting Standards through either ECSAFA or IASB guidance.

duty to act in accordance with *S194 (1)* or indemnify him against any liability incurred as a result of breach thereof.

- The Fourth Schedule requires the auditors report to state whether in their opinion the company's balance sheet and profit and loss account and the group accounts have been properly prepared in accordance with the Act and whether in their opinion a true and fair view is given.
- *S191 (2)* and *S192 (1)* requires that persons to be appointed as auditors be only those duly qualified, eligible, and entitled to act as such under the Public Accountants and Auditors Act.

12. **The Public Accountants and Auditors Act (Cap 53:06) prohibits persons from practicing as a certified public accountant if not registered under the Act (Section 15).** Section 16 of the Public Accountants and Auditors Act sets requirements for registration and practicing as a certified public accountant, including age limits, Malawi residency or temporary employment or residency permit, service under a training contract, passing prescribed examinations, and holding a practicing certificate.

13. **The Public Accountants and Auditors Act established the Malawi Accountants Board (MAB) and the Public Accountants Examination Council (PAEC).** Under the Act, the Malawi Accountants Board has powers to regulate the profession in both practice and training, while the Public Accountants Examination Council has powers to set syllabi and examinations and co-ordinate the marking and adjudication of examinations for accountancy training in Malawi. The Act requires the Public Accountants Examination Council to ensure that the examination and marking of PAEC-applied standards are acceptable as of equal academic standing to those applied by the Association of Chartered Certified Accountants (ACCA) in the United Kingdom or some other professional body of equivalent standing.

14. **The Public Accountants and Auditors Act gives SOCAM a mandate to set accounting and auditing standards in Malawi.** Under the Act, SOCAM is required to continuously review and disseminate to its members information concerning internal and international developments in technical matters affecting the profession of accounting and auditing. The Act also calls upon SOCAM to set accounting and auditing standards appropriate to the conditions prevailing in Malawi, and to continued international acceptance of the audited financial statements originating in Malawi.

15. **A draft bill in Parliament would transfer examination responsibility from PAEC to SOCAM and create a fully fledged Institute of Certified Public Accountants in Malawi (ICPAM).** This new law will repeal the current Public Accountants and Auditors Act and enact a new law in the same name. The Malawi Accountants Board will remain, but the functions of the Public Accountants Examination Council will be assumed by the ICPAM. In all other respects ICPAM will continue to exercise the current powers and responsibilities of SOCAM.<sup>17</sup> The ROSC team considers the creation of ICPAM a move in the right direction.

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<sup>17</sup> See paragraph 27 below.

16. **The Capital Market Development Act (Cap 46:06), which empowers the Reserve Bank of Malawi to regulate capital markets, does not require the application of IFRS.** Part VI of the Act, dealing with financial statements, requires companies whose securities are traded on the capital market to comply with requirements of the Companies Act on accounts and audit. Already noted, the Companies Act does not require IFRS application.

17. **The Capital Market Development Act requires that a copy of the annual return required by S182 of the Companies Act—including a directors’ report required under S189 of the Companies Act—be submitted to the Reserve Bank of Malawi.** There is no evidence of co-ordination between the two regulators, the Registrar and the Reserve Bank of Malawi, to ensure that the returns filed are indeed copies of the same document.

18. The Malawi Stock Exchange rules provide a basis for application of IFRS, International Standards on Auditing, consolidated accounts, and publication of accounts as follows:

- MSE Rule S5.31 (a) requires that all MSE-listed companies must prepare annual financial statements in accordance with the issuer’s national law and, in all significant respects, with GAAP and IFRS.
- MSE Rule S5.31 (b) requires MSE-listed companies to have their annual financial statements audited, and reported on, in accordance with Malawi auditing standards<sup>18</sup>; or in the case of external companies, in accordance with the national auditing standards acceptable to the MSE Committee or International Standards on Auditing.
- MSE Rule S5.31 (c) requires that financial statements for MSE-listed companies must be in consolidated form if the listed company has subsidiaries, unless the MSE committee agrees otherwise.
- MSE Rules S7.19 and S7.20 require that listed companies publish half-year unaudited financial statements within three months after the reporting period and full-year audited financial results within six months after the reporting period. .

19. **The Banking Act, Insurance Act (Cap 47:01), and regulatory directives on banks and insurance companies do not require banks and insurance companies to apply IFRS.** These institutions are registered under the Companies Act, which does not require IFRS. Effectively, the SOCAM directive is the only legislation/regulation requiring IFRS application for these institutions. Of course, as public interest institutions, banks, and insurance companies are expected to have the highest standards of financial reporting. The law should specifically require all public interest institutions to apply appropriate accounting standards. However, regulations on banks and insurance companies

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<sup>18</sup> From the year 2001, Malawi adopted ISA as Malawi’s own auditing standards

do require their auditors to conduct audits in accordance with International Standards on Auditing.<sup>19</sup>

20. Bank regulation does require these institutions to publish, within six months of the end of their financial year, audited annual financial statements in at least two local newspapers of wide circulation in Malawi. This ensures availability of the banking financial statements to the public.

21. **A draft Financial Services Bill (2007) is umbrella legislation under which the Reserve Bank of Malawi would regulate all financial institutions, including existing RMB-regulated banks and new ones (micro finance institutions, pension funds, and other credit institutions).** The draft legislation contains no clause requiring financial institutions to apply IFRS; but there is a requirement for auditors of these institutions to conduct audits in accordance with International Standards on Auditing and also for the auditors to report the extent to which the financial statements of the institutions comply with GAAP in Malawi. It is essential that legal requirements clearly separate the responsibility of the preparers of financial statements from the responsibility of auditors of the same financial statements. Preparers have no legal responsibility to ensure that auditors comply with the regulation to report. There is a gap in the draft legislation. There is no requirement for preparers to apply accounting standards. However, the ROSC team believes this gap can be corrected by an RMB-issued directive, using powers under the new (Financial Services) act.

22. **The Public Finance Management Act (No. 7 of 2003) requires financial statements of government and state-owned enterprises to comply with GAAP.** The Act defines GAAP as promulgated by IFAC or practices that have the support of the accounting profession in Malawi or similar countries. For state owned corporate entities, the GAAP applicable, (those that have the support of the profession in Malawi) is IFRS.<sup>20</sup>

23. **Section 184 of the Constitution of the Republic of Malawi establishes the office of the Auditor General with responsibility to audit all public accounts of Malawi and report to the National Assembly.** The Constitution allows the Auditor General to exercise all powers in relation to public accounts as may be prescribed by an Act of Parliament.

24. **The Public Audit Act (No. 6 of 2003) gives the Auditor General the duty to review and approve the audited accounts of state-owned enterprises.** The Act also gives the Auditor General the responsibility to conduct audits of state-owned enterprises that have not had their financial statements audited by firms of public auditors or for which the Auditor General does not approve the audited financial statements.

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<sup>19</sup> Reserve Bank of Malawi's directive on annual audits requires the engagement letter between an independent auditor and the financial institution to stipulate that the audit will be conducted in accordance with International Standards on Auditing.

<sup>20</sup> The profession accounting body in Malawi, SOCAM, decided and issued a directive in the year 2001, that all companies in Malawi shall apply IFRS.

25. **The Taxation Act (Cap 41:01) neither requires IFRS-compliant financial statements nor audited financial statements.** However the Act requires every person operating on a business to keep sufficient records of income and expenditure to allow its tax position to be ascertained.<sup>21</sup> Although this is the case, the ROSC team was informed that the Malawi Revenue Authority relies on the accounts of an organization if the accounts have been audited by professionals. The Malawi Revenue Authority is also able to use such accounts as a benchmark for assessing similar businesses that may not have had the same quality of accounts or audit. The Malawi Revenue Authority has observed that tax payers with good quality accounting records have better tax planning. Improving the coverage of quality accounting should therefore improve the efficiency of tax assessment and collection.

## B. The Profession

26. **The Public Accountants and Auditors Act gives the Malawi Accountants Board powers to regulate the accountancy profession. However at the moment, MAB is not in a position to effectively regulate the profession.** The Malawi Accountants Board has nine persons on its board of directors. Four persons are appointed by the Minister of Finance and five persons are appointed by SOCAM. The present scheme appears to give SOCAM control over MAB for which it appoints a majority of directors. Another matter for the Malawi Accountants Board is that the actual composition of the Board has always been dominated by members in practice. The current chairperson is a practicing auditor who owns a practice. As to technical capacity, the Board does not have enough professionally qualified officers in its employment to independently discharge its responsibilities. For these reasons, MAB is not currently effectively regulating the profession.

27. **The Society of Accountants in Malawi is a self-regulated membership institution, established in 1969 as a company limited by guarantee.** SOCAM is governed by a Council of 12 persons elected annually. As of December 2006, SOCAM had 311 professional members, 40 practicing and 271 non-practicing. This figure is estimated to be 65 percent of all professional accountants in Malawi.<sup>22</sup> SOCAM also has 75 diploma-level members. SOCAM is a member of the International Federation of Accountants (IFAC) and the Eastern Central and Southern African Federation of Accountants (ECSAFA).<sup>23</sup> SOCAM aims to ensure its members are technically up to date and serve the public interest. The SOCAM Memorandum and Articles of Association outline sixteen objectives, among which are the following five:

- Secure for the community within its sphere of influence the existence of a class of persons well qualified to be employed in the responsible and difficult duties which increasingly devolve upon public accountants as a result of growth and

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<sup>21</sup> Taxation Act (Cap 41:01) Section 54.

<sup>22</sup> ACCA indicates that it has 400 members and CIMA indicates that it has 80 members in Malawi. There are other foreign professional qualifications in Malawi although each is significantly less than ACCA and CIMA.

<sup>23</sup> ECSAFA members include professional accountancy bodies of Botswana, Democratic Republic of Congo, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Namibia, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

development of industry and commerce and the increasing diversity and complexity of all forms of social and economic activity;

- Maintain and promote the status of the profession of accountant, promote and safeguard the rights and interests of its members in all matters affecting the profession, uphold and enforce among its members a high standard of efficiency and professional conduct in the interests of the public generally and give concentrated expression to their opinions upon all questions and laws affecting the business of the profession;
- Encourage and promote the study of the profession and arrange, provide, conduct, and supervise professional examinations, education, and training;
- Issue members, on proof of due qualifications, with certificates permitting them to conduct public practice, and prohibit other members from engaging in like activities;
- Hold conferences and meetings for the reading of papers and delivery of lectures and for the acquisition and dissemination by these and other means of information connected with the profession and encourage the use of the recognized best methods of bookkeeping, costing, accountancy, auditing, and investigations into the affairs of companies and other bodies whether constituted by statute or otherwise.

28. **SOCAM appears to have good market recognition in the country.** A majority of employers, as evidenced by their advertised requirements for accountants, prefers to employ accountants who are SOCAM members. SOCAM conspicuously contributes to national economic discussions, one such area being the country's annual government budgeting process. SOCAM formulated the Code of Best Practice for Corporate Governance in Malawi, which was based on the Republic of South Africa's King's Report. The Code, requires accounting standards used in the preparation of financial statements to be brought in line with international accounting standards.<sup>24</sup>

29. **SOCAM lacks technical capacity to fully deliver its objectives and discharge its responsibilities.** Council members and all members who serve on SOCAM council committees are all volunteers with full-time jobs elsewhere. The secretariat has only one professionally qualified accountant, the Executive Director. Because of inadequate technical capacity, SOCAM cannot meet IFAC membership obligations in a comprehensive manner.<sup>25</sup> There are required areas where the institution has not effectively delivered its objectives or failed to discharge its responsibilities, particularly, setting of accounting and auditing standards as required by the law and disseminating implementation guidance on accounting and auditing standards to practitioners.

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<sup>24</sup> The Code has a section on Financial Reporting and Auditing, which, apart from the requirements of accounting standards as mentioned, also requires companies to; have an effective internal audit function, establish an Audit Committee, requires head of internal audit and external audit partner to bring all significant findings arising from audit activities to the attention of the audit committee and if necessary to the board of directors.

<sup>25</sup> IFAC requires member organizations to meet obligations in 7 areas: quality assurance, international education standards, international standards related to audit assurance, code of ethics, public sector accounting standards, investigation and discipline, and International Financial Reporting Standards.

30. **All full-fledged professional members of SOCAM hold foreign accounting qualifications.** The majority of the members hold ACCA qualification, but many other professional qualifications are also recognized in Malawi.<sup>26</sup> Members in good standing with recognized professional qualifications are eligible for non-practicing membership of SOCAM. Those wishing to practice are required to pass examinations in Malawi tax and company law, in addition to having 30 months of supervised post-qualification experience in an audit environment. SOCAM members maintain their membership with the accountancy body through which they qualified. The result is that they end up paying professional membership fees and submitting information on hours of continuous professional development (CPD) achieved to both professional groups. SOCAM does not have its own qualification scheme through which it can develop reciprocal recognition with other accountancy bodies.

31. **In Malawi, only practicing members (auditors) are regulated; other professional accountants (non-members) are not regulated.** Practicing accountants are legally required to hold a practicing license issued by the Malawi Accountants Board. SOCAM annually reviews all practicing accountants on whether they are adhering to the conditions of their license, which includes meeting continuous professional development (CPD) requirements and adherence to ethics. SOCAM also annually monitors all its other non-practicing members on CPD requirements. The agreed international standard for meeting competence is for everyone in the accounting profession to meet CPD requirements. IFAC makes monitoring CPD requirements mandatory for its members. Malawi can ensure that persons in the accounting profession are technically up to date by making SOCAM membership mandatory for all accountants. Equally, employers should be sensitized and encouraged to insist that job applicants be members of SOCAM.

32. **There are more diploma-level technician accountants in Malawi than those with SOCAM membership.**<sup>27</sup> The accounting diploma qualification is largely seen as an early step to full professional accounting qualification. But there are many diploma holders who never qualify and yet remain a valuable resource in delivering accounting services in the country. A benefit of SOCAM membership for the diploma-level technicians is receiving communications on professional technical updates. With the majority of technicians outside the system, this valuable resource of technical updates becomes less efficient over time. This issue is addressed in the Recommendations (Chapter VI).

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<sup>26</sup> SOCAM recognizes the following professional qualifications issued by the Institute of Chartered Accountants in England and Wales (ICAEW), Institute of Chartered Accountants of Ireland (ICAI), Institute of Chartered Accountants in Scotland (ICAS), Association of Chartered Certified Accountants (ACCA), Chartered Institute of Management Accountants (CIMA), Chartered Institute of Public Finance and Accountancy (CIPFA), South African Institute of Chartered Accountants (SAICA), Institute of Chartered Accountants of Zimbabwe (ICAZ), Institute of Chartered Accountants in Australia (ICAA), Canadian Institute of Chartered Accountants (CICA), Zambia Institute of Chartered Accountants (ZICA), Society of Management Accountants of Canada (CMA), Australian Society of Certified Public Accountants (ASCPA), American Institute of Certified Public Accountants (AICPA), Institute of Chartered Accountants of New Zealand (ICANZ), and Institute of Chartered Accountants of Sri Lanka

<sup>27</sup> By December 2006, PAEC had qualified 1,320 diploma-level accountants, compared to 75 in SOCAM.

33. **Draft legislation proposes a merger of SOCAM and PAEC while the Malawi Accountants Board would remain on its own.** The draft bill has already been taken to Parliament. Under present arrangements, the Malawi Accountants Board and Public Accounts Education Council, although two different institutions, are administered by the same professional officers. The Accountants Board benefits from the substantive PAEC budget. Once separated from Public Accounts Education Council, it will be essential to ensure that the Malawi Accountants Board is not crippled by inadequate financial resources.

34. **Malawi appears to have a shortage of locally produced accountants.** Evidence shows a significant presence of foreign accountants working in Malawi. The Government and training institutions have failed to retain professionally qualified accountants. On the other hand, the Malawi Investments Promotion Agency indicates that it is within the law for foreign investors to choose persons for key positions in their companies for which they have made significant investment. The ROSC team was told that it has been observed by the Malawi Investments Promotion Agency that the head of finance is always a position for which foreign investors request to bring in expatriates. Malawi should consider the need for marketing local accountants and local qualifications to the foreign investors. No survey has however been undertaken to determine the actual number of accountants required in Malawi.

35. Audit firms belonging to international networks **control the audit market.** All eleven companies on the Malawi Stock Exchange are audited by two large firms belonging to the international networks of professional services firms. These two firms audit eight out of the nine banks in the country. Malawi has fourteen auditing firms; four are local firms each with two partners, five are also local with one partner, and five belong to international networks.<sup>28</sup> Having such concentration of audits handled exclusively by so few could be a source of systemic risk for the country. Deliberate effort should be made to spread out audits to firms of all sizes and develop the local audit firms to provide the quality of service expected by the larger companies.

36. **There are no reported cases of litigation against auditors in Malawi.** Under MAB requirements, professional indemnity insurance is compulsory, but is not readily available to some categories of practitioners. The ROSC team found that a two-year old firm—a sole practitioner—had no professional indemnity insurance. The insurance companies had refused him the coverage on the grounds that he had no track record on which they could base an assessment of risk. There have also been one or two cases where auditors had been disciplined for breach of professional conduct, but the judicial process is stymied by unclear legal provisions.

### C. Professional Education and Training

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<sup>28</sup> The five international network audit firms are Deloitte, KPMG, PriceWaterhouseCoopers, Ernest and Young, and Graham Carr.

37. **Training and qualification of accounting technicians is available locally under Public Accountants Examination Council.** Public Accountants Examination Council has a joint examination scheme with ACCA, whereby ACCA guarantees the standard of examinations that are set locally. However even at that level, there is competition from foreign-based accounting qualifications, the strongest being ACCA's Certified Accounting Technician (CAT) Scheme and to a lesser extent, the Association of Accounting Technicians (UK) qualification. The PAEC and CAT courses are open to graduates of secondary school (high school), but their course contents are somewhat different due to enrollment requirements and syllabi content. The Public Accountants Examination Council enrolls students who have a Malawi School Certificate of Education with a pass in mathematics. The CAT Scheme enrolls students who have attained age 16. The PAEC syllabus includes business math and statistics, economics and business law; the CAT syllabus does not have these subjects. Those differences in course content lead to different exemptions in the profession-level examinations. The Malawi Accountants Board recently made a unilateral decision to not recognize the Certified Accounting Technician Scheme as entitling its holders to the diploma-level membership in SOCAM. The Public Accountants Examination Council also offers a certificate in accounting theory while ACCA also has a certificate in financial management.

38. **The University of Malawi, offers a bachelor's degree in accountancy (BAcc).** The BAcc degree appears to have a good reputation in the market.<sup>29</sup> The BAcc holders have an easier time passing their professional exams and are quick to work independently when employed. Malawi has developed strong local pre-professional accounting qualifications. Although this is the case, the ROSC team found that there are capacity issues in the Department of Accountancy in the University of Malawi and Malawi College of Accountancy, the two main institutions offering accountancy education and training for these pre-professional qualifications:.

39. **The Department of Accountancy in the University of Malawi and Malawi College of Accountancy face serious challenges in obtaining reading materials for students and in the development of their faculties.** Both institutions largely depend on ACCA CAT student's manuals even though there are some subjects that are not offered by the CAT Scheme and sometimes editions are out of date. Both institutions have problems in retaining staff. The competitiveness of remuneration packages available elsewhere makes it difficult for the institutions to develop their faculties and attract PhD-level lecturers.

40. **Practical training attainment for professional accountants is not adequately monitored.** The competency of some professional accountants has drawn complaints from the hiring market. The complaints are leveled especially at the accountants who most recently qualified and have received inadequate practical training. No arrangements exist for designating approved practical training providers and for monitoring the attainment of practical training. The exception is for auditors who must have 30 months of supervised

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<sup>29</sup> BAcc includes psychology, which gives broader development to the students; is a 4-year course therefore covers subjects in more depth; and includes IFRS, International Standards on Auditing, and ethics in its requirements.

experience in an audit environment. There are 14 audit firms in Malawi and, as such, it has not been difficult to monitor the practical audit training requirements.

41. **SOCAM requires all professional members (practicing and non-practicing) to undertake continuous professional development.** Members must complete 50 CPD hours per annum. SOCAM monitors the members and issues warnings and advice on any shortfall on CPD requirements. For more serious CPD underperformance, a member may be summoned by the SOCAM disciplinary committee, which can impose sanctions; however this situation has not occurred.

42. **SOCAM arranges seminars as part of the CPD program.** However, the seminars are not always considered responsive toward assisting practitioners in applying IFRS and International Standards on Auditing, particularly for small and medium enterprises. The ROSC team met with auditors and accountants who attended SOCAM seminars; all indicated that they did not receive sufficient guidance for implementation of accounting and auditing standards. While acknowledging the effort by SOCAM to organize seminars addressing technical issues of accounting and auditing standards, the seminar attendees appeared resigned that SOCAM lacks the technical capacity to move beyond its current capacity.

#### **D. Setting Accounting and Auditing Standards**

43. **The statutory function of SOCAM to set standards requires that the standards be appropriate to the conditions in Malawi.** It also requires ensuring continued international acceptance of audited financial statements originating in Malawi. SOCAM however does not have standard setting capacity. Although SOCAM has a standard setting committee, it is a voluntary body that is not in a position to effectively carry out the onerous responsibility of setting standards.

44. **Following an ECSAFA resolution, effective January 2001, SOCAM directed all companies in Malawi to comply in full with IASB-issued IFRS and all auditors in Malawi to comply in full with IFAC-issued International Standards on Auditing.** This decision, made under the aegis of the SOCAM statutory standard setting function, in effect put an end to any consideration whether the standards are appropriate to the conditions in Malawi. Although on a positive side, it makes financial statements originating in Malawi internationally acceptable, subject of course to correct implementation of the international accounting and auditing standards.

45. **Effectively, there is no standards setting in Malawi except for regulatory directions mainly in the financial services sector.** This situation may not pose a problem for foreign companies, which appear to be influenced by their parent companies, particularly on disclosure. However, this does create a problem for many local companies, especially small and medium enterprises for which the standards are too complex to implement cost effectively. SOCAM has not adopted the recent ECSAFA-issued accounting guide for small and medium enterprises but has chosen to wait for the IASB release of IFRS for small and medium enterprises expected in late 2008.

## E. Ensuring Compliance with Accounting and Auditing Standards

46. **The SOCAM directive requiring all companies to apply IFRS does not come with prescribed penalties for noncompliance.** There is no appointed regulator to monitor compliance making it difficult to enforce this directive.

47. **Penalties for failure to prepare financial statements in accordance with the Companies Act and for acting as an auditor in contravention of the Act are too low to be an effective deterrent.** Section 186 (3) of the Companies Act states that failure by an officer of a company to take reasonable steps to comply with sections 180 to 185 of the Act [these sections deal with keeping of accounting records, preparation and circulation of financial statements and submission of annual return] shall render the officer liable to six-months imprisonment and a fine of K1, 000. Section 186 (3) b states that a person shall not be sentenced to imprisonment unless, in the opinion of the court, the offence was committed willfully. Section 192 (2) states that a persons who acts as auditor in contravention of the Act shall be liable to a fine of K2,000.

48. **Locally, there is no comprehensive implementation guidance to ensure compliance with standards.** Every year SOCAM orders, sells and distributes manuals on accounting and auditing standards to members. SOCAM also regularly conducts seminars covering new standards. But these efforts fall short of the implementation guidance required by most accountants to effectively comply with the standards. Only accountants in foreign-controlled companies and audit firms belonging to international networks, which have the opportunity to tap technical expertise from foreign-based (mainly South African-based) technical offices, appear to be comfortable with international standards.

49. **Regulatory bodies do not have the technical expertise and capacity to ensure compliance.**

- *Malawi Accountants Board* does not have the technical capacity to independently regulate the accounting profession. It relies on the technical input of SOCAM.
- *SOCAM* has a wider range of responsibilities currently dwarfing its technical capacity, which consequently is affecting its effectiveness.
- *Registrar* has an inefficient filing system and human resource capacity constraints. The filing system is manual; and with filing requirements for over 8,000 registered companies, it is impossible for the Registrar to check for compliance of financial statements with requirements of the Company's Act. In any case the Registrar does not have the staff complement or properly qualified staff to check compliance of financial statements.
- *Reserve Bank of Malawi* has human resource capacity constraints. The Reserve Bank as a regulator of banks, insurance companies, and the capital market, may have the staff complement for its supervisory functions but it is not

enough.<sup>30</sup> And the skills are not adequate to undertake checking IFRS compliance even if legislation requires compliance.

- **Auditor General** has had capacity and resources constraints and to date has been unable to stretch the resources to discharge the function of reporting on state-owned enterprises. At the time of collection of information for this report, the ROSC team found that the Auditor General's office had several constraints:
  - (a) continued absence of an Auditor General (at that time for over 1 year);
  - (b) inadequate staff (with an established staff capacity of 352, only 100 actual staff);<sup>31</sup>
  - (c) low budget (an ideal budget of K8 million per month, the current K5 million per month is an improvement over past K1.5 million per month);
  - (d) lack of resources for training staff; and
  - (e) lack of organizational independence (although they have operational independence).

Due to these constraints, the office has not been able to submit reports to the National Assembly as only the Auditor General can sign reports, produce timely reports (with a backlog of two years), or review audits of and reports on state-owned enterprises. The audit reports issued by the Auditor General's office have not been published for several years since the previous Auditor General died in office and Parliament has not filled the position.

50. **The Malawi Stock Exchange (MSE) recognizes the need for checking compliance with financial reporting requirements of listed companies.** However they believe that SOCAM is responsible for ensuring compliance with the applicable standards. The Malawi Stock Exchange has one professional officer designated to check financial reporting compliance and two other MSE officers who assist in this function when necessary. These three professional MSE officers also have other management functions. MSE reported having picked some cases of noncompliance on specific matters, the matters were discussed with the concerned companies and resulted in improvements made in the subsequent financial statements. The ROSC team was told there has not been a case where financial statements had to be reissued after such a review. The ROSC team found that SOCAM does not have any arrangement for monitoring and enforcing accounting and auditing standards applied in the case of financial reporting by MSE-listed companies or of any other institutions.

51. **SOCAM, through quality reviews conducted on statutory auditors, checks compliance with auditing standards.** Annually, SOCAM engages consultants from South Africa's Independent Regulatory Board for Auditors to conduct quality reviews of

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<sup>30</sup> The ROSC team learned that the Non Bank Financial Institutions (NBFI) at Reserve Bank of Malawi has a staff complement of 13 compared to a recommended staff complement of 33.

<sup>31</sup> These numbers exclude administrative staff.

auditors in the country. Defaulters have had penalties including fines and working under a mentoring arrangement – for persistent defaulters. So far there has been no expulsion. The review is conducted on a three-year cycle; up to 2006, it was based on a partner review only. SOCAM is finalizing negotiations with ACCA to join the ECSAFA-sponsored audit quality control scheme that has been set up on a regional basis to assist ECSAFA members to comply with the IFAC membership obligation on quality control. The new scheme is expected to start in January 2008 and will extend to audit firms.

### III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

52. **Following a SOCAM decision in 2001, corporate entities of all types and sizes are trying to produce financial statements in accordance with the IFRS.** All corporate financial statements, which the ROSC team came across, mentioned that the financial statements had been prepared on the basis of IFRS. However, identified application difficulties and compliance gaps, as discussed in the next two paragraphs, indicate that the adoption of IFRS faces significant challenges in Malawi.

53. Stakeholders mentioned encountering difficulties in implementation of some standards due to:

- ***Differences in interpretation.*** Banks and their auditors on one hand and Reserve Bank of Malawi on the other had taken different positions in calculating fair values under IAS 39, *Financial Instruments: Recognition and Measurement*. Each side is convinced of its position, and the dialogue continues but the matter remains unresolved.
- ***Practical difficulties in dealing with requirements.*** There are difficulties in determining component values under IAS 16, *Property, Plant and Equipment*, and generally in determining fair values as required by IFRS.
- ***Practical difficulties in application.*** The application of IAS 19, *Employee Benefits*, in Malawi would require companies to provide for severance pay, required to be accrued for all employees under current Malawi law. This has proved difficult to implement due to the size of the liability that assumes all employees will qualify for severance pay at some point.

The ROSC team was also informed of other IFRS that have caused particular difficulties, including IFRS 4, *Insurance Contracts*; IAS 32, *Financial Instruments Presentation*; and IAS 40, *Investment Property*.

54. The ROSC team reviewed 23 sets of financial statements from 8 listed companies (including 3 banks), 4 other banks, 5 insurance companies, and 6 state-owned enterprises. The review did not cover compliance with “recognition and measurement” requirements of accounting standards, which is not detectable through a review of financial statements. The ROSC review of the audited financial statements showed some compliance gaps in the following areas:

- **IAS 1, *Presentation of financial statements*.** One set of financial statements provided little information on the face of the income statement and omitted providing explanatory notes. However, a clearly labeled appendix, not within the financial statement set, provided more information for the figures of revenue, other income, and expenses. IAS 1 requires explanatory notes to be provided as part of a complete set of financial statements. In this case, the information in the financial statements was too insufficient to be useful.

Another issue of presentation was noted in 6 sets of accounts. Explanatory notes were included but as part of the statement of changes in equity. This does not comply with the provisions of IAS 1 that requires explanatory notes be provided separately from the main statements making up the financial statements. As a matter of fact, the said explanatory notes appeared to distract from the cash flow statement, which came after the statement of changes in equity.

Another issue of noncompliance in presentation was noted in 2 sets of financial statements that incorporated “statement of source and application of funds” instead of a cash flow statement.

- **IAS 2, *Inventories*.** Three sets of financial statements had a policy contrary to requirements of IAS 2. In one set, it was indicated that one category of inventories was valued at weighted average cost while another category of inventory was valued at the lower of cost and net realizable value. The other two sets indicated their accounting policy on inventory was based on invoice cost and others on landed cost. These policies are not compliant with IAS 2, which requires inventories to be measured at the lower of cost and net realizable value.
- **IAS 7, *Cash flow statement*.** Some financial statements did not reconcile cash and cash equivalents as shown in the cash flow statement to the amounts in the balance sheet. In four sets of financial statements, the term “cash and cash equivalents” in the balance sheets was used to refer to a figure comprising cash and bank balances while the same term was used in the cash flow statement to refer to a figure comprising cash balances, bank balances, and other highly liquid assets. This is not compliant with IAS 7.

One financial institution did not show changes in cash and cash equivalents but changes in “liquid assets.” The term may be the institution’s own terminology as it did not include some items which form cash and cash equivalents as defined in IAS 7. This practice also means that comparison with other similar institutions was impossible.

- **IAS 24, *Related party disclosures*.** One financial institution did not make any single disclosure on related parties transactions and balances. In a majority of the financial statements, while the disclosures were made, the contents were lacking. For instance, one financial institution made no disclosure on

compensation made to key management personnel, while four other financial institutions disclosed compensation paid to key management personnel in total only without the breakdown required by IAS 24 of short-term compensation, long-term compensation, post-employment benefits, and share-based payment. Also missing on some disclosures on related party transactions were the terms and conditions of the transactions with related parties and provisions for doubtful debts and bad debts.

- **Authorization for issue of financial statements.** Three sets of financial statements did not indicate who authorized issuance of the financial statements and when. Although the financial statements had signatures to which dates were appended, this is not enough to comply with IAS 10, *Events After the Balance Sheet Date*, which states an entity shall disclose the date when the financial statements were authorized for issue and who gave that authorization. The practice of having individual directors sign financial statements without indicating whether they have board authority is not good corporate governance. In good corporate governance, the board structure is unitary; that is, no individual has power alone. Despite SOCAM issuing a code of good practice for corporate governance in Malawi in 2001, not all company managers are aware of the correct practice.
- **IAS 19, Employee benefits.** Three sets of financial statements had no single disclosure on employee benefits. The others disclosed that the company has a defined contribution pension scheme and the company has no obligation to provide post-employment benefits beyond the defined contribution to the pension fund. However, in most financial statements there was no disclosure of the amount recognized as an expense for the defined contribution scheme during the year. IAS 19 requires disclosure of the amount recognized as an expense during the year.

#### IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

55. **A SOCAM directive states that all auditors in Malawi will comply with International Standards on Auditing (ISA).** The directive was made by SOCAM as per requirements of the Public Accountants and Auditors Act to mandate the use ISA in Malawi. However no guidance was issued as to the application of the standards. And no arrangements were made to ensure that all users have access to the standards. The ISA are updated from time to time and therefore no arrangements to disseminate the updates.

56. **Some auditors may not be applying ISA.** The ROSC team came across some audit opinions on financial statements, which did not make reference to complying with ISA.

57. **Independence of auditors is not always observed.** Most preparers of company financial statements, who were interviewed by the ROSC team, said they sought assistance from the auditors in instances where they had problems applying IFRS. These auditors were better trained and qualified in the application of IFRS. This practice does affect an

auditor's independence, blurring the line between preparer and auditor of financial statements, and may be indicative of problems with corporate governance—directors, not auditors, are responsible for preparation of financial statements. Some audit firms that prepare financial statements also audit the same financial statements. The larger firms indicate if they follow this practice then they use separate departments for preparation and auditing. However the smaller firms admit that the same preparer and auditor is used. In either case, the auditors cannot be identified as “independent.”

58. **Audit firms are unable to comply with the requirements of the ethics code on independence or quality control aspects of IFAC-issued International Standard on Quality Control 1, *Quality Control for Audit, Assurance and Related Services Practices*.** The problem stems from capacity. Local and international audit firms in Malawi are small (5 partners or less, and many one or two partner firms). The solution by internationally affiliated firms is to get support from their South Africa parent branches. SOCAM has encouraged smaller local firms to establish arrangements with other similar firms to back up each other. This action however is not being monitored.

59. **Lack of audit firm reviews can affect perceptions of quality.** Compliance with IFAC membership obligations requires both partner reviews and practice reviews. To date only partner reviews have been undertaken in Malawi. However, the ROSC team understands that, beginning in 2008, practice reviews will also be administered.

60. **Lack of information and evidence constrains the auditors.** Auditors are unable to follow correct analytical procedures without proper information. Also, auditors must rely on management representations on some financial matters. In many cases the practicing auditors do not seem to be able to apply appropriate procedures due to their unfamiliarity with the complexities of business activities carried out by the client. Also, too much reliance on management representations without taking necessary steps to obtain evidence about appropriateness of particular treatments, affect the quality of audit. One example was noted in a set of reviewed financial statements showing on loans that were granted by a company to staff at interest rates significantly less than market rates; the directors had decided that the carrying amount of the loans was equal to fair value. The auditor, without trying to determine the arm's length pricing of loans, accepted this view of the directors.

## V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

61. **A culture of savings and investments has not developed in Malawi.** Accordingly interest in financial statements has not aroused public interest, other than among listed companies. However, immediate factors should change this environment: *privatization of public enterprises* and *general improvement in macro economics*. With notable activity in the past two years, the privatization of public enterprises has resulted in people investing in companies and developing the Malawi Stock Exchange. The general improvement in macro economics should result in more savings and investments. Both these investing and saving factors should result in demand for good quality financial reporting.

62. **The quality of financial statements is influenced by auditors, and reliance is placed on auditors.** Except for listed companies and subsidiaries of multinational corporations, the quality of financial reporting was heavily dependent on input from the auditors. Generally there is a belief by stakeholders that audited accounts are good quality accounts with even greater confidence placed on financial statement audited by the larger auditing firms with international networks. Only auditors from the relatively Big Five firms with international connections appear to have the necessary capacity to understand and apply international standards.

63. **Financial statements lack depth especially on disclosures.** Some stakeholders indicate finding lack of depth in local financial reporting, especially on disclosures when compared to financial reporting in other countries, particularly South Africa.

64. **Lack of strong oversight affects the quality of financial reporting.** Some stakeholders indicate that lack of strong oversight institutions adds to the poor quality of financial reporting. There has been a notable lack in oversight of financial statements of state-owned enterprises due to the inadequate capacity in the Auditor General's Office.

## VI. POLICY RECOMMENDATIONS

65. The policy recommendations are based on feedback from the key in-country stakeholders. In this regard, a workshop was held in Blantyre, Malawi on June 13, 2007. The workshop was the final consultation with stakeholders in the ROSC Accounting and Auditing exercise in Malawi. The workshop attracted 58 participants including representatives of; the central bank (Reserve Bank of Malawi), the Registrar of Companies, the Auditor General, SOCAM, Malawi Accountants Board, Malawi Stock Exchange, Malawi Investment Promotion Agency, the Law Society of Malawi, Malawi Law commission, academics, audit partners from the big four firms and other smaller firms, training institutions, accountants from listed companies, banks, state owned enterprises and other companies. It was agreed at the conclusion of the workshop that a detailed Country Action Plan (CAP) will be developed and implemented on the basis of these policy recommendations. It is expected that any development program for accounting and auditing reform and development, whether carried out with the country's own resources or with assistance from international development partners, would be carried out in the context of implementing all or parts of the CAP. The Government of Malawi, represented by the Accountant General, would play a pivotal role in organizing donor coordination in this respect.

### **Improving statutory framework**

66. **Amend the Companies Act.** Through legal authority, require preparers of financial statements to comply with properly defined accounting standards. Ensure that penalties for failure to comply with the appropriate accounting standards and for failure to file financial statements with appropriate authorities are set at appropriate levels (based on local economic realities) to act as effective deterrents.

67. **Enact a modern version of the Public Accountants and Auditors Act taking into account recent international developments.** Review the Public Accountants and Auditors Act to: strengthen the regulatory functions of MAB as recommended in paragraph 77. The existing draft Public Accountants and Auditors Bill should be updated to include the recommendations in this report before debate in parliament.

68. **Update financial services legislation.** Incorporate in the Financial Services Bill, which will cover all regulated financial institutions, a requirement for preparers of financial statements to comply with properly defined accounting standards.

### **Preparing and filing of financial statements**

69. **Require full IFRS compliance only by public interest entities.** It is important that public interest entities be properly defined according to relevance in Malawi. Generally, public interest entities include exchange-listed companies, other public companies, and all institutions in the financial services sector. Large non-public companies should also be included in the requirement to prepare IFRS-compliant financial statement because of their impact on the economy.

70. **Develop financial reporting requirements for SMEs appropriate to local conditions.** Small and medium enterprises (SMEs) should not be required to prepare financial statements in compliance with IFRS. The IFRSs are not meant for the SMEs. . Malawi should quickly make arrangements for issuing simplified financial reporting standards for SMEs and define the category of businesses to which they should apply. The simplified financial reporting standards may be based on either the ECSAFA-issued guidelines for SMEs, or the IASB-issued exposure draft on IFRS for small and medium-sized entities. This will immediately relieve most small businesses of trying unsuccessfully to implement IFRS. The law should have a provision by which small and medium enterprises are subjected to less onerous accounting requirements, ones that are appropriate to the local economic realities of Malawi.

71. **Launch awareness campaign for directors on their responsibilities in the preparation of high-quality financial statements.** Directors of companies must take the lead in addressing shortfalls in the preparation of financial statements. An awareness campaign should be launched by SOCAM in liaison with the Institute of Directors briefing directors of their responsibility regarding financial reporting requirements and monitoring and enforcement systems. Exhibiting strengths and weaknesses of financial reporting in Malawi, emerging international developments, and the role of high-quality financial reporting in strategic and portfolio investments, as well the subsequent impact on the country's development and growth. This campaign could include other corporate governance matters. Accordingly, the ROSC for Corporate Governance should be conducted in Malawi

### **Auditing financial statements**

72. ***Issue practical implementation guidance on International Financial Reporting Standards.*** SOCAM<sup>32</sup> should issue implementation guidance on IFRS in consultation with the International Accounting Standards Board. The guidance should be illustrated with local cases. SOCAM should ensure that all interpretations and other guidance will be promptly available to its members.

73. ***Issue practical implementation guidance on International Standards on Auditing.*** SOCAM should issue implementation guidance on International Standards on Auditing in consultation with the International Auditing and Assurance Standards Board of IFAC. SOCAM should ensure all interpretations and other guidance will be promptly available to its members

74. ***Develop a more competitive audit environment.*** SOCAM should encourage the development of a more competitive audit environment by enhancing capacity in other firms through, for example encouraging mergers, acquisitions and networking.

75. ***Support small practitioners in their development.*** SOCAM should establish a support group that focuses on small practitioners and their unique issues that have impact by virtue of their size—such matters as getting professional indemnity insurance and meeting quality assurance requirements. The group should help ensure better professional grounding for the small auditors and in turn facilitate capacity building in local audit firms.

## **Monitoring and Enforcement**

76. ***Ensure high-quality financial reporting with an effective enforcement mechanism.*** It is widely acknowledged that three important links are required in the enforcement sequence:

- Directors and top management must ensure that financial statements are prepared in accordance with established standards.
- Auditors must act independently and in accordance with auditing standards to report whether financial statements comply with applicable accounting standards and represent a true and fair view of the entity's financial position and results.
- Regulators, both self regulatory organizations and statutory regulators, must implement arrangements for efficient monitoring of compliance and consistently take appropriate action against violators.

On regulation, the emerging best practice internationally is for more independent oversight or regulation in areas of greater public interest. Cross cutting all the three links is the issue of capacity.

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<sup>32</sup> Reference to SOCAM in the “policy recommendations” section of this report means SOCAM’s successor body, yet to be established Institute of Certified Public Accountants in Malawi (ICPAM).

77. **Reorganize the Malawi Accountants Board (MAB).** Take the following steps to establish a strong independent regulator for auditors and public interest entities:

- **Ensure MAB retains power of quality control in financial reporting .** This will mean empowering MAB to: (a) carry out review of corporate financial statements to monitor and enforce compliance with the applicable financial reporting standards; and (b) conduct practice review of audit firms/auditors to monitor and enforce compliance with the applicable auditing standards and auditor's code of ethics. This will not mean taking the disciplinary function away from SOCAM. Although the MAB will be empowered to exercise the financial reporting quality control function, it may delegate to the professional accountancy body some of these functions. However, the MAB should not delegate to the professional accountancy body any of the monitoring and enforcement functions relating to public interest entities.
- **Designate the Malawi Accountants Board as the central regulator in matters of compliance with accounting and auditing standards.** All other regulators—Registrar, Reserve Bank of Malawi, Malawi Stock Exchange, and Auditor General—should co-operate with the Accountants Board in their regulation of compliance with accounting and auditing standards. While the other regulators have other diverse functions, the Malawi Accountants Board would be solely responsible for accounting and auditing. Specialized technical expertise could easily be developed within the Board, allowing all other regulators access. With designated responsibilities, confusion among regulators would be eliminated. Co-ordination of the regulators would also ensure a holistic approach to issues of compliance with accounting and auditing standards.
- **Expand the mandate of the Malawi Accountants Board.** The mandate should include compliance of IFRS regulations for public interest entities. The conduct of public interest entities is vitally important in economic stability, and a strong and independent regulator will help improve compliance with accounting standards.
- **The Malawi Accountants Board should issue accounting and auditing standards.** This will mean providing authority to MAB for issuance of legally enforceable accounting and auditing standards.. Common practice in economies of this nature places responsibility for issuing accounting and auditing standards with a statutory body. The Malawi Accountants Board with adequate technical capacity and independence from the profession should be able to set and issue standards. MAB should be free to co operate with the profession body to create the required independent standard setting arrangement.

### **Capacity building for strengthening the profession**

78. **Address the capacity constraints of regulators.** Ensure availability of financial statements and enable regulators to enforce compliance of financial reporting requirements. The capacity for ensuring the financial reporting compliance should be concentrated and co-ordinated under one central institution, which in this case is the restructured MAB.

- ***Equip the Malawi Accountants Board with structural, technical and resource capacity to effectively discharge its functions.*** The structural composition of the Accountants Board should not be dominated by practitioners. Board members can be selected from retired practitioners, academics, and other individuals of good professional standing and integrity. The Malawi Accountants Board should recruit and hire full-time, properly qualified officers who would also be trained to discharge the new technical responsibilities of the reorganized Accountants Board. The Government (initially with donor support) should commit to adequate financial needs of the Accountants Board. The financial needs would cover much more than the current use but also go toward expanded and worthy functions.
- ***Registrar of Companies.*** The filing system should be automated to allow a comprehensive assessment whether companies have or have not submitted returns, as well as to retrieve documents efficiently. Registrar staff should be properly qualified and trained to check compliance to the Companies Act. Initially the Registrar should have adequate human resource capacity to check the compliance of public interest entities and then with expanded capacity—when the system becomes efficiently automated—to monitor and enforce compliance of all companies.
- ***Malawi Stock Exchange.*** Enhance the MSE technical capacity by recruiting more professional officers who would be designated to check compliance with MSE rules on financial reporting requirements of listed companies. Ensuring high-quality financial reporting for MSE-listed companies will boost confidence on the Malawi Stock Exchange and contribute to building strong financial systems in Malawi.
- ***Reserve Bank of Malawi.*** Properly qualified and trained staff should be recruited and retained specifically to effectively deal with matters of compliance with accounting and auditing requirements of banks and the other financial institutions.
- ***Auditor General.*** The National Audit Office should be given organizational independence by separating it from mainstream government departments. This is in line with good practice internationally. The objective, making the Auditor General a stronger and more independent regulator for accounting and auditing requirements of state-owned enterprises and government, would improve the standards of financial reporting in this sector. The Auditor General would be able to control the quality of staff recruited and institute policies to develop and retain the staff. The National Audit Office should be adequately funded to enable it to discharge its responsibilities; this investment by the Government into the system will improve confidence and efficiency in the operations of the National Audit Office.

79. ***Strengthen the institutional capacity of SOCAM.*** Necessary steps should be aimed at ensuring SOCAM has technical capacity to meet all IFAC membership obligations. This

can be achieved through better organizational structuring and recruiting more professionally qualified officers to support the Executive Director. The following matters should also be addressed within SOCAM in making it more responsive to the needs of the profession:

- ***Provide assistance and guidance on implementation of accounting and auditing standards.*** SOCAM should desist from automatic adoption of international standards without guidance on issues that should be considered in their contextual application to Malawi. SOCAM should review the implementation of more difficult standards and find an acceptable procedure for implementing them in context with Malawi. Likewise the accounting standards for small and medium enterprises will only be effectively applied if the practitioners have implementation guidance. Guidance on proper implementation of adopted standards is a key factor to yielding high-quality financial reporting.
- ***Monitor attainment of practical training by all professional accountants.*** SOCAM should designate approved practical training providers and specify detailed competencies with levels of expected achievement and specified time periods. Ultimately, SOCAM should strictly monitor and ensure that accountants seeking SOCAM membership have attained the qualifications as specified in the approved practical training.
- ***Improve content and delivery of continuing professional development.*** The provision of continuing professional development by SOCAM should cater to the needs of large firms, small firms, technicians, and other preparers. SOCAM should continuously survey the market to determine the areas of difficulty where practitioners and preparers need help and, accordingly, tailor the professional development programs. Effort should be made to ensure that CPD programs sufficiently address technical issues as obligated by accounting and auditing standards with plenty examples of local case studies.
- ***Develop—and preferably regulate—services for the accounting technicians.*** The accounting technicians in developing countries like Malawi are the workhorses of the accounting profession. Malawi has well-respected accounting technician qualification programs. SOCAM should move to organize this group of technicians in a strong professional body. SOCAM should regulate this body in a manner that ensures consistency in delivery of services to the public, particularly small and medium enterprises for which this group normally provides services.
- ***Localize the profession.*** Malawi recognizes qualifications of 16 foreign professional bodies. These international linkages should be maintained but with a move toward increasing domestic qualifications, leading to lower costs for access into professional body membership. SOCAM should ensure there is reciprocity with any foreign qualification giver. Holders of foreign qualifications should not be granted rights to practice in Malawi if those same rights do not exist in the home country (CIMA qualification does not give audit rights in the United Kingdom, for example).

80. *Support training institutions and development of their faculties.* The Department of Accountancy in the University of Malawi and Malawi College of Accountancy should be supported in getting sufficient, up-to-date teaching manuals as well as textbooks. These institutions should also be supported with resources to enable them to attract and retain properly qualified lecturers. Beyond that, they should also be supported in developing their accounting faculties to a level of high-quality research capacity that will support the entire accounting profession in dealing with the complexities encountered in its work and strengthening its own development for the future. Support to these leading providers of accounting education in Malawi would ensure a steady stream of professionally prepared graduates who can implement and sustain high-quality financial reporting standards. They will also provide research necessary for developing locally appropriate accounting and auditing standards and assistance and guidance on implementation of standards.