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**GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE  
(Second Edition)**

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## **DISCLAIMER**

This Guidebook is issued by the Work Group to review the Guidebook for Audit Committees in Singapore (WG) to provide practical guidance and recommendations of best practices for Audit Committees of companies listed on the Singapore Exchange. The guidance is not exhaustive and prescriptive. Audit Committees should exercise their own judgement on the manner and extent to which the guidance would be applicable to them, having regard to their own circumstances.

While efforts have been made to arrive at practical recommendations that are relevant to Audit Committees, the WG takes no responsibility for the accuracy or completeness of information in this guidebook and accepts no responsibility for any errors or omissions. The reader should obtain professional advice regarding any specific set of facts or issues. The WG expressly disclaims any and all loss or liability (whether in negligence or otherwise) in respect of this guidebook and its use by any person. No part of this guidebook may be reproduced (with or without any alterations or modifications) without the prior written consent of the Monetary Authority of Singapore, the Accounting and Corporate Regulatory Authority and the Singapore Exchange Limited.

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# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## Foreword

This Guidebook is to help Audit Committees do their work better.

MAS, ACRA and SGX are strongly committed to maintaining and strengthening the standards of corporate governance in listed companies in Singapore. Audit Committees play an important role in the governance and oversight of companies. They are central to ensuring that good internal controls and risk management systems are in place as well as delivering sound financial reporting. The growing complexities of the business environment impose even greater demands on Audit Committees. This Guidebook is therefore timely.

The first edition of the Guidebook was developed by the Audit Committee Guidance Committee and published in October 2008. It has been a good source of guidance for Audit Committee members over the past six years. Naturally, since its issuance, there have been changes in corporate legislation and regulations as well as to both the local and overseas corporate governance landscapes. In particular, the Code of Corporate Governance issued on 2 May 2012 contains revisions to the principles in relation to Accountability and Audit. There was hence a need to review the Guidebook to ensure its continued relevance.

Since June 2013, a Work Group (WG) comprising industry practitioners has worked tirelessly to produce an updated and effective guide for Audit Committee members. Besides covering the relevant changes to the revised Code of Corporate Governance and refreshing the case studies, the WG also introduced guidance on new areas of concern to Audit Committees that were not covered previously.

We express our thanks to all WG members for their dedication in reviewing the Guidebook. In particular, we would like to thank Mr Danny Teoh for his leadership in chairing this WG. We are also encouraged by the support from industry practitioners who have provided their invaluable comments and suggestions in the survey conducted by the WG.

Accounting and Corporate  
Regulatory Authority

Monetary Authority of  
Singapore

Singapore Exchange  
Limited

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## Chairman's Message

The Work Group (WG) to review the Guidebook for Audit Committees in Singapore was convened by the Monetary Authority of Singapore (MAS), the Accounting and Corporate Regulatory Authority (ACRA), and the Singapore Exchange (SGX) in June 2013. Comprising Audit Committee members from the business community and representatives from various stakeholder groups, the WG was tasked to review the Guidebook to include changes in corporate legislations and regulations, as well as developments in the global and local corporate governance landscapes since the issuance of the Guidebook in October 2008.

This second edition of the Guidebook was developed with inputs from, and in consultation with, industry and stakeholders. To ensure that the revised Guidebook will meet the needs of Audit Committee members in terms of scope, practicality and usefulness, the WG conducted a survey of over 700 Audit Committee Chairmen of companies listed on the mainboard of the Singapore Exchange. Feedback and suggestions for areas of improvement received have been carefully considered by the WG as it approached its work.

The revised Guidebook sets out guidance, case studies and best practices adopted by the business community and based on the WG members' experience. Reference has also been made to best practices from other jurisdictions and publications from various professional associations. The Guidebook is not intended to be exhaustive or prescriptive. Audit Committees are encouraged to adapt the guidance and practices to their particular circumstances, and to seek professional advice as they deem appropriate.

Many parties have contributed to the review of the Guidebook. I would like to acknowledge the commitment and dedication of all WG members and the Secretariat staff from MAS, ACRA and SGX. I would also like to express my appreciation to KPMG, PricewaterhouseCoopers LLP and WongPartnership for resource support. Finally, on behalf of the WG, I would like to thank all respondents of the survey and the AC Chairmen who provided their feedback on the draft Guidebook.

Against the ever-changing industry and regulatory backdrop, Audit Committees must be vigilant in monitoring the governance and oversight of companies. I hope that this revised Guidebook will serve the needs of current and future Audit Committees as they continue to play their important role.

DANNY TEOH

Chairman, Work Group to Review Guidebook for Audit Committees in Singapore





# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## How to use this Guidebook

This Guidebook provides Audit Committee (AC) members of Singapore listed companies with practical guidance to assist in carrying out their functions, duties and responsibilities as AC members, bearing in mind the requirements relevant to ACs as outlined in the Companies Act, the Singapore Exchange Securities Trading Limited Listing Manual and the Code of Corporate Governance.

This Guidebook strives to assist AC members in achieving higher standards of corporate governance by setting out certain best practices for ACs. The best practices may not be applicable to all ACs to the same extent. In recognition of the different types, sizes and circumstances of listed companies and the unique difficulties each company may face, ACs are urged to apply these best practices according to what is suitable and practical for their companies. ACs are strongly encouraged to adapt and modify these recommended best practices to make them relevant and applicable for their company where necessary.

### Sections of the Guidebook

The Guidebook comprises six sections. Each section opens with a table listing the key relevant regulatory requirements and guidelines for ACs with respect to that particular area. As this list serves only as a reference and is not intended to be exhaustive, AC members are advised to refer to the relevant sections in full in the Companies Act, the Singapore Exchange Securities Trading Limited Listing Manual and the Code of Corporate Governance as appropriate.

The best practices sub-section that follows focuses on areas in which ACs often face uncertainty, as well as provides practical solutions and guidance to issues ACs commonly encounter. Some of the issues and guidance included in this Guidebook may not provide the most optimal solution for all scenarios. Companies are encouraged to seek the necessary professional advice where appropriate.

Each section will then end with the detailed regulatory requirements and guidelines that were listed at the start of each section. As with the summary table, this sub-section serves only as a reference and is not intended to be exhaustive.

The six sections of the Guidebook are:

1. AC Composition

This section aims to provide guidance for current and prospective AC members to assess their independence and suitability for membership in the AC. It also outlines the roles and responsibilities of AC members.

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## 2. AC Agenda

The second section sets the scope of the AC, including its interaction with the Board, its annual workplan and periodic meetings, as well as its oversight responsibility over interested person transactions and the whistle-blowing policy.

## 3. Risk Management and Internal Controls

The Board is responsible for the governance of risk, but it is common for the Board to delegate oversight of risk management and internal controls to the AC. This section outlines the common risk governance structures and the various frameworks to ensure that the company's risk management and internal control system is adequate and effective.

## 4. Internal Audit

Internal audit is an important function to assist the Board in discharging its duties. This section examines the considerations when deciding whether the internal audit function should be in-house or outsourced. It also covers the common issues relating to AC's oversight over the internal audit function.

## 5. Financial Reporting

A key duty of the AC is to review the significant financial reporting issues and judgements so as to ensure the integrity of the company's financial statements. This section also highlights factors indicative of weaknesses in the financial reporting process.

## 6. External Audit

The last section describes the role of external auditors, factors that the AC should consider when evaluating the independence of external auditors, as well as considerations for the appointment of external auditors, their remuneration and terms of engagement.

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## References

The regulatory requirements and guidelines referred to in this Guidebook can be accessed via the following web links:

- The Singapore Companies Act (Chapter 50) (31 Oct 2006) can be accessed via this link:  
<http://statutes.agc.gov.sg/aol/search/display/view.w3p;page=0;query=Compld%3A9cd0848f-78c3-4c54-9923-3d6a618853a6;rec=0;resUrl=http%3A%2F%2F>
- The Singapore Exchange Securities Trading Limited Listing Manual can be accessed via this link:  
<http://rulebook.sgx.com>
- The Code of Corporate Governance (3 May 2012) can be accessed via this link:  
[http://www.mas.gov.sg/~media/resource/fin\\_development/corporate\\_governance/CGCRevisedCodeofCorporateGovernance3May2012.pdf](http://www.mas.gov.sg/~media/resource/fin_development/corporate_governance/CGCRevisedCodeofCorporateGovernance3May2012.pdf)
- The Financial Reporting Standards (effective for annual periods beginning on 1 Jan 2014) can be accessed from the Accounting Standards Council website via this link:  
<http://www.asc.gov.sg/frs/index.htm>

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## Table of Abbreviations

These abbreviations apply throughout this Guidebook, unless the context otherwise permits:

Abbreviations	Description
AC	Audit Committee
Board	Board of Directors
CA	Companies Act (Chapter 50)
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CR or Catalist Rule	SGX Catalist Rule
CReg	Companies Regulations (1990)
CRO	Chief Risk Officer
EA	External Audit
ERM	Enterprise Risk Management
FAQ	Frequently Asked Question
FRS	Financial Reporting Standards
IA	Internal Audit
IFA	Independent Financial Adviser
IPT	Interested Person Transaction
ISCA	Institute of Singapore Chartered Accountants
Listing Manual	SGX Securities Trading Limited Listing Manual which includes the Mainboard and Catalist Listing Rules
LR or Listing Rule	SGX Mainboard Listing Rule
NC	Nominating Committee
RPT	Related Party Transaction
SGX	Singapore Exchange Limited
The Code	Singapore Code of Corporate Governance (2012)

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 1: AUDIT COMMITTEE COMPOSITION

### Contents

Section	Sub-section
1.1 Table of Regulatory Requirements and Guidelines	-
1.2 Best Practices	<ul style="list-style-type: none"><li>• Independence and Objectivity</li><li>• Role of NC in AC Appointments</li><li>• Selection of AC Members</li><li>• Selection of AC Chairman</li><li>• Terms of Reference</li><li>• Tenure of the AC</li></ul>
1.3 Regulatory Requirements and Guidelines	-

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 1: AUDIT COMMITTEE COMPOSITION

### 1.1 Table of Regulatory Requirements and Guidelines

(Detailed regulatory requirements and guidelines in 1.3)

<b>Regulatory Requirements</b> [Mandatory Compliance]	<b>Guidelines</b> [Comply or Explain]
<p data-bbox="343 629 630 786"><u><i>Audit Committees</i></u> CA Section 201B(2) CA Section 201B(3) CA Section 201B(4)</p> <p data-bbox="215 875 762 947"><u><i>Announcement of Specific Information</i></u> LR 704(8)/ CR 704(7)</p> <p data-bbox="295 994 687 1066"><u><i>Directors and Management</i></u> LR/CR 720(1) and (2)</p>	<p data-bbox="863 510 1350 582"><u><i>Board Composition and Guidance</i></u> Code Guideline 2.1</p> <p data-bbox="959 629 1254 824"><u><i>Audit Committees</i></u> Code Principle 12 Code Guideline 12.1 Code Guideline 12.2 Code Guideline 12.9</p>

*The above list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook.*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE


## SECTION 1: AUDIT COMMITTEE COMPOSITION

### 1.2 Best Practices

*The AC plays a critical role in ensuring the integrity of the financial statements through its oversight of the company's financial reporting process, internal control system and audit function. To discharge this role properly, the Board (including the NC) must ensure that it has individuals with the appropriate qualifications to provide independent, objective and effective oversight.*

#### Independence and Objectivity

1.2.1 An AC is required to have a minimum of 3 members<sup>1</sup>, although it is not uncommon for an AC to comprise more than 3 members, depending on the scope and complexity of its work.


FAQ 1:	
	<b>CEO Involvement on AC</b> <b>Q:</b> Can the CEO (also a director) be a member of the AC?
<b>A:</b> The Companies Act does not prohibit the CEO from being a member of the AC.  However, the Code recommends that the AC comprises only Non-Executive Directors <sup>2</sup> . Therefore, the CEO, being an Executive Director, should not be a member of the AC.  In most companies, the CEO or Managing Director and the CFO would be invited to attend AC meetings to provide Management input as required by the AC.	

<sup>1</sup> Guideline 12.1 of the Code

<sup>2</sup> Guideline 12.1 of the Code

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## SECTION 1: AUDIT COMMITTEE COMPOSITION

Case Study 1:	
	<b>Independence and Objectivity Factors</b> This case study illustrates the factors NC members could consider in determining the composition of the AC and suitability of a director for the AC.
<b>Context</b> The AC of Company Y comprises the following 4 members:	
<ul style="list-style-type: none"><li>• Member A is an Independent Director of Company Z, a company owned by the single largest minority shareholder and/or associate of single largest minority shareholder of Company Y. Member A has been on the Board of Company Z for more than 10 years.</li><li>• Member B is an Independent Director of more than eight listed companies and he is also the Chairman of the AC for seven of these listed companies. Member B is a retired professional.</li><li>• Member C is a vice president of a company providing contractor and consultancy services for coal mine exploration programmes. Prior to his employment with the consultancy firm, Member C was a financial analyst in an asset valuation company and he was part of the team involved in the valuation of Company Y's coal mining assets two financial years prior to his appointment as an Independent Director of Company Y.</li><li>• Member D is a pre-IPO investor who had provided a convertible loan to Company Y, convertible into shares in Company Y upon listing. Although Member D has less than 10% shareholding in Company Y, he is the single largest minority shareholder of Company Y upon its listing as Company Y's shareholding base is fragmented.</li></ul>	
<b>Q:</b> What factors could the NC members and the Board consider in determining if a director is independent?	
<b>A:</b> Guideline 2.3 of the Code sets out examples of relationships which would deem a director not to be independent. While the Code has set out these guidelines, the Board and NC may wish to consider some other factors in evaluating their independence. In relation to the AC members, the Board and NC may wish to consider:	
<ul style="list-style-type: none"><li>• <u>Member A</u> The extent of his involvement in the management of Company Z, the relationship with the single largest minority shareholder and/or associate of single largest minority shareholder of Company Y arising from his long tenure as an Independent Director of Company Z, as well as whether there is any arrangement/understanding</li></ul>	



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## SECTION 1: AUDIT COMMITTEE COMPOSITION

between Member A and the single largest minority shareholder and/or associate of single largest minority shareholder of Company Y with regard to his appointment on the Board of Company Y.

- Member B

The extent of any potential conflict of interests arising from his directorships in other listed companies. For example, whether he holds directorships in other competitor companies. The nature of his other directorships, as well as whether disclosure and/or consent need to be obtained from Board members, and the amount of time and involvement which may be devoted to Company Y's affairs are relevant factors for determining his suitability as an AC member.

- Member C

The extent of his ownership in the valuation firm, the authority and direct or indirect involvement in the team that provided the valuation service for Company Y should be determined. In addition, if he is the owner of the valuation firm, consideration should also be given if the amount of professional fees paid for the valuation is significant.

- Member D

Although he is not a 10% shareholder of Company Y, the extent of his influence as the single largest minority shareholder on the decision-making process of Company Y should be considered. In addition, the significance of his economic interest in Company Y relative to his pre-IPO investment should be evaluated in determining whether his ability to exercise independent judgment could be impaired.

In practice, many companies obtain annual confirmations of independence from their directors. **Appendix A1** provides a sample confirmation of independence form that a director is usually required to complete upon his appointment and on an annual basis. This sample has been prepared based on Guideline 2.3 of the Code which provides examples of relationships which could deem a director not to be independent. These relationships are not intended to be exhaustive.

1.2.2 The consideration of independence is often a matter of substance rather than of strict compliance with specific rules. The individual director would be in the best position to determine his independence having regard to his circumstances and relationships with the company, its related corporations<sup>3</sup> and its 10% shareholders<sup>4</sup>. Below are some additional factors directors could consider when confirming their independence:

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<sup>3</sup> A corporation that is the holding company or subsidiary of another corporation, or the subsidiary of the holding company of another corporation [Section 6 of the Companies Act]

<sup>4</sup> Guideline 2.3 of the Code

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## SECTION 1: AUDIT COMMITTEE COMPOSITION

- **Shareholding interest:** A shareholding interest in the company beyond a certain limit such that it may affect the director's ability to make independent decisions. This shareholding interest should include share options and other convertible securities, as well as, all shareholdings held by the director.
- **Gift or financial assistance:** The receipt of shares or other securities in the company by way of a gift or financial assistance from the company or its major shareholders for the purchase of shares/securities in the company other than pursuant to an approved scheme.
- **Past association:** Past association with a professional firm/adviser as a director, partner, principal or employee who has, in the immediate past, before the director's appointment, provided professional services of a significant<sup>5</sup> or material nature or scope to the listed company (and interested persons where the listed company has close business or operational interactions with such interested persons). An intervening period of one year is sometimes applied for this assessment. Whether such a period is appropriate depends on the circumstances, which the AC member is in the best position to judge. Specifically, a former partner or director of the company's existing auditing firm or auditing corporation should not be appointed as a member of the company's AC within 12 months after ceasing to be a partner of the auditing firm or director of the auditing corporation, and for as long as he has any financial interest in the firm or corporation<sup>6</sup>. He can however serve as a non-independent Board member.
- **Business dealings:** Material business dealings<sup>7</sup> or involvement with the company or its interested persons in the recent past.
- **Representative of shareholder:** A representative of a shareholder appointed specifically to represent or protect the interest of that shareholder whose interests may not be aligned with those of the shareholders as a whole.
- **Financial dependence:** Financial dependence on the listed issuer group or its associates, e.g. if a director has no other major sources of income and is financially dependent on the fees, he would need to carefully consider whether he can indeed exercise the independent judgement required of him.

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<sup>5</sup> As a guide, payments aggregated over any financial year in excess of S\$200,000 should generally be deemed significant [Guideline 2.3(d) of the Code]

<sup>6</sup> Guideline 12.9 of the Code

<sup>7</sup> Guideline 2.3(d) of the Code

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## SECTION 1: AUDIT COMMITTEE COMPOSITION

Case Study 2:	
	<b>Independence and Objectivity</b> This case study illustrates the suitability of a partner or director of a company's former auditing firm as an AC member.
<b>Context</b> The NC of a company proposes to appoint the audit partner of the company's ex-auditing firm, Firm A, as an AC member in conjunction with the listing of the company in FY2013. Firm A was the auditor of the company prior to the company's IPO and the candidate was the audit partner-in-charge of the first two sets (Year 1 and Year 2) of the three sets of financial statements disclosed in the company's IPO prospectus. The company's financial statements for Year 3 onwards were audited by another auditing firm.	
<b>Q:</b> What factors could the NC members consider in determining if he is suitable?	
<b>A:</b> Guideline 12.9 of the Code sets out the situations which would deem a former partner or director of the company's existing auditing firm or auditing corporation to be unsuitable. While the proposed appointment of the candidate in this case does not fall squarely in the circumstances provided by Guideline 12.9 of the Code, the Board, taking into consideration the recommendations of the NC, may wish to apply the same principles surrounding potential conflict of interest when evaluating the suitability of the candidate.  In this case, even though the audit partner of the company's ex-auditing firm has stepped down as the auditor of the company for more than 12 months or any period which the company deems appropriate, he is not suitable as an AC member of the company. Arising from his position as the partner of the ex-auditing firm, he may be put in a position of conflict if concerns arise relating to the financial statements of the company which were the subject of the audit by the ex-auditing firm. The NC may wish to re-assess his suitability after a suitable time period has lapsed, such that the concerns on the conflict of interest would not arise.	

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## SECTION 1: AUDIT COMMITTEE COMPOSITION

### Role of NC in AC Appointments

1.2.3 In making their recommendations to the Board, the NC should firstly determine if a director is independent. The factors set out in 1.2.2 are not intended to be exhaustive. The NC would still need to conduct its own assessment of the individual's independence. Correspondingly, the prospective director should be diligent in disclosing relationships significant to the company or himself that might potentially compromise his independence (real or perceived).

1.2.4 The NC should also determine if a prospective director is appropriately qualified to discharge his responsibility.

### Selection of AC Members

1.2.5 As a body, the AC should possess relevant skills in order to be effective overseers of the financial reporting process. The Code recommends that at least two AC members, including the AC Chairman, have recent and relevant accounting or related financial management expertise or experience<sup>8</sup>, which could be interpreted as having some or all of the following:

- **The ability to read and understand financial statements**, including a company's balance sheet, income statement and cash flow statement
- **The ability to understand and assess the general application** of local or other generally accepted accounting principles
- **The ability to ask pertinent questions** about the company's financial reporting process
- **The ability to effectively challenge Management's assertions** on financials and Management's responses when appropriate
- **The ability to understand internal controls and risk factors** relevant to the company's operations, including those relating to information technology, treasury operations, industry, financial derivatives, biological assets and mining concessions
- **Experience gained through executive responsibility** for a sizeable business including having or having had responsibility for the finance function, such as being or having been a CEO, CFO or other senior officer with financial oversight responsibilities
- **Education or professional qualifications** relating substantially to accounting or finance
- **Experience in working** within the areas of corporate finance, financial reporting or accounting

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<sup>8</sup> Guideline 12.2 of the Code

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## SECTION 1: AUDIT COMMITTEE COMPOSITION

1.2.6 AC members should have complementary knowledge and experience in financial matters as well as an understanding and appreciation of the company's business. Each AC member should generally seek to understand:

- **The company's major economic, financial, operating, and compliance risks**
- **The company's financial reporting process**
- **The business operations** of the company
- **The social, political, ethical, economic and legal framework** within which the company operates
- **The difference between the oversight function** of the AC and the decision-making function of Management

1.2.7 The combination of skills within the AC should reflect broad experience and knowledge relevant in assisting the AC in discharging its responsibilities as set out in its Terms of Reference as set out in 1.2.13.

1.2.8 Members should be given the opportunity to attend technical and professional development courses to keep abreast of legislative, accounting and other relevant issues<sup>9</sup>. *For additional guidance on AC training, please refer to the sub-section on Training in Section 2 - Audit Committee Agenda.*

1.2.9 The AC should have the authority to retain external legal counsel, accounting or other advisers, when it considers necessary, without the prior permission of the Board or Management. The AC should be provided with the necessary resources to support its work<sup>10</sup>.

### **Selection of AC Chairman**

1.2.10 The AC Chairman is pivotal in ensuring the overall effectiveness of the AC and the efficient planning and conduct of meetings. The Companies Act requires the AC Chairman to be independent, with no involvement in any executive functions in the company or its related companies<sup>11</sup>. Although there are no restrictions, in practice, a Non-Executive Chairman of the Board would not normally assume the role of AC Chairman.

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<sup>9</sup> Guideline 12.8 of the Code

<sup>10</sup> Guideline 12.3 of the Code

<sup>11</sup> Section 201B(3) of the Companies Act


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## SECTION 1: AUDIT COMMITTEE COMPOSITION

1.2.11 The AC Chairman should have recent and relevant accounting or related financial management expertise or experience<sup>12</sup>, and should be sufficiently knowledgeable about the entity's business, its financial reporting and auditing requirements.

1.2.12 The tenure of appointment of the AC Chairman should be determined by the Board.

### Terms of Reference

FAQ 2:	
	<p><b>Delegate Additional AC Responsibilities</b></p> <p><b>Q:</b></p> <p>Can the Board delegate duties to the AC, in addition to its statutory responsibilities? To what extent should the AC accept such responsibilities?</p>
<p><b>A:</b></p> <p>Where necessary and appropriate, the Board can delegate duties to the AC in addition to its statutory responsibilities. The AC should only accept these duties to the extent that members have the necessary time and skills to discharge them. The Terms of Reference for the AC which spell out all its responsibilities should be updated accordingly.</p>	

1.2.13 For the AC to function effectively, the AC should define the scope of its oversight responsibilities and how these are to be discharged. The Terms of Reference for the AC should address the following:

- **Roles and responsibilities** of the AC, AC Chairman and the AC Secretary
- **Authority for the AC to seek independent professional advice**, at the company's expense
- **Provision of direct access** to anyone in the organisation to conduct any investigation to enable the AC to discharge its responsibilities
- **Non-Executive role of the AC** which does not generally include making business or commercial decisions

1.2.14 **Appendix A2** provides samples of AC Terms of Reference.

<sup>12</sup> Guideline 12.2 of the Code

# **GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE**

## **SECTION 1: AUDIT COMMITTEE COMPOSITION**

1.2.15 Where the documented Terms of Reference of an AC does not contain terms that the Board expects the AC to oversee, e.g. in relation to risk management, the AC should agree on a revised mandate with the Board.

### **Tenure of the AC**

1.2.16 The NC or the Board should carefully consider the length of term each member should serve. Rotation of AC members refreshes and introduces new perspectives to AC processes. Rotation also creates opportunities for a greater number of Board members to gain better understanding of the functioning of the AC. However, given the complex nature of the role, this has to be balanced with the need to have members who possess the necessary accumulated knowledge to discharge their responsibilities effectively.

1.2.17 The NC or the Board should consider how rotations can be staggered to ensure continuity of the AC's work and the orderly transfer of accumulated knowledge.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 1: AUDIT COMMITTEE COMPOSITION

### 1.3 Regulatory Requirements and Guidelines

*The following list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook. They are only summaries for ease of reference and it is advisable to refer to the actual section or rule in its entirety when applying it to particular situations or events.*

#### *Board Composition and Guidance*

1.3.1 **The Code Guideline 2.1:** There should be a strong and independent element on the Board, with independent directors<sup>13</sup> making up at least one-third of the Board.

#### *Audit Committees*

1.3.2 **CA Section 201B(2):** An AC shall be appointed by the directors from among their number (pursuant to a resolution of the Board of Directors and shall be composed of 3 or more members of whom a majority shall not be –

- (a) Executive Directors of the company or any related corporation;
- (b) A spouse, parent, brother, sister, son or adopted son or daughter or adopted daughter of an Executive Director of the company or of any related corporation; or
- (c) Any person having a relationship which, in the opinion of the Board of Directors, would interfere with the exercise of independent judgment in carrying out the functions of an AC.

1.3.3 **CA Section 201B(3):** The members of an AC shall elect a Chairman from among their number who is not an Executive Director or employee of the company or any related corporation.

1.3.4 **CA Section 201B(4):** If a member of the AC resigns, dies or for any other reason ceases to be a member with the result that the number of members is reduced below 3, the Board of Directors shall, within 3 months of that event, appoint such number of new members as may be required to make up the minimum number of 3 members.

1.3.5 **The Code Principle 12:** The Board should establish an AC with written terms of reference which clearly set out its authority and duties.

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<sup>13</sup> Assessment of director independence in Guideline 2.3 of the Code



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 1: AUDIT COMMITTEE COMPOSITION

- 1.3.6 **The Code Guideline 12.1:** The AC should comprise at least three directors, the majority of whom, including the AC Chairman, should be independent. All of the members of the AC should be non-executive directors. The Board should disclose in the company's Annual Report the names of the members of the AC and the key terms of reference of the AC, explaining its role and authority delegated to it by the Board.
- 1.3.7 **The Code Guideline 12.2:** The Board should ensure that the members of the AC are appropriately qualified to discharge their responsibilities. At least two members, including the AC Chairman, should have recent and relevant accounting or related financial management expertise or experience, as the Board interprets such qualification in its business judgement.
- 1.3.8 **The Code Guideline 12.9:** A former partner or director of the company's existing auditing firm or auditing corporation should not act as a member of the company's AC: (a) within a period of 12 months commencing on the date of his ceasing to be a partner of the auditing firm or director of the auditing corporation; and in any case (b) for as long as he has any financial interest in the auditing firm or auditing corporation.

### *Announcement of Specific Information*

- 1.3.9 **Listing Rule 704(8) / Catalyst Rule 704(7):** An issuer must announce any appointment or reappointment of a director to the Audit Committee. The issuer must state in the announcement whether the Board considers the director to be independent. The issuer must also provide such additional disclosure as may be appropriate in the circumstances to enable its shareholders to assess the independence or otherwise of the appointed director. In the event of any retirement or resignation which renders the Audit Committee unable to meet the minimum number (not less than three) the issuer should endeavour to fill the vacancy within two months, but in any case not later than three months.

### *Directors and Management*

- 1.3.10 **Listing / Catalyst Rule 720(1) and (2):** An issuer must comply with Listing Rule 210(5), Listing Rule 221 (if applicable) and Listing Rule 210(9)(e) (if applicable) / Catalyst Rule 406(3), on a continuing basis. A Catalyst issuer must also consult its sponsor prior to making any changes to its Board of Directors. Without limiting the generality of the foregoing, where a director is disqualified from acting as a director in any jurisdiction for reasons other than on technical grounds, he must immediately resign from the Board of Directors of the issuer. An announcement containing the details in Appendix 7.4.2 of the Listing Rules / Appendix 7G of the Catalyst Rules must be made.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 2: AUDIT COMMITTEE AGENDA

### Contents

Section	Sub-section
2.1 Table of Regulatory Requirements and Guidelines	-
2.2 Best Practices	<ul style="list-style-type: none"><li>• Interaction with the Board and Delegation of Responsibilities</li><li>• Tone from the Top</li><li>• Setting the Annual Workplan</li><li>• AC Calendar</li><li>• Meeting Agenda</li><li>• Conduct of Meeting</li><li>• Performance Assessment</li><li>• Training</li><li>• Interested Person Transactions</li><li>• Whistle-blowing</li></ul>
2.3 Regulatory Requirements and Guidelines	-

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 2: AUDIT COMMITTEE AGENDA

### 2.1 Table of Regulatory Requirements and Guidelines

(Detailed regulatory requirements and guidelines in 2.3)

Regulatory Requirements [Mandatory Compliance]	Guidelines [Comply or Explain]
<p style="text-align: center;"><u>Conduct of Meeting</u> CA Section 201B(6) CA Section 201B(7) CA Section 201B(8)</p> <p style="text-align: center;"><u>Performance Assessment</u> LR 610(6) / CR 407(4)(c) LR-Appendix 7.4.1 / CR-Appendix 7F</p> <p style="text-align: center;"><u>Training</u> LR 704(7) and Appendix 7.4.1 / CR 704(6) and Appendix 7F</p> <p style="text-align: center;"><u>Interested Person Transactions</u> LR/CR 905 LR/CR 906 LR/CR 912 LR/CR 916 LR/CR 917 LR/CR 920 FRS 24 – Disclosure (Extracts)</p> <p style="text-align: center;"><u>Whistle-blowing</u> LR 704(14) / CR 704(13) LR / CR 719(2) CR 224(2)(c) and (d)</p>	<p style="text-align: center;"><u>Role and Duties of Audit Committee</u> Code Principle 12 Code Guideline 12.4 Code Guideline 12.6</p> <p style="text-align: center;"><u>Conduct of Meeting</u> Code Guideline 12.3</p> <p style="text-align: center;"><u>Performance Assessment</u> Code Principle 5 Code Guideline 5.1 Code Guideline 5.2 Code Guideline 5.3</p> <p style="text-align: center;"><u>Training</u> Code Guideline 12.2 Code Guideline 1.6</p> <p style="text-align: center;"><u>Whistle-blowing</u> Code Guideline 12.7</p>

*The above list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook.*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 2: AUDIT COMMITTEE AGENDA

### 2.2 Best Practices

#### **Interaction with the Board and Delegation of Responsibilities**

2.2.1 The Board should establish an AC with written Terms of Reference which clearly set out its authority and duties<sup>14</sup>. While the Board may delegate the authority to make decisions to the AC, the Board cannot abdicate its responsibility. Any such delegation should also be disclosed.

#### **Tone from the Top**

2.2.2 It is essential that the Board sets the tone on the importance of an adequate and effective risk management and internal controls systems. This should be filtered down to the Management and then down to all levels of staff.

#### **Setting the Annual Workplan**

2.2.3 At the start of each year, the AC should set out the annual workplan that lists the key activities that it needs to undertake during the year.

2.2.4 Based on the workplan, the AC Chairman, in consultation with the Company Secretary, should determine the frequency and timing of its meetings. The AC meetings should coincide with key dates within financial reporting and audit cycles. The number of meetings and their duration should vary depending on the scope and complexity of issues to be discussed.


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<sup>14</sup> Principle 12 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 2: AUDIT COMMITTEE AGENDA

### AC Calendar

FAQ 3:	
	<b>Frequency of Meetings</b> <b>Q:</b> How frequently should the AC meet to enable members to discharge their responsibilities adequately?
<b>A:</b> The ACs of companies with quarterly reporting requirements should meet at least quarterly.	

2.2.5 The AC should meet as frequently as required. **Appendix B1** provides a sample AC annual agenda planner.

2.2.6 There should be a sufficient time interval between the AC meeting and the Board meeting so as to allow any matters arising from the AC meeting to be completed and reported to the Board as appropriate.

2.2.7 The AC should meet with the internal auditors and external auditors, without Management's presence, at least once a year, for them to communicate matters of mutual concern<sup>15</sup>.

2.2.8 The AC should undertake a full discussion on all issues, as may be required to enable all parties to seek clarification, ask questions and provide input.

2.2.9 The auditors should update the AC on the status of outstanding audit action plans and current year audit issues. Such discussions should be documented in the meeting minutes.

### Meeting Agenda

2.2.10 The AC Chairman should review the meeting agenda to ensure that critical issues are identified and prioritised so that these matters are tabled and addressed early in the agenda, in order to allow sufficient time for discussion.

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<sup>15</sup> Guideline 12.5 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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2.2.11 The AC should require Management to:

- Confirm at each meeting that no adverse or unusual events have taken place and where there are such events, their impact have been appropriately accounted for and/or disclosed
- Provide timely information on changes in business strategies and other relevant information

FAQ 4:	
	<p><b>Key Financial Information</b></p> <p><b>Q:</b></p> <p>What are some of the key financial information that the AC should request and receive from Management?</p>
<p><b>A:</b></p> <p>Many companies provide the following information to the AC on a quarterly basis, and present them at each AC meeting. Such information includes reports on the performance and financial position of the company in respect of:</p> <ul style="list-style-type: none"><li>• Current Period/Year</li><li>• Last Year</li><li>• Budget/Forecast</li></ul> <p>with explanations for any material variances. Any unusual or non-recurring items should be identified and explained.</p> <p>Materials to be provided before review of the performance of the company for each quarter should include:</p> <ul style="list-style-type: none"><li>• Comments from Management</li><li>• Comments from auditors, if applicable (where an audit, review or agreed upon procedures have been undertaken)</li><li>• Financial review procedures undertaken by Management in the preparation of the financial statements (where no audit or review is performed by the auditors) to ensure its integrity and accuracy</li></ul> <p>The AC could require the CFO to provide frequent standing reports to identify and highlight areas of concern to the AC.</p>	

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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FAQ 5:	
	<p><b>AC Meeting Efficiency and Effectiveness</b></p> <p><b>Q:</b></p> <p>Some AC meetings take two hours while others can take as long as half a day. How could the AC ensure that the meeting is conducted in an efficient and effective manner?</p>
<p><b>A:</b></p> <p>In practice, most companies provide 2 to 4 hours for the AC to deal with standard agenda matters. Members should provide up to 4 hours to attend a routine AC meeting, so that there is sufficient time for members to participate and contribute to matters discussed. The AC Chairman can also call for a pre-AC discussion with Management to understand the issues before the scheduled AC meeting.</p> <p>To ensure that meetings are conducted efficiently and effectively, AC members should:</p> <ul style="list-style-type: none"><li>• Have a good understanding and appreciation of agenda matters to be discussed</li><li>• Receive information, documents or relevant meeting materials ahead of the meeting in order to have adequate time for review of the materials (It is a good practice to agree that all meeting materials are received at least a pre-agreed number of days before the meeting)</li><li>• Devote time to review and read all meeting materials so as to be informed and apprised of matters to be discussed</li><li>• Come prepared for meetings so that discussions are meaningful and fruitful</li></ul> <p>The Chairman should stay focused and lead discussions on key areas.</p> <p>Specifically for non-standard and non-routine agenda items, the AC should request that Management provide an executive summary to assist the AC to understand these items.</p>	

### Conduct of Meeting

2.2.12 It is the AC Chairman's responsibility to ensure that the meeting is scheduled on a date/time convenient to all members. Members should ensure attendance as far as possible. Members unable to attend should consider participating in the meeting via teleconference, video conference or any other form of audio or audio-visual communication means.

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## SECTION 2: AUDIT COMMITTEE AGENDA


Case Study 3:	
	<p><b>Tabling of Proposal Without Prior Notice</b></p> <p>This case study illustrates what an AC could do if it needs more time to consider a proposal tabled by Management without prior notice during a routine AC meeting.</p>
<p><b>Context</b></p> <p>Towards the close of a routine AC meeting, the CEO tabled a proposal for the acquisition of a piece of development land from a related party, under 'Any Other Business'.</p> <p>A short oral presentation on the value of the land and the purpose of the acquisition was made by the CEO, following which approval was sought for the acquisition to be recommended to the Board for consideration.</p> <p>A proposed development plan was also tabled.</p> <p>The meeting was scheduled to end in half an hour.</p> <hr/> <p><b>Q:</b></p> <p>What should the AC do?</p> <p><b>A:</b></p> <p>Unless approval of transactions of this nature has been delegated by the Board to the AC, the AC should request that this matter be tabled at a Board meeting. However, if approval has already been delegated by the Board to the AC, the meeting could be adjourned and re-convened at a future date after members have received and reviewed all pertinent and relevant financial information on the proposed acquisition (e.g. valuation, funding, rate of return, cash flow projection and other information related to the interested person etc.). Members may submit their comments and input before the re-convened meeting to ensure effective and efficient conduct of the meeting.</p> <p>Management must be reminded that oral presentations should be accompanied by appropriate management papers and other reports. Significant and important matters should not be tabled under 'Any Other Business' but as separate agenda items.</p>	



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## SECTION 2: AUDIT COMMITTEE AGENDA

FAQ 6A:	
	<p><b>Professional Assistance</b></p> <p><b>Q:</b></p> <p>What should the AC do if Management reported that it has entered into transactions without obtaining the necessary prior approval from the AC and the Board?</p>
<p><b>A:</b></p> <p>The AC could take some or more of the following steps:</p> <ul style="list-style-type: none"><li>• <b>Seek professional assistance</b> of lawyers and auditors (in some situations, involving transactions that require disclosure or shareholder approval, consultation with the regulators might be appropriate)</li><li>• <b>Decide on an appropriate course of action</b> in consultation with the Board, having regard to advice received from the company's professional advisers and the regulators, including the need for an immediate announcement</li></ul>	

FAQ 6B:	
	<p><b>Conflict Resolution</b></p> <p><b>Q:</b></p> <p>How could the AC Chairman and members resolve conflicts or disagreements within the AC?</p>
<p><b>A:</b></p> <p>All differing views should be considered in frank and open discussions within the AC with the objective of addressing conflicts or disagreements.</p> <p>The Chairman of the Board and/or the Board could be consulted.</p> <p>The AC Chairman should be guided by his/her personal and the majority view. While there does not always need to be a full consensus in AC decisions, dissenting views may be minuted.</p> <p>In some situations, it would be appropriate for unresolved issues that concern breaches of laws and regulations to be brought to the attention of the regulators.</p>	


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2.2.13 The AC meeting minutes should be given to the AC Chairman for initial approval before circulating to the AC members for comments, within a reasonable time period. Many companies have the policy of circulating the meeting minutes within 7 working days after the meeting.

2.2.14 **Appendix B2** provides examples of good practices for an effective AC Chairman.

### Performance Assessment

FAQ 7:	
	<p><b>AC Performance Evaluation</b></p> <p><b>Q:</b> Should the AC conduct a performance evaluation of itself and individual members on the Committee?</p>
<p><b>A:</b> In most companies, the Board or the NC conducts a formal review on Board effectiveness which would also include the performance of the AC as a whole. If the AC Chairman or members of the AC have any feedback on their fellow directors on the AC, they would normally give their comments during this review.</p>	

2.2.15 Together with the NC, the AC could carry out a performance assessment exercise in these ways:

- Evaluation of the performance of the Committee as whole
- Evaluation of the individual performance of each member through both a self- and a peer evaluation
- Evaluation by the AC Chairman of the performance of each member
- Evaluation by members of the performance of the Chairman

These evaluations could involve facilitation or review by an external party.

2.2.16 The AC may include these factors in its evaluation criteria:

- Expertise
- Enquiring attitude, objectivity and independence
- Judgement
- Understanding of the company's business
- Commitment to the AC's duties and responsibilities


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- Willingness to devote the time needed to prepare for and participate in the Committee's deliberations
- Timely responses
- Attendance and participation at meetings

2.2.17 On an annual basis, the Committee could review its performance against the Terms of Reference of the Committee, to ensure that the Committee has carried out its responsibilities<sup>16</sup>. **Appendix B3** provides a sample checklist for self-assessment by the AC.

2.2.18 The results of the evaluation may be reviewed with the Board so that appropriate action can be taken on any recommendations resulting from the review. Feedback may be provided to the NC for consideration in its recommendation to the Board for the re-election of retiring members.

FAQ 8:	
	<b>AC Chairman Performance</b> <b>Q:</b> What can the AC members do if the AC Chairman is not discharging his duties effectively?
<b>A:</b> The AC members could provide feedback on the AC Chairman's performance to the NC. If an annual performance evaluation is carried out, this feedback should be addressed during the evaluation.	

### Training

#### *Training Requirements for AC members*


2.2.19 It is a good practice for AC members to be continuously updated with the changes in the regulatory environment and industry best practices, through appropriate training<sup>17</sup>.

<sup>16</sup> Principle 5 of the Code

<sup>17</sup> Guidelines 1.6 and 12.8 of the Code

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FAQ 9:	
	<b>AC Training Requirements</b> <b>Q:</b> What are the training requirements for AC members?
<b>A:</b> The training needs for each AC member will vary, depending on an individual's area of expertise as well as the circumstances of the company. Collectively as a group, AC members should ensure they have most if not all, of the recent and relevant skills required to discharge their duties and have access to other skills they do not possess themselves. The training needs between one AC member and another are therefore not the same. An AC member should discuss with the AC Chairman on the training needs that would enhance his contribution to the AC, as part of an overall training programme for the AC.	

2.2.20 Unless undertaken by the NC, the AC Chairman should monitor the needs of the AC members and consider relevant courses for the members to attend. Such courses should provide the AC members with the necessary knowledge to discharge their oversight responsibilities effectively.

2.2.21 Management should provide the AC with access to the company's training programmes, whether in-house or externally sourced.

2.2.22 At the point of its IPO launch, it is typical that the issue manager arranges training for the directors to brief them on their responsibilities.

2.2.23 The costs of courses and seminars attended by the AC members should be borne by the company<sup>18</sup>.

2.2.24 To the extent necessary, AC members should ensure that they have sufficient training on matters unique to the industry and business environment in which the company operates.

2.2.25 The expertise that collectively an AC should have would typically include knowledge of accounting standards, financial reporting requirements, corporate governance, regulatory and compliance requirements and risk management.

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<sup>18</sup> Guideline 1.6 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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2.2.26 AC members who do not have financial expertise or experience should attend general financial training and acquire an understanding of basic concepts in accounting principles and financial reporting.

2.2.27 Directors with no prior experience in serving on ACs of Singapore listed companies should familiarise themselves with the relevant laws and regulations of Singapore and any other jurisdiction that are pertinent to the company and their duties as a director and as an AC member.

2.2.28 The Company Secretary, external auditors and internal auditors may be asked to provide regular and timely updates to the AC on changes in the regulatory environment, accounting standards and industry best practices.

### *Orientation for incoming AC members*

2.2.29 The AC should work with Management and other compliance functions (e.g. IA, legal, risk management) on a formal process to brief new Committee members to ensure that they understand their responsibilities, the company's business and its operations, current issues, the audit process and the performance expectations of the Board. The briefing session should include:

- An overview by Management and relevant compliance functions on the company's risk and compliance framework and any current audit and financial reporting issues
- Meetings with Management and the internal auditor to discuss any unusual transactions or other matters that come under the purview of the Committee or that may concern the Committee
- An introduction to and a meeting with the external auditor

2.2.30 The new AC members should be provided with:

- A copy of the AC Terms of Reference, minutes of recent AC meetings together with the relevant meeting papers
- Copies of relevant company policies and procedures

2.2.31 **Appendix B4** sets out a list of topics that could be covered in the orientation programme for the AC members.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 2: AUDIT COMMITTEE AGENDA

### Interested Person Transactions

#### *Scope of the AC's responsibility for IPT and RPT*

2.2.32 When a company transacts with individuals who have significant influence over the decision-making process in the company (in line with the concept of “interested persons” under the Listing Manual), there is a risk that the interests of the company or its shareholders may be compromised. The AC, with Independent Directors as the majority, is tasked to review such transactions (under the Listing Manual) and ensure that they are carried out on normal commercial terms and are not prejudicial to the interests of the company or its minority shareholders<sup>19</sup>. The actual circumstance for each company may differ from the case examples provided in this guidebook. As such, ACs are advised to consult SGX when in doubt.

#### FAQ 10:



#### Clarifying Differences Between IPT and RPTs

**Q:**

Are all IPTs also RPTs and all RPTs also IPTs?

**A:**

The definition of an “Interested Person Transaction” (IPT) under the Listing Manual is narrower than the definition of a “Related Party Transaction” (RPT) under the Singapore FRS. An IPT may be simultaneously classified as an RPT. However, an RPT may not necessarily qualify as an IPT. Why? The definitions of an interested person and a related party illustrate this:

An “interested person” of a company, as defined in the Listing Manual, would encompass its directors, CEO, controlling shareholder and any of their associates.

However, *FRS 24* for RPTs sets out a definition of “related party” that is wider than that of an “interested person”. Related parties are defined in *FRS 24* in a longer listing of relationships that covers key Management personnel, close family members, corporate entities with control, joint control, common control or significant influence ties and certain of their connected persons. Importantly, because *FRS 24* is used for financial reporting purposes, it stipulates that ‘in considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form’.

<sup>19</sup> Chapter 9 of SGX Listing/Catalist Rules

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The Listing Manual in a similar vein states that in applying these (IPT) rules, regard must be given to (1) the objective of the Chapter and (2) the economic and commercial substance of the IPT, instead of merely the 'legal form and technicality'.

Because of this, there are situations where the AC would need to consider the economic substance of an IPT and the spirit of the rules if it is to discharge its duties under the IPT rules.

Please refer to **Appendix B5** for a summary of differences between IPT and RPT.

2.2.33 The AC should be mindful that, apart from the compliance obligations for IPTs under the Listing Manual, transactions entered into may also potentially require related party disclosures in the financial statements under FRS 24.

*For guidance on the review of RPT in relation to financial reporting, please refer to the section on Financial Reporting.*

### Case Study 4:



#### Determining the Value of IPTs

This case study illustrates how the AC should determine the value of IPTs.

#### Context

Listed Company A's subsidiary ("Subsidiary A") took out bank loans to finance its operations in the People's Republic of China ("PRC"). As part of the bank's requirements, a guarantee is required to be furnished by another PRC company which is not part of the borrowing group of companies. Company X, which is an associate of a director of Listed Company A provided this guarantee in favour of Subsidiary A without charging Company A for the provision of the guarantee.

Company X also requested for banking facilities in PRC and to reciprocate the provision of the guarantee by Company X in favour of Subsidiary A, Listed Company A agreed to guarantee the bank loans to Company X. The value of Listed Company A's guarantee in favour of Company X exceeded 5% of latest audited net tangible assets (NTA) of Listed Company A and its subsidiaries but shareholders' approval was not obtained prior to the provision of this guarantee. The directors failed to properly consider the requirements relating to disclosure and/or shareholders' approval under Chapter 9 of the Listing Manual, mistakenly considering only the "incremental value" of the cross guarantees as being below 5% of the Group's latest audited NTA.

Listed Company A was subsequently required to seek ratification of the IPTs at an extraordinary general meeting.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 2: AUDIT COMMITTEE AGENDA

### *Discharging oversight responsibility on IPT*

2.2.34 To enable the AC to properly discharge its oversight role over IPTs, Management must put in place a framework for the identification, valuation, approval and reporting of IPTs. The AC should satisfy itself that the framework will provide reasonable assurance that IPTs will be identified, evaluated, presented for review and approval and promptly announced, where required. **Appendix B6** sets out an example statement of policy on IPTs.

2.2.35 The AC's role in relation to IPTs is distinct from the Board's. Whilst the Board considers the commercial merits of and approves IPTs, the AC's role is focused on the controls over the approval and pricing of IPTs to ensure that interested persons do not abuse their powers to gain unfair advantage to the detriment of the company and its minority shareholders. All directors, and not just those on the AC, must be satisfied that the terms of the transaction are not prejudicial to the interests of the company and its shareholders.


### *Identification of 'Interested Persons'*

2.2.36 To facilitate the identification of individuals who may have influence over decisions made by the company, the AC could request the directors and the CEO (namely individuals identified as 'interested persons' in the Listing Manual) to submit regular disclosures on the directorships and shareholdings held by them and their associates and to sign a representation letter that the information submitted is complete, at least on an annual basis. In certain circumstances where it may be necessary to request similar disclosures from a controlling shareholder who is not a director, officer or employee of the company, the availability of such information from the controlling shareholder may be subject to the willingness of the controlling shareholder to volunteer such information. **Appendix B7** sets out an example of such a disclosure form. Notwithstanding the foregoing, directors and the CEO should bear in mind they have a duty to disclose any interest they may have in any proposal or transaction under consideration of the Board.



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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Case Study 5:	
	<b>Identifying 'Interested Persons'</b> This case study illustrates how an AC could act if it has concerns regarding a possible IPT.
<b>Context</b> A listed property developer recently awarded a multi-million dollar waste management contract to a local contracting company. It was subsequently discovered that the contracting company was owned by a brother-in-law and a cousin of the listed developer's controlling shareholder, who is also the CEO of the listed developer. The shareholder and CEO pointed out that neither the brother-in-law nor the cousin fell within the definition of 'interested person' under the Listing Manual and hence he saw no reason to disclose his relationship with them to the Board. He further clarified that he was not involved in the tender review or the selection process.	
<b>Q:</b> How should the AC respond?	
<b>A:</b> Under the Listing Manual, neither the brother-in-law nor the cousin fall within the definition of 'interested persons'. However, as transactions with such parties carry a risk of being prejudicial to the company or its minority shareholders, it is advisable that they be placed before the AC.  As mentioned in Listing Rule 902, the AC should have regard to commercial substance and not just form and technicality, in applying the Listing Manual on IPTs. As a result, notwithstanding the definition of interested persons, it is good practice for the CEO to discuss with the AC transactions that could be construed as falling within the spirit of the IPT rules. Even if it does not fall within the definition of an IPT, such a transaction might be an RPT requiring disclosure in financial statements.  The determination of whether such relationships are interested person relationships is not straightforward, and hence may require professional advice.  If the transaction is not considered to be an IPT but it poses risks which are similar to an IPT that the AC sees a need to oversee, the AC would normally direct Management to put appropriate controls in place and report periodically to the AC.	

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2.2.37 The Listing Manual defines “associates” for the purpose of IPTs. Examples of relationships that do not come within the definition of “associate” in the Listing Manual, but that may potentially exert an influence over an interested person, are set out below:

- (a) relatives of a director, CEO, or controlling shareholder who do not fall within the strict definition of “interested person”; and
- (b) individuals who share a common home, habitat or residence and/or have a close relationship with or financial dependence on a director, CEO, or controlling shareholder


2.2.38 Such relationships that potentially pose risks which are similar to IPTs are not easy to uncover, if there is an intention to conceal them from the AC. Certain entities with which the company has major transactions may potentially be interested persons which have not been identified. The AC should be aware of the possibility of such concealed interested person relationships. In normal circumstances, unless the AC has reason to believe that not all the IPTs are being identified, it does not implement additional procedures to uncover them.

2.2.39 Where the AC becomes aware of the other potentially close relationships with parties that are not interested persons, the AC should consider the need to make further enquiries on the influence that these parties might be able to exercise over the company, and consider the need for further disclosure, professional advice and/or consultation with the SGX.

2.2.40 Whether the relationship with any party does in fact exert any influence, real or perceived, over the outcome of executive decisions made by directors and officers of the company, is a matter of judgement for the AC. In making its assessment, the AC should take into account all known circumstances. As the AC has to take into account the economic and commercial substance of the IPT, different conclusions may be arrived at in different situations for relationships that have the same legal form.

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Case Study 6:	
	<p><b>Review of 'Interested Persons' Transactions</b></p> <p>This case study illustrates transactions that the AC may review to ensure that the terms are on arm's length, normal commercial terms and are not prejudicial to the company.</p>
<p><b>Context</b></p> <p>Listed Company A and Company B are in the same business. Listed Company A transacts with Company B for the purchase and sale of raw materials and rental of Company B's warehousing facilities. The directors and owners of Company B are cousins of Listed Company A's director and CEO. The AC of Listed Company A understands that Listed Company A and Company B used to be held under the same holding company, Company X, before Company X was restructured.</p> <hr/> <p><b>Q:</b></p> <p>Should the AC of Listed Company A consider these transactions as IPTs?</p> <p><b>A:</b></p> <p>As the definition of "interested person" under the Listing Manual does not encompass cousins, Company B would not fall under the definition of an interested person under the Listing Manual on this basis. If so, transactions with Company B would technically not by virtue of the said family relationship fall within the definition of IPTs under the Listing Manual.</p> <p>Notwithstanding this, the AC should consider, among others, the following factors when determining whether it should review the terms of such transactions to ensure that the terms are at arm's length, on normal commercial terms and are not prejudicial to the interest of Listed Company A:</p> <ul style="list-style-type: none"><li>• The family relationship between the directors of Listed Company A and Company B;</li><li>• Whether Listed Company A and Company B are managed by different Management teams; and</li><li>• Whether any of Listed Company A's directors and/or controlling shareholders have any shareholdings in Company B and vice versa.</li></ul> <p>In addition, the AC could also consider whether disclosure of these transactions should be made in the interest of transparency.</p>	

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### *Aggregation of Transactions with ‘Interested Person’ or the Associates of ‘Interested Persons’*

Case Study 7:	
	<p><b>Aggregating Transactions with ‘Interested Person’</b></p> <p>This case study illustrates transactions that the AC may review to ensure that the terms are on arm’s length, normal commercial terms and are not prejudicial to the company.</p>
<p><b>Context</b></p> <p>Listed Company A lost most of its finance team around the time of its reporting deadline for its full year results. As an interim measure to meet its imminent reporting deadline, Listed Company A enlisted the services of an accounting firm (“Company X”) owned by an Independent Director of Listed Company A to prepare its financial statements for the financial year. The full year financial statements of Listed Company A were subsequently reviewed and approved by the AC, of which the Independent Director is a member. For its work, Company X billed Listed Company A an invoice amounting to S\$30,000. During the year, Company X also provided ad hoc accounting consultancy services on a number of occasions to Listed Company A. The total billings of Company X exceeded S\$100,000 during the year. Since each of these billings amounted to less than S\$100,000, Listed Company A did not disclose these transactions in its annual report.</p>	
<p><b>Q:</b></p> <p>Should these transactions be aggregated to determine the value of the IPTs conducted with Company X?</p>	
<p><b>A:</b></p> <p>When considering whether transactions undertaken with interested persons should be aggregated, the similarity in the economic and commercial substance of the transactions, rather than just the nominal value of each of the transactions, should be taken into account. If the AC forms the opinion that the services provided by Company X are commercially and substantially connected, the transactions should be aggregated even though each billing amounted to less than S\$100,000. Accordingly, the Independent Director should declare these dealings to the AC and Company A should make the requisite disclosure in its annual report.</p>	

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**Q:**

What other considerations should the AC take into account with regard to the services provided by the Independent Director's firm?

**A:**

The AC should consider the appropriateness for the Independent Director concerned to participate in the AC's deliberation on the financial statements since such statements were prepared by the Independent Director's firm.

The AC should also consider the continued suitability of the Independent Director to act as an AC member and an Independent Director, and whether such an arrangement would provide the necessary checks and balances with regards to supervising the finance function of Listed Company A. In determining his suitability, consideration should also be given to the form and substance of the total economic benefits (including any director fees) that the Independent Director will directly and indirectly derive from Listed Company A.

### FAQ 11:



#### **Aggregating Transactions with Associates of 'Interested Persons'**

**Q:**

Do transactions with the associates of an interested person need to be aggregated with those entered into with that same interested person?

**A:**


Rule 908 of the Listing Manual considers transactions between an entity at risk and interested persons who are members of the same group, to be transactions between an entity at risk and the same interested person, subject to certain exceptions. Such transactions are to be aggregated as if these are all entered into with the same person, for the purpose of establishing the relative size and significance of the IPTs with the interested person. As this analysis can be very complicated, the AC should consider the need for professional advice where in doubt.

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### *Transaction Pricing*

2.2.41 To ascertain if an IPT is conducted at an appropriate price that does not prejudice the company, the AC could ask, through Management, for a comparative quote from an independent third party or engage an external specialist or adviser to advise on the pricing of the proposed transaction.

<b>Case Study 8:</b>	
	<b>Considerations for Reviewing Transaction Pricing</b> This case study illustrates how an AC could go about satisfying itself that the pricing of a transaction is appropriate.
<b>Context</b> Listed Company A is proposing to buy several patents, from a research company owned by one of the directors of Listed Company A, for S\$10 million. Listed Company A's Management has prepared case-for-investment papers showing that there is a sound business case for the purchase at the proposed price, with the return on investment exceeding the threshold rate used by Listed Company A. Management has also engaged an external specialist, who has issued a written report to say that the fair value of the patents on the royalty relief method is at least S\$10 million. The proposed price (when aggregated with all other transactions with the same interested person in the financial year) is less than 5% of the latest audited NTA of Listed Company A's group.	
<b>Q:</b> What could the AC of Listed Company A do to determine if the transaction price is on normal commercial terms and not prejudicial to the interests of Listed Company A or its minority shareholders?	
<b>A:</b> The AC could ensure that the Board has considered the commercial merits of the proposed investment and all relevant comparables. It could discuss with Management the basis and assumptions behind Management's valuation of the patents and review the specialist report on the valuation, considering the independence and qualifications of the specialist. Based on those discussions and review, the AC could consider whether an IFA should be engaged to advise the Board.	

2.2.42 Where the AC relies on an IFA, it should ensure that the work of the IFA is not unduly influenced by the IFA's contact and relationship with Management or the interested person. As a minimum, the AC should ensure that it has available to it a list of professional firms for the purpose of appointment and the final say in the appointment decision.

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### *Approval of IPTs*

#### Recurring Transactions - General Mandate

2.2.43 The company may seek a general mandate from shareholders for recurring IPTs of a revenue or trading nature or those necessary for its day-to-day operations such as the purchase and sale of supplies and materials, but not in respect of the purchase or sale of assets, undertakings or businesses.

2.2.44 Where transactions are expected to be carried out in the company's ordinary course of business pursuant to a general mandate, the AC should ensure that there is a framework for review of the company's compliance with the procedures set out in the general mandate:

- The AC should provide oversight for the setting up of a framework to monitor the interested person transactions
- The AC could also designate the Internal Auditor to ensure that the procedures under the framework are followed and to require the Internal Auditor to report to the AC on a quarterly basis

#### FAQ 12:



#### **Renewal of IPT General Mandate**

An IPT general mandate was first obtained three years ago, and had been renewed on the same terms annually since. The company intends to issue a circular to shareholders this year, proposing the renewal of the mandate for another year on the same terms. In order to avoid requiring an IFA's opinion, the AC will include in the circular a statement confirming *inter alia* that the methods or procedures for determining transaction prices (as set out in the circular) have not changed and are sufficient to ensure that the transactions will be conducted on normal commercial terms and will not be prejudicial to the interests of the company and its minority shareholders.

**Q:**

What should the AC do prior to the release of this statement?

**A:**

To support the AC in making such confirmations, the AC could discuss with Management the methods or procedures currently in place and ascertain whether there are practical issues in the application of the current procedures and if changes or enhancements are required. The AC should consider whether the internal auditor, the external auditor or a professional firm should be tasked to review the adequacy and effectiveness of the methods and procedures.

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### One-Off Transaction not covered by General Mandate

2.2.45 When considering an IPT that is not covered by a general mandate, the significance of the transaction to the company will determine the extent of detail to which the AC should review the transaction. Management would typically be asked to provide the AC with their analysis of the impact of significant IPTs on the company, in writing and by presentation. Information on IPTs that should be circulated and presented include:

- The rationale for entering into the transaction
- The rationale for transacting with this counterparty and not a third party
- The cost and benefit accruing to the company from the transaction
- Background and financial status of the counterparty
- The interested person's relationship with the counterparty
- The asset being acquired
- The basis for arriving at the transaction price
- Other terms of the transaction

### ***Management Reporting on IPTs***

2.2.46 The AC should be fully briefed on information about the company which may have a material bearing on IPTs or RPTs. This would include background information on the company's substantial shareholders and the identity of interested persons, related parties, key business partners, major customers, major suppliers and parties to major contracts.

2.2.47 When new directors join the AC, the AC Chairman should ensure that the new AC member is fully briefed on such background information. Management should update the AC where there is:

- A material change in substantial shareholders, resulting in changes in the identity of interested persons and related parties
- A major change in the way the company operates, including changes in key customers, suppliers and parties to major contracts

2.2.48 The AC should receive information on IPTs regularly from Management. Often, this is received quarterly and would include these factors:

- A summary of IPTs
- Confirmation that mandated procedures have been followed
- Mandate on pricing criteria/guidelines every quarter
- Comparison of transacted prices with prices contracted with other non-related parties (if available), or with external market prices



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- Declaration that prices for IPTs are reasonable and within market rates
- Gross margins on IPTs, where relevant

### *Independent Assessment on Effectiveness of IPT Policy and Procedures*

2.2.49 One possible avenue to obtain evidence to support the AC's annual statement on IPTs is through the IA function. The AC could request the Internal Auditor to review the effectiveness and relevance of IPT policies and procedures.

2.2.50 **Appendix B8** sets out the conditions that could indicate potential RPTs. **Appendix B9** sets out possible motivations for RPTs and **Appendix B10** sets out indicators of fraud in RPTs.

The following case studies examine independent assessment on effectiveness of IPT policy and procedures.

Case Study 9A:	
	<b>Identification of potential RPTs and IPTs</b> Specifically, this scenario illustrates the measures an AC could take to be assured that potential RPTs and IPTs are identified.
<b>Context</b> Listed Company A, a manufacturer of retail apparel has been conducting a considerable proportion of its business with a group of companies, comprising Company X and Company Y, whose common parent company is incorporated in the British Virgin Islands (BVI parent company).  Company X is both a supplier and a customer to Listed Company A. It sells raw materials to Listed Company A and purchases finished goods from Listed Company A. Management has explained that such transactions arise when Company X receives orders from its own customers that it cannot meet.  Company Y is one of Listed Company A's major customers, contributing almost 20% of revenue. For this reason, Management of Listed Company A often grants preferential rates and generous payment terms to Company Y. The orders placed are large but irregular.  As the operations grew, Listed Company A has recently entered into a ten-year lease for premises and land with the BVI parent company, for its new plant expansion.	

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The BVI parent company is a joint venture between the former CFO of Listed Company A and the wife of the Managing Director of Listed Company A. The BVI parent company is indirectly controlled by the Managing Director of Listed Company A, who provided the funds for his wife to invest in the joint venture.

However, the Board of Listed Company A does not consider Company X and Company Y to be associates [of its Managing Director] and no disclosures were or are made of transactions between Listed Company A and these three companies. As a result, the shareholders of Listed Company A are not aware of the nature of the links that the Managing Director has with Company X and Company Y, nor the effect that transactions with these corporations have on Listed Company A's reported results.

Neither does Listed Company A disclose the BVI parent company as an 'interested person'. The lease transaction with the BVI company is not treated as an IPT. The listed company did not obtain shareholders' approval for the lease (even though the relevant threshold under Chapter 9 of the Listing Manual was crossed), nor was an opinion issued by the AC or an IFA on the transaction.

**Q:**

What could the AC do to be assured that transactions with potential related parties and interested persons are identified?

**A:**


The AC should be mindful of the possibility that undisclosed RPTs or IPTs might be entered into with the objective of managing earnings. This requires that these transactions be identified. Apart from obtaining regular declarations from directors and the CEO on their directorships and interests in corporations deemed as 'associates', the AC could have requested Management to provide information on the background of key trading partners, such as the shareholders backing these trading partners and the basis on which the trading terms are agreed.

The AC should be alert to potential indicators of RPTs and IPTs. Where there are such indications (some of these examples being set out in **Appendix B8**), the AC should require Management to provide additional information on the transactions and the background of the trading partners to satisfy itself whether the transaction might be a RPT or an IPT where:

- The trading partner is both a supplier and a customer
- The terms offered to the trading partner are generous or not at market rates
- The trading partner is incorporated in a tax haven with little or no infrastructure.

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Case Study 9B:	
	<p><b>Assessing transactions that may impact disclosures</b></p> <p>This case study illustrates some of the issues an AC should consider and the means to address them when assessing a transaction that may raise concerns regarding regulatory disclosures and IPTs.</p>
<p><b>Context</b></p> <p>A listed issuer is majority-owned by two directors, who are the Executive Chairman and the CEO. The Executive Chairman is the father of the CEO. The company has agreed to sell a business unit for S\$2 million to a company owned by the CEO's nephew. The consideration is to be satisfied by a loan extended by the listed issuer to the buyer to finance this sale. This transaction was not reported to the AC as an IPT. The AC chairman became aware of the connection with the CEO's nephew in a casual conversation prior to the completion of the sale.</p> <p>When asked about the transaction, the CEO took the view that his nephew is not an 'interested person' under the Listing Manual and that the company's procedures relating to IPTs therefore did not apply. He also pointed out that this sale was being handled by the company's corporate strategy head and that he has had no direct involvement in the transaction.</p>	
<p><b>Q:</b></p> <p>What are the issues that the AC has to deal with?</p> <p><b>A:</b></p> <p>There are four issues that the AC faces above:</p> <ul style="list-style-type: none"><li>• Non-disclosure by an Executive Chairman and the CEO of their relationship with a party entering into a transaction with the company</li><li>• The effect of the sale of the business unit on the interests of the company and its minority shareholders</li><li>• The basis of arriving at the sale price and the commercial terms of the arrangement</li><li>• The form, economic substance and commercial terms (including as to interest and repayment) of the loan to the buyer, which is a company owned by the CEO's nephew</li><li>•</li></ul>	
<p><b>Q:</b></p> <p>How could the AC go about resolving the above issues?</p> <p><b>A:</b></p> <ul style="list-style-type: none"><li>• The first issue the AC has to deal with is the failure of the CEO/Executive Chairman to disclose his relationship with the buyer of the business.</li></ul>	

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While a strict interpretation of the Listing Manual suggests that the AC does not need to review transactions with individuals that are not covered by the definition of 'interested persons', where there is doubt on whether the transaction may be in substance considered an IPT, the AC should be alerted to these transactions. The AC should have regard to commercial substance and not just form and technicality, in applying the Listing Manual on IPTs. The AC could encourage the Executive Chairman and the CEO to discuss with the AC transactions with parties where they have a relationship that falls outside of the 'interested person' definition set out in the Listing Manual. In relation to the transaction with the CEO's nephew, the AC should seek full facts relating to the nature of the relationship between the CEO and his nephew and decide on what involvement that the AC should undertake in the review and approval of the transaction and its terms.

- The second issue relates to whether the sale of the business unit is in line with the company's objectives and in its best interests. This is a matter for the Board to decide. If this sale had been agreed without the Board's prior approval, the AC should consider whether the authorisation limits in place are adequate to deal with such situations, as the sale of business units would typically require Board approval. Because the company has already entered into a contractually binding obligation to sell the business unit, the Board's decisions would have to be considered in the light of this obligation and would likely be made with the help of legal advisers.
- The third issue relates to whether the sale price and the terms of sale are appropriate and do not prejudice the company or its minority shareholders.
- The fourth issue relates to whether the loan to the buyer should be considered an IPT and whether the terms of the loan are at arm's length. Furthermore, the AC should also consider the rationale for the provision of the loan to the buyer.

**The listing rules require IPT to be subject to the review by AC.** Where a transaction does not fall squarely within the definition of an IPT, as in this case, the AC could consider the substance instead of the form and legality for the purpose of determining if the disposal should have been dealt with as if it was an IPT.

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The AC should agree with Management and set out the guidelines on the relationships and transactions that would need to be escalated to the AC for the purpose of determining whether they fall within the ambit of the Listing Manual. The AC should determine if there were any other transactions preceding the disposal that if aggregated with the disposal, would cross the threshold set out under Listing Rule 906 and therefore require shareholders' approval.

The AC should also consider if there were any actions by the company preceding the disposal that would raise concerns on the disposal.

### Whistle-blowing

2.2.51 A whistle-blowing policy is a formalised, secure and confidential procedure where employees or any individual can report any wrongdoings such as fraud, misconduct, breach of any health and safety law, or any other illegal act, either on the part of Management or by fellow employees. Elements of a good whistle-blowing policy are set out in **Appendix B11** and a sample of a whistle-blowing policy is provided in **Appendix B12**.

2.2.52 As recommended by the Code, the AC should seek to satisfy itself that there are proper arrangements in place for staff of the company and any other persons to raise concerns about possible improprieties relating to financial reporting or other matters. The AC would need to ensure that there are appropriate arrangements for such concerns to be raised and, where appropriate, independently investigated for appropriate follow up action to be taken<sup>20</sup>.

### *Scope of the whistle-blowing policy*

2.2.53 The scope of the whistle-blowing policy should at minimum, address the regulatory obligations of the AC as set out in the Code and the Listing/Catalist Rules. As such, the scope of the whistle-blowing policy may be defined as follows:

- **Unethical and improper practices** or alleged wrongful conduct relating to financial reporting or other related matters
- **Non-compliances** with regulatory requirements or corporate policies relating to financial reporting or related matters

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<sup>20</sup> Guideline 12.7 of the Code

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- **Questionable or suspicious practices** relating to accounting policies/ treatments or audit matters
- **Any other acts that may have a material impact** on the company's operating results or financial position

### ***Recipient of whistle-blowing reports***

2.2.54 The recipient of the whistle-blowing report should be independent and not subject to undue influence or pressure by Management. These personnel could be considered as appropriate independent recipients:

- AC Chairman
- External parties such as Company Secretary, legal adviser, outsourced IA firm
- Head of IA department
- Dedicated team or department that handles investigations of misconduct or any other matters and has a direct reporting line to Independent Directors

2.2.55 The AC has to consider if an internal recipient is sufficiently independent to deal with the complaint.

2.2.56 Recipients are required to submit all feedback received to the AC who will then decide on the actions required. The AC could include the review of whistle-blowing reports in their routine meeting agenda.

2.2.57 Recipients of whistle-blowing reports are responsible for ensuring that all feedback received is accounted for, appropriately secured (with restricted user access) and reported to the AC.

2.2.58 The AC may wish to set a timeframe for the timely resolution of matters arising from whistle-blowing reports.

### ***Protection for whistle-blowers***

2.2.59 The recipient should also ensure the confidentiality of the whistle-blower's identity.

2.2.60 Where the identity of the whistle-blower is known, steps should be taken to ensure that the whistle-blower is not subjected to reprisals.

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### *Whistle-blowing channels*

2.2.61 The AC should recommend that the whistle-blowing policy provides options for the whistle-blower to report via different channels such as electronic mailbox, facsimile and postal mail.

### *Communication of whistle-blowing policy*

2.2.62 The existence of a whistle-blowing policy should be disclosed in the company's Annual Report, and procedures for raising such concerns should be publicly disclosed as appropriate<sup>21</sup>. It should also be regularly communicated to the staff of the company. Such communication should reach out to staff of all levels, new and existing staff, consultants, part-time and temporary staff and be written in an appropriate format and style that ensures that the intended audience can understand it. The company may also consider communicating the policy to its stakeholders such as its customers, suppliers and service providers.

2.2.63 The AC may consider having the whistle-blowing policy accessible through the company's website or intranet, notice boards or internal electronic mail system.

### *Review of whistle-blowing policy*


2.2.64 The AC may wish to conduct an annual review of the whistle-blowing policy and arrangements to ensure that related changes in legal and regulatory requirements are updated and that the arrangements have been effective. Where necessary, the arrangements should be amended.

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<sup>21</sup> Guideline 12.7 of the Code

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FAQ 13:	
	<p><b>Review of whistle-blowing policy</b></p> <p><b>Q:</b> What are some of the factors that the AC could consider when reviewing a whistle-blowing policy?</p>
<p><b>A:</b> The AC may want to consider these factors:</p> <ul style="list-style-type: none"><li>• <b>Does the policy set the right tone</b> to encourage users to blow the whistle?</li><li>• <b>Are there adequate procedures</b> to track the actions taken in relation to concerns raised and to ensure appropriate and timely follow-up action has been taken to investigate and, if necessary, resolve problems indicated by whistle-blowing?</li><li>• <b>Have confidentiality issues been appropriately addressed</b> in the policy?</li><li>• <b>Are potential internal users of the whistle-blowing policy identified and informed of the procedures?</b></li><li>• <b>Does the policy specify protection</b> for the whistle-blowers?</li><li>• <b>Are protocols established</b> for the timely distribution of each type of complaint to appropriate individuals within the company and to the AC and Board where appropriate?</li><li>• <b>Are complaints of any kind involving senior Management automatically and directly submitted</b> to the AC or other designated independent parties without filtering by Management or other personnel?</li><li>• <b>Are the internal auditors carrying out periodic review on the design and operating effectiveness</b> of the whistle-blowing procedures?</li></ul>	


### ***Dealing with anonymous feedback***

2.2.65 Notwithstanding that the feedback is anonymous, the AC should evaluate the information provided, on the basis of credibility and materiality having regard to the supporting evidence.



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Case Study 10:	
	<b>Handling an Unsubstantiated Complaint</b> This case study illustrates how an AC could deal with an unsubstantiated complaint of a breach by the Chairman
<b>Context</b> The AC Chairman receives an anonymous letter that claims that the Chairman did not make the necessary regulatory disclosure relating to an investment by the company. The claim is supported with details which cannot be verified at this point.	
<b>Q:</b> What could the AC do?	
<b>A:</b> The AC Chairman could convene a meeting with the AC members to review the contents of the letter. If the AC considers that there is a possibility of fraud, in accordance with the Listing Rule 719(2)/Catalist Rule 719(2), the AC should discuss the facts of the case with the external auditors and seek legal advice. The AC Chairman could take the necessary action and discuss the concerns highlighted in the letter with the Chairman.  If the AC does not consider that there is a likelihood of fraud, the AC should seek clarification from the Chairman and consider the need to escalate the issue to the Board for resolution. Where the AC is not satisfied with the Board's decision, the AC could seek advice from the external auditors and/ or the legal counsel.  <i>For more comprehensive guidance on fraud, please refer to the section on Risk Management and Internal Controls.</i>	

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### *Handling whistle-blowing reports*

Case Study 11 <sup>22</sup> :	
	<p><b>Handling Whistle-blowing Reports</b></p> <p>The following case study illustrates what an AC could do in response to allegations of fraudulent revenue recognition and bribery involving foreign government officials.</p>
<p><b>Context</b></p> <p>Prior to the announcement of audited financial results and a secondary placement, the AC was confronted by a whistle-blower's allegations of fraudulent revenue recognition and bribery of government officials by one of the group's foreign subsidiaries. In response to the allegations, the AC appointed the legal counsel working on the secondary placement to undertake an investigation.</p> <p>The appointed legal counsel found evidence of collusion and bribery involving management of the foreign subsidiary and government officials from a small sample of government projects. In the time available, a limited review of other government contracts involving the particular foreign subsidiary was carried out. It did not yield evidence of further wrongdoing. It had the appearance of an isolated local incident involving only the management of the foreign subsidiary. A review of email traffic between the foreign subsidiary and head office aroused some suspicion by a member of the AC of an inappropriate tone at the top set by the group CFO on revenue recognition and an encouragement to bribe officials. Additionally, the same AC member also raised concerns over the financial incentives enjoyed by the group CFO in meeting financial targets. These concerns were dismissed by the other AC members as an insult to the integrity of the group CFO as the financial incentives were enjoyed by all senior Management.</p> <p>The group auditors accepted the report of the investigating legal counsel despite reservations from its own forensic team and evidence of revenue recognition problems raised by audit teams in other parts of the group. The group auditors issued an unqualified report on the financial statements which were included in the prospectus of the secondary offering.</p>	

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Note: This case study is based on the movie drama "Risking It All" produced by PricewaterhouseCoopers LLP, 2008. All copyrights and other intellectual property rights contained in "Risking It All" belong solely to PricewaterhouseCoopers LLP. PricewaterhouseCoopers LLP is an affiliated firm of PricewaterhouseCoopers

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Soon after the successful secondary placement, leaked emails from the group CFO to the management of the foreign subsidiary authorising the payment of bribes to government officials were published. This resulted in the reopening of the investigation revealing the full extent of the fraudulent revenue accounting and the use of slush funds to bribe government and corporate officials to win contracts. This was not limited to government contracts or just contracts involving the particular foreign subsidiary. As a result, the financial statements for two years had to be restated. The company was censured and heavily fined by the regulators and law suits against the Board and senior Management were filed by shareholders.

**Q:**

What could the AC have done to ensure that the whistle-blower's allegations are thoroughly investigated?

**A:**

As the allegations could adversely affect the company and jeopardise the placement, the AC should report the matter to the Board and recommend that an independent investigation be conducted.

The AC should consider the competence, independence and objectivity of the legal counsel appointed to act as investigators. In complex assignments, the legal specialists might be supported by forensic accounting specialists.

When fraudulent practices are uncovered, the AC could consider informing the relevant authorities and the need for shareholder announcements. Thorough (as opposed to expedient) investigative and corrective actions are required. The AC should be objective in its investigation and not be unduly influenced by the possible failure of the capital raising exercise.

The external auditors should be informed. The AC should discuss with the external auditors their findings from the audit.

The AC could work with the Board to strengthen the corporate culture to promote ethical behaviour and the appropriate "tone at the top".

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### 2.3 Regulatory Requirements and Guidelines

*The following list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook. They are only summaries for ease of reference and it is advisable to refer to the actual section or rule in its entirety when applying it to particular situations or events.*

#### *Role and Duties of Audit Committee*

**2.3.1 The Code Principle 12:** The Board should establish an AC with written terms of reference which should clearly set out its authority and duties.

**2.3.2 The Code Guideline 12.4:** The duties of the AC should include:

- (a) reviewing the significant financial reporting issues and judgements so as to ensure the integrity of the financial statements of the company and any announcements relating to the company's financial performance;
- (b) reviewing and reporting to the Board at least annually the adequacy and effectiveness of the company's internal controls, including financial, operational, compliance and information technology controls (such review can be carried out internally or with the assistance of any competent third parties);
- (c) reviewing the effectiveness of the company's IA function;
- (d) reviewing the scope and results of the external audit, and the independence and objectivity of the external auditors; and
- (e) making recommendations to the Board on the proposals to the shareholders on the appointment, re-appointment and removal of the external auditors, and approving the remuneration and terms of engagement of the external auditors.

**2.3.3 The Code Guideline 12.6:** The AC should review the independence of the external auditors annually and should state (a) the aggregate amount of fees paid to the external auditors for that financial year, and (b) a breakdown of the fees paid in total for audit and non-audit services respectively, or an appropriate negative statement, in the company's Annual Report. Where the external auditors also supply a substantial volume of non-audit services to the company, the AC should keep the nature and extent of such services under review, seeking to maintain objectivity.

#### *Conduct of Meeting*

**2.3.4 CA Section 201B(6):** The auditor has the right to appear and be heard at any meeting of the Audit Committee and shall appear before the Committee when required to do so by the Committee.

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- 2.3.5 **CA Section 201B(7):** Upon the request of the auditor, the Chairman of the Audit Committee shall convene a meeting of the Committee to consider any matters the auditor believes should be brought to the attention of the directors or shareholders.
- 2.3.6 **CA Section 201B(8):** Each Audit Committee may regulate its own procedure and in particular the calling of meetings, the notice to be given of such meetings, the voting and proceedings thereat, the keeping of minutes and the custody, production and inspection of such minutes.
- 2.3.7 **The Code Guideline 12.3:** The AC should have explicit authority to investigate any matter within its Terms of Reference, full access to and co-operation by Management and full discretion to invite any director or Executive Officer to attend its meetings, and reasonable resources to enable it to discharge its functions properly.

### *Performance Assessment*

- 2.3.8 **Listing Rule 610(6) / Catalist Rule 407(4)(c):** A statement by the issuer's Audit Committee should be provided in the prospectus, offering memorandum, introductory document and shareholders' circular that, after making all reasonable enquiries, and to the best of their knowledge and belief, nothing has come to the attention of the Audit Committee members to cause them to believe that the person appointed as the chief financial officer (or its equivalent rank) does not have the competence, character and integrity expected of a chief financial officer (or its equivalent rank) of a listed issuer.
- 2.3.9 **Listing Rule - Appendix 7.4.1 / Catalist Rule – Appendix 7F:** In relation to the appointment of key persons of the company such as directors, chief executive officer, chief financial officer, chief operating officer, general manager, or other executive officer of equivalent authority, the Board is required to comment on this appointment (including rationale, selection criteria, and the search and nomination process).
- 2.3.10 **The Code Principle 5:** There should be a formal annual assessment of the effectiveness of the Board as a whole and its Board committees and the contribution by each director to the effectiveness of the Board.
- 2.3.11 **The Code Guideline 5.1:** Every Board should implement a process to be carried out by the Nominating Committee for assessing the effectiveness of the Board as a whole and its Board committees and for assessing the contribution by the Chairman and each individual director towards the effectiveness of the Board. The Board should state in the company's Annual Report how the assessment of the Board, its Board committees and each

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director has been conducted. If an external facilitator has been used, the Board should disclose in the company's Annual Report whether the external facilitator has any other connection with the company or any of its directors. This assessment process should be disclosed in the company's Annual Report.

**2.3.12 The Code Guideline 5.2:** The Nominating Committee should decide how the Board's performance may be evaluated and propose objective performance criteria. Such performance criteria, which allow for comparison with industry peers, should be approved by the Board and address how the Board has enhanced long-term shareholder value. These performance criteria should not be changed from year to year, and where circumstances deem it necessary for any of the criteria to be changed, the onus should be on the Board to justify this decision.

**2.3.13 The Code Guideline 5.3:** Individual evaluation should aim to assess whether each director continues to contribute effectively and demonstrate commitment to the role (including commitment of time for meetings of the Board and Board committees, and any other duties). The Chairman should act on the results of the performance evaluation, and, in consultation with the Nominating Committee, propose, where appropriate, new members to be appointed to the Board or seek the resignation of directors.

### *Training*

**2.3.14 Listing Rule 704(7) and Appendix 7.4.1 / Catalyst Rule 704(6) and Appendix 7F:** In relation to the appointment of directors of the company, the company is required to disclose details of training undertaken by the appointee in the roles and responsibilities of a director of a listed company if he does not have prior experience as a director of a listed company.

**2.3.15 The Code Guideline 12.2:** The Board should ensure that the members of the AC are appropriately qualified to discharge their responsibilities. At least two members, including the AC Chairman, should have recent and relevant accounting or related financial management expertise or experience, as the Board interprets such qualification in its business judgement.

**2.3.16 The Code Guideline 1.6:** Incoming directors should receive comprehensive and tailored induction on joining the Board. This should include his duties as a director and how to discharge those duties, and an orientation program to ensure that they are familiar with the company's business and governance practices. The company should provide training for first-time director in areas such as accounting, legal and industry-specific knowledge as appropriate.

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It is equally important that all directors should receive regular training, particularly on relevant new laws, regulations and changing commercial risks, from time to time.

The company should be responsible for arranging and funding the training of directors. The Board should also disclose in the company's Annual Report the induction, orientation and training provided to new and existing directors.

### *Interested Person Transactions*

**Objective of IPT regulations [as set out in Chapter 9 of the Listing Manual and Catalist Rules]** The following extracts from Chapter 9 of the *Listing Manual and Catalist Rules* serve to provide the reader with basic information on IPTs in relation to AC responsibilities. These extracts are not a substitute for and should be read together with the full Chapter 9 rules. Chapter 9 of the *Listing Manual and Catalist Rules* can be accessed from the SGX website via this link: <http://rulebook.sgx.com>

### General Requirements

#### **2.3.17 Listing / Catalist Rule 905:**

- (1) An issuer must make an immediate announcement of any IPT of a value equal to, or more than, 3% of the group's latest audited net tangible assets.
- (2) If the aggregate value of all transactions entered into with the same interested person during the same financial year amounts to 3% or more of the group's latest audited net tangible assets, the issuer must make an immediate announcement of the latest transaction and all future transactions entered into with that same interested person during that financial year.
- (3) Rule 905(1) and (2) does not apply to any transaction below \$100,000.

#### **2.3.18 Listing / Catalist Rule 906:**

- (1) An issuer must obtain shareholder approval for any IPT of a value equal to, or more than:
  - (a) 5% of the group's latest audited net tangible assets or
  - (b) 5% of the group's latest audited net tangible assets, when aggregated with other transactions entered into with the same interested person during the same financial year. However, a transaction which has been approved by shareholders, or is the subject of aggregation with another transaction that has been approved by shareholders, need not be included in any subsequent aggregation.
- (2) Rule 906(1) does not apply to any transaction below \$100,000.

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### Sale of Property Units

**2.3.19 Listing / Catalist Rule 912:** In deciding on any sale of units of its property projects to an issuer's interested persons or a relative of a director, Chief Executive Officer or controlling shareholder, an issuer's Board of Directors must be satisfied that the terms of the sale(s) are not prejudicial to the interests of the issuer and its minority shareholders. The Audit Committee must review and approve the sale(s) and satisfy itself that the number and terms of the sale(s) are fair and reasonable and are not prejudicial to the interests of the issuer and its minority shareholders.

### Exceptions: IPTs which are not required to comply with Rule 906

**2.3.20 Listing / Catalist Rule 916:** *These transactions are not required to comply with Rule 906:*

- (3) The provision of a loan to a joint venture with an interested person if:
- (c) the issuer confirms by an announcement that its Audit Committee is of the view that:
    - (i) the provision of the loan is not prejudicial to the interests of the issuer and its minority shareholders; and
    - (ii) the risks and rewards of the joint venture are in proportion to the equity of each joint venture partner and the terms of the joint venture are not prejudicial to the interests of the issuer and its minority shareholders.

### Announcement Requirements

**2.3.21 Listing / Catalist Rule 917:** An announcement under Rule 905 must include the following information:

- (4) (a) A statement:
- (i) whether or not the Audit Committee of the issuer is of the view that the transaction is on normal commercial terms, and is not prejudicial to the interests of the issuer and its minority shareholders; or
  - (ii) that the Audit Committee is obtaining an opinion from an IFA before forming its view, which will be announced subsequently.

### IPTs Under General Mandate

**2.3.22 Listing / Catalist Rule 920:**

- (1) An issuer may seek a general mandate from shareholders for recurrent transactions of a revenue or trading nature or those necessary for its day-to-day operations such as the purchase and sale of supplies and materials, but not in respect of the purchase or sale of assets, undertakings or businesses. A general mandate is subject to annual renewal.



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- (b) A circular to shareholders seeking a general mandate must include:
  - (i) An opinion from the Audit Committee if it takes a different view to the independent financial adviser
  
- (c) An independent financial adviser's opinion is not required for the renewal of a general mandate provided that the Audit Committee confirms that:
  - (i) the methods or procedures for determining the transaction prices have not changed since last shareholder approval; and
  - (ii) the methods or procedures in Rule 920(1)(c)(i) are sufficient to ensure that the transactions will be carried out on normal commercial terms and will not be prejudicial to the interests of the issuer and its minority shareholders.

### Related Party Disclosures under FRS

These FRS extracts serve to provide the reader with basic information on related parties in relation to AC responsibilities. These extracts should *not* be read in isolation of the FRS. The FRS can be accessed from the Accounting Standards Council website via this link: <http://www.asc.gov.sg/frs/index.htm>

#### 2.3.23 FRS 24 – Disclosure (Extracts):

- 14. To enable users of financial statements to form a view about the effects of related party relationships on an entity, it is appropriate to disclose the related party relationship when control exists, irrespective of whether there have been transactions between the related parties.
  
- 18. If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17 [of FRS 24] to disclose key Management personnel compensation. At a minimum, disclosures shall include:
  - (a) the amount of the transactions;
  - (b) the amount of outstanding balances, including commitments, and:
    - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
    - (ii) details of any guarantees given or received;
  - (c) provisions for doubtful debts related to the amount of outstanding balances; and

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- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

### *Whistle-blowing*

**2.3.24 Listing Rule 704(14) / Catalist Rule 704(13):** The Exchange may require an issuer to appoint a special auditor to review or investigate the issuer's affairs and report its findings to the Exchange or the issuer's Audit Committee or such other party as the Exchange may direct. The issuer may be required by the Exchange to immediately announce the requirement, together with such other information as the Exchange directs. The issuer may be required by the Exchange to announce the findings of the special auditors.

**2.3.25 Listing / Catalist Rule 719(2):** If the Audit Committee of an issuer becomes aware of any suspected fraud or irregularity, or suspected infringement of any Singapore laws or regulations or rules of the Exchange or any other regulatory authority in Singapore, which has or is likely to have a material impact on the issuer's operating results or financial position, the Audit Committee must discuss such matter with the external auditor and, at an appropriate time, report the matter to the Board and to the sponsor (for Catalist issuers). The sponsor of the Catalist issuer should inform the Exchange where necessary.

**2.3.26 Catalist Rule 224(2)(c) and (d):** A sponsor must liaise with the Exchange on matters which should be brought to its attention, including notifying the Exchange when an issuer refuses to heed its advice on matters which may involve or lead to a breach of the Rules; and when it forms the opinion that the trading of the issuer's securities should be halted or suspended, or that the issuer should be delisted.

**2.3.27 The Code Guideline 12.7:** The AC should review the policy and arrangements by which staff of the company and any other persons may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The AC's objective should be to ensure that arrangements are in place for such concerns to be raised and independently investigated, and for appropriate follow up action to be taken. The existence of a whistle-blowing policy should be disclosed in the company's Annual Report, and procedures for raising such concerns should be publicly disclosed as appropriate.

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## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

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Section	Sub-section
3.1 Table of Regulatory Requirements and Guidelines	-
3.2 Context	<ul style="list-style-type: none"><li>• Key requirements</li><li>• Key definitions</li></ul>
3.3 Best Practices	<ul style="list-style-type: none"><li>• Risk Governance and Oversight Structures</li><li>• Board Assurance Framework</li><li>• ERM and Internal Control Frameworks</li><li>• Assurance Framework</li><li>• Control Deficiency Evaluation</li><li>• Disclosure Requirements</li></ul>
3.4 Regulatory Requirements and Guidelines	-

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

### 3.1 Table of Regulatory Requirements and Guidelines

(Detailed regulatory requirements and guidelines in 3.4)

Regulatory Requirements [Mandatory Compliance]	Guidelines [Comply or Explain]
<p style="text-align: center;"><u>Audit Committee</u> CA Section 201B(5)(a)(ii)</p> <p style="text-align: center;"><u>Content of Prospectus, Offering Memorandum and Introductory Document</u> LR 610(5)/CR 407(4)(b)</p> <p style="text-align: center;"><u>Appointment of Special Auditors</u> LR 704(14)/CR 704(13)</p> <p style="text-align: center;"><u>Suspected Fraud or Irregularity</u> LR/CR 719(1) LR/CR 719(2)</p> <p style="text-align: center;"><u>Annual Reports</u> LR 1207(10)/CR 1204(10)</p>	<p style="text-align: center;"><u>Risk Management and Internal Controls</u> Code Principle 11 Code Guideline 11.1 Code Guideline 11.2 Code Guideline 11.3 Code Guideline 11.4</p> <p style="text-align: center;"><u>Audit Committee</u> Code Guideline 12.4(b)</p>

*The above list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook.*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

### 3.2 Context

#### Key requirements

3.2.1 AC members are required to understand the key requirements contained within SGX Listing Rule 1207(10), SGX Practice Note 12.2, Catalist Rule 1204(10), Catalist Practice Note 12B and Principle 11 of the Code.

The table below provides a summary of the differences between the disclosures required to comply with the Listing Manual compared to the Code.

3.2.2 AC responsibilities cut across both requirements. Whilst the existing SGX Listing Rules require disclosure of an opinion regarding the adequacy of internal controls with basis (as outlined in SGX Practice Note 12.2 / Catalist Practice Note 12B), they also require companies to disclose whether they comply with the Code and provide explanations where they did not.

It is recommended that ACs adopt the higher standard of the Code to understand and comment on both the adequacy and effectiveness of both the risk management and internal control systems.

Aspects	Code (2005)	Guidelines on CG 2013 <sup>23</sup>	LR 1207(10) / CR 1204(10)	Code (2012)
Internal Controls				
Adequacy	✓	✓	✓	✓
Effectiveness				✓
Risk Management				
Adequacy	✓	✓		✓
Effectiveness				✓

#### Key definitions

3.2.3 There are concepts contained within the Listing Manual and Principle 11 of the Code that AC members should be familiar with in order to enable them to discharge their responsibilities. For a number of these terms, there are no formal definitions provided as they may vary as every company has a unique set of circumstances that requires an element of judgment in determining the appropriate response to satisfy compliance requirements. Brief explanations for some of the terms are set out below.

<sup>23</sup> Guidelines on Corporate Governance for Financial Holding Companies, Banks, Direct Insurers, Reinsurers and Captive Insurers which are incorporated in Singapore, Apr 2013

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## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

- **Adequate and effective**
  - (a) **Adequate** – having enough of something or sufficient i.e. are the risk management and internal control systems designed appropriately?
  - (b) **Effective** – producing the intended or desired results i.e. are the risk management and internal control systems operating as intended?

The risk management and internal control systems are considered adequate and effective if they provide reasonable assurance for the managing of the company's risks, the safeguarding of its assets, the reliability of financial information, and the compliance with laws and regulations. *Refer to "Appendix G – Reviewing Adequacy and Effectiveness" of the Risk Governance Guidance for Listed Boards.*

- **Assurance by CEO and CFO** – a positive declaration intended to give confidence. The CEO and CFO should establish mechanisms to enable them to provide assurance to the Board regarding the adequacy and effectiveness of the risk management and internal control systems.
- **Control deficiency** – a control deficiency exists when it fails, in terms of adequacy (design) and/or effectiveness (operation), to prevent or detect events, on a timely basis, impacting the achievement of objectives.
- **Control evaluation** – the evaluation of the materiality of the control deficiency should include both quantitative and qualitative considerations. Qualitative factors that might be important in this evaluation include the nature of the risk management and internal control systems objectives involved and the possible consequences of the deficiency.

Furthermore, in determining whether a control deficiency, or combination of deficiencies, is a significant deficiency or a material deficiency, the effect of compensating controls and whether such controls are adequate and effective should be evaluated and tested.

- **Enterprise Risk Management ("ERM")** – a process applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity and manage risk to be within its risk tolerance, to provide reasonable assurance regarding the achievement of the entity's objectives<sup>24</sup>.

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<sup>24</sup> Adapted from the Enterprise Risk Management – Integrated Framework 2004, published by the Committee of Sponsoring Organisations of the Treadway Commission (COSO)

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- **Internal control** – a process designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance<sup>25</sup>. Internal control includes control environment, risk assessment, control activities, information and communication and monitoring activities<sup>26</sup>.
- **Likelihood** – the chance of the key controls failing to prevent or detect a financial/non-financial consequence within the reporting period.
- **Potential magnitude** – the consequence or impact of the control deficiency should it occur.
- **Opinion with basis** – an opinion with basis outlines the approach that has been adopted to arrive at the opinion. Based on current practices, opinions regarding the adequacy of internal controls should be expressed as a positive opinion. This requires a high level of confidence and the AC should typically view some form of documentation as evidence. Hence, sufficient evidence needs to be gathered to be reasonably certain that evidence to the contrary, if it exists, would have been identified<sup>27</sup>.
- **Risk management** – coordinated activities to direct and control an organisation with regard to risk<sup>28</sup>.
- **Risk tolerance** – defined as the boundaries of risk-taking outside of which the organisation is not prepared to venture in the pursuit of long term business objectives<sup>29</sup>.
- **Significant risks** – potential events that could give rise to a material impact (financial and non-financial) and/or events that could cause a material change in stakeholder perceptions.
- **Sound system of risk management and internal control systems** – a robust process, including supportive ‘tone-at-the-top’, that ensures risks relevant to the company are adequately addressed and mitigated.

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<sup>25</sup> COSO Internal Control - Integrated Framework 2013

<sup>26</sup> Adapted from the COSO Internal Control - Integrated Framework 2013

<sup>27</sup> IIA – Practical considerations regarding internal auditing expressing an opinion on internal control

<sup>28</sup> ISO31000 International Risk Management Standard

<sup>29</sup> Appendix D – “Setting Risk Tolerance” of the Risk Governance Guidance for Listed Boards

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## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

### 3.3 Best Practices

#### Risk governance and oversight structures

##### *Determine the appropriate structure*

3.3.1 The Board is ultimately responsible for ensuring that Management establishes a sound system of risk management and internal controls to safeguard shareholders' interests and the company's assets.

3.3.2 To fulfil its oversight responsibility, the Board may retain responsibility or delegate that authority to a Board committee. In determining the appropriate risk governance structure, consideration must be given to key factors (such as the size, complexity, geographic spread and significant risks facing the organisation).

3.3.3 The common risk governance structures are outlined below:

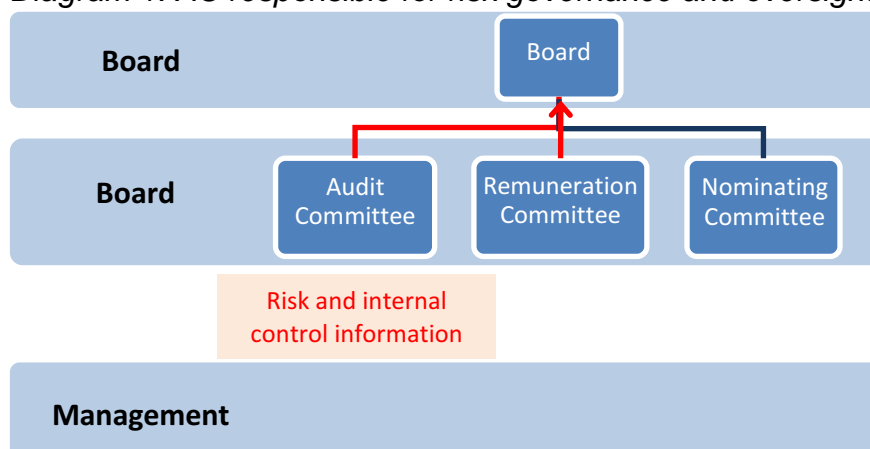
- Oversight by AC;
- Oversight by Board Risk Committee (BRC)<sup>30</sup>; or
- Oversight by Board.

##### *AC responsible for oversight of risk management and internal controls*

3.3.4 It is common for the Board to delegate oversight of risk management and internal controls to the AC.

3.3.5 Diagram 1 provides a high-level overview of where the AC is responsible for the oversight of risk management and internal controls.

*Diagram 1: AC responsible for risk governance and oversight*




<sup>30</sup> Page 9 and Appendix A – “Ways in which the Board can Govern Risk” of Risk Governance Guidance for Listed Boards



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3.3.6 Where the Board has delegated the oversight responsibility to the AC, the AC needs to assess its ability to discharge this responsibility.

Key guidance 1:	
	<p><b>Risk governance structure must be tailored for each company</b></p> <p>The AC should take into consideration its size and composition, the scale, diversity and complexity of the company's operations and the nature of the significant risks that the company faces. Conversely, the composition of the AC and the way it operates should be dependent on the type of risks that the AC is responsible for overseeing.</p>

3.3.7 The AC should consider having at least one member who has relevant experience related to the oversight function for risk management and internal controls. Collectively, the AC should have relevant experience with the company's industry and also be familiar with the company's business operations.

3.3.8 With the globalisation of businesses and increasing sophistication of financial market offerings, the risks faced by companies are becoming more difficult to anticipate and comprehend. Where the risks are complex and the understanding of such risks beyond the AC's expertise, the AC should recommend to the Board to set up supplementary arrangements to oversee specific risks or establish a BRC to oversee non-financial risks.


3.3.9 These are examples of the complex non-financial risks that the AC should pay attention to:

- **Complex business operations** with a low tolerance for error
- **Geographically dispersed operations**
- **IT systems** on which the business is critically dependent

**Appendix C1** provides a list of possible types of risks faced by companies. Further examples can be found in "Appendix F – Information Technology ("IT") Risks that Boards should be aware of" from the Risk Governance Guidance for Listed Boards.

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## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

Key guidance 2:	
	<p><b>AC composition and relevant experience</b></p> <p>For newly formed ACs, it is particularly important to ensure that the Independent Directors and other AC members are appropriately skilled, qualified and have the relevant experience. Where AC members have concerns they may not possess the necessary skills, qualifications, experience, they should:</p> <ul style="list-style-type: none"><li>• <b>Discuss with the Chairman</b> their concern that they may not have the required industry knowledge to effectively oversee the overall risk management process and/or identify the possibility of the AC engaging external professionals to advise them</li><li>• <b>Review the composition of the AC</b> and consider whether new AC members with relevant experience could help the AC carry out the oversight responsibility</li><li>• <b>Identify relevant training programmes</b> that the AC members could attend to close the knowledge gap</li><li>• <b>Review the need for a separate Risk Committee</b> to oversee the management of non-financial risks and make recommendations to the Board</li></ul>

*BRC responsible for oversight of risk management and internal controls*

3.3.10 The Board may establish a separate BRC to assist it in carrying out its responsibility of overseeing the company's risk management framework and policies<sup>31</sup>.

3.3.11 Diagram 2 provides a high-level overview of where the BRC is responsible for oversight of risk management and internal controls.

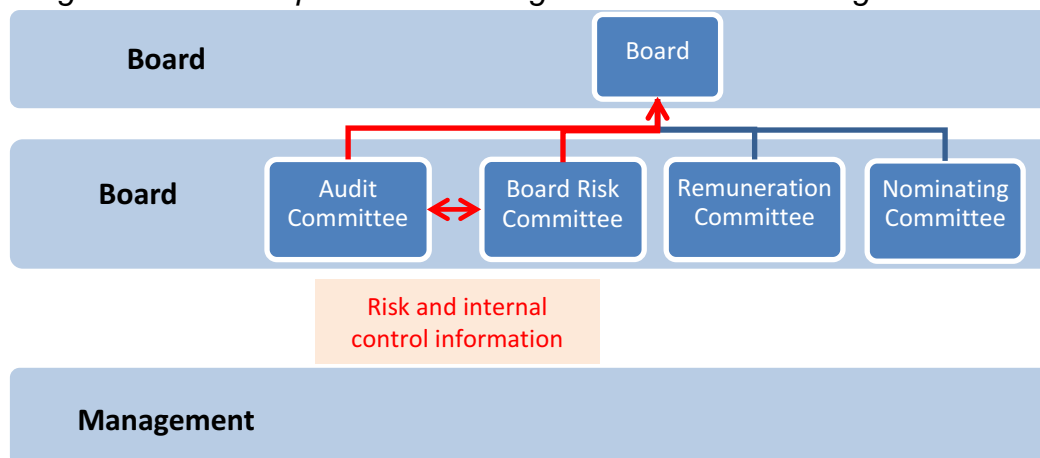
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<sup>31</sup> Guideline 11.4 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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Diagram 2: BRC responsible for risk governance and oversight



3.3.12 Where the overall supervision of risk management rests with another Board Committee, the AC could be actively involved in monitoring Management's efforts in managing financial reporting-related risks, and liaise closely with the BRC to make sure that the BRC understands the work done by the AC. AC members should clarify the holistic framework in place to provide assurance to the Board and key stakeholders regarding the adequacy and effectiveness of the risk management and internal control systems.

3.3.13 The Board and/or AC can engage internal auditors or external consultants to conduct an independent review (in accordance with the Risk Governance Guidance for Listed Boards) on the effectiveness of the risk management policies and processes approved by the BRC and make recommendations to enhance the controls.


3.3.14 The AC and BRC should plan their work based on the same risk framework so that differences in approach or focus between the two Board Committees would be minimised. Information between the AC and BRC can be shared in different ways such as:

- Having common directors on the AC and the BRC
- Having arrangements for the AC and BRC to share information on a regular basis; and/or
- Circulating the minutes of the BRC and the AC among the BRC, AC and the Board for their information

3.3.15 Where there is a separate risk manager or Chief Risk Officer, there should be regular and open line of communication with the Head of IA or Chief Audit Executive.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

Key guidance 3:	
	<p><b>Common risk management framework</b></p> <p>When establishing a risk governance structure, where more than one Board Committee is responsible for risk oversight, it is essential to create a common understanding of the respective Committee's scope, roles and responsibilities to ensure completeness and consistency, and minimise duplication of effort. The following factors should be considered:</p> <ul style="list-style-type: none"><li>• <b>Common risk parameters</b> – establishing consistent definitions for determining the consequence, likelihood and risk ratings will enable meaningful comparisons of risks across the organisation</li><li>• <b>Agreed risk profile</b> – presenting a consolidated risk profile (based on a common understanding of the risk universe) to the respective Board Committees will assist in discharging their risk oversight responsibilities, as there is visibility of all the key risks facing the organisation (i.e. risks are not being presented in isolation)</li><li>• <b>Risk based IA plan</b> – ensuring IA develops its audit plan, scope and coverage of work from the common risk universe and/or risk profile</li></ul>

*Board responsible*


3.3.16 Where the Board has decided not to delegate oversight of the risk management and internal control systems to a Board Committee, then for the Board to effectively discharge its oversight responsibilities on risk management and internal controls, the Board needs to undertake the activities which are typically carried out by the AC or BRC.

***Clarify the activities to be performed by the AC or BRC***

3.3.17 Key Guidance 4 provides examples of the typical activities required to be performed by the AC or BRC regarding risk management and internal controls.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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<b>Key guidance 4:</b>	
	<p><b>Examples of risk management and internal control oversight activities</b></p> <p>The examples provided below are illustrative and not meant to be an exhaustive list. AC and BRC members must consider the appropriateness of activities according to the size, nature, complexity of the company’s operations.</p>
<b>Review and recommend for Board approval</b>	<b>Review and advise/escalate to the Board on key matters (as per agreed reporting protocols)</b>
<ul style="list-style-type: none"> <li>• Company’s risk management policy</li> <li>• Company’s overall risk tolerance and strategy</li> <li>• Risk parameters and risk assessment process</li> <li>• Confirmation that CEO and CFO have provided a report regarding their assurances on the effectiveness of the risk management and internal control systems</li> </ul>	<ul style="list-style-type: none"> <li>• Adequacy and effectiveness of the company’s risk management and internal control systems</li> <li>• Company’s risk profile and significant risk information (risk dashboard)</li> <li>• Company’s breaches of risk limits</li> <li>• Status of risk mitigating action plans and timeliness to rectify deficiencies</li> <li>• Assurance mechanisms and reports to verify adequacy and effectiveness of risk management and internal control systems (e.g. IA reports, EA reports, risk and control certifications)</li> <li>• Company’s risk culture (e.g. ‘tone-at-the-top’, fraud awareness, level of engagement in risk activities)</li> </ul>

### ***Formalise the Terms of Reference***

3.3.18 The AC and/or BRC should ensure that the documented Terms of Reference are consistent with the agreed mandate from the Board<sup>32</sup>. Where the AC has responsibility for risk governance, it may consider broadening its title to “Audit and Risk Committee”.

<sup>32</sup> Principle 12 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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Refer to “Appendix B – Sample Terms of Reference for a Board Risk Committee” of Risk Governance Guidance for Listed Boards.

**NOTE:** For the purposes of the following pages (within this section), it is assumed that the Board has delegated authority to the AC for risk governance and oversight.

### FAQ 14:



#### **Governance and oversight challenges for smaller companies**

**Q:**

I am an AC member for a listed company that sells a homogenous household product, has a turnover of less than S\$100 million and operates entirely within Singapore. How do I ensure that there is an appropriate structure in place to enable my Board to discharge its duties regarding risk governance?

**A:**

Regardless of the size of the company, it is still critical for AC members to make enquiries to understand the existing Board, Board Committees and Management structures to clarify roles and responsibilities in relation to risk governance.

Typically, for smaller listed companies operating with a homogenous product in a single geographic location, the risk process should drive common definitions of risk, risk parameters and risk escalation points. A risk profile/register should exist, either top down (at executive level) or bottom up (from aggregating divisional risk submissions).

The AC member should check the AC terms of reference to ensure it adequately captures key risk management and internal control responsibilities and activities and request changes if it does not. At a minimum, in this scenario, the AC should be responsible for reviewing (and advising the Board on matters as per the agreed reporting protocols) the risk policy, risk tolerance, risk profile, risk mitigating action plans and assurance activities for significant risk areas.

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## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

### FAQ 15:



#### **Governance and oversight challenges for larger, more complex companies**

**Q:**

I am an AC member for two different listed companies. Company A is listed in Singapore with operations in multiple jurisdictions and Company B is listed in Singapore with listed subsidiaries (with independent Boards). How do I ensure that there is an appropriate structure in place to enable my Board to discharge its duties regarding risk governance?

**A:**

This is a common issue for directors and AC members governing companies with complex structures and diverse operations. It poses real challenges with regard to the process for obtaining sufficient evidence of the adequacy and effectiveness of the risk management and internal control across significant parts of the company (e.g. divisions, subsidiaries, locations etc) but also the legalities in requesting reports or seeking independent assurance.

The AC must work with Management to understand the following:

- **Significance** – what process has been adopted to define significance (in terms of financial materiality and reputational impact) regarding the company group structure and risks across the business? Which entities, divisions, locations are in scope? For example, an entity/division which exposes the Group to brand and reputation risk even though it may not be financially material or significant to the Group.
- **Framework** – what is the risk management and internal control system across the company group structure? How is it communicated to significant parts of the Group? What is the process to understand similarities or differences?
- **Aggregation** – what is the process for consolidating risk information at the entity and Group level? Have consistent parameters been defined and implemented to enable aggregation and analysis?
- **Assurance mechanisms** – what is the assurance framework to check adequacy and effectiveness of the risk management and internal control systems across the company group structure? What is the scope, coverage, frequency of internal and external audits and other assurance activities? What are the legal rights to conduct independent audits?
- **Attestation** – is there a form of control self-assessment in existence across the large complex organisation?

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- **Reporting** – what is the risk management and internal control reporting policy for the company group structure? What is the scope, coverage, frequency of internal and external audit reports and other assurance provider reports? How is this implemented and what are the legal rights to request access to risk management and internal control information?
- **Escalation** – how are risks escalated and addressed throughout the company group structure?
- **Deficiencies** – how have risk management and internal control deficiencies been defined? How are risk management and internal control systems deficiencies aggregated? What constitutes a reportable risk management and internal control deficiency?

It is recommended that large companies with diverse operations establish risk management and internal control systems that are relevant and applicable for all parts of the Group such that they can be cascaded and consistently adopted. This will promote a common understanding of risk concepts and enable effective aggregation and analysis of risks as comparisons are possible.

Defining significant risks and internal control deficiencies for the Group will enable reportable risk management and internal control deficiencies to be more readily identified, analysed and understood. Financial materiality, going concern matters and changes in stakeholder perceptions are key factors to consider when defining what is significant.

### Board Assurance Framework

#### *Clarify the 'holistic' Board Assurance Framework*

3.3.19 AC members should clarify the 'holistic' Board Assurance Framework in place to provide assurance to the Board and key stakeholders regarding the adequacy and effectiveness of the risk management and internal control systems. Diagram 3 sets out an example of a Board Assurance Framework.

3.3.20 There is no one-size-fits-all approach to developing a Board Assurance Framework as each company has a unique set of circumstances that must be taken into account. AC members should consider all activities outlined in the Board Assurance Framework and determine the extent to which they should be in place within the company.

3.3.21 AC members should make enquiries regarding the existence of and interrelationship between risk management, internal controls and assurance

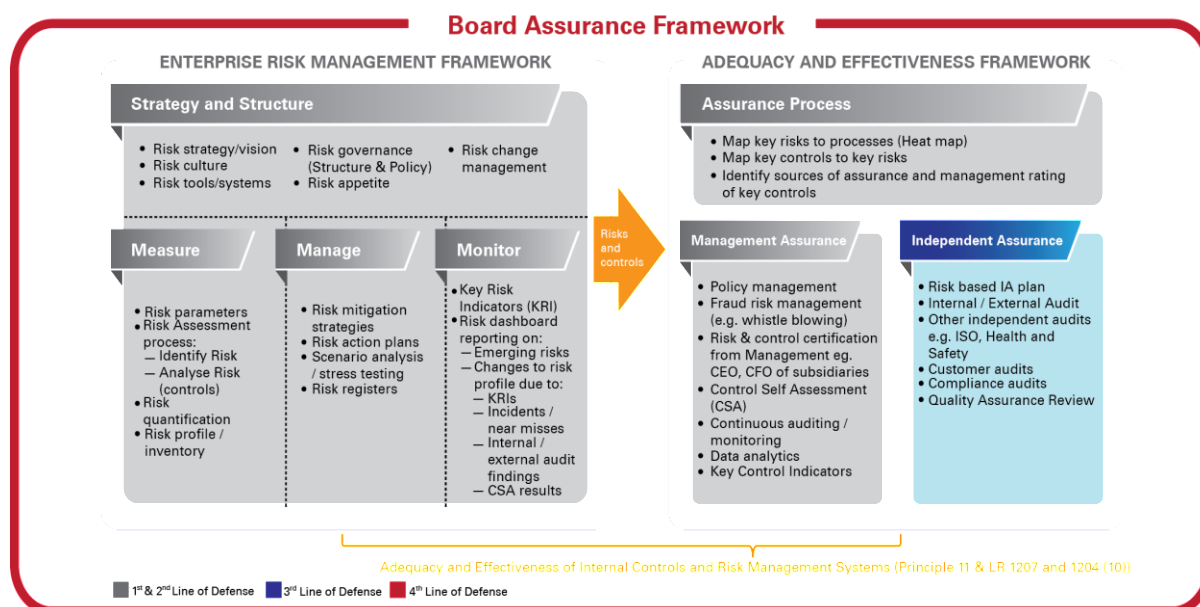


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mechanisms. The Board Assurance Framework highlights the main elements which can help to satisfy compliance requirements and stakeholder expectations.

Diagram 3: Board Assurance Framework



Source: KPMG Risk Consulting Singapore Board Assurance Framework (incorporating KPMG's 4 Lines of Defence model), 2014

### Clarify the Communication between and across the 'Lines of Defence'

3.3.22 AC members should also make enquiries regarding the roles and functions embedded within and across the Board Assurance Framework. In particular, they should take into account the key roles and responsibilities and level of communication (i.e. nature and frequency) between and within:

- First line of defence (risk owners/managers)
- Second line of defence (risk management and compliance functions)
- Third line of defence (independent assurance providers e.g. IA)
- Fourth line of defence (Board oversight)

Please refer to **Appendix C2** for an overview of the Institute of Internal Auditors "Three Lines of Defence Model" and KPMG "Four Lines of Defence Model".

### Risk Indicators and Monitoring Mechanisms

3.3.23 AC members should make enquiries to clarify and understand the ERM framework that is in place. A critical process within the ERM framework is to establish appropriate risk measurement, managing and monitoring mechanisms.

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3.3.24 Identifying and establishing key risk indicators (KRIs) appropriate to the nature, size and complexity of the organisation/industry is considered an important aspect of the risk monitoring regime. KRIs provide information on how effectively the key controls are in mitigating the key risks. Adverse trends in KRIs may assist in identifying control gaps that require rectifying and/or enhanced assurance activities.

3.3.25 Reporting information as part of 'risk dashboard' for AC members enables greater visibility and transparency of the risk and control environment. It also aids the AC's understanding of the linkages between the risk, internal control and assurance mechanisms which are fundamental to the Board Assurance Framework.

### ***Capturing and reporting assurance outcomes***

3.3.26 In assessing the adequacy and effectiveness of the risk management and internal control framework, the AC should target its activities to achieve these objectives:

- Provide direction for the adequate allocation of resources (such as manpower and capital) for risk management, internal controls and assurance processes;
- Build consensus among the Board members and Management on acceptable risk levels (in terms of risk likelihood and its impact) and monitor current risk levels; and
- Monitor Management's accountability for risk management, internal controls and assurance processes

3.3.27 AC members should clarify and establish a process for capturing and reporting the results generated from the Board Assurance Framework. The information should be sufficient enough to provide the Board with confidence in the process and enable them to:

- Provide an opinion with basis regarding the adequacy of internal controls;
- Comment on the adequacy and effectiveness of risk management and internal controls; and
- Confirm assurances received by the CEO and CFO regarding effectiveness of risk management and internal controls.

3.3.28 ACs should agree on an approach with the Board regarding the nature and frequency of reporting outcomes to support disclosures. Examples of reports could include risk profile updates, risk mitigating action plans (with timeframes to resolve areas for improvement), risk and control dashboards (including key risk indicators and key control indicators) as well as risk and assurance maps.

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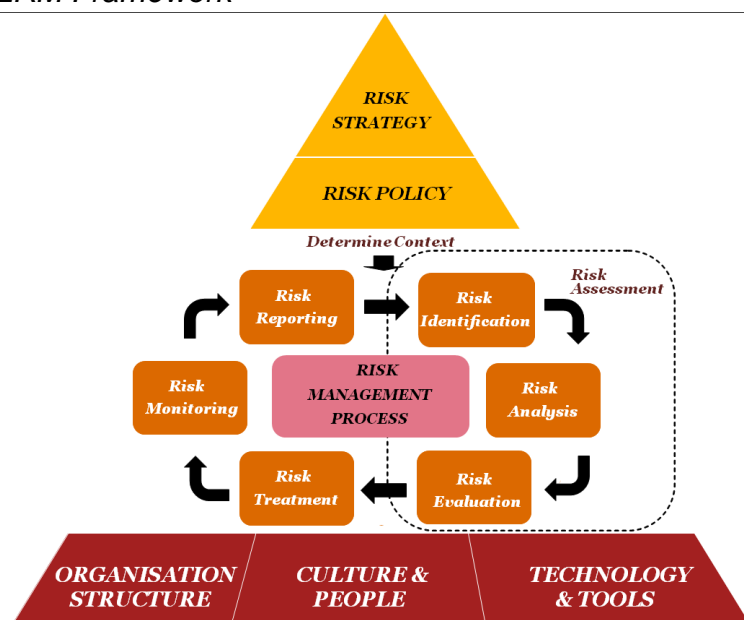
### ERM and internal control frameworks

#### *Establish an ERM framework*

3.3.29 AC members should ensure that there is an ERM framework in place that enables risks and internal controls to be identified, assessed, managed, monitored and reported.

3.3.30 Although there is no definitive model of an ERM framework that fits all companies, there are certain common characteristics embodied in internationally recognised risk management standards and in the leading risk management frameworks operating in practice. An illustrative ERM framework is presented in Diagram 4<sup>33</sup>.

Diagram 4: ERM Framework



Source: 2011© PricewaterhouseCoopersLLP All rights reserved, Reproduced with permission

3.3.31 The Board, when considering a possible ERM framework for the company, may wish to have regard to the following six common characteristics of leading, sustainable international risk management frameworks:

- (i) Risk Strategy and Policy
  - The consideration of risk as a company sets its strategic direction
  - How risk is considered as a company allocates its capital across competing priorities
  - How risk is reflected in the policies that are adopted

<sup>33</sup> Sections 6.5 and 6.7, pages 12 and 13 of Risk Governance Guidance for Listed Boards

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- (ii) Risk Process - How risk is identified, assessed and responded to in day to day activities
- (iii) Risk Structure - The specific risk management functions and responsibilities established to sustain the focus on risk management
- (iv) Culture - The culture and behaviours that need to be developed and sustained to support effective risk management and reinforce - doing the right thing naturally
- (v) Risk Systems and Tools - The systems and tools used to facilitate the risk management process
- (vi) Assurance - How assurance is gained over the effective operation of the risk management framework and continuously improved over time

3.3.32 AC members should ensure that there is a risk policy in place. A risk policy<sup>34</sup> is a critical component of the ERM framework as it sets the objectives, key roles and responsibilities, identifies key activities and sets boundaries of the ERM framework. *Refer to “Appendix C – Understanding what Constitutes a Sound System of Risk Management and Internal Controls” of the Risk Governance Guidance for Listed Boards.*

3.3.33 AC members should ensure that the company’s level of risk tolerance has been defined<sup>35</sup>. *Refer to “Appendix D – Setting Risk Tolerance” of the Risk Governance Guidance for Listed Boards.*

3.3.34 Risk tolerance may vary according to the various categories of risks the company may face. ACs should therefore recognise that risk tolerance levels have to be capable of being expressed differently for different classes of risk and at different levels of the organisational structure.

3.3.35 Setting risk tolerance is ultimately a Board decision but the Board may delegate oversight of the process to the AC. The risk management policy should describe the tolerance for various classes of risk and how much of each type of risk can be taken without endangering the organisation.


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<sup>34</sup> Appendix C – “Understanding What Constitutes a Sound System of Risk Management and Internal Controls” of the Risk Governance Guidance for Listed Boards

<sup>35</sup> Guideline 11.1 of the Code

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Key guidance 5:	
	<p><b>Risk tolerance may be expressed in different forms</b></p> <p>AC members should confirm/review the company's risk tolerance. The company's risk tolerance may be expressed in different ways, depending on the nature of business and types of risks they face. Such methods include, but are not limited to:</p> <ul style="list-style-type: none"><li>• Statements - translate the corporate strategy into explicit statements of risk</li><li>• Measures - quantitative and qualitative metrics which can be used to articulate the statement</li><li>• A limit framework - determines the limits or thresholds against the measures</li><li>• A governance framework - states the roles and responsibilities of individuals charged with delivering risk appetite</li></ul>

### ***Establish an internal control framework (e.g. COSO – Integrated Framework)***

3.3.36 AC members should ensure that the company has considered and established an internal control framework (as part of the ERM framework).

3.3.37 The COSO Internal Control Framework is a leading framework that ACs can consider. An overview of the COSO Internal Control Framework is set out at **Appendix C3**.


Key guidance 6:	
	<p><b>Internal control principles and characteristics</b></p> <p>AC members should consider the principles and characteristics of the internal control system to assist in forming a view about the adequacy and effectiveness.</p> <p>The system of internal control should:</p> <ul style="list-style-type: none"><li>• be integrated with the operations of an organisation and be integral to its culture;</li><li>• be capable of responding quickly to risks arising from factors within the organisation and changes in the business environment; and</li><li>• include procedures for timely reporting to appropriate levels of management any significant control slippages or weaknesses together with remedial action undertaken.</li></ul>

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	<p>In addition, internal control procedures should, as far as possible, be kept simple, and ensure that:</p> <ul style="list-style-type: none"><li>• the costs of such procedures do not outweigh the benefits; and</li><li>• staff at all levels are aware of the importance of maintaining adequate controls, not alienated by unnecessary complexity in implementing it.</li></ul>
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### FAQ 16:

	<p><b>Establishing risk management and internal control systems</b></p> <p><b>Q:</b></p> <p>I am an AC member for a newly listed company that does not have formally established risk management and internal control systems. How do I establish adequate and effective risk management and internal control systems?</p>
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### A:

The first step in establishing adequate and effective risk management and internal control systems is understanding your business.

For example, a financial institution compared to a packaging company has a very different set of regulatory drivers, risks and stakeholder expectations. Financial institutions require much more sophisticated risk quantification tools (due to their inherent levels of systemic financial risks associated with their complex risk profiles) compared to the packaging company (which may carry more operational risks).

AC members should make enquiries of Management to explain the key objectives and approach of the risk management and internal control systems and confirm that these are appropriate for the company. For example, the risk language may need to be considered to ensure all participants in the risk process understand and engage in the process.

AC members should also consider how peer companies have disclosed and explained their risk frameworks through review of annual report disclosures and/or industry enquiries.

AC members must satisfy themselves that Management has a consistent and clear understanding of the risk management and internal control systems which at a minimum includes clearly defining and communicating (at all levels of the company):

- Risk management policy
- Risk management roles and responsibilities

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- Risk tolerance
- Risk parameters
- Risk assessment process
- Risk reporting and escalation process (including risk profile, risk and control registers, risk action plans)
- Risk aware culture (including risk training and awareness for key personnel in the company)

### ***'Risk-Aware' Culture***<sup>36</sup>

3.3.38 AC members should ensure that there is an appropriate 'risk-aware' culture in the organisation.

3.3.39 Given that risk is inherent in everything that a company does, every person in the company should be involved in identifying, assessing, managing and monitoring risks. Whilst the Board is ultimately responsible for the company's management of risk, a 'risk-aware' culture needs to be in place throughout the organisation for risk management to be effective.

3.3.40 The Board, AC and Management are collectively responsible for the prevention and detection of fraud and errors in financial reporting. They need to set the right tone, create and maintain a culture of integrity complemented by sound ethics, and establish appropriate controls to prevent and detect fraud or errors in financial reporting.

#### **Key guidance 7:**



#### **Indicators of a poor risk culture**

AC members should be aware of the following situations that may indicate a poor risk culture exists in the organisation:

- Risks are not identified/escalated in a timely manner i.e. there is no early warning of risk events and Management are often responding to 'issues/incidents'
- Risk is considered in isolation from strategic planning and/or major decision making in the organisation
- Risks identified in the risk profile are generic and do not appear to change significantly over time
- Risks are assessed and reported separately by function/division e.g. financial risks are rated and reported differently from operational risks

<sup>36</sup> Appendix K – "Setting and Instilling the Right Culture" of Risk Governance for Listed Boards

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	<ul style="list-style-type: none"><li>• Risks and mitigating actions are not regularly reviewed/debated by the AC as other agenda items take priority</li><li>• Risk mitigating actions are often overdue and not prioritised to be implemented effectively</li><li>• There is limited guidance or explanation about how the risk, internal control and assurance framework link together</li></ul>
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### Assurance Framework

#### *Establish an assurance programme*

3.3.41 AC members should confirm their understanding of the company's assurance programme over risk management and internal controls. This programme should contain a balance of mechanisms from the assurance process, management assurance and independent assurance.

#### *Assurance process*

3.3.42 To assess the adequacy and effectiveness of Management's efforts in risk management and internal controls, the AC should request Management present an update of risk management efforts. The update should cover the following areas:

- **Assessment of the company's key risks**
- **Identification of specific 'risk owners'** who are responsible for the risks identified
- **Description of the processes and systems** in place to identify and assess risks to the business and how risk information is collected on an ongoing basis
- **On-going gaps in the risk management process** such as system limitations in capturing and measuring risks, as well as action plans to address the gaps
- **Status and changes in plans undertaken by Management** to manage key risks
- **Clarification of the roles and responsibilities of executives** managing each risk
- **Description of the risk monitoring and escalation processes** and also systems in place



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3.3.43 Furthermore, the AC should consider the need for Management to prepare the following documents to clarify the assurance coverage, including:

- Mapping key risks to key controls
  - Mapping key risks/key controls to processes (heat map)
  - Identifying sources of assurance and management rating of key controls
- Refer to “Appendix I – The Enterprise Summary (“Helicopter View”) of the Risk Governance Guidance for Listed Boards.*

### **Management Assurance**

#### *Control self-assessment*

3.3.44 A control self-assessment programme is a tool that Management can use to assess the control effectiveness as well as business processes within the organisation. The programme allows Management and staff directly responsible for the business function, to work together in the identification and assessment of risk, as well as the design of internal controls and business processes to address these risks. By empowering staff with participation in a risk management process, increases their awareness for risk and reinforces their responsibility and accountability for internal controls.

3.3.45 Where Management has carried out internal control self-assessment exercises, to validate the design and/or operating effectiveness of internal controls, the AC should request that Management report, at least once a year, on the nature of the self-assessment procedures performed, as well as the results of such self-assessments.

3.3.46 Should there be significant control weaknesses identified in the internal control self-assessment exercise, the AC should request Management to explain the impact and the actions taken to rectify them. Such discussions should be documented in the AC meeting minutes.

3.3.47 The AC should assess Management’s efforts in promoting such a ‘risk-aware’ culture. Steps in this direction would include the existence of a control self-assessment programme, risk workshops and other risk discussion forums which together promote awareness of risks and controls for staff at all levels. Management can either conduct training on risk management themselves, or with the assistance of external consultants. An effective knowledge management programme promoting and heightening risk awareness should also be put in place.

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3.3.48 To assess the effectiveness of the internal control self-assessment results, the AC could engage internal auditors or an external adviser to conduct an independent review of a sample of the self-assessment responses. The independent reviewer's findings would provide the AC with an understanding of the Management's attitude towards risk and control issues.

*CEO/CFO (and other key management personnel) risk and control certifications*

3.3.49 The AC should arrange for the CEO and the CFO to sign an undertaking confirming their awareness and respective responsibilities for risk management and internal controls, that they have designed the risk management and internal control systems that are appropriate for the business and that the risk management and internal control systems are operating effectively.

3.3.50 In addition, the AC should discuss with Management significant deficiencies in the design or operation of the risk management and internal control systems and any changes that arise. Depending on the complexity of the business, ACs may extend this discipline to other selected management executives of the Group.

### Key guidance 8:



#### **CEO and CFO risk and control certifications**

The assurances provided by the CEO and CFO regarding the effectiveness of the risk management and internal control systems should be based on conclusions/evidence gathered from reviews/checks performed to enable the declaration to be made confidently, without being false or misleading.

These declarations could confirm that the CEO and CFO:

- **Are responsible for establishing and maintaining a system of risk management and internal controls**
- **Have designed such risk management and internal controls** to ensure that material information relating to the company, its consolidated subsidiaries and equity-accounted associates is made known on a timely basis to the CEO and CFO by others within those entities
- **Have evaluated the effectiveness** of the company's risk management and internal controls and reported to the AC based on an up-to-date evaluation of the risk management and internal controls

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	<ul style="list-style-type: none"><li>• <b>Have disclosed to the company's auditors and the AC</b> (a) all significant deficiencies in the design or operation of risk management and internal controls which could adversely affect the company's ability to record, process, summarise, or report financial data and (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the company's risk management and internal controls</li><li>• <b>Have indicated in their report</b> whether or not there are significant changes in risks and internal controls or other factors that could significantly affect risk management and internal controls to the date of evaluation, including any corrective action with regard to significant deficiencies and material deficiencies.</li></ul>
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### *Fraud risk management*

3.3.51 The AC should review the existing internal controls implemented by Management so that anti-fraud programmes are adequately established within the company. This provides the Board with reasonable assurance that frameworks are in place to identify fraud risks. It may include a whistle-blowing policy and procedures for escalating suspicious transactions or behaviour to the Board and Management. For further guidance on whistle-blowing, please refer to the section on whistle-blowing.

3.3.52 The AC could request Management to report all cases of suspected and actual frauds, thefts and breaches of laws at each AC meeting. Management's reporting on such cases should be documented in the AC meeting minutes and shared with the Board.

3.3.53 The AC could engage the internal auditors to critically evaluate the framework designed by Management to identify and assess potential fraud risks and management override of controls. In situations where there are specific concerns, the help of external forensic specialists may be required to supplement the work of the internal auditors. Management should report to the AC the actions developed to address weaknesses highlighted in the review. This exercise should be carried out at least once a year.

3.3.54 The AC could also consider whether there are any areas of particular fraud risk that require special attention or monitoring by the internal auditors.

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3.3.55 In evaluating the review performed by internal auditors in connection with potential fraud, the AC could consider the following questions:

- Do the audit procedures address fraud risks?
- What are the fraud risks identified by the auditors?
- What is the auditor's assessment of fraud based on their enquiries with Management?
- How has the risk of Management override of internal controls been addressed in the audit procedures?

### FAQ 17:



#### Fraud risk management

**Q:**

What should the AC do if fraud is discovered?

**A:**

In accordance with the Listing Rule 719(2) / Catalist Rule 719(2), the AC should discuss the facts of the case with the external auditors and, where appropriate, seek professional advice. The AC should also escalate the issue to the Board at an appropriate time.

Following this, the AC could call upon the internal auditors, the external auditors or other relevant specialists to conduct an investigation to determine the following:

- How the fraud was committed
- Motivation for the fraud
- Impact of the fraud – financial, operational, reputation

Where the fraud is attributable to one or more of the following factors, the AC may need to take appropriate steps to address each of them:

- **Internal control weakness**

The AC could ask Management to confirm that immediate action plans have been taken to address the gaps. The internal auditors should also report to the AC on the adequacy of these action plans.

- **Management override**

The AC could request the internal auditors to recommend enhancements of the oversight mechanisms to prevent, deter, or detect Management override of internal controls. The AC could also recommend to the Board the disciplinary or legal actions to be taken against the personnel responsible.

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- **Override by the Controlling Shareholder, Board members or Senior Management**

Where the suspected perpetrators include the controlling shareholder or an Executive Director, the AC may need to seek professional advice, as appropriate, on actions necessary to ensure that the interests of the minority shareholders are protected.

The AC could make recommendations to the Board to suspend the duties of the personnel involved, take action to safeguard the assets of the company, and report to the authorities, where appropriate.

Consideration should be given to the need for discussions with the regulators. Where the investigation commissioned by the AC is or may be obstructed by Management, the AC should consider what powers the regulators might have to facilitate investigations. For example, the SGX has the power to direct the company to appoint special auditors to investigate the company's affairs, as do the regulators of certain financial institutions. In such situations, a dialogue with the regulators could expedite the investigations.

*For guidance on financial reporting fraud, please refer to the section on Financial Reporting and for more information on the AC's role in fraud investigations, please refer to the Whistle-blowing section.*


### *Data analytics*

3.3.56 Where appropriate, AC members should make enquiries as to the use of Data Analytics ("DA") with the organisation.

3.3.57 DA provides a means of viewing large amounts of data in a format that can provide transparency not attainable through any other selective transaction based monitoring procedure. DA ensures a much higher level of coverage, further insight into business, quantification of financial impact of business decisions, accounting, practices and internal controls.

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<b>Key guidance 9:</b>	
	<p><b>Benefits of Data Analytics</b></p> <p>If used properly data analytics can be invaluable to auditors and management alike in their risk management and internal control efforts.</p>
<b>Assist auditors to improve the effectiveness and coverage of testing...</b>	<b>Support management's continuous monitoring and surveillance efforts...</b>
<ul style="list-style-type: none"> <li>• 100% population testing</li> <li>• Identification of key vulnerabilities and evaluate current performance</li> <li>• Recommendation of practical changes to systems and processes for subsequent implementation</li> <li>• Impact analysis testing (as a change of line of business, mergers, spikes in activity)</li> <li>• Re-performance (calculations, regulatory reporting, error reports, system feeds, financial reports)</li> <li>• End to End system/ process testing</li> </ul>	<ul style="list-style-type: none"> <li>• Surveillance system optimisation, tuning and implementation</li> <li>• Dashboard development</li> <li>• Extension of operational capabilities and interfaces of existing fraud and compliance solutions and platforms</li> <li>• Key Performance Indicators monitoring</li> <li>• Key controls monitoring</li> <li>• Management reporting</li> </ul>
<b>Facilitate risk reporting and analytic assessments</b>	
<ul style="list-style-type: none"> <li>• Risk and compliance assurance</li> <li>• Independent model validation</li> <li>• Quantitative assessment and back testing</li> <li>• Upgrading risk and analytic platforms</li> <li>• Risk and finance data governance and integration</li> <li>• Regulatory compliance monitoring and assessment</li> </ul>	

### *Other Management assurance mechanisms*

3.3.58 AC members should consider all types of Management assurance mechanisms and select those that are relevant to their organisation. Examples of other types of Management assurance mechanisms include but are not limited to Quality Assurance Reviews, continuous auditing/monitoring and Key Control Indicators.

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### *Independent Assurance*

3.3.59 Depending on the scale and complexity of business operations, the AC should consider the need to engage internal auditors or external consultants to conduct an independent review of the risk management framework and the effectiveness of existing risk management controls or risk mitigation plans and to make recommendations to enhance these controls. The need and frequency of such a review would be determined based on the circumstances of the business and its risk environment.

*Appendix C of Risk Governance Guidance for Listed Boards provides guidance on what constitutes a sound system of risk management and internal controls and Appendix L of Risk Governance Guidance for Listed Boards sets out sample questions to ask when reviewing Risk Management and Internal Controls Systems.*

### *Internal Audit*

3.3.60 The AC is responsible for directing the IA function. Balancing other matters, this requires that the AC decides on the extent of IA resources required and approves the scope of work proposed by the internal auditors. The AC should require the internal auditors to benchmark their evaluation of internal controls against an internationally recognised framework, such as the Committee of Sponsoring Organizations of the Treadway Commission. This benchmark may help identify and address major risk and control issues.

3.3.61 Where the company has complex operations or systems and specialised skills are not available within the IA team, the expertise of the IA team could be augmented by the addition of external specialists (e.g. forensic and information technology specialists). These specialists could be engaged on a project or retainer basis.

3.3.62 Should there be significant control weaknesses identified in the IA reports, the AC should take additional steps to understand the root cause of each weakness. The AC could request Management officials directly involved to explain the underlying causes and ask senior Management to report on the actions planned to rectify them.

3.3.63 The AC should also request the internal auditors to confirm, on an on-going basis, the implementation of actions agreed by Management in response to previous reports by the internal auditors, the external auditors or the regulators. Their reporting on these remedial actions should be presented at each AC meeting.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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3.3.64 At each AC meeting or upon request by the internal auditors, the AC should have a private discussion with the internal auditors, without the presence of Management to discuss any sensitive issues arising from the internal auditors' work.

### *External Audit*

3.3.65 The AC should request the external auditors to present their findings on internal control weaknesses noted during their statutory financial audits and highlight findings which are disputed by Management or where Management has not agreed to implement remedial actions which would rectify the reported weaknesses.

3.3.66 At each AC meeting where the external auditors report on their findings, or upon the request of the external auditors, the AC should have a private discussion with the external auditors, without the presence of Management, to discuss any sensitive issues arising from the external auditors' findings.

### ***Assessing the control environment***

3.3.67 The AC plays an important role in ensuring that the Board and Management put in place an appropriate culture promoting ethical behaviour. To assess whether top Management sets the right tone that supports risk-conscious attitudes, the AC could consider whether these concerns exist<sup>37</sup>:

- **The Board thinks that risk management is 'not its problem'**
- **The company is focused only on internal financial controls** rather than the wider scope of internal controls
- **Reviewing internal controls is regarded only as a regulatory exercise** for the purpose of making a public statement, rather than embedded as part of the business
- **Risk management is seen as a narrow area of the business** where responsibility is delegated to a specified function, e.g. internal auditors or insurance
- **The company has not identified any key risks**
- **Employees have no training or experience** in risk management

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<sup>37</sup> Hong Kong Institute of Certified Public Accountants, June 2005, 'Chapter C: Responsibilities for Internal Control and Risk Management, and the Process of Review', *Internal Control and Risk Management – A Basic Framework*, Section 2.0 'Board Policies', paragraph 2.5 pg 21



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3.3.68 The AC could engage the internal auditors or external advisers to assess the effectiveness of and compliance with the company's code of ethics. The internal auditors or external advisers should report their findings directly to the AC. Management should report to the AC on the actions proposed to address any internal control weaknesses reported.

3.3.69 Regular meetings with key Management, internal and external auditors and the company's compliance staff can also facilitate the AC's understanding of the company's control environment.

### Evaluating Control Deficiencies with Respect to the Risk Management and Internal Control Systems

3.3.70 The AC is responsible for conducting a review of the adequacy and effectiveness of the risk management<sup>38</sup> and internal control systems<sup>39</sup>. It is important that ACs confirm a common understanding of the concepts in relation to identifying deficiencies in the risk management and internal control systems.

Please refer to **Appendix C4** for an illustrative guide, highlighting one way to define and develop control deficiency evaluation processes.

#### Key guidance 10:



#### Control deficiency consideration

When identifying control deficiencies, it is important to note that it does **not** depend on whether an event (with financial and/or non-financial consequences) has actually occurred.

AC members should consider whether there is a **possibility** that the Group's internal controls will fail to prevent or detect the achievement of objectives relating to the risk management and internal control systems.

<sup>38</sup> If the AC is tasked by the Board to oversee the company's risk management framework and policies under Guideline 11.4 of the Code

<sup>39</sup> Guideline 12.4 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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3.3.71 The AC should ensure that Management has established a process to:

- **Identify control deficiencies:** including defining key concepts and processes to evaluate the adequacy and effectiveness of the risk management and internal control systems;
- **Evaluate the severity of control deficiencies:** including prioritising and aggregating control deficiencies in relation to the risk management and internal control systems; and
- **Action, report and disclose control deficiencies:** including defining timeframes for rectifying the deficiency, reporting and escalation mechanisms and impact on disclosure obligations

3.3.72 The AC should carefully consider those control deficiencies assessed as not being adequate and/or not being effective (when aggregated at a Group level) as they present a higher chance for reportable deficiencies to occur.

### Disclosure requirements

#### ***Assurance from CEO and CFO on the effectiveness of risk management and internal controls***

3.3.73 The Board and AC should receive assurance from CEO and CFO that financial records are maintained and that the risk management and internal control systems are effective. This should be disclosed in the Annual Report<sup>40</sup>. Typically, for the CEO and CFO to provide assurance to the AC, a formal control self-assessment certification program would be established across the organisation to raise awareness of risk management and internal control responsibilities and provide the basis to support the assurance furnished by the CEO and CFO to the AC.

3.3.74 The AC should perform sufficient due diligence on the process adopted. AC members should make enquires about and review the process that the CEO and CFO adopted to arrive at their conclusion regarding risk management and internal control effectiveness. *Refer to “Appendix M – Providing Commentary on Risk Management and Internal Controls” of the Risk Governance Guidance for Listed Boards.*

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<sup>40</sup> Guideline 11.3 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

### ***Board comment on the adequacy and effectiveness of risk management and internal control systems***

3.3.75 The AC should undertake an annual assessment for the purpose of assisting the Board to make its public statement in the Annual Report on the adequacy and effectiveness of the company's risk management and internal control systems as recommended under Guideline 11.3 of the Code. The assessment should consider issues dealt with in reports reviewed by the AC during the year together with any additional information necessary to ensure that the AC has taken account of all significant aspects of risks and internal controls for the company for the year under review and up to the date of approval of the annual report and accounts<sup>41</sup>.

<b>Key guidance 11:</b>	
	<p><b>ACs annual assessment of the adequacy and effectiveness of internal controls</b></p> <p>The AC's annual assessment should in particular consider the:</p> <ul style="list-style-type: none"><li>• Changes in the nature and extent of significant risks, and the company's ability to respond to changes in its business and the external environment</li><li>• Scope and quality of management's ongoing monitoring of risks and of the system of internal controls, and, where applicable, the work of its IA function and other providers of assurance</li><li>• Extent and frequency of the communication of the results of the monitoring to the Board or appropriate committee(s) which enables it to build up a cumulative assessment of the state of internal controls in the company and the effectiveness with which risk is being managed</li><li>• Incidence of significant internal controls failings or weaknesses that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the company's financial and/or non-financial performance or condition</li><li>• Effectiveness of the company's public reporting processes</li></ul>

<sup>41</sup> Appendix H – "Risk Assurance and the Annual Assessment" of the Risk Governance Guidance for Listed Boards

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

3.3.76 In order to obtain assurance that the company's risks are managed adequately and effectively, it is necessary to have an overview of the company's risks, as well as an understanding of the mechanisms put in place to address these risks. Management's role is to assist the AC in developing this understanding. Appendices I and J of the Risk Governance Guidance for Listed Boards provide examples/illustrations of what can be done in terms of documentation to support this.

3.3.77 The AC (or appropriate committee) may commission an independent audit for its assurance, or where it is not satisfied with the company's system of risk management or internal controls.

### FAQ 18:



#### Preparing accurate, timely and complete disclosures

**Q:**

What do I do as an AC member where gaps in the risk management and internal control systems are identified? How do I disclose deficiencies?

**A:**

AC members must work with Management to develop a clear understanding of what constitutes a significant/material break down of key internal controls, with respect to the risk management and internal control systems. This should take into account materiality (financial and non-financial impact) and the type of deficiency noted, for example, whether it was a gap, lapse or an enhancement relating to adequacy (design) and effectiveness (operating as intended).

As an AC member you should encourage your organisation to commence the process for reviewing the risk management and internal control systems early in the year to enable deficiencies to be identified and rectified where possible prior to financial year-end disclosure/reporting periods.

Where deficiencies regarding key internal controls for significant risk areas are not rectified prior to financial year-end, the AC should:

- request Management to prepare a report regarding the deficiencies and what is being done to rectify them;
- request an independent audit to validate the results of the internal control deficiencies; and
- where the deficiency is a genuine failure, then the AC should identify where the risk management and internal control systems are deficient, stating reasons for the deficiency(ies) and what action plans have been initiated/implemented to rectify it.

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## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

3.3.78 The AC should consider the extent to which control deficiencies, with respect to risk management and internal control systems, are identified, assessed and/or aggregated at a Group level (where subsidiary structures exist) to determine whether there are material deficiencies in the risk management and internal control systems.

3.3.79 To the extent that material deficiencies in the risk management and internal control systems remain unrectified at the financial year-end, the AC (and Board) should ensure that Management has provided an adequate explanation for what is being done to address the material deficiencies (that includes information needed by stakeholders to make informed assessments about the risk management and internal control systems). The AC should incorporate this into the report to the Board regarding the adequacy and effectiveness of risk management and internal control systems.

3.3.80 The Board's comment should reflect the conclusion reached regarding the adequacy and effectiveness of the risk management and internal control systems, covering financial, operational, compliance and information technology controls. This should be based on the extent of material deficiencies identified and reported individually and on an aggregated basis.

### ***Opinion (with basis) on the adequacy of internal controls***

3.3.81 The Board with the concurrence of the AC should provide an opinion regarding the adequacy of the internal controls over financial, operational and compliance risks (to be disclosed in Directors' Report or Corporate Governance Section of Annual Report)<sup>42</sup>. Furthermore, the disclosures must outline the basis for the opinion for examples of disclosures – refer to examples provided in SGX Practice Note 12.2 / Catalist Practice Note 12B.

3.3.82 To the extent that material deficiencies relating to the adequacy of the internal controls over financial, operational and compliance risks remain unrectified at the financial year-end, the Board should ensure that Management has provided a robust explanation of the action plans to address the material deficiencies. The Board should disclose material deficiencies (and what is being done to rectify them) relating to the adequacy of the internal controls over financial, operational and compliance risks as part of the opinion.

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<sup>42</sup> SGX Listing Rule 1207(10)

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

3.3.83 To assist Boards in preparing meaningful disclosures in relation to the opinion on the adequacy of internal controls (and increasingly the Board's comments on the adequacy and effectiveness of risk management and internal control systems), example disclosures are outlined in the table below.

Refer to **Appendix C5** for further guidance on determining the opinion on the adequacy of internal controls.

<b>Type of opinion</b> (in relation to SGX LR 1207(10) / CR 1204(10) requirements)	<b>Example disclosures</b>
<b>Clean opinion</b>	The Board, with the concurrence of the Audit Committee, are of the opinion that the Group's internal controls, addressing financial, operational, compliance and information technology controls, and risk management systems were adequate and effective as at [date].
<b>Adverse opinion</b>	The Board, with the concurrence of the Audit Committee, are of the opinion that the Group's internal controls, addressing financial, operational, compliance and information technology controls, and risk management systems were <b>not</b> adequate and effective as at [date].  The following material deficiency(ies) were identified: <i>1) [Details of material deficiency to be provided]</i>  The following actions have been identified to address the material deficiencies: <i>1) [Details of actions to address material deficiencies to be provided]</i>

3.3.84 Currently, the Board's opinion is stated as either positive ('clean') or negative ('adverse'), depending on whether 'material' deficiencies were identified and remained un-rectified at the time of disclosure.

# **GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE**

## **SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS**

3.3.85 There may, however, be situations where some Boards (and Audit Committees) deem it necessary to disclose additional information, regarding the adequacy and effectiveness of risk management and internal control systems. Such information may relate to significant (but not material) deficiencies and/or material changes to the risk management and internal control systems.

3.3.86 Whilst evaluation of this information will not affect their ability to issue a 'clean' opinion, some Boards (and Audit Committees) may, at their own discretion, choose to provide greater transparency and context to users of the information.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

### 3.4 Regulatory Requirements and Guidelines

*The following list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook. They are only summaries for ease of reference and it is advisable to refer to the actual section or rule in its entirety when applying it to particular situations or events.*

#### *Risk Management and Internal Controls*

- 3.4.1 **The Code Principle 11:** The Board is responsible for the governance of risk. The Board should ensure that Management maintains a sound system of risk management and internal controls to safeguard shareholders' interests and the company's assets, and should determine the nature and extent of the significant risks which the Board is willing to take in achieving its strategic objectives.
- 3.4.2 **The Code Guideline 11.1:** The Board should determine the company's levels of risk tolerance and risk policies, and oversee Management in the design, implementation and monitoring of the risk management and internal control systems.
- 3.4.3 **The Code Guideline 11.2:** The Board should, at least annually, review the adequacy and effectiveness of the company's risk management and internal control systems, including financial, operational, compliance and information technology controls. Such review can be carried out internally or with the assistance of any competent third parties.
- 3.4.4 **The Code Guideline 11.3:** The Board should comment on the adequacy and effectiveness of the internal controls, including financial, operational, compliance and information technology controls, and risk management systems, in the company's Annual Report. The Board's commentary should include information needed by stakeholders to make an informed assessment of the company's internal control and risk management systems. The Board should also comment in the company's Annual Report on whether it has received assurance from the CEO and the CFO:
- (a) that the financial records have been properly maintained and the financial statements give a true and fair view of the company's operations and finances; and
  - (b) regarding the effectiveness of the company's risk management and internal control systems.



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## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

3.4.5 **The Code Guideline 11.4:** The Board may establish a separate Board Risk Committee or otherwise assess appropriate means to assist it in carrying out its responsibility of overseeing the company's risk management framework and policies.

### *Audit Committee*

3.4.6 **CA Section 201B(5)(a)(ii):** The functions of an AC shall be to review with the auditor, his evaluation of the system of internal accounting controls.

3.4.7 **The Code Guideline 12.4(b):** The duties of the AC should include reviewing and reporting to the Board at least annually the adequacy and effectiveness of the company's internal controls, including financial, operational, compliance and information technology controls (such review can be carried out internally or with assistance of any competent third parties).

### *Content of Prospectus, Offering Memorandum and Introductory Document*

3.4.8 **Listing Rule 610(5) / Catalist Rule 407(4)(b):** The prospectus, offering memorandum, introductory documents and shareholders' circular should include an opinion of the Board, with the concurrence of the Audit Committee on the adequacy of the internal controls, addressing financial, operational and compliance risks.

### *Appointment of Special Auditors*

3.4.9 **Listing Rule 704(14) / Catalist Rule 704(13):** The Exchange may require an issuer to appoint a special auditor to review or investigate the issuer's affairs and report its findings to the Exchange or the issuer's Audit Committee or such other party as the Exchange may direct. The issuer may be required by the Exchange to immediately announce the requirement, together with such other information as the Exchange directs. The issuer may be required by the Exchange to announce the findings of the special auditors.

### *Suspected Fraud or Irregularity*

3.4.10 **Listing / Catalist Rule 719(1):** An issuer should have a robust and effective system of internal controls, addressing financial, operational and compliance risks. The Audit Committee (or such other committee responsible) may commission an independent audit on internal controls for its assurance, or where it is not satisfied with the systems of internal control. For Catalist issuers, the Audit Committee should consider the recommendation of the continuing sponsor.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

**3.4.11 Listing / Catalyst Rule 719(2):** If the Audit Committee of an issuer becomes aware of any suspected fraud or irregularity, or suspected infringement of any Singapore laws or regulations or rules of the Exchange or any other regulatory authority in Singapore, which has or is likely to have a material impact on the issuer's operating results or financial position, the Audit Committee must discuss such matter with the external auditor and, at an appropriate time, report the matter to the Board and to the sponsor (for Catalyst issuers). The sponsor of the Catalyst issuer should inform the Exchange where necessary.

### *Annual Reports*

**3.4.12 Listing Rule 1207(10) / Catalyst Rule 1204(10):** The annual report must contain an opinion of the Board, with the concurrence of the Audit Committee on the adequacy of the internal controls, addressing financial, operational and compliance risks.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

### Contents

Section	Sub-section
4.1 Table of Regulatory Requirements and Guidelines	-
4.2 Best Practices	<ul style="list-style-type: none"><li>• Establishing an IA Function</li><li>• Considerations for an In-house IA Function</li><li>• Considerations for an Outsourced IA Function</li><li>• Common Issues Relating to the AC's Oversight on the IA Function</li></ul>
4.3 Regulatory Requirements and Guidelines	-

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

### 4.1 Table of Regulatory Requirements and Guidelines

(Detailed regulatory requirements and guidelines in 4.3)

<b>Regulatory Requirements</b> [Mandatory Compliance]	<b>Guidelines</b> [Comply or Explain]
<p style="text-align: center;"><u><i>Audit Committees</i></u> CA Section 201B(5)(a)(v)</p>	<p style="text-align: center;"><u><i>Audit Committees</i></u> Code Guideline 12.4(c) Code Guideline 12.5</p> <p style="text-align: center;"><u><i>Internal Audit</i></u> Code Principle 13 Code Guideline 13.1 Code Guideline 13.2 Code Guideline 13.3 Code Guideline 13.4 Code Guideline 13.5</p>

*The above list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook.*


# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

### 4.2 Best Practices

#### Establishing an IA Function


##### 4.2.1 IA is an important function to assist the Board in discharging its duties

FAQ 19:	
	<b>Requirement to Establish an IA Function</b> <b>Q:</b> Should a listed company have an IA function?
<b>A:</b> The Code recommends the establishment of an IA function to assist the AC in discharging its responsibilities <sup>43</sup> . The Companies Act envisages that each listed company has in place an IA function and tasks the AC with the review of the scope and results of the IA procedures.  Many companies have an IA function set up in one of these ways: <ul style="list-style-type: none"><li>• In-house function<ul style="list-style-type: none"><li>– IA team set up within the company</li><li>– Parent company IA function utilised on a cost-sharing basis</li></ul></li><li>• Outsourced IA function</li></ul> For a company that does not have IA arrangements in place, or is in the process of establishing such arrangements, it is critical for the AC to obtain assurance on the internal controls. In the short term, the AC could consider requesting the external auditor (subject to their agreement) to perform additional procedures in areas where the AC has concerns. In the longer term, the AC needs to consider how it discharges its responsibility in reviewing the adequacy and effectiveness of risk management systems and internal controls, if the company does not have IA arrangements.  An IA function is necessary (whether in-house, outsourced or co-sourced) given that the AC is required to review and report to the Board at least annually the adequacy and effectiveness of the company's internal controls, including financial, operational, compliance and information technology controls.	

<sup>43</sup> Principle 13 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

Case Study 12:	
	<p><b>Determining the Right IA Model</b></p> <p>This case study illustrates some of the factors an AC could consider when deciding whether to have an in-house, outsourced or co-sourced IA function.</p>
<p><b>Context</b></p> <p>The AC has decided that the company needs to have an IA function, following its rapid expansion into joint ventures in several new markets. It is not sure whether to engage in-house resources, to outsource the function to an external service provider or to have a co-source arrangement.</p>	
<p><b>Q:</b></p> <p>What are some of the factors that the AC could consider when making its decision?</p> <p><b>A:</b></p> <p>The AC could consider the following factors:</p> <ul style="list-style-type: none"><li>• <b>Scale</b> of the company's operations</li><li>• <b>Corporate culture</b> towards the outsourcing of non-core business operations</li><li>• <b>Role of the IA function</b> as a training ground for operational or Management positions</li><li>• <b>Availability of relevant expertise</b> in-house</li><li>• <b>Ability to recruit and retain</b> competent and skilled internal auditors</li><li>• <b>Need to maintain institutional knowledge and culture</b></li><li>• <b>Rights given to the company</b> in joint venture agreements with respect to the conducting IAs</li></ul> <p>Where an in-house IA function has been established, the AC can still, on an ad-hoc basis, outsource limited areas of complex or specialised work, or co-source work in respect of overseas or high risk operations.</p>	

4.2.2 **Appendix D1** summarises the benefits and drawbacks of each of the different ways in which the IA function can be set up.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

### FAQ 20:



#### **Establishing an IA Function**

This case study illustrates how an AC could address a dispute with Management regarding the establishment of an IA function

**Q:**

What could the AC do if Management (or the Chairman of the Board) does not agree with the AC on the size of the IA function that the company needs?

**A:**

The AC could seek to understand the rationale for Management or the Chairman's view that the investment in IA ought to be more limited. Where necessary, the AC could escalate this to the Board for resolution.

The AC needs to be independently minded with regard to its duty of making sure that the IA function is adequately resourced and independent of the activities it audits. In the absence of required support from the IA function, the AC should consider its ability to review and report to the Board at least annually the adequacy and effectiveness of the company's internal controls, including financial, operational, compliance and information technology controls.

### **Considerations for an in-house IA function**


#### ***Promoting the independence of an in-house IA function***

*An in-house IA function provides the AC with a ready pool of IA professionals who have in-depth knowledge of the business and who are available to conduct reviews at short notice or investigations of a sensitive nature. The IA department should work closely with management to provide the AC with timely feedback on control gaps, compliance lapses and where appropriate, Management performance.*

*Conversely, the close working relationship between Management and the IA department heightens the need for the AC to support the IA function in maintaining its independence and objectivity.*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

FAQ 21:	
	<p><b>Independence Considerations for an In-house IA Function</b></p> <p><b>Q:</b> How can the AC support independence in an in-house IA function?</p>
<p><b>A:</b> To empower the IA function with an appropriate level of independence and authority, the Head of IA should report functionally to the AC.</p> <p>The AC can further enhance the independence and objectivity of the IA function by assuming these responsibilities:</p> <ul style="list-style-type: none"><li>• <b>Provide the Head of IA with open and direct access</b> to the AC Chairman and its members at all times</li><li>• <b>Ensure an audit charter is approved by</b> the Board setting out the purpose, authority, responsibility and reporting line for the Head of IA</li><li>• <b>Ensure that the IA function is adequately resourced</b> and independent of the activities it audits</li><li>• <b>Ensure that the IA function has unfettered access</b> to all of the company's documents, records, properties and personnel</li><li>• <b>Conduct private discussion sessions</b> with the Head of IA, without Management's presence</li><li>• <b>Review the performance</b> of the Head of IA and approve his annual compensation package within the company's guidelines</li><li>• <b>Interview, select and appoint</b> the Head of IA</li><li>• <b>Have the final say</b> in the removal of the Head of IA</li><li>• <b>Carry out an exit interview</b> with a departing Head of IA to understand the reasons for his departure</li></ul>	

4.2.3 Some of the factors that the AC could consider in the appointment of the Head of IA include these factors:

- **Proficiency in IA standards**, procedures and techniques
- **Relevant industry experience** (preferred)
- **Appreciation of the fundamentals** of internal controls, risks and accounting
- **Understanding of Management principles**
- **Independence, integrity and objectivity**
- **Management skills and leadership quality**



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4.2.4 As the governing authority of the IA function, the AC should assume these functional responsibilities:

- **Approve the overall charter** of the IA function (See **Appendix D2** for a sample of an IA charter)
- **Approve the risk-based** IA plan
- **Approve the IA budget and resource plan**
- **Receive communications from the Head of IA** on the results of the IA activities or other matters that the Head of IA determines are necessary, including private meetings with the Head of IA without Management's presence
- **Approve all decisions regarding the appointment** (including remuneration package) or removal of the Head of IA
- **Provide input to the annual performance appraisal** and the salary adjustments for the Head of IA
- **Make appropriate enquiries of Management and the Head of IA**, to determine whether there are limitations in scope or budget which may impede the ability of the IA function to execute its responsibilities

4.2.5 The IA's primary line of reporting should be to the Chairman of the AC<sup>44</sup>. For administrative purposes, the Head of IA should report to the CEO or any executive with sufficient authority and stature who can provide the IA function with appropriate support. The IA function has to be well-placed in the organisation to access the proper flow of information and key executives and managers needed to carry out its duties effectively<sup>45</sup>.

4.2.6 In evaluating the appropriateness in selecting the individual responsible for the administrative reporting line for the IA function, the AC should consider these questions:

- **Does the individual have sufficient authority and stature** to ensure the adequacy and effectiveness of the function?
- **Does the individual have an appropriate control and governance mindset** to assist the Head of IA in his role?
- **Does the individual have the time and interest** to actively support the Head of IA on audit issues?
- **Does the individual understand the functional reporting relationship** and support it?

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<sup>44</sup> Guideline 13.1 of the Code

<sup>45</sup> Guideline 13.2 of the Code

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## SECTION 4: INTERNAL AUDIT

4.2.7 The administrative reporting role should be limited to the facilitation of the day-to-day operations of the IA function which typically includes:

- Budgeting and management accounting
- Human resource administration
- Internal communication and information flow
- Administration of the organisation's internal policies and procedures

### FAQ 22:



#### Considerations for an in-house IA function

**Q:**

In some companies, the IA function reports administratively to the CFO or his designate in the finance department. How can the AC support the IA function in maintaining its independence when it audits the activities performed or is supervised by the officer to whom the IA department reports?

**A:**

The AC could request the Head of IA to report on any limitation in scope or reporting of results that are imposed by the administrative reporting officer.

Where the Head of IA has reported significant restrictions on the scope of audit and the reporting of results, the AC could try to understand the situation further by discussing this with Management. Upon clarification of the facts, the AC could work with Management on a resolution that addresses Management's concerns and the Committee's need for an independent assessment of internal controls.

The AC could consider whether the IA function would be better supported if it reports administratively to the CEO instead.

#### ***Training and professional development***

*While the in-house IA team focuses on building its institutional knowledge, there may be insufficient attention to updating team members on emerging audit trends and issues. In the longer term, the IA procedures and audit skill sets may cease to be effective in addressing the increasing complexities of the business processes and systems.*

4.2.8 During the annual review of the IA plan, the AC should assess whether the in-house team has the appropriate skills to address the audit needs.

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- 4.2.9 Where the in-house team lacks the necessary specialised skills to audit areas such as information technology, treasury operations, industry, financial derivatives trading, biological assets, mining concessions or any specific industry or country experience, the AC could ask the Head of IA to explore how the company can meet immediate needs by outsourcing certain audits or engaging relevant specialists (internally or externally), or co-sourcing to support the in-house team.
- 4.2.10 Where there are longer-term needs for such specialised skills, the AC could ask the Head of IA to recruit the necessary specialists into the team or to send the existing team for training in the specialised area. Co-sourcing, involving an internal team working together with external specialists, can also provide an avenue for upgrading of specialised skills.
- 4.2.11 As part of its annual review of the IA budget, the AC should request the Head of IA to report on the nature and frequency of training and seminars attended by the staff to enhance their skill sets in specialised areas and professional IA standards. Based on the training needs, the AC should assess the adequacy of the budget set aside for the in-house team to upgrade their skills.
- 4.2.12 The Head of IA could consider engaging the external auditors to provide the requisite training on accounting standards and technical skills updates.

### ***Career development of IA personnel***

*One of the major challenges faced by an in-house IA function is the ability to attract and retain experienced staff. Reasons commonly cited for staff turnover in the in-house IA function include the lack of a career path in the organisation, limited scope of IA activities and uncompetitive remuneration packages.*

- 4.2.13 To maintain a stable and experienced team of in-house internal auditors, the AC could work with Management to develop a staff rotation programme where high performers spend a specific period in IA and are also rotated to other departments in the organisation. In some companies, the IA function is positioned as a training ground for operational and managerial executive positions. There are also other companies which establish a 'guest auditors' programme where a manager or staff from an operations or business department participates in an IA of another department. This programme enables staff outside of the IA function to appreciate the work of the IA function and build better rapport.

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4.2.14 As a matter of good practice, the AC should ask for regular benchmarking exercises to assess the competitiveness of the remuneration packages offered to IA staff.

### Considerations for an Outsourced IA Function

*An outsourced IA function offers a proposition contrastingly different from an in-house IA function.*


*An external party projects visibly enhanced independence and objectivity, and is thus a major source of reassurance to the AC. The outsourced service provider would typically also leverage its range of clients and IA techniques to provide the AC with insights into industry best practices and the latest management tools available.*

*However, periodic visits by the outsourced IA team and changes in the audit team may limit the ability of an outsourced service provider to acquire deep knowledge of the business operations and therefore its ability to offer valuable insights.*

*The key challenge for the AC in managing an outsourced IA function is to ensure that the service provider is knowledgeable about the company's business. Furthermore, it has to be willing to commit adequate resources and offer its expertise at a cost that represents the best value to the company.*

### Sourcing, Selecting and Appointing the Service Provider

4.2.15 To ensure that the outsourced IA service provider is not beholden to Management, the AC has to visibly lead the process of interviewing, selecting and approving the appointment of service providers<sup>46</sup>.

FAQ 23:	
	<p><b>Sourcing, Selecting, and Appointing the Service Provider</b></p> <p><b>Q:</b></p> <p>What could the AC consider when selecting a service provider for outsourced IA services?</p>

<sup>46</sup> Guideline 13.1 of the Code

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### A:

- **Expertise, experience and resources** in providing IA services
  - Firm's or service provider's capability and experience of similar engagements
  - Knowledge and IA experience in the industry, including knowledge of Singapore regulatory requirements, if appropriate
  - Experience and qualifications of IA team members
  - Size of the service provider's IA practice
  - Firm's or service provider's IA service support in the regional or global market
- **Audit methodology and approach** (including the audit approach towards IT systems, where appropriate)
  - Proposed IA methodology, approach and technology
  - Quality assurance procedures and commitment
  - Proposed deliverables (i.e. the form of the audit report)
- **Understanding service requirements**
  - Understanding the company's operating environment, businesses and key risks
  - Proposed IA plan
- **Fees and fee assumptions**
  - Estimated hours expected to be incurred
  - Annual fee
  - Policy on out-of-pocket expenses
  - Staff-mix, i.e. proportion of senior level resources in the team
- **Contract terms**
  - Disclaimer clauses
  - Exclusions and limitation of liability
  - Indemnity clauses
  - Ownership of intellectual property
  - Access to working papers
  - Use of the company's name for the firm's marketing purposes
  - Termination
  - Distribution of audit report
- **Independence of internal auditors**
  - Direct reporting to AC
  - No provision of other services that will render the service provider beholden to the Management

Where possible, the AC could verify the credentials and experience of the service providers through reference checks.

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4.2.16 The AC should consider the need to conduct open or closed tenders for the sourcing of an IA service provider. Where the AC has a consensus on the criteria for the service provider, Management could conduct a closed tender by inviting those firms or corporations that meet the criteria to submit bids.

4.2.17 The invitation to quote should clearly set out relevant information on the company's businesses and the expectations of the IA role to ensure that the fee quotes from the outsourced service providers reflect the complexity and scope of the company's business. Fees should not be the overriding sole criterion used to select and engage an IA outsourced provider. Where practical, Management and/or the AC should arrange for a session with each interested firm to brief them on the scope of services required and the expected role.

### FAQ 24:



#### Sourcing, Selecting, and Appointing the Service Provider

Q:

How much should a company spend on IA activities?

A:

The AC should consider obtaining the following information to arrive at a decision on the amount that the company should spend on IA activities:

- **Budget allocated by comparable companies for the IA function** which the IA service provider can help to compile
- **Fee estimates provided by different bidders** in a competitive bid process
- **Feedback from the internal auditors** on the extent of resources required to address the company's risk areas
- **Scope of IA function** as it widens to factor in new regulations and business developments

The appropriate level of spending on IA activities depends on the level of risk, complexity and scale of the business operations. The AC should use benchmarks carefully, ensuring that they are appropriate.

4.2.18 The AC should review the adequacy of the budget, ensuring that there are no budgetary limitations that would constrain the ability of the IA function to carry out its work.

4.2.19 To ensure that the outsourced IA service provider obtains information for its work and has access to key executives and managers, the AC should assign an IA coordinator to liaise with the service provider on administrative matters.

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4.2.20 The IA coordinator assigned should have sufficient authority to provide the IA function with the appropriate support to execute its audits effectively.

### **Common Issues relating to the AC's Oversight on the IA Function**

#### ***Scope of IA Activities***

*The IA function is sometimes engaged in special projects or asked to take on an advisory role to Management. In these situations, the AC needs to be able to distinguish those services that, while valuable to Management, may compromise the IA function's objectivity and distract it from its primary compliance role.*

4.2.21 The AC can authorise the internal auditors, through the IA Charter, to undertake additional specified services that the AC has concluded would not represent a conflict of interest and would not detract from its obligations to the Committee. A sample IA Charter is set out in **Appendix D2**.

4.2.22 Consulting services typically provided by internal auditors take the form of informal and formal advice, analysis and assessments. By providing consulting services, the internal auditors can deepen their knowledge and understanding of the company's business processes and issues without necessarily impairing their objectivity.


4.2.23 To ascertain if the proposed consulting services could potentially impair the auditor's objectivity, the AC should consider whether the internal auditor has taken over management decision-making functions. Where there is a decision to adopt or implement recommendations made by Management arising from the consulting services, the objectivity of the IA should not normally be threatened.

#### ***IA Plan***

4.2.24 The AC has a statutory obligation under the CA to review the scope of the IA work and ascertain if the IA plan adequately addresses key risk areas.

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## SECTION 4: INTERNAL AUDIT

FAQ 25:	
	<p><b>Assessing IA Coverage</b></p> <p><b>Q:</b></p> <p>How could the AC assess whether the coverage of the IA plan is adequate?</p>
<p><b>A:</b></p> <p>In assessing the adequacy of the coverage, the AC could consider whether these factors have been addressed:</p> <ul style="list-style-type: none"><li>• <b>A robust audit risk assessment process is in place</b> to identify key risk areas</li><li>• <b>Key risk areas are included</b> in the audit plan</li><li>• <b>Group internal controls, addressing financial, operational, compliance risks and IT risks have been addressed</b> in the audit plan</li><li>• <b>There is regular and adequate audit coverage</b> over the following:<ul style="list-style-type: none"><li>– High risk activities particularly in cases where IA resource shortage impacts on the ability to complete the annual audit plan</li><li>– Significant operations which may include:<ul style="list-style-type: none"><li>▪ Overseas operations taking into consideration the local state of corporate governance practices and standards, quality of local management expertise and stability of local political and regulatory environment</li><li>▪ Operations with significant volume of transactions or activities</li><li>▪ Operations that have material contributions to the listed entity's consolidated accounts</li><li>▪ Operations in highly regulated environments or industries</li></ul></li></ul></li><li>• <b>Where there are areas that the internal auditors may not have the expertise to audit effectively</b> or do not have access to information or Management (e.g. information technology, biological assets, mining concessions and foreign operations), such audits are outsourced to relevant specialists</li><li>• <b>The disposition of prior year findings has been reviewed</b></li></ul>	

4.2.25 Where the company has other internal compliance functions (such as legal, ethics, health and safety, security, risk management) the AC could enquire on the working relationship between the IA function and these other functions in facilitating the monitoring and reporting of material risk and control issues to the AC.



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4.2.26 To assess the effectiveness of the working relationship between the IA function and the internal compliance functions, the AC could ask the Head of IA to present the findings from their review of the work of the compliance functions and confirm if these activities have taken place:

- **Minutes of meetings of the compliance functions have been shared** with the IA function
- **The IA function has reviewed the sufficiency of the procedures** carried out by the compliance functions
- **Reports issued by the compliance functions have been circulated** to the IA function for review

4.2.27 Given that there may be areas of overlap between the work of the internal auditor and the external auditor, the AC should review the extent of reliance placed by the external auditor on the internal auditor's work. The AC should request that the auditors work with each other to minimise duplication of efforts where possible. Where there is limited or no reliance, the AC should enquire the reasons from the auditors.

4.2.28 To ensure that significant joint venture operations can be covered by the IA plan, the AC could encourage Management to include a right-to-audit clause in joint venture agreements or at the minimum, the right to receive audit reports from the joint venture partner(s).

4.2.29 For offshore subsidiaries and associated companies incorporated in countries where statutory audits are not required, the AC should consider the need to conduct an audit of those operations, taking into consideration the materiality of their contribution to the listed entity's financial statements and the extent to which the transactions in these entities have physically taken place in these countries where the controls for those economic activities are limited.

### ***Reporting***

4.2.30 The internal auditors should generally provide the following to the AC on a regular basis:

- **Independent (to the extent possible), objective assurance** and consulting activities relating to the adequacy and effectiveness of the organisation's risk management, internal controls and governance processes
- Information on the organisation's significant risk exposures and internal controls deficiencies

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

- **Incident reporting** such as security and information technology lapses
- **Gathering of information** and arranging discussions with subject matter experts, to address the AC's questions and information needs relating to risk management, internal controls and governance processes
- **Confirmation of the adequacy of the audit staff** and budget requirements, as well as the scope and result of IA activities

4.2.31 The internal auditors should also update these matters at each AC meeting:

- **Status of the audits** in the annual IA plan
- **Key findings arising** from completed audits
- **Implementation status** of outstanding Management action plans (if any)

### FAQ 26:



#### Common issues relating to the AC's oversight on the IA function

**Q:**

What should the AC look out for when reviewing the IA report?

**A:**


An executive summary highlighting the key findings:

- **Assess if the conclusion is reasonable** given the findings noted
- **Understand the basis for arriving at the ratings** and whether the ratings are consistent with the AC's desired balance of control and efficiency
- **Probe into findings or recommendations** which are disputed by Management
- **Ask Management for underlying reasons** for issues raised in the findings and ensuring that root causes are addressed
- **Assess whether Management's responses to findings address the risks** adequately
- **Assess the significance and impact of residual risk** accepted by Management

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## SECTION 4: INTERNAL AUDIT

### *Assessing the performance of the IA Function*

FAQ 27:	
	<p><b>Common issues relating to the AC's oversight on the IA function</b></p> <p><b>Q:</b> How should the AC assess the efficiency, adequacy and effectiveness of the IA function?</p>
<p><b>A:</b> The AC should, at least annually, review the adequacy and effectiveness of the IA function against agreed performance criteria (see <b>Appendix D3</b>) including:</p> <ul style="list-style-type: none"><li>• <b>The overall comprehensiveness of the IA plan</b> and its relationship to the strategic objectives of and key risks faced by the company</li><li>• <b>Delivery of timely IA services</b> in accordance with the plan</li><li>• <b>The quality of reporting and communications</b></li><li>• <b>The competence of IA staff</b></li><li>• <b>The adequacy of resources and appropriateness of the resource</b> mix to achieve the agreed mandate and audit plan</li><li>• <b>The value of the IA function</b> - whether the IA function adds value to the organisation and if so, in what ways does it best add value</li><li>• <b>Where appropriate, the extent to which the IA function is facilitating process improvements</b> and a culture of continuous improvement</li><li>• <b>A re-assessment of whether the alternative of outsourcing the IA function</b> would result in a better realisation of objectives</li></ul> <p>The AC could consider seeking comments from the external auditors on the adequacy and effectiveness of the IA function and compare the respective findings from both teams on common areas of work, as a means of gauging the quality of the IA work.</p>	

4.2.32 The AC should assess whether the IA function has access to specialised skills necessary to deal with complex treasury, technology and operating strategies employed by the company.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE


## SECTION 4: INTERNAL AUDIT

4.2.33 To obtain assurance that the IA activity is in conformity with the standards set by nationally or internationally recognised professional bodies for IA, the AC could consider engaging a qualified independent reviewer to carry out an assessment of the IA function against these standards including the Standards for the Professional Practice of Internal Auditing set by the Institute of Internal Auditors (IIA)<sup>47</sup>.

4.2.34 The IIA recommends that such an assessment to be conducted at least once every five years. Results of the assessment should be communicated to the AC and the Board. For outsourced IA functions, the AC should obtain confirmation from the service provider that their work conforms to the IIA Standards for the Professional Practice of Internal Auditing and the IIA Code of Ethics.

4.2.35 **Appendix D4** provides a sample assessment checklist for the AC to evaluate the performance of the IA function.

### *Managing disagreements between IA function and Management*

FAQ 28:	
	<p><b>Common issues relating to the AC's oversight on the IA function</b></p> <p><b>Q:</b></p> <p>Management and the internal auditors disagree on the proposed recommendation to address a control gap. What could the AC do?</p>
<p><b>A:</b></p> <p>The AC could consider these courses of action:</p> <ul style="list-style-type: none"><li>• <b>Seek to have a full understanding</b> of the issue and the areas of disagreement, by having a discussion with all parties concerned and thereafter concluding its fact-finding by taking an independent position and communicating its decision to all parties concerned</li><li>• <b>Obtain an opinion from an external adviser</b> with the relevant expertise (e.g. the external auditors)</li></ul>	


<sup>47</sup> Guideline 13.4 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

4.2.36 Where the IA findings may lead to disagreements with Management, such as when the findings touch on sensitive issues and involve senior Management, direct involvement of the AC in facilitating the discussions with Management will help the IA function to remain effective.

### *Private Session with Auditors*

Case Study 13:	
	<p><b>Private Session with Auditors</b></p> <p>This case study illustrates how an AC could handle feedback from the internal auditors regarding weaknesses in internal controls.</p>
<p><b>Context</b></p> <p>In a private discussion session with the AC, the internal auditor shared his preliminary observation that certain internal controls are unacceptably weak as a result of decisions made by Management to improve operational efficiency and that these internal controls weaknesses may have an adverse material impact on the quality of financial reporting information.</p>	
<p><b>Q:</b></p> <p>How could the AC handle the feedback?</p>	
<p><b>A:</b></p> <p>Given that the internal auditor has yet to confirm his observation, the AC could consider waiting for the conclusion of the audit before taking up the matter with Management. The AC should require the audit to be completed with urgency.</p>	

4.2.37 **Appendix D5** sets out a list of high-level questions that the AC could ask the internal auditors during the private session.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 4: INTERNAL AUDIT

### 4.3 Regulatory Requirements and Guidelines

*The following list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook. They are only summaries for ease of reference and it is advisable to refer to the actual section or rule in its entirety when applying it to particular situations or events.*

#### *Audit Committees*

- 4.3.1 **CA Section 201B(5)(a)(v):** The functions of an AC shall be to review the scope and results of the internal audit procedures.
- 4.3.2 **The Code Guideline 12.4(c):** The duties of the AC should include reviewing the effectiveness of the company's internal audit function.
- 4.3.3 **The Code Guideline 12.5:** The AC should meet (a) with the external auditors, and (b) with the internal auditors, in each case without the presence of the company's Management, at least annually.

#### *Internal Audit*

- 4.3.4 **The Code Principle 13:** The company should establish an effective internal audit function that is adequately resourced and independent of the activities it audits.
- 4.3.5 **The Code Guideline 13.1:** The Internal Auditor's primary line of reporting should be to the AC Chairman although the Internal Auditor would also report administratively to the CEO. The AC approves the hiring, removal, evaluation and compensation of the head of the internal audit function, or the accounting / auditing firm or corporation to which the internal audit function is outsourced. The Internal Auditor should have unfettered access to all the company's documents, records, properties and personnel, including access to the AC.
- 4.3.6 **The Code Guideline 13.2:** The AC should ensure that the IA function is adequately resourced and has appropriate standing within the company. For the avoidance of doubt, the IA function can be in-house, outsourced to a reputable accounting/auditing firm or corporation, or performed by a major shareholder, holding company or controlling enterprise with an IA staff.
- 4.3.7 **The Code Guideline 13.3:** The internal audit function should be staffed with persons with the relevant qualifications and experience.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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4.3.8 **The Code Guideline 13.4:** The Internal Auditor should carry out its function according to the standards set by nationally or internationally recognised professional bodies including the Standards for the Professional Practice of Internal Auditing set by The Institute of International Auditors.

4.3.9 **The Code Guideline 13.5:** The AC should, at least annually, review the adequacy and effectiveness of the IA function.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 5: FINANCIAL REPORTING

### Contents

Section	Sub-section
5.1 Table of Regulatory Requirements and Guidelines	-
5.2 Best Practices	<ul style="list-style-type: none"><li>• Competence of the Finance Team</li><li>• Overseeing the Integrity of Financial Statements</li><li>• Other Key Financial Information</li><li>• Factors Indicative of Weaknesses in Financial Reporting Process</li></ul>
5.3 Regulatory Requirements and Guidelines	-



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 5: FINANCIAL REPORTING

### 5.1 Table of Regulatory Requirements and Guidelines

Detailed regulatory requirements and guidelines in 5.3)

<b>Regulatory Requirements</b> [Mandatory Compliance]	<b>Guidelines</b> [Comply or Explain]
<p><u>Internal Controls</u> CA Section 201(1A) CA Section 199(1) CA Section 199(2A)</p> <p><u>Audit Committees</u> CA Section 201B(5)(a)(vi)</p> <p><u>Financial Statements</u> LR / CR 705(1) LR / CR 705(2) LR / CR 705(3) LR / CR 705(5)</p> <p><u>Announcement of Cessation</u> LR-Appendix 7.4.2 / CR-Appendix 7G</p>	<p><u>Audit Committees</u> Code Guideline 12.4(a)</p>

*The above list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook.*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 5: FINANCIAL REPORTING

### 5.2 Best Practices

#### Competence of the Finance Team

5.2.1 The company's CFO and finance team are critical in supporting effective audits and high quality financial reporting and disclosure. The AC should be satisfied that the CFO is appropriately qualified and competent, and that he/she has adequate staff resources with the appropriate experience and expertise, and that the CFO is able to perform his/her duties. In satisfying itself, the AC should have regard to the number and experience of supporting staff, the size and complexity of the group and the frequency of cross-border dealings. The AC should also ask the external auditor about the adequacy and effectiveness of the company's financial reporting process.

5.2.2 The AC may consider participating in the appointment of the CFO by reviewing Management's recommendation of candidates and their qualifications and experience before concurring with Management's recommendation on the choice of candidate.

#### FAQ 29:



#### Best Practices

**Q:**

How can the AC assure itself that the accounting or finance function is competent and adequately resourced?

**A:**

The AC could:

- **Obtain feedback on the competency and adequacy** of the finance function from the external auditors and internal auditors during the private sessions
- **Enquire into the root causes** for major/significant audit adjustments to ascertain the competence of the finance personnel
- **Have frequent interactions with finance personnel**, to understand their concerns and assess their competency

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 5: FINANCIAL REPORTING

### **Overseeing the Integrity of Financial Statements**

5.2.3 Under the Companies Act, the directors are required to take all reasonable steps to ensure that the Act's provisions regarding financial statements of the company are complied with. In practice, the directors delegate the task of preparing the financial statements to Management. In this context, whilst Management is primarily responsible for the preparation of complete, accurate and reliable financial statements and also for formal announcements relating to the company's financial performance, it remains the Board's responsibility to have oversight of the integrity of the financial statements and other related disclosures. The Board, whether individually or collectively, will need to undertake the due diligence they believe appropriate to satisfy themselves that the financial statements comply with the requirements of the Companies Act. The Board may seek the help of the AC in discharging such responsibilities<sup>48</sup>.

5.2.4 Strong and candid relationships with Management and the external auditor are crucial – the AC should engage both parties in frank and timely discussions. It is important for the AC to demonstrate an appropriate level of scepticism and ask probing questions to ascertain whether the full year and quarterly financial statements are complete and consistent with operational and other information known to the AC.

5.2.5 During the AC's review of the full year and quarterly financial statements, its discussions with Management and/or the external auditors should address the numerous qualitative factors that can affect financial statements, including these factors:

### ***Assurance provided by CEO and CFO to the Board***

5.2.6 Under the Code, the CEO and CFO should provide assurance to the Board that the financial records have been properly maintained and the financial statements give a true and fair view of the company's operations and finances<sup>49</sup>. The AC should carry out due diligence when reviewing the CEO and CFO's assurances and their basis. If necessary, the AC should require a presentation from the Management.

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<sup>48</sup> Guideline 12.4(a) of the Code

<sup>49</sup> Guideline 11.3 of the Code

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### FAQ 30:



#### Key Questions Regarding CEO and CFO Assurances

**Q:**

What should the AC ask the CEO and CFO to support their assurances that the financial reports have been properly maintained and the financial statements give a true and fair view of the company's operations and finance?

**A:**

The AC could ask the CEO and CFO:

- **What mechanisms** do you have in place **to identify significant risks and key controls** to financial reporting?
- What process do you have in place to **check that the risk management and internal control systems are adequate and effective** with respect to financial reporting?
- **How often do you check that key controls are operating as intended?**
- What **evidence do you obtain** to satisfy yourself that key controls are operating effectively across your organisation?
- **What is the culture** within/across the organisation to highlight/mitigate risk and control deficiencies with respect to financial reporting?
- **The basis of any judgements or estimates** made
- **Whether there were any financial accounting issues** that were flagged by the internal or external auditors, such as changes in accounting policies/practices or changes in significant estimates
- **The turnover of the Finance or Accounting team** handling the financial reports

#### ***Accounting Policies***

*The AC should ensure it understands the company's significant accounting policies and assess whether the policies applied are reasonable and appropriate.*

5.2.7 When assessing existing accounting policies (particularly in instances where acceptable alternative principles are available), the AC may consider these factors:

- **Appropriateness of the accounting policy** based on the substance of the transaction


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- **Manner in which each significant alternative accounting principle would affect transparency** of financial information, how well understood and how useful financial information would be
- **Identification of financial statement amounts** which are affected by the choice of principles
- **Information concerning accounting principles** used by peer group companies – whether existing accounting policies are conservative or liberal in comparison
- **The external auditor’s views** on the choice of accounting policy
- **When considering a proposed change in accounting policies, the following factors may be considered:**
  - Management’s rationale for the change. If it is a change to adopt a ‘preferred’ policy, why was it not used previously?
  - Have the regulators or the external auditors ever questioned the existing policy?
  - Whether the policy is adopted by peer group companies?
  - The external auditors’ views on the change?
  - What is the effect of not implementing the change?
  - How will the change affect the company’s current and future earnings, executive compensation or bonus plans and/or loan covenants?
- **Implications of new accounting standards on the financial statements**, including:
  - Standards which affect the company for the first time in the current year
  - Standards which affect the company for the first time in a future year
  - Standards under development that may affect the company’s financial statements when adopted
- **The appropriateness of methods used to account** for significant unusual transactions or transactions in emerging areas for which there are no specific applicable accounting standards, taking into consideration:
  - Management’s basis for determining the appropriateness of the methods used
  - External auditors’ views on the methods used

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Case Study 14:	
	<b>Proposed Accounting Treatment Change</b> This case study illustrates a situation of a “voluntary” change in an accounting treatment.
<b>Context</b> Term fees were recognised progressively by a teaching establishment as revenue over the period of the course. Just before the second quarter results announcement, Management of the company changed its revenue recognition policy to account for revenue upon registration, at which time the non-refundable fees for the term would be payable in full. At the AC meeting to consider the draft announcement, the AC noted that the change in accounting treatment had a material impact on the financial performance for the quarter. Management briefed the AC on the change in the accounting treatment, and explained that the new accounting treatment was more reflective of the economics of its business since the fees were received in full at the start of each term and were not refundable; furthermore, there were no marginal costs relating to the earning of such revenue.	
<b>Q:</b> What are the matters that the AC should take into account in considering the proposed change in accounting treatment?	
<b>A:</b> The AC could ask Management for an analysis of the old and new accounting treatments against the relevant accounting standard, and the basis of their conclusion that the new accounting treatment was more in line with the accounting standard.  The AC should ask Management for the reasons for the change in the accounting treatment. Factors that the AC could weigh up in considering the change include the quality of the accounting analysis and resultant conclusions, the motivation of Management in making the change, the timing of the change, and the manner of presentation.  The AC could also consider the extent of disclosures in the financial statements, the view of the external auditors on the merits of the change in accounting treatment and the possibility of obtaining a formal opinion from them or other advisers.	

### ***Errors and Mis-statements***

*The AC should have a clear understanding of how Management and the external auditors define and evaluate materiality for financial reporting purposes, especially with respect to errors and mis-statements.*

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5.2.8 In its discussion with the external auditors and Management, the AC should:

- **Seek to establish the quantitative and qualitative criteria** used by Management to determine materiality. In particular, the AC may consider:
  - The performance measures or other specific factors considered in making materiality judgements, for example, whether materiality is measured in relation to sales, gross margins, segment margins, specific financial statement line items, or before and after special non-recurring items
  - How the materiality criteria affect the period-to-period comparability of reported financial conditions and results of operations
- Apply the criteria towards determining the materiality of errors and mis-statement

In addition, the AC may consider whether any mis-statement:

- Conceals changes in profitability or earnings trends
  - Hides the company's failure to meet analysts' consensus expectation
  - Changes a loss into income or vice versa
  - Conceals unlawful transactions or improper acts by senior Management
  - Has an impact on the company's compliance with the terms of its contractual (including loan) agreements or regulatory requirements
  - Relates to a business segment which contributes significantly to the company's operations or profitability
  - Increases Management compensation (by satisfying performance threshold requirements)
- **Where material errors or mis-statements are found, the AC should discuss** with the external auditors and Management to decide the appropriate action to be taken, including reporting to the Board

### ***Judgements and Estimates***

*Estimates are subjective and can change with time, given more experience and evolving business circumstances. The AC should recognise the susceptibility of estimates to manipulation and carefully scrutinise areas involving estimates, particularly if these could have a significant impact on reported earnings.*


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5.2.9 In assessing the acceptability of estimates to be reflected in the financial statements and related disclosures, the AC should:

- **Ask Management to identify major items** for which judgements and estimates are significant (for example, uncollectible accounts receivables, slow-moving or obsolete inventories, asset impairments and the fair valuation of financial instruments)
- **Understand how judgements and estimates are determined** and subsequently monitored, taking into consideration:
  - Key business assumptions and dependencies supporting the estimates
  - Quality of processes and systems and also reliability of the underlying data supporting the estimates
- **Where judgements and estimates involve a range of possible outcomes, the discussion could indicate how the recorded estimate relates to the range** and how various selections within the range would affect financial reporting

A sample checklist for assessing fair values and estimates in financial reports is set out at **Appendix E1**.

FAQ 31:	
	<p><b>Key Questions to Ask Regarding Balances with Judgments/ Estimates</b></p> <p><b>Q:</b></p> <p>What are some examples of questions that the AC could ask Management?</p>
<p><b>A:</b></p> <p><b>(a) Uncollectible accounts receivable:</b></p> <ul style="list-style-type: none"><li>• What is the bad debts amount this period? How does it compare to the last period?</li><li>• How is the allowance for doubtful accounts determined?</li><li>• Has there been a change in the methodology or assumptions used in determining the allowance? If so, why?</li><li>• How is its adequacy evaluated?</li></ul> <p><b>(b) Slow-moving or obsolete inventory:</b></p> <ul style="list-style-type: none"><li>• What steps are taken to identify slow-moving or obsolete inventory which requires provision?</li></ul>	



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- How is provision for such inventory determined and evaluated for adequacy?
- Are there any significant write-downs? If so, why? How do these writedowns compare to the last period?

**(c) Impairment assessments for assets** (e.g. plant and equipment):

- Are the carrying values regularly reviewed to determine whether there has been impairment in value? How were these carrying values evaluated?
- How are the recoverable amounts determined? What are the assumptions and cashflow estimates used? Is the discount rate used appropriate?

**(d) Fair valuation of financial instruments:**

- How is the fair market value determined for financial instruments which do not have a readily determinable market value? What is the valuation methodology adopted?
- Where experts are used, are they reliable?

- **If an entity has significant contingencies for which no recorded estimated liability has been provided, the AC should consider:**
  - Why Management did not record the particular estimate
  - Likelihood of underlying events occurring
  - Current and future financial statement impact of Management's decisions
- **Consider whether the provision balances continue to be appropriate.** If the enterprise has recorded estimates which are 'slow moving' in terms of resolution of the matters to which the estimate relates (e.g. litigation or provision for doubtful debts), Management and the external auditors should assess the continued need for the recorded estimate
- **The adequacy of the disclosure of contingencies**, including the exposure to losses in excess of any recorded amounts
- **Consider how estimates historically match up against actual results**
- **Monitor movements in provisions established in prior periods**

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### ***Use of special structures and timing of actions which affect financial statements***

*The AC should note any unusual or complex items and their accounting treatment. In particular, the AC should consider the manner in which financial reporting was affected by the transactions, the transparency of the financial reporting and disclosures and the impact of the unusual transactions on the comparability of financial condition and performance between past and future periods.*

5.2.10 Where special purpose financing structures or unusual transactions which affect ownership rights (such as leveraged recapitalisations, joint ventures and preferred stock of subsidiaries) exist, the AC should consider these factors:


- Impact of the special structures on risks and rewards of the entity, timing and amounts of reported income and cash flow
- Impact of the structures on transparency and how well the enterprise's economic position is understood as compared to its financial statements
- Comparative structures used in practice

5.2.11 Where there are significant period-to-period changes in the accounts (such as significant increases in volume immediately before the period-end close, significant changes between the final quarter's results, the trend over the first three quarters or the recording of one-off transactions), the AC should consider:

- Reasons for the major variations and/or the purpose behind the significant transactions
- Economic substance of the transactions
- Impact of the transactions on the financial statements

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Case Study 15:	
	<p><b>Use of special structures and timing of actions which affect financial statements</b></p> <p>These case studies illustrate the use of special structures.</p>
<p><b>Context (A)</b></p> <p>A controlling shareholder and certain key executives induce a company to fraudulently exclude from its annual and quarterly consolidated financial statements over \$2.3 billion in bank debts by deliberately shifting those liabilities into the books of the company's off-balance sheet, unconsolidated affiliates.</p> <p>This precipitated a series of misrepresentations about these liabilities, including the creation of: (1) sham transactions backed by fictitious documents to give the false appearance that the company had actually repaid debts when, in truth, it had simply shifted them to unconsolidated entities and (2) misleading financial statements by giving the false impression through the use of footnotes that stated liabilities listed in the company's financials included all outstanding bank debts.</p>	
<p><b>Context (B)</b></p> <p>The CFO of a company led a team to create off-books offshore entities (used for planning and avoidance of taxes, raising profitability of a business) to hide losses that the company was taking, and made the company appear more profitable than it actually was.</p> <p>The company funded some of its investments by entering into arrangements with outside third parties. These joint investments typically were structured as separate, special purpose entities (SPEs) to which the company and other investors contributed assets or other consideration.</p> <p>Under the accounting rules applicable at the time, an SPE could receive off-balance-sheet treatment if the third-party investment was genuinely at risk, among other things. If the third party was not truly independent, or its investment was not truly at risk, consolidation of the SPE into the company's balance sheet would be required. Some of the SPEs were not eligible for off-balance-sheet treatment because the supposedly independent third party investors were controlled by the CFO and others. Also the third party 'investment' was not at risk, since the company, the CFO, or others provided the funds to be invested or guaranteed the investment against risk of loss. Thus, these SPEs should have been consolidated into the company's balance sheet.</p>	

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### *Related Party Transactions*

*The AC should pay attention to the frequency and significance of transactions with related parties particularly those that are not in the ordinary course of business.*

The discussion could address:

- **Whether the enterprise had similar transactions at similar prices** with unrelated parties
- **Whether transactions were undertaken on a best available price basis**
- **Whether the transactions or pricing of the transactions impacted financial reporting** in any significant manner which would not be obvious to a user of the financial statements
- **Financial statement impact and disclosures of these items**, as well as how such transactions reflect the underlying economics
- **The adequacy and clarity of the disclosure of RPTs**

*For guidance on how to differentiate between IPTs and RPTs, please refer to the section on IPTs.*

#### Case Study 16:



#### **Frequent and Significant RPTs**

This case study illustrates an instance where the company engages in frequent and significant transactions with related parties. As the company in this case is transacting with its director and CEO, these transactions may also be considered as IPTs under Chapter 9 of the Listing Manual.

#### **Context**

The CEO, CFO and a director of a company granted themselves large amounts of secret low interest and interest-free loans from the company which they used for personal expenses. They then induced the company to forgive the outstanding loans without disclosure to investors.

On numerous occasions, the CEO and CFO arbitrarily classified and reclassified their indebtedness to the company between the company's corporate loan programme (which is intended to provide low interest loans to enable executives and employees to pay taxes due as a result of the vesting of ownership of shares granted under the company's restricted share ownership plan) and a relocation loan programme, without having any regard for the legitimate and authorised purposes of the two programmes.

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In addition, the CEO and CFO also engaged in undisclosed real estate transactions with the company and its subsidiaries. These included the CEO's purchase of an apartment for his wife from the company and the company's purchase of the CFO's property for far more than its market value.

### **Audit adjustments**

*The AC should note adjustments recommended by the auditor that individually or in aggregate, could have a significant effect on the entity's financial reporting process.*

5.2.12 In their discussions with the external auditors, the AC should note:

- Whether the adjustments are indicative of significant internal control deficiencies that could cause interim or future financial reports to be materially mis-stated
- Uncorrected mis-statements aggregated by the auditors and deemed by Management to be immaterial
- Effect of unrecorded adjustments on subsequent years' financial statements

5.2.13 When considering the adjustments made by the external auditors during the year-end audit, the AC should request the external auditors to present their observations of how these audit adjustments might point to similar errors in quarterly results announced earlier.

### **Case Study 17:**



#### **Audit Adjustments**

This case study illustrates how audit adjustments may have a significant effect on the entity's financial reporting process

#### **Context**

The financial results of a company were manipulated through a series of accounting entries and/or adjustments made before or after the end of each financial reporting period. For instance:

- Accounting entries were backdated to the last financial reporting period so that the period manipulated would show the achievement of the desired results
- Accounting entries were added, deleted, amended or replaced with other entries so that the financial performance would show an achievement of the desired results

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### ***Completeness and Clarity***

*The AC should assess the completeness and clarity of the financial statements, disclosures in financial statements, financial results announcements and other materials filed with the SGX or otherwise publicly distributed.*

#### 5.2.14 Points for consideration:

- The AC should ask Management if the information in the financial statements clearly and fully reflects the on-going operations of the business. Does it cause any distortion of the actual results?
- The AC should perform the due diligence necessary to satisfy themselves that the financial statements have been prepared in accordance with the relevant accounting standards. They should also ascertain from Management and the auditors if there are any non-compliance issues or omissions that they should be aware of.
- If the AC identifies a material item that Management has not proposed to disclose, it should question Management's reasons for non-disclosure.
- Where the company discloses earnings guidance, forward-looking information and other financial information, the AC should carefully assess whether the company is in a credible position to provide such information, taking into consideration these factors:
  - Quality of systems and reliability of data underlying the financial information
  - Underlying business assumptions and the likelihood of such assumptions occurring
  - Management's history in meeting past earnings targets
  - Analysts' expectations of the company

Where the AC reviews press releases, it should be guided by all the above points to ensure that the information in press releases is factually accurate, consistent and not misleading.

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### *Reviewing group financial statements*

5.2.15 When reviewing consolidated financial statements, the AC should take note of these additional factors during its discussions with Management and/or the external auditors:

- **Were the accounting policies consistently adopted** by all companies in the group?
- **What were the significant judgements and estimates involved** in the subsidiaries' financial statements and how do they affect consolidated financial statements
- **Are all significant matters or transactions of the subsidiaries properly reflected** in the consolidated financial statements?
- **Where subsidiaries prepare individual audited financial statements, were the audit opinions qualified?** If yes, how did Management resolve the matters which gave rise to the audit qualifications and how did these affect the consolidated financial statements?
- **Where there were changes in the composition of the group (e.g. acquisition or disposal of subsidiaries), have these been properly accounted for** in the consolidated financial statements?
- **Has an impairment review of goodwill arising on consolidation (if any) been properly performed and accounted for** in the consolidated financial statements?

### *Other Matters*

5.2.16 Other matters for consideration may include these factors:

- ***Consideration of factors affecting asset and liability carrying values***

Discussions of the AC with Management may include:


- Factors taken into consideration when valuing tangible and intangible assets. Such factors may include: rights, privileges or conditions that are attached to the ownership interest, remaining economic life / legal life, earnings capacity, nature and history, economic outlook of relevant economies and the condition and outlook of the specific industry

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- The company's bases for determining useful lives assigned to tangible and intangible assets and salvage values (discussion should include the type and quality of evidence supportive of such bases/factors)
- Carrying value of other assets and liabilities, including an explanation of how factors affecting carrying values were selected and how alternative selections would have affected the financial condition and earnings of the enterprise

- ***Disagreements between Management and Auditors***

Case Study 18:	
	<p><b>Disagreements between Management and Auditors</b></p> <p>This case study illustrates the measures an AC can take when the external auditors disagree with Management on financial reporting issues.</p>
<p><b>Context</b></p> <p>The external auditors disagreed with Management on the interpretation of FRS 36 Impairment of Assets and how Management performed the impairment assessment on the company's fixed assets. In addition, Management had also refused to provide certain information requested by the external auditors as it felt that such information is neither relevant nor necessary in performing the impairment assessment.</p>	
<p><b>Q:</b></p> <p>What should the AC do?</p> <p><b>A:</b></p> <p>The AC should note the disagreements between Management and the external auditors and seek to resolve the conflict in a timely manner. Where appropriate, the AC should engage the auditors and Management in discussion and consider the following:</p> <ul style="list-style-type: none"><li>• Understand the transaction, issues, concerns and accounting implications (including alternative and preferred accounting treatments)</li><li>• Determine whether to consult additional resources, e.g. seek a second opinion from another audit firm if the disagreement concerns accounting standards and their application</li></ul>	



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- ***Assessment of responses to regulators with respect to financial reporting matters***

The AC members should also consider whether Management has taken appropriate remedial actions with respect to letters issued by ACRA in relation to financial reporting matters.

- ***Fraud and Illegal Acts***

The AC members could consider the work of the Risk Committee (if one had been set up) in identifying the risk of fraud, which may impinge on financial reporting and what may motivate Management to perpetrate fraud, how Management may override controls to engage in and conceal fraudulent financial reporting and how entity assets could be misappropriated.

The AC should take note of the applicable anti-bribery/anti-fraud laws in the jurisdictions in which the company has operations or presence.

The AC may be delegated responsibility for the oversight of risk management. The AC would then need to review the framework and processes for identifying and managing major risks including the risk of fraud. *Please refer to the section on Risk Management and Internal Controls for guidance.*

The AC should consider whether there is evidence that fraud involving senior Management or causing a material mis-statement of financial statements exists. The AC may wish to pay particular attention to these situations, which may indicate the possibility of fraud or illegality:

- **Rapid growth** or unusual profitability
- **Significant transactions** with related persons, in particular, transactions not in the ordinary course of business
- **Significant sales** to unknown entities
- **Recurring negative cash flows** from operations or inability to generate cash flows from operations while reporting earnings
- **Significant or highly complex transactions** or structures
- **Unusual increases** in gross margin

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- **Significant estimates** or subjective judgements
- **Limiting auditor access**
- **Domination of Management** by a single person/party without mitigating controls
- **Payment of significant commissions/consultancy fees** (i.e. the amount is high in comparison to the profits recorded)

The AC should ensure that: (i) Management has designed and implemented the necessary internal controls for the prevention and detection of fraud and (ii) a system is in place to encourage timely, competent and confidential review, investigation and resolution of suspected fraud. This should include a process for:


- **Evaluating the likelihood**, nature and severity of fraud
- **Conducting an investigation** / fact-finding exercise of appropriate scale and engaging outside expertise where necessary
- **Keeping the information confidential**
- **Notifying regulatory agencies** where necessary. The AC can achieve this through effective use of the IA function supplemented by their enquiries of Management. In certain companies, the AC has also instituted the practice of having Management provide a representation letter to the Board stating that they have undertaken the necessary steps to implement internal controls to prevent and detect fraud. See also Management representation letter to external auditors below

In the event of resignations of key Management personnel such as the CFO, CRO and IA Head, and where relevant, sponsors of Catalist-listed companies, the AC could conduct exit interviews to establish if there were unresolved issues or disagreements that led to their resignations.

*For more comprehensive guidance on fraud, please refer to the section on Risk Management and Internal Controls and the subsection on Whistle-blowing in AC Agenda.*

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Case Study 19:	
	<b>AC Review of Unusual Transactions</b> This case study illustrates measures an AC could adopt to review unusual transactions.
<b>Context</b> A company has been reporting strong growth in a new line of business, with a Fortune 500 company taking up almost all of the company's capacity and generating a gross profit margin significantly above those recorded in other areas of the company's business. As a result of criminal investigations not originally involving the company but which had eventually extended to the company, it was subsequently discovered that the entire new line of business was a sham, with fictitious sales that never involved the Fortune 500 company. The sales were settled seemingly on time, using the company's own cash that had been diverted from the company through inflated prices for equipment purchases. These purchases had been routed through tax haven companies that were in fact related parties.	
<b>Q:</b> What should the AC do when a new line of business is being launched?	
<b>A:</b> Where a material line of business is embarked on, the AC should seek a detailed understanding of the proposed business and its expected impact on the financial results of the company. The original case-for-investment papers submitted to the Board should be reviewed, and compared to subsequently reported results, with explanations provided by Management.  Where the AC feels that there are certain aspects of the financial information relating to the new business that it cannot fully understand, it should engage in open discussions with the internal auditors and the external auditors to get other views. The AC could direct the auditors to pay particular attention to the areas in which the AC has concerns, and report on the procedures undertaken and the conclusions reached.	

- **Management representation letter**

The AC should review and approve the Management representation letter before this letter is provided to the external auditors. During the course of the external audit, the external auditors would have placed some reliance on representations made by Management on matters material to the entity's financial statements. Such matters typically include:

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- Management acknowledging that they have caused the entity to maintain proper accounting books and records and a system of internal controls so as to ensure the preparation of financial statements in accordance with the entity's accounting policies
- Management making available all the accounting books and records to the external auditors
- Management disclosing to the auditors its knowledge of fraud or suspected fraud affecting the entity, including knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements
- Significant accounting estimates and judgements adopted by Management in preparing the financial statements, including the basis, assumptions and Management plans which would affect the valuation of certain assets and liabilities
- Management confirming that there are no unrecorded/undisclosed liabilities and contingencies which should be recorded/disclosed in the financial statements

These matters have a critical effect on the entity's financial statements. They also affect the external auditors' work and their conclusion on the entity's financial statements. Hence, it is important that the AC review the Management representation letter making sure all representations to the external auditors is in line with the understanding of the AC where the entity's financial reporting is concerned. If the AC has any queries or doubts, the AC should discuss these with Management.

### Other Key Financial Information

5.2.17 Paragraph 5.2.5 above listed and discussed some of the factors which the AC should take into consideration in their discussions with Management when reviewing the company's financial statements.

5.2.18 Such discussions should take place every quarter.

5.2.19 In addition, the AC could also ask Management to provide a summary of key financial information on a monthly basis (rather than quarterly), so that the AC can be alerted to any potential financial problems within the company early on, and apply appropriate remedial actions to address the problems. Examples of key financial information include:

- Operating revenue composition and margins
- Net profits before and after tax
- Return on total assets
- Earnings per share

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- Working capital ratios
- Gearing ratios
- Net tangible asset per share
- Trade receivables and payable turnover
- Free cashflows
- Loan covenants (potential breach)

### Factors Indicative of Weaknesses in Financial Reporting Process

5.2.20 In addition to having regular discussions with Management when reviewing the company's financial statements, the AC should also be alert to any weaknesses in the company's financial reporting process. Examples of 'red flags' which may indicate weaknesses include:

- **High turnover** of key accounting personnel
- **Frequent significant changes in accounting practices and estimates** by Management that are not in line with industry norms
- **Numerous late adjustments** raised by Management after accounts are closed
- **Unexplained significant fluctuations** in account balances
- **Material variances between physical and book value** inventories
- **Material variances between confirmations** received and book values for assets and liabilities e.g. accounts receivable, bank balances and accounts payable
- **Numerous audit adjustments** raised by the external auditors, especially when these adjustments relate to errors in the financial statements
- **Numerous Management letter points** pertaining to (a) errors and discrepancies noted in the company's accounting books and records and (b) lapses in internal accounting control process for example inadequate Management oversight
- **Frequent change of internal/external auditors and Independent Directors**

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### 5.3 Regulatory Requirements and Guidelines

*The following list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook. They are only summaries for ease of reference and it is advisable to refer to the actual section or rule in its entirety when applying it to particular situations or events.*

#### *Internal Controls*

5.3.1 **CA Section 201(1A):** Subject to subsections (14) to (14C), the financial statements referred to in subsection (1) shall comply with the requirements of the Accounting Standards, and give a true and fair view of the financial position and performance of the company.

5.3.2 **CA Section 199(1):** Every company and the directors and managers thereof shall cause to be kept such accounting and other records as will sufficiently explain the transactions and financial position of the company and enable true and fair profit and loss accounts and balance-sheets and any documents required to be attached thereto to be prepared from time to time, and shall cause those records to be kept in such manner as to enable them to be conveniently and properly audited.

5.3.3 **CA Section 199(2A):** Every public company and every subsidiary of a public company shall devise and maintain a system of internal accounting controls sufficient to provide a reasonable assurance that —

- (a) assets are safeguarded against loss from unauthorised use or disposition; and
- (b) transactions are properly authorised and that they are recorded as necessary to permit the preparation of true and fair profit and loss accounts and balance-sheets and to maintain accountability of assets.

#### *Audit Committees*

5.3.4 **CA Section 201B(5)(a)(vi):** The functions of the AC includes reviewing the financial statements of the company and, if it is a parent company, the consolidated financial statements, submitted to it by the company or the parent company, and thereafter to submit them to the directors of the company or parent company.

5.3.5 **The Code Guideline 12.4(a):** The duties of the AC should include reviewing the significant financial reporting issues and judgements so as to ensure the integrity of the financial statements of the company and any announcements relating to the company's financial performance.

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## SECTION 5: FINANCIAL REPORTING

### *Financial Statements*

- 5.3.6 **Listing / Catalyst Rule 705(1):** An issuer must announce the financial statements for the full financial year (as set out in Appendix 7.2 of the Listing Rules / Appendix 7C of the Catalyst Rules) immediately after the figures are available, but in any event not later than 60 days after the relevant financial period.
- 5.3.7 **Listing / Catalyst Rule 705(2):** An issuer must announce the financial statements for each of the first three quarters of its financial year (as set out in Appendix 7.2 of the Listing Rules / Appendix 7C of the Catalyst Rules) immediately after the figures are available, but in any event not later than 45 days after the quarter end.
- 5.3.8 **Listing / Catalyst Rule 705(3):** An issuer which does not fall within the subsections in Rule 705(2) must announce its first half financial statements (as set out in Appendix 7.2) immediately after the figures are available, but in any event not later than 45 days after the relevant financial period.
- 5.3.9 **Listing / Catalyst Rule 705(5):** In the case of an announcement of interim financial statements (quarterly or half-yearly, as applicable, but excluding full year financial statements), an issuer's directors must provide a confirmation that, to the best of their knowledge, nothing has come to the attention of the Board of Directors which may render the interim financial statements to be false or misleading in any material aspect. In order to make this confirmation, directors would not be expected to commission an audit of these financial statements. The confirmation may be signed by 2 directors on behalf of the Board of Directors.

### *Announcement of Cessation*

- 5.3.10 **Listing Rule - Appendix 7.4.2 / Catalyst Rule – Appendix 7G:** In relation to the cessation of key persons of the company such as directors, chief executive officer, chief financial officer, chief operating officer, general manager, or other executive officer of equivalent authority, the company is required to announce whether there are any unresolved differences in opinion on material matters between the person and the Board of Directors including matters which would have a material impact on the group or its financial reporting.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 6: EXTERNAL AUDIT

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6.3 Regulatory Requirements and Guidelines	-



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 6: EXTERNAL AUDIT

### 6.1 Table of Regulatory Requirements and Guidelines

(Detailed regulatory requirements and guidelines in 6.3)

<b>Regulatory Requirements</b> [Mandatory Compliance]	<b>Guidelines</b> [Comply or Explain]
<p style="text-align: center;"><u><i>Audit Committees</i></u>                      CA Section 201B (5)                      CA Section 201B (6)                      CA Section 201B (7)</p> <p style="text-align: center;"><u><i>Appointment of Auditors</i></u>                      CA Section 206 (1A)                      CReg Regulation 12                      LR/CR 712(1)                      LR/CR 712(2)                      LR/CR 713(1)                      LR/CR 715(1)                      LR/CR 715(2)                      LR/CR 716(1) and (2)</p> <p style="text-align: center;"><u><i>Annual Reports</i></u>                      LR 1207(6)(b)/CR 1204(6)(b)</p>	<p style="text-align: center;"><u><i>Audit Committees</i></u>                      Code Guideline 12.4(d)                      Code Guideline 12.4(e)                      Code Guideline 12.5                      Code Guideline 12.6</p>

*The above list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook.*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 6: EXTERNAL AUDIT

### 6.2 Best Practices

#### **Role of External Auditors**

6.2.1 Some directors, including AC members, may not have a clear understanding of the role of the external auditors and the primary objective of having an EA performed on the company's financial statements. As a result, there is a gap between what the directors perceive to be the responsibilities of the external auditors and what the external auditors accept to be their responsibilities. This is commonly termed the 'Audit Expectation Gap'.

#### ***Audit expectation gap***

6.2.2 The audit expectation gap is defined as the difference between what the public expects from an audit and what the audit profession understands the audit objective to be. Some of the common misconceptions are:

- Auditors accept primary responsibility for financial statements
- Auditors 'certify' financial statements
- Auditors perform one hundred percent checks
- Auditors give early warning of possible business failures

6.2.3 The reality, however, is that Management, as preparers of the financial statements, is primarily responsible for their accuracy and an audit only provides reasonable assurance that the financial statements are free of material mis-statements. An audit is not a guarantee of the entity's solvency or financial performance.

#### ***Relying on the external audit***

6.2.4 The primary objective of the EA therefore is to add credibility to financial statements, rather than the detection of fraud and errors.

6.2.5 The AC should therefore review the external auditors' engagement letter for a clear communication of the external auditors' role and responsibilities. Only with a clear understanding can the AC better leverage on the work performed by the external auditors in discharging their oversight responsibility on the financial statements and the financial reporting process.

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### Audit Scope and Approach<sup>50 51</sup>

6.2.6 The AC should obtain a good understanding of the scope of the external auditor's work and the approach they will be adopting in performing the audit of the company's financial statements.

6.2.7 For a start, the AC should request for a copy of the external auditors' engagement letter and review this letter to have an overall understanding of the scope and extent of the external auditors' work. This will help the AC to understand the EA coverage as well as ensure that all key financial statement risks are considered during the audit process.

6.2.8 Before the start of the audit, the AC should receive an audit plan from the auditors. This document should set out the audit scope and approach. However, to further enhance the AC's understanding of the EA scope and approach, the AC should have a discussion with the external auditor and during that discussion, the AC may consider asking these questions:

- **What are the objectives** of the EA?
- **How do the external auditors define materiality** in setting their audit scope?
- **What are the company's financial reporting requirements** and what is the expected time frame to comply with these requirements?
- **How do the external auditors identify** the key financial statement risks that will affect the audit and the audit approach? How will the external auditors communicate these risks to the AC?
- **Do the external auditors have a role** in detecting material errors, fraud and illegal acts? How will these be addressed in the audit?
- **How do the external auditors evaluate** the adequacy and effectiveness of the company's internal controls over the financial reporting functions?

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<sup>50</sup> In developing guidance for the parts on "Audit Scope and Approach", "Private Session with External Auditors" and "Engagement of External Auditors" in Section 6: "External Audit" of the guidebook, reference was made to Ernst & Young LLP, 2009, *Audit Committee Member Toolkit*, United States

<sup>51</sup> Adapted from *Audit Committee Effectiveness – What Works Best*, 4<sup>th</sup> edition, by The Institute of Internal Auditors Research Foundation ("IIARF"). Copyright © 2011 by The IIARF strictly reserved. No parts of this document may be reproduced, stored in any retrieval system, or transmitted in any form, or by any means electronic, mechanical, photocopying, recording, or otherwise, without prior written permission of IIARF. Permission has been obtained from the copyright holder, The IIARF to publish this reproduction, which is the same in all material respects, as the original unless approved as changed.


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- **Are there any financial statement areas where the external auditor does not plan to rely on internal controls and why not?**
- **How will the external auditors coordinate their work with the internal auditors?**
- **How do company computer systems and applications affect the audit approach?** How will the external auditor audit these areas?
- **How will recent changes in accounting policies or regulatory requirements impact this year's financial statements?**
- **How do the external auditors obtain assurance over areas that involve Management judgement and estimates?**
- **How will the external auditors identify and audit RPTs?**
- **How will any recent changes in the company – e.g. major acquisitions or disposals of investments, new product lines – affect the audit scope and approach?**
- **How will the external auditors follow up on the audit issues highlighted in the previous period?**
- **Where the company has subsidiaries and associates, some questions that the AC may consider asking the external auditors include:**
  - Which subsidiaries will the external auditor audit? What procedures will the external auditors do for those not audited?
  - What company locations will the external auditors visit this year and why? How do the external auditors determine which locations to visit?
  - What procedures will the external auditors perform for associates?
  - If other audit firms are involved, will the external auditors rely on their audit report without undertaking additional procedures? If not, what are the procedures the external auditors would undertake to be satisfied that the other auditor's work is acceptable and that they are independent?

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FAQ 32:	
	<b>AC Response to Fraud Enquiries by External Auditor</b> <b>Q:</b> How should the AC respond to the external auditor's queries relating to fraud?
<b>A:</b> When the external auditors make enquiries with the AC concerning fraud within the company, the AC may wish to consider the information provided by Management and have a discussion with Management, if necessary. The AC may also wish to refer to the fraud reporting process which has been put in place by Management.  In addition, during its discussion with the external auditors in this area, the AC could highlight to the external auditors any additional areas which may require particular audit emphasis. Such areas could be areas where, in the AC's opinion, the relevant internal controls are weak or lacking. The AC could refer to the work and results of the IA function and the Risk Management Committee of the company in order to identify such areas.	

### Management Letter

6.2.9 During the course of its engagement, the external auditors would typically review the company's accounting procedures and internal controls and provide a Management letter documenting the matters that have come to their attention. While the matters identified in the auditor's Management letter do not usually constitute material weaknesses that would have caused the auditors to modify their opinion expressed in the audit report, it is important that the AC obtain and review a copy of the Management letter. In discussing the letter with the auditors, the AC should:

- **Focus on whether the auditor's Management letter highlights unusual weaknesses**, such as the collectibility of receivables, saleability of inventory, significant post-balance sheet date events, or susceptibility to fraud or illegal acts
- **Review and monitor** Management's response to the auditors' findings and recommendation
- **Review the weaknesses** highlighted and categorise each of the weaknesses (e.g. criticality/materiality)

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For each category, the AC shall establish procedures for follow-up and set reasonable timelines for implementation of remedial action. The AC should focus on weaknesses that are critical and material, since these will have an impact on the key company risks/ financial statements.

### Cost-effectiveness

6.2.10 Some questions the AC could consider in evaluating the cost effectiveness of the entity's audit function (IA and EA) include:


- **Are the EA fees reasonable** in light of the size and complexity of the entity's business during the year? How does the audit fee compare to those charged by peer companies within the industry? What are the external auditors' fees for the current year's audit? What caused the increase/decrease compared to the previous year? If a reduction in fee has been offered, whether this results in a proposed change in the scope of the audit; particularly with respect to the procedures undertaken to identify significant risks? Whether a reduction in the audit fee would lead to a reduction in the overall level of work performed and accordingly lead to the audit quality being compromised?
- **Are the external auditors able to rely on the work performed** by the internal auditors?
- **Were the external auditors able to meet the company's reporting timetable?**
- **What are the qualifications** of the engagement partner and the team members?
- **What are the audit firm's plan and procedures** for partner rotation and to ensure a smooth transition to the new partner?

### Private Session with External Auditors

6.2.11 Guideline 12.5 of the Code recommends that the AC should meet with the external auditors without the presence of the company's Management, at least annually. **Appendix F1** provides a list of possible questions which the AC could raise during the private session with the external auditors.

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Case Study 20:	
	<p><b>Private Session with External Auditors</b></p> <p>This case study illustrates the usefulness of the AC having a private session with the external auditors without the presence of Management.</p>
<p><b>Context</b></p> <p>Company A has five directors. The Managing Director holds significant shares in the company and his nephew is employed in the company as the CFO and put in charge of the company's finance team. The CFO is tasked with the responsibility to ensure that the company has a proper financial reporting process which includes the preparation and presentation of the company's financial statements. While his nephew is a Certified Public Accountant (CPA), members of the AC have some concerns over the CFO's competency given his young age and that he has no prior working experience in a similar industry. In addition, given his relationship with the Managing Director, they are also concerned about whether the CFO is able to discharge his responsibility objectively where the preparation of true and fair financial statements are concerned.</p>	
<p><b>Q:</b></p> <p>Given that the AC has limited opportunities to work closely with the CFO and the finance team on a daily basis, how could the AC get any objective feedback on the CFO's performance?</p>	
<p><b>A:</b></p> <p>The AC should consider meeting regularly in private with the external auditors to discuss issues such as auditor's performance, Management's performance, future agenda topics or how the AC might improve its own performance. In particular, when the AC meets independently with the external auditors, the AC will be able to obtain an objective and critical assessment of the CFO and Management's performance in areas concerning the proper maintenance of accounting records and the preparation of true and fair financial statements.</p>	

6.2.12 The AC should also consider the following in their private meetings with the external auditors at the conclusion of the EA process:

### ***Exposure areas***

- **What are the areas of major concern to the external auditors** and have these been sufficiently communicated to the AC?

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- **What are the most critical accounting policies** (i.e. those that are both important in portraying the entity's financial position and results and require substantial judgement to be exercised by Management)?
- **What are the most significant accounting estimates** and judgements? Did Management change the basis and assumptions supporting these estimates and judgements during the current period? Did the external auditors agree with the changes?
- **Did the external auditors use specialists** or consult with the firm's experts on any significant issues?
- **Are the external auditors aware of any significant tax exposure items** for the entity? Has the entity adequately dealt with and accounted for such exposure items in its financial statements?

### *Findings and conclusions*

- **What are the external auditors' observations** on the quality of the company's internal control environment, including the 'tone-at-the-top'?
- **What are the external auditors' overall evaluation** of the degree of comparability between the presentation of the current period's financial statements and that of previous periods? Were there reclassifications of previous periods' reported amounts and why? Did the entity change its approach to its financial statements presentation?
- **In the external auditors' opinion, is Management aggressive** in:
  - Their selection of accounting policies for the company?
  - Making their accounting estimates and assumptions?
- **Were there any changes in accounting policies** that have a significant effect on the current period's financial statements? Do they agree with the changes?
- **Did the entity apply its accounting policies consistently** from previous periods? How did the entity's accounting policies compare with other companies in the same industry?
- **Were there any significant changes made to internal controls** during the current period over the entity's financial reporting process?



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- **Did the external auditors note any unusual transactions?** Were the external auditors satisfied with the accounting treatment?
- **What were the audit findings in the high-risk areas?** Did the external auditors have any specific comments or recommendations in these areas?
- **Did the external auditors note any material weaknesses** or control deficiencies over the entity's financial reporting process? If yes, what was the effect on the financial statements?
- **Were there any financial reporting issues** the AC should be aware of?
- **What type of audit opinion did the external auditors expect to issue** on the financial statements?
- **Did the external auditors become aware of any instances of known or suspected fraud committed by employees**, questionable payments or breaches of laws and regulations?

### *Co-operation from Management*<sup>52</sup>

- **Was Management co-operative during the course of the EA?** Did the external auditors encounter any difficulties, including significant disagreements with Management, during the audit?
- **Were time pressures placed on the external auditor's work?** If so, how did this affect the audit procedures performed and the conclusion drawn by the external auditors?
- **Did Management attempt to influence the scope and extent of the auditors' work?**
- **Were any audit adjustments raised by the external auditors related to errors in the financial statements?** How did the external auditors resolve these audit adjustments with Management? Were they unnecessarily defensive?
- **Where the external auditors identified material weaknesses or control deficiencies over financial reporting**, did Management respond adequately to address the issues?

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<sup>52</sup> Ernst & Young LLP, 2009, *Audit Committee Member Toolkit*, United States

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### *Management's competence regarding financial reporting responsibilities*

- **Did Management raise many late adjustments after the accounts were closed?**
- **Was Management competent in discharging their financial reporting responsibilities?**
- **Did Management have a good understanding of financial reporting requirements and other related regulatory requirements?**
- **If the external auditors had worked with the internal auditors, in the external auditors' view, were the internal auditors qualified for their responsibility and job scope?**
- **Was the finance team adequately staffed (e.g. experienced personnel and other resources)?**

### *Re-appointment and resignation of the external auditors*

- Will the external auditors be seeking re-appointment? If not, what are the reasons?
- In the event that the external auditors resign, the AC should investigate the issues giving rise to their resignation, particularly where the issues relate to material weaknesses in the company's internal controls. The AC should:
  - Engage Management and outgoing auditors in separate discussions to understand the issues, concerns and accounting implications of the resignation
  - Assess whether further action is necessary, including the need to consult additional expertise/resources and/or bring the issues to the attention of relevant authorities
  - Establish a reasonable timeline to address the issues and follow up on Management's implementation
  - Ensure that Management report the resignation of the external auditor to SGX

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### Engagement of External Auditors

6.2.13 One of the duties of the AC is to make recommendations to the Board on the proposals to the shareholders on the appointment, reappointment and removal of external auditors. In addition, the AC should approve the remuneration and terms of engagement of the external auditors. In order to discharge its responsibilities, the AC should consider instituting a formal process for the engagement of the external auditors.

6.2.14 In formalising such a process, the AC may wish to consider these factors:

- **Identifying the necessary procedures** involved in the reappointment of external auditors on an annual basis and set out the timeframe for the performance of these procedures. These procedures typically include:
  - Scheduling meetings with respective parties, e.g. Management, Board and audit firms for the evaluation and selection of auditors
  - Arranging for the approval of the appointment at the company's annual general meeting, making any necessary SGX announcements and lodgement of statutory forms etc
- **Setting out the criteria** to be used for the evaluation and selection of external auditors. These would include:
  - The company's specific needs (e.g. if the company is in a specialised industry such as banking and insurance, the external auditors selected should have relevant knowledge and expertise within the industry)
  - The audit requirements in other jurisdictions where the company has operations
  - Number of audit firms invited for evaluation
  - Acceptable fee levels

6.2.15 The evaluation and selection process should cover both the evaluation of external auditors for new appointments, as well as the evaluation of the incumbent external auditors with regard to re-appointment. **Appendix F2** provides a sample checklist for evaluation of external auditors. During the evaluation process, some of the factors that the AC should consider may include the following:

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### *Evaluation of External Auditors for New Appointments*

- **Background of the audit firm**
  - **The audit firm's commitment** towards ensuring staff continuity on the company's audit, including the audit firm's staff turnover experience in the last three years and also other quality control systems
  - **What are the assigned partner's and manager's other similarly-sized clients?**
  - **How and why is the audit firm different** from other firms being considered and why is the firm selected
  - **How much attention the audit firm would give** to the company
  - **What is the extent of commitment and number of man-hours** the key team members would undertake to conduct the company's audit each year
  - **The audit firm's reputation** (including obtaining a copy of the firm's most recent peer review report, outcome of recent firm inspections or other regulatory oversight reviews, if available), a related letter of comments and the firm's response to the letter of comments
  - **The audit firm's approach** to the resolution of technical disagreements (a) among engagement personnel and (b) between the firm and the client
  - **The audit firm intends to comply with the requirement for audit partner rotation** every five years (this is especially relevant to those companies that operate in specialised industries)
  - **The audit firm's representation and network** in other jurisdictions that the company/group has operations in
  - **How the audit firm co-ordinates with its counterparts** in other jurisdictions for audits involving multiple jurisdictions
  - **How and to what extent the audit firm can keep the AC and Management apprised** of changes in accounting standards


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- ***Experience in Industry***
  - The audit firm's as well as the proposed key team members' experience in providing audit and tax services to companies in the same sector, as well as companies of a comparable size
  - Identify the partner, manager and accountant in-charge who will be assigned to the company's audit if the audit firm is appointed and provide their work experience in biographic material
- ***Relationship and Experience with Regulators***
  - The audit firm's as well as the proposed key team members' experience in providing audit services to listed companies in the past three years
  - Any investigation by the regulatory authorities where either the audit firm or their clients were the subject (including concerns on practices and standards)
  - If there are any complaints against key team members who have been levelled by ISCA or a regulatory authority and the remedial actions that have been taken by the audit firm
  - If there are any civil or criminal litigation matters involving the audit firm but not necessarily the client
  - Any positions taken by the audit firm with respect to accounting and audit matters, with the SGX, ISCA and/or others, that could be viewed as controversial and are related to the company's business
- ***Expected Approach to this Audit***
  - How the firm will approach the audit of the company, including the use of any associated or affiliate member firm personnel
  - The audit firm's fee proposal for the audit, with whatever guarantees that may be given regarding fee increases in future years. Ensure that the fee as proposed is sufficient to cover the work that the firm expects to perform if appointed
  - Understand how frequently and in what manner (e.g. meetings and/or reports) the audit firm will be communicating matters arising from the audit to the AC

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FAQ 33A:	
	<p><b>Listed Subsidiaries Selecting External Auditor</b></p> <p><b>Q:</b></p> <p>Company S is a subsidiary of Company P. Both companies are incorporated in Singapore and are listed on the SGX. Must Company S engage the same accounting firm as Company P?</p>
<p><b>A:</b></p> <p>As Company S is itself listed on the SGX, it may appoint different auditors according to the SGX Listing Rule 716. In this case, the AC of Company S should carry out the evaluation and selection process as stated in paragraph 6.2.15 above.</p>	

FAQ 33B:	
	<p><b>AC Oversight of Listed Subsidiary AC</b></p> <p><b>Q:</b></p> <p>Does the AC of the listed parent company have oversight responsibility for the effectiveness of the AC of the listed subsidiary? How should the AC of the listed parents discharge this oversight responsibility in a group structure?</p>
<p><b>A:</b></p> <p>Each listed company must have its own AC which discharges its responsibilities in accordance with its mandate/Terms of Reference. The AC forms a major part of an organisation's control environment. It is good practice for the AC of the parent company to understand and have confidence in the effectiveness of the AC of a listed subsidiary.</p> <p>The parent company or major shareholder can discharge an oversight role through a variety of mechanisms, including but not limited to:</p> <ul style="list-style-type: none"><li>• Reviewing minutes from the listed subsidiary AC meetings</li><li>• Arranging for the AC Chairman from the parent company to meet with the AC Chairman from the listed subsidiary and/or attend the listed subsidiary AC meetings (where there are areas of common interest, such as IA activities and/or material matters to be discussed)</li><li>• Requesting and reviewing a letter of assurance/report from the listed subsidiary AC regarding the financial statements and risk management and internal control adequacy and effectiveness (including the CEO/CFO assurances)</li><li>• Requesting the CEO/CFO of listed subsidiaries to attend the parent company AC to present/discuss material matters/concerns</li></ul>	

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- Arranging to meet privately with the Head of IA/EA to understand the control environment across the group structure (including listed subsidiaries)
- Requesting to review any reports showing the outcome of performance assessments conducted in relation to the AC of the listed subsidiary

The Management of the parent company could also contact the subsidiary's Management to understand any key issues that could potentially have a material impact on the group's financial statements. The parent company's AC could then receive Management reports on key issues relating to the listed subsidiary.

The parent company's AC could also consider requesting the parent company's auditor to present key significant or critical issues noted by the subsidiary's auditors. Under Section 207(6) of the Companies Act, the parent company's auditors have the right of access at all times to the accounting and other records, including registers, of any subsidiary. The auditors are also entitled to require from any officer or auditor of any subsidiary information and explanations in relation to the affairs of the subsidiary as they require for the purpose of reporting on the consolidated accounts.

### FAQ 33C:



#### **Appointing External Auditors for Wholly-Owned Unlisted Subsidiaries**

**Q:**

Company A is listed on the SGX and its auditors are one of the Big 4 accounting firms in Singapore. Company A has a wholly-owned, unlisted subsidiary in China. In appointing an auditor for the subsidiary, must Company A appoint an accounting firm in China that belongs to the same Big 4 network as its auditors?

**A:**

The SGX Listing Rules do not require that the same network of accounting firms be appointed. However, Rule 715(2) of the SGX Listing Manual requires that Company A must engage suitable auditors for its significant foreign-incorporated subsidiaries and associated companies. In evaluating and selecting an appropriate auditor for its subsidiary, the AC of Company A could consider the factors as stated in paragraph 6.2.15 above. In addition, the AC should also consult its auditors on additional factors they should consider in appointing the subsidiary's auditor. This is because Company A's auditors would need to rely on the audit work performed by the subsidiary's auditors in order to express an opinion on the consolidated financial statements comprising Company A and its subsidiary.

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### *Evaluation of External Auditors for Re-appointment*

- Fees should not be the sole consideration of the AC when it recommends to the Board the re-appointment of existing auditors. Some factors that the AC may consider are:
  - The engagement partner and team members' overall business acumen and knowledge and experience in the company's industry
  - The AC's ability to build a trusting relationship with the partner in charge and its level of comfort with periodic contact between meetings
  - The auditor's ability to clearly, candidly and effectively communicate issues and concerns to the Committee, both in private sessions and during meetings
  - The auditor's ability to work co-operatively with Management, including the CEO and non-financial management, while maintaining objectivity
  - The auditor's ability to meet deadlines in providing services and responding to issues in a timely manner

### **Auditors' Independence**

6.2.16 The external auditors should be free from any business or other relationships with the company that could materially interfere with their ability to act with integrity and objectivity. The AC should give careful consideration to the actual and perceived independence of the external auditors and establish a formal and transparent framework to ensure that the external auditor's ability to conduct the audit is not impaired, or perceived to be impaired.

6.2.17 Such a framework should include these policies and procedures:

- Obtaining an annual confirmation from the external auditors that they have maintained their independence with respect to the company in accordance with the Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities ("the Ethics Code") set out in the Fourth Schedule to the Accountants (Public Accountants) Rules (Cap. 2, R1, 2006 Ed.)



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- Pre-approve the types of services (audit and permissible non-audit services) that can be performed by the external auditors. For non-audit services, AC could consider setting a fee limit above which the AC should be consulted and separately approve and/or require annual reporting and review of such services on a case-by-case basis
- Under the Ethics Code, there are certain restrictions on non-assurance services that may be provided by the external auditor
- Examples of prohibited services include, but are not limited to:
  - Accounting and bookkeeping services
  - IA services
  - Information technology (IT) systems services involving the design or implementation of financial IT systems used to generate information forming part of the client's financial statements
  - Recruitment services in respect of certain key management positions (e.g. CEO, CFO)
  - Valuation services involving matters material to the financial statements and significant degree of subjectivity
  - Certain corporate finance services (e.g. promoting, dealing in or underwriting the client's shares)
- For non-assurance services that are not clearly prohibited, the AC should review the nature of the services to ensure that independence threats arising (e.g. self-review, self-interest, advocacy threats) are not significant or safeguards are being applied to reduce the threat to an acceptable level

### FAQ 34:



#### Assessing Auditor Independence

**Q:**

Can the company engage the tax department of its external auditors to provide tax services?

**A:**

Most tax services may be carried out by the tax arm of the external auditors without impinging upon the independence of the external auditors. Taxation services comprise a broad range of services, including:

- (a) Tax return preparation and compliance
- (b) Tax planning and other tax advisory services
- (c) Assistance in the resolution of tax disputes/appeals

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 6: EXTERNAL AUDIT

As for other services which are not prohibited, the AC should review the specific nature and scope of each type of tax work and ensure that the conduct of these services will not result in self-review or advocacy threats to the external audit.

- Review the non-audit services provided by the external auditors on an annual basis and the corresponding fees
- Where the fees paid to the external auditors for non-audit services in a financial year exceed 50% of the total amount of fees paid to the auditors in that financial year, the AC should conduct a review of all fees and expenses paid to the auditors and determine if the auditors' independence may be impaired<sup>53</sup>
- Where the total amount of annual fees from non-audit services compared to annual audit fees is 50% or more, the AC should request for the external auditor's independence assessment and conduct its own review to evaluate if the appropriate safeguards have been applied so as to determine if the auditors' independence may be impaired

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<sup>53</sup> Regulation 12 of the Companies Regulations and Section 206(1A) of the Companies Act

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 6: EXTERNAL AUDIT

### 6.3 Regulatory Requirements and Guidelines

*The following list of regulatory requirements and guidelines is not intended to be exhaustive and serves only as a reference for this section of the Guidebook. They are only summaries for ease of reference and it is advisable to refer to the actual section or rule in its entirety when applying it to particular situations or events.*

#### *Audit Committees*

**6.3.1 CA Section 201B (5):** The functions of an AC shall include:

(a) to review

- (i) with the auditor, the audit plan;
- (ii) with the auditor, his evaluation of the system of internal accounting controls;
- (iii) with the auditor, his audit report;
- (iv) the assistance given by the company's officers to the auditor;
- (v) the scope and results of the internal audit procedures; and
- (vi) the balance-sheet and profit and loss account of the company and, if it is a holding company, the consolidated balance-sheet and profit and loss account, submitted to it by the company or the holding company, and thereafter to submit them to the directors of the company or the holding company; and

(b) to nominate a person or persons as auditor, notwithstanding anything contained in the articles or under section 205, together with such other functions as may be agreed to by the AC and the Board of Directors.

**6.3.2 CA Section 201B(6):** The auditor has the right to appear and be heard at any meeting of the AC and shall appear before the Committee when required to do so by the Committee.

**6.3.3 CA Section 201B(7):** Upon the request of the auditor, the Chairman of the AC shall convene a meeting of the Committee to consider any matters the auditor believes should be brought to the attention of the directors or shareholders.

**6.3.4 The Code Guideline 12.4(d):** The duties of the AC should include reviewing the scope and results of the external audit, and the independence and objectivity of the external auditors.

**6.3.5 The Code Guideline 12.4(e):** The duties of the AC should include making recommendations to the Board on the appointment, re-appointment and removal of the external auditors, and approving the remuneration and terms of engagement of the external auditors.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 6: EXTERNAL AUDIT

6.3.6 **The Code Guideline 12.5:** The AC should meet (a) with the external auditors, and (b) with the internal auditors, without the presence of Management, at least annually.

6.3.7 **The Code Guideline 12.6:** The AC should review the independence of the external auditors annually and should state (a) the aggregate amount of fees paid to the external auditors for that financial year, and (b) a breakdown of the fees paid in total for audit and non-audit services respectively, or an appropriate negative statement, in the company's Annual Report. Where the external auditors also supply a substantial volume of non-audit services to the company, the AC should keep the nature and extent of such services under review, seeking to maintain objectivity.

### *Appointment of Auditors*

6.3.8 **CA Section 206 (1A):** Without prejudice to subsection (1), a public company shall, under prescribed circumstances, undertake a review of the fees, expenses and emoluments of its auditor to determine whether the independence of the auditor has been compromised, and the outcome of the review shall be sent to all persons entitled to receive notice of general meetings of the company.

6.3.9 **CReg Regulation 12:** For the purposes of section 206(1A) of the Act, a review of the fees, expenses and emoluments of an auditor of a public company shall be undertaken if the total amount of the fees paid to the auditor for non-audit services in any financial year of the company exceeds 50% of the total amount of the fees paid to the auditor in that financial year.

6.3.10 **Listing / Catalist Rule 712(1):** An issuer must appoint a suitable auditing firm to meet its audit obligations, having regard to the adequacy of the resources and experience of the auditing firm and the audit engagement partner assigned to the audit, the firm's other audit engagements, the size and complexity of the listed group being audited, and the number and experience of supervisory and professional staff assigned to the particular audit.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## SECTION 6: EXTERNAL AUDIT

**6.3.11 Listing / Catalyst Rule 712(2):** The auditing firm appointed by the issuer must be:-

- (a) Registered with the Accounting and Corporate Regulatory Authority (“ACRA”);
- (b) Registered with and/or regulated by an independent audit oversight body acceptable to the Exchange. Such oversight bodies should be members of the International Forum of Independent Audit Regulators, independent of the accounting profession and directly responsible for the system of recurring inspection of accounting firms or are able to exercise oversight of inspections undertaken by professional bodies; or
- (c) Any other auditing firm acceptable by the Exchange.

**6.3.12 Listing / Catalyst Rule 713(1):** An issuer must disclose in its annual report the date of appointment and the name of the audit partner in charge of auditing the issuer and its group of companies. The audit partner must not be in charge of more than 5 consecutive audits for a full financial year, the first audit being for the financial year beginning on or after 1 January 1997, regardless of the date of listing. The audit partner may return after two years.

**6.3.13 Listing / Catalyst Rule 715(1):** Subject to Rule 716, an issuer must engage the same auditing firm based in Singapore to audit its accounts, and its Singapore-incorporated subsidiaries and significant associated companies.

**6.3.14 Listing / Catalyst Rule 715(2):** An issuer must engage a suitable auditing firm for its significant foreign-incorporated subsidiaries and associated companies.

**6.3.15 Listing / Catalyst Rule 716(1) and (2):** An issuer may appoint different auditing firms for its subsidiaries or significant associated companies provided that the issuer’s Board and Audit Committee are satisfied that the appointment would not compromise the standard and effectiveness of the audit of the issuer; or the issuer’s subsidiary or associated company, is listed on a stock exchange.

### *Annual Reports*

**6.3.16 Listing Rule 1207(6)(b) / Catalyst Rule 1204(6)(b):** The annual report must contain enough information for a proper understanding of the performance and financial conditions of the issuer and its principal subsidiaries, including at least a confirmation by the Audit Committee that it has undertaken a review of all non-audit services provided by the auditors and they would not, in the Audit Committee’s opinion, affect the independence of the auditors.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

### Appendix A1: Sample confirmation of Director's independence form

(In completing this confirmation, a Director may wish to consider other factors that could affect his independence. These are discussed under "Independence and Objectivity", sections 1.2.1 and 1.2.2 of the "AC Composition" section.)

**[COMPANY NAME]**  
(Incorporated in [COUNTRY NAME])  
(Co. Reg. No: [CO NO])

### CONFIRMATION OF INDEPENDENCE

To the best of my knowledge and belief, as at the date of this document, I confirm the following:

1. That I \*am/am not an employee of **[COMPANY NAME]** ("the Company") or any of its related corporations and \*have/have not been employed by the Company or any of its related corporations for the current or any of the past three financial years.
2. That I \*have/do not have an immediate family member (\*spouse, child, adopted child, step-child, brother, sister or parent) who is, or has been in any of the past three financial years, employed by the Company or any of its related corporations and whose remuneration is determined by the Company's Remuneration Committee.
3. That I, or my immediate family member (\*spouse, child, adopted child, step-child, brother, sister or parent) \*have/have not accepted any significant compensation from the Company or any of its related corporations for the provision of services for the current or immediate past financial year, other than compensation for Board service.
4. That I \*am/am not, or my immediate family member (\*spouse, child, adopted child, step-child, brother, sister or parent) \*is/is not, and have/have not been, in the current or immediate past financial year, \*a 10% shareholder of \*or a partner in (with 10% or more stake), \*or an executive officer of, or \*a director of, any organisation to which the Company or any of its subsidiaries made, or from which the Company or any of its subsidiaries received, significant payments or material services which may include auditing, banking, consulting and legal services (including any amount which aggregated over any financial year is in excess of S\$200,000), in the current or immediate past financial year.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

5. That I \*am/am not, or any of my immediate family members (\*spouse, child, adopted child, step-child, brother, sister or parent) \*is/is not a 10% shareholder of the Company.

6. That I \*am/am not or \*have/have not been directly associated with\*\* a 10% shareholder of the Company, in the current or immediate past financial year.

*\*\* defined as being accustomed or under an obligation, formal or informal, to act in accordance with the directions, instructions or wishes of the 10% shareholder in relation to the corporate affairs of the corporation*

7. That I \*do/do not have a relationship with the Company, its related corporations, its 10% shareholders or its officers that could interfere or be reasonably perceived to interfere, with my exercise of independent business judgment with a view to the best interests of the Company and in carrying out my functions as an Independent Director and as a member of any Board committee(s).

Relevant details in respect of my above declarations are as follows:

*(Note to Director: If any of the relationships stated above exist, please provide details)*

.....  
.....  
.....

In view of the foregoing, I am of the opinion that I \*suitable/unsuitable to be considered an Independent Director for the purposes of Principle 2 of the Code of Corporate Governance.

.....  
Name :  
Date :

*\* Delete, where inapplicable.*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

### Appendix A2: Sample AC Terms of Reference

#### ***Example 1 - Sample AC Terms of Reference [where a separate Board Risk Committee (BRC) established]<sup>54</sup>***

##### **Objective**

To support the Board fulfil its oversight responsibilities in the following areas of:

- Financial statement preparation and integrity
- Risk management and internal controls (in relation to financial reporting risk)
- Internal audit (resources, performance and scope of work)
- External audit (qualifications, independence, engagement and fees)

Additional delegation of responsibilities to the AC may include the following:

- Compliance (legal, regulatory and company policies)
- Interested persons transactions (IPTs)

##### **Authority**

The AC is authorised<sup>55</sup> by the Board to:

- Assist the Board in fulfilling its roles and responsibilities in accordance with the Terms of Reference detailed in this document
- Seek any information that it requires from any employee of the company in order to perform its duties
- Have direct and unrestricted access to the representatives of the external auditor, Head of IA, and Management
- Meet with any relevant person of the company without the executive manager present, if necessary
- Obtain professional advice at the company's expense whenever deemed necessary<sup>56</sup>

##### **Membership**

The Board shall appoint an AC that has sufficient and relevant expertise to fulfill its role effectively<sup>57</sup>.

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<sup>54</sup> KPMG Risk Consulting, Singapore 2014

<sup>55</sup> Guideline 12.3 of the Code

<sup>56</sup> Guideline 6.5 of the Code

<sup>57</sup> Guideline 12.2 of the Code



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

The AC shall consist of the following:

- At least three directors
- Be composed exclusively of non-executive directors
- Have a majority of its members, including the AC Chairman, as independent<sup>58</sup>

New AC members shall receive an induction covering the AC's Terms of Reference, and be provided with an overview of the company's risk management and internal control systems.

The AC members are required to keep abreast of changes in accounting standards and issues which have a direct impact on financial statements<sup>59</sup>.

### Secretary

The Secretary of the company shall be the Secretary of the AC.

### Meetings

The AC shall meet at least four times a year at appropriate times in the company's reporting and audit cycle and whenever deemed necessary.

Attendance by all AC members at each meeting is expected, whether in person or via tele- or video-conference. The AC will invite members of Management (e.g. CEO, CFO), auditors (e.g. Head of IA, external auditor) or others (e.g. Non-Executive Directors, subject matter experts) to attend meetings and provide pertinent information, as necessary.

The AC will meet separately, periodically (at least annually) with Management. The AC shall meet (a) with the external auditors, and (b) with the internal auditors, in each case without the presence of Management, at least annually<sup>60</sup>. The external auditors and internal auditors may request a meeting with the AC whenever deemed necessary.

Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes will also be prepared.

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<sup>58</sup> Guideline 12.1 of the Code

<sup>59</sup> Guideline 12.8 of the Code

<sup>60</sup> Guideline 12.5 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

### Reviews

To ensure that the AC is fulfilling its stewardship duties to the Board, the AC will:

- review, at least annually, the AC Terms of Reference and recommend to the Board any appropriate amendments for approval
- review the annual agenda incorporating any changes in the Terms of Reference
- agree and review its key performance metrics with the NC with respect to how it discharges its roles and responsibilities
- conduct an annual assessment of its performance against its Terms of Reference duties and responsibilities and provide a report of the findings to the Board<sup>61</sup>
- conduct an annual assessment of each AC member (the AC Chairman should provide a report of the findings to the NC and Board Chairman)<sup>62</sup>

### Reporting Requirements

In addition to providing the Board with a copy of the agenda, committee papers and minutes of its meetings, the AC will ensure that:

- the AC Chairman reports to the Board on AC meetings, regarding all relevant matters and appropriate recommendations, in a written report (with supporting material) for noting or approval by the Board
- the AC addresses any other reporting responsibilities

### Responsibilities

The Board shall appoint an AC that has sufficient and relevant expertise to fulfill its role effectively<sup>63</sup>.

#### i) Overseeing Financial Reporting

- Monitor the integrity of the financial information provided by the company, in particular by reviewing the relevance and consistency of the accounting standards used by the company (i.e. entity level) and its group (i.e. consolidation level)
- Assess, and challenge, where necessary, the accuracy, completeness, and consistency of financial information (including interim reports) before submitting to the Board for approval or made public
- Review the assurance provided by the CEO and CFO regarding the financial records being properly maintained and the financial statements giving a true and fair view of the company's operations and finances<sup>64</sup>

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<sup>61</sup> Principle 5 of the Code

<sup>62</sup> Principle 5 of the Code

<sup>63</sup> Guideline 12.2 of the Code

<sup>64</sup> Guideline 11.3 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

### ii) **Overseeing Risk Management and Internal Controls Over Financial Reporting**

- At least annually, review the adequacy and effectiveness of the risk management and internal control systems regarding financial reporting risks<sup>65</sup>. This may include reviewing Management and/or assurance provider reports (e.g. IA) to highlight significant findings and recommendations, inclusive of Management's responses
- Review periodically management risk profiles identifying significant risk areas (with particular focus on financial reporting risks and controls)
- Coordinate with the BRC on its oversight of non-financial and financial risk management and internal control matters. Arrange for access to and review BRC reports regarding the adequacy and effectiveness of risk management and internal control systems
- Where responsibility is delegated by the Board, prepare AC report regarding the adequacy and effectiveness of risk management and internal control systems to the Board (as part of SGX Listing Rule 1207 (10) requirements and Principle 11 of the Code of Corporate Governance)
- Review disclosures in the Annual Report relating to the adequacy and effectiveness of the risk management and internal control systems (with particular focus on financial reporting risks and controls)<sup>66</sup>
- Review the company's procedures for detecting fraud and whistle-blowing, and ensure that arrangements are in place by which staff of the company and any other persons may, in confidence, raise concerns about possible improprieties in matters of financial reporting, financial control, or any other matters<sup>67</sup>

### iii) **Overseeing Internal Audit**

- Monitor and assess the role and effectiveness of the IA function<sup>68</sup> (including the IA charter, plans, activities, staffing, budget, resources, and organisational structure of the IA function)
- Conduct internal quality assurance review (QAR) of the IA function at least annually<sup>69</sup>. Conduct independent validation of QAR at least once every five years
- Where the QAR identifies gaps/ lack of expertise with the existing IA function, the AC may consider co-sourcing or outsourcing options for the IA function.
- Review the IA program and reports on a periodic basis and monitor Management's responsiveness to the findings and recommendations

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<sup>65</sup> Guideline 11.2 of the Code

<sup>66</sup> Guideline 11.3 of the Code

<sup>67</sup> Guideline 12.7 of the Code

<sup>68</sup> Guideline 12.4 of the Code

<sup>69</sup> Guideline 13.5 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

- Ensure that the Head of IA has direct and unrestricted access to the Chairman of the Board and AC, and is able to meet separately and privately to discuss matters/concerns<sup>70</sup>
- Participate in the appointment, replacement or dismissal of the Head of IA<sup>71</sup>

### iv) **Overseeing External Audit**

- Oversee the company's relations with the external auditor (including audit scope, approach and fees)<sup>72</sup>
- Review the performance of the external auditors, to facilitate the selection, appointment, re-appointment, and removal (e.g. assess effectiveness through level of errors identified, accuracy in handling key accounting audit judgments, and response to queries from the AC)<sup>73</sup>
- Monitor and assess annually, the external auditor's independence or objectivity is not impaired (including the amount of fees and provision of non-audit services)<sup>74</sup>
- Review the audit representation letter (particularly in relation to non-standard issues) and the external auditor's Management letter to assess whether it is based on a good understanding of the company's business, and monitor the responsiveness of Management to the recommendations made (or the reasons why they have not been acted upon)
- Establish regular meetings with the external auditors to discuss matters that the AC or auditors believe should be discussed privately
- Ensure that the external auditors have direct and unrestricted access to the Chairman of the AC and the Chairman of the Board

### **Additional Responsibilities (as required)**

The following additional responsibilities may be delegated to the AC:

#### **i) Compliance**

- Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of Management's investigation and follow up of any instances of non-compliance
- Monitor the processes for addressing complaints made regarding accounting, internal controls and/or auditing matters
- Clarify the company's code of conduct and process for disseminating requirements across all company personnel and monitoring levels of compliance

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<sup>70</sup> Guideline 13.1 of the Code

<sup>71</sup> Guideline 13.1 of the Code

<sup>72</sup> Guideline 12.4 of the Code

<sup>73</sup> Guideline 12.4 of the Code

<sup>74</sup> Guideline 12.6 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

- Maintain open communication with and receive periodic reports from Management and company legal counsel regarding compliance matters

### ii) Interested Persons Transactions

- Review IPTs to consider whether they are on normal commercial terms and are not prejudicial to the interests of the company or its minority shareholders
- Determine methods or procedures for determining the transaction prices are sufficient to ensure that the transactions will be carried out on normal commercial terms and not prejudicial to the issuer or its minority shareholders
- Direct Management to present the rationale, cost-benefit analysis and other details relating to IPTs subject to a specific mandate
- Receive reports from Management and IA regarding IPTs. Report to shareholders on IPTs as required by the Listing Manual

### *Example 2 - Sample Audit and Risk Committee (ARC) Terms of Reference<sup>75</sup>*

#### Objective

To support the Board fulfil its oversight responsibilities in the following areas of:

- Financial statement preparation and integrity
- Risk management and internal controls (in relation to financial, operational, compliance, and information technology controls)
- Internal audit (resources, performance and scope of work)
- External audit (qualifications, independence, engagement and fees)

Additional delegation of responsibilities to the ARC may include the following:

- Compliance (legal, regulatory and company policies)
- Interested person transactions (IPTs)

#### Authority

The ARC is authorised<sup>76</sup> by the Board to:

- Assist the Board in fulfilling its roles and responsibilities in accordance with the Terms of Reference detailed in this document
- Seek any information that it requires from any employee of the company in order to perform its duties
- Have direct and unrestricted access to the representatives of the external auditor(s), Head of IA, and Management

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<sup>75</sup> KPMG Risk Consulting, Singapore 2014

<sup>76</sup> Guideline 12.3 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

- Meet with any relevant person of the company without the executive manager present, if necessary
- Obtain professional advice at the company's expense whenever deemed necessary<sup>77</sup>

### Membership

The Board shall appoint an ARC that has sufficient and relevant expertise to fulfill its role effectively<sup>78</sup>.

The ARC shall consist of the following:

- At least three directors
- Be composed exclusively of non-executive directors
- Have a majority of its members, including the ARC Chairman, as independent<sup>79</sup>

New ARC members shall receive an induction covering the ARC's Terms of Reference, and be provided with an overview of the risk management and internal control systems.

The ARC members are required to keep abreast of changes in accounting standards and issues which have a direct impact on financial statements<sup>80</sup>.

### Secretary

The Secretary of the company shall be the Secretary of the ARC.

### Meetings

The ARC shall meet at least four times a year at appropriate times in the company's reporting and audit cycle and whenever deemed necessary.

Attendance by all ARC members at each meeting is expected, whether in person or via tele- or video-conference. The ARC will invite members of Management (e.g. CEO, CFO), auditors (e.g. Head of IA, external auditor) or others (e.g. Non-Executive Directors, subject matter experts) to attend meetings and provide pertinent information, as necessary.

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<sup>77</sup> Guideline 6.5 of the Code

<sup>78</sup> Guideline 12.2 of the Code

<sup>79</sup> Guideline 12.1 of the Code

<sup>80</sup> Guideline 12.8 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

The ARC will meet separately, periodically (at least annually) with Management. The ARC shall meet (a) with the external auditors, and (b) with the internal auditors, in each case without the presence of Management, at least annually<sup>81</sup>. The external auditors and internal auditors may request a meeting with the ARC whenever deemed necessary.

Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes will also be prepared.

### Reviews

To ensure that the ARC is fulfilling its stewardship duties to the Board, the ARC will:

- review, at least annually, the ARC Terms of Reference and recommend to the Board any appropriate amendments for approval
- review the annual agenda incorporating any changes in the Terms of Reference
- agree and review its key performance metrics with the NC with respect to how it discharges its roles and responsibilities
- conduct an annual assessment of its performance against its Terms of Reference duties and responsibilities and provide a report of the findings to the Board<sup>82</sup>
- conduct an annual assessment of each ARC member (the ARC Chairman should provide a report of the findings to the NC and Board Chairman)<sup>83</sup>

### Reporting Requirements

In addition to providing the Board with a copy of the agenda, committee papers and minutes of its meetings, the ARC will ensure that:

- the ARC Chairman reports to the Board on ARC meetings, regarding all relevant matters and appropriate recommendations, in a written report (with supporting material) for noting or approval by the Board
- the ARC addresses any other reporting responsibilities

### Responsibilities

The Board shall appoint an ARC that has sufficient and relevant expertise to fulfill its role effectively<sup>84</sup>.

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<sup>81</sup> Guideline 12.5 of the Code

<sup>82</sup> Principle 5 of the Code

<sup>83</sup> Principle 5 of the Code

<sup>84</sup> Guideline 12.2 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

### i) **Overseeing Financial Reporting**

- Monitor the integrity of the financial information provided by the company, in particular by reviewing the relevance and consistency of the accounting standards used by the company (i.e. entity level) and its group (i.e. consolidation level)
- Assess, and challenge, where necessary, the accuracy, completeness, and consistency of financial information (including interim reports) before submitting to the Board for approval or made public
- Review the assurance provided by the CEO and CFO regarding the financial records being properly maintained and the financial statements giving a true and fair view of the company's operations and finances<sup>85</sup>

### ii) **Overseeing Risk Management and Internal Controls (in relation to financial, operational, compliance, and information technology controls)**

- Review the company's levels of risk tolerance and risk policies, and oversee Management in the design, implementation and monitoring of the risk management and internal control systems<sup>86</sup>
- Review the company's risk profile/risk dashboard on a regular basis to understand the significant risks facing the company and how they are being mitigated
- At least annually, review the adequacy and effectiveness of the risk management and internal control systems (including understanding the linkage between risks, controls and sources/evidence of assurance) with respect to financial, operational, compliance and information technology controls<sup>87</sup>. This may include reviewing Management and/or assurance provider reports (e.g. IA) to highlight significant findings and recommendations, inclusive of Management's responses
- Review the assurance provided by the CEO/CFO regarding the effectiveness of risk management and internal controls<sup>88</sup>
- Prepare ARC report regarding the adequacy and effectiveness of risk management and internal control systems to the Board (as part of SGX Listing Rule 1207 (10) requirements and Principle 11 of the Code of Corporate Governance)
- Review disclosures in the Annual Report relating to the adequacy and effectiveness of the risk management and internal control systems<sup>89</sup>
- Review the company's procedures for detecting fraud and whistle-blowing, and ensure that arrangements are in place by which staff of the company and any

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<sup>85</sup> Guideline 11.3 of the Code

<sup>86</sup> Guideline 11.1 of the Code

<sup>87</sup> Guideline 11.2 of the Code

<sup>88</sup> Guideline 11.3 of the Code

<sup>89</sup> Guideline 11.3 of the Code



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

other persons may, in confidence, raise concerns about possible improprieties in matters of financial reporting, financial control, or any other matters<sup>90</sup>

### iii) **Overseeing Internal Audit**

- Monitor and assess the role and effectiveness of the IA function<sup>91</sup> (including the IA charter, plans, activities, staffing, budget, resources, and organisational structure of the IA function)
- Conduct internal quality assurance review (QAR) of the IA function at least annually<sup>92</sup>. Conduct independent validation of QAR at least once every five years
- Where the QAR identifies the gaps/ lack of expertise with the existing IA function, the AC may consider co-sourcing or outsourcing options for the IA function
- Review the IA program and reports on a periodic basis and monitor Management's responsiveness to the findings and recommendations
- Ensure that the Head of IA has direct and unrestricted access to the Chairman of the Board and ARC, and is able to meet separately and privately to discuss matters/concerns<sup>93</sup>
- Participate in the appointment, replacement or dismissal of the Head of IA<sup>94</sup>

### iv) **Overseeing External Audit**

- Oversee the company's relations with the external auditor (including audit scope, approach and fees)<sup>95</sup>
- Review the performance of the external auditors, to facilitate the selection, appointment, re-appointment, and resignation (e.g. assess effectiveness through level of errors identified, accuracy in handling key accounting audit judgments, and response to queries from the ARC)<sup>96</sup>
- Monitor and assess annually the external auditor's independence or objectivity is not impaired (including the amount of fees and the provision of non-audit services)<sup>97</sup>
- Review the audit representation letter (particularly in relation to non-standard issues) and the external auditor's Management letter to assess whether it is based on a good understanding of the company's business, and monitor the responsiveness of Management to the recommendations made (or the reasons why they have not been acted upon)
- Establish regular meetings with the external auditor to discuss matters that the ARC or auditors believe should be discussed privately.

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<sup>90</sup> Guideline 12.7 of the Code

<sup>91</sup> Guideline 12.4 of the Code

<sup>92</sup> Guideline 13.5 of the Code

<sup>93</sup> Guideline 13.1 of the Code

<sup>94</sup> Guideline 13.1 of the Code

<sup>95</sup> Guideline 12.4 of the Code

<sup>96</sup> Guideline 12.4 of the Code

<sup>97</sup> Guideline 12.6 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX A (AC COMPOSITION)

- Ensure that the external auditors have direct and unrestricted access to the Chairman of the ARC and the Chairman of the Board

### Additional Responsibilities (as required)

The following additional responsibilities may be delegated to the ARC:

#### i) Compliance

- Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of Management's investigation and follow up of any instances of non-compliance
- Monitor the processes for addressing complaints made regarding accounting, internal controls and/or auditing matters
- Clarify the company's code of conduct and process for disseminating requirements across all company personnel and monitoring levels of compliance
- Maintain open communication with and receive periodic reports from Management and company legal counsel regarding compliance matters

#### ii) Interested Persons Transactions

- Review IPTs to consider whether they are on normal commercial terms and are not prejudicial to the interests of the company or its minority shareholders
- Determine methods or procedures for determining the transaction prices are sufficient to ensure that the transactions will be carried out on normal commercial terms and not prejudicial to the issuer or its minority shareholders
- Direct Management to present the rationale, cost-benefit analysis and other details relating to IPTs subject to a specific mandate
- Receive reports from Management and IA regarding IPTs. Report to shareholders on IPTs as required by the Listing Manual



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B1: AC Annual Agenda Planner<sup>98</sup>

AC members are required to allocate sufficient time to effectively consider key areas of responsibility. The example agenda planner outlined below provides guidance for how to balance AC priorities throughout the year.

Scheduled meetings				
Assuming Financial Year-End 31 December	Feb	May	Aug	Nov
<b>Assess financial information</b>				
Review significant accounting and reporting issues and assess material financial estimates and assumptions used				
Review and approve quarterly financial statements and announcements				
Review budget and forecasts				
Review conflicts of interest, interested and related party transactions				
<b>AC composition and effectiveness</b>				
Review AC charter, annual agenda and attendees				
Assess AC composition including individual member's performance, qualifications (e.g. financial literacy, skills and experience) and member rotation/succession planning				
<b>Risk management and internal controls</b>				
Assess requirements of SGX listing rule 1207 (10) and Code of Corporate Governance Principle 11 regarding adequacy and effectiveness of: - risk management (e.g. risk profile, risk appetite) - internal controls (e.g. IA and CSA findings and results)				
Review CEO/CFO assurance to Board regarding effectiveness of risk management and internal control				

	Recommended timing
	As required

<sup>98</sup> KPMG Risk Consulting, Singapore 2014 – Extract from KPMG's AC Annual Agenda Planner

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Scheduled meetings				
Assuming Financial Year-End 31 December	Feb	May	Aug	Nov
<b>External auditors</b>				
Recommend appointment and re-appointment and evaluation of the external auditors (including review of fees, provision of non-audit services, objectivity/independence, review of audit plan)				
Review external auditor's report, findings and progress on Management actions (discuss issues with auditor in the absence of Management)				
<b>Internal auditors</b>				
Review IA charter (if necessary), approve appointment of IA and review performance				
Review IA plan (including progress, implementation of Management actions, changes to the plan and/or resource issues) - discuss issues with the internal auditor in the absence of Management				
<b>Compliance and other responsibilities (If delegated to the AC)</b>				
Review legal and regulatory matters that may have a material impact on the company				
Review compliance report from Management, and correspondence (if any) from regulatory bodies (with a material impact on the company)				
Review whistle-blowing arrangements and reports as well as irregularities (including fraud) reports				
Conduct special investigations and perform other activities, as appropriate				
<b>Reporting</b>				
Maintain minutes and report to the Board				



Recommended timing



As required

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B2: Examples of good practices for an effective AC Chairman<sup>99</sup>

- **Lead from the front**, decide what your AC is going to achieve, plan a schedule and push it through vigorously, keeping up with the momentum. A useful AC will be pro-active, not merely a critical audience
- **Get the timetable for meetings right** to ensure that the AC considers matters in good time for recommendations to be effective and influential
- **Use the agenda both to control meetings** (ensure the right topics are covered in the right order) and to ensure that members are prepared for the meetings
- **Know the strengths and weaknesses** of the other AC members well enough to encourage and guide them effectively
- **Plan to rectify** if you do not have the right mix of knowledge and experience amongst the AC members to give the support you need
- **Ensure that the AC's decision and concerns are reported to the Board** regularly and effectively, orally as well as by circulation of the minutes
- **Ensure that the CFO recognises the need to brief you** in good time on critical reporting issues, particularly any proposals to change accounting policies and why
- **Know or learn enough about the audit** and how it is organized to be able to probe the external auditors and not to be confused by their expertise
- **Ensure that the external auditors recognise that they must keep you informed** of all relevant technical developments which will affect either the financial statements or the audit
- **Expect useful, informative, timely and relevant reports** to Management from auditors. Act promptly and vigorously on their contents
- **Be alert to indications of the external auditors' unease**, and be responsive to requests to consult with the auditors alone, outside the framework of AC meetings
- **Use the mandatory requirements of financial reporting as a lever** to increase the importance the company attaches to financial communication and to financial controls
- **Review regularly the company's approach to internal controls** and the professionalism of those employed to install and/or monitor them
- **Push for prompt and regular reports** from the IA department, focusing on identified risk areas. Regard inadequate or dilatory reporting as a danger signal which should trigger further pressure and also be drawn to the attention of the Board
- **Push for active tracking by Management of the status of audit findings**, that implementation dates for action are scheduled and that IA undertake follow up reviews
- **Maximise the power of risk management processes** such as risk self-assessment by management

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<sup>99</sup> Deloitte Touche Tohmatsu, 2004, 'Appendix 9: Tips and Hints for the AC Chairperson', *Keeping Directors on Course - Audit Committees: A Better Practice Guide*

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

- **Understand the company's approach** to obtaining and maintaining efficient and appropriate computer systems and ensuring their security. Ensure that periodic external professional reassurance is obtained about the continuing effectiveness of the systems
- **Ensure that the AC has the flexibility** to be able to respond quickly to the unexpected, and does not become entrenched in a routine. Late decisions to change financial reports may demand fast and relatively informal AC input if the AC is to avoid being by-passed

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B3: Sample AC self-assessment checklists

Examples of checklists for self-assessment of the effectiveness of the AC

#### (A) AC Self-Assessment<sup>100</sup>

Using a scale of 1 (low) to 10 (high), complete each question by placing the score in the two boxes beside the question. 'Actual' is your view of the current position of AC on that issue. 'Ideal' is the score that you would like to see. The difference will allow us to see the size of the issue and, therefore, its relative priority.

	Actual	Ideal	N/A	Comments
<b>A. Creating an Effective Audit Committee</b>				
1. Appropriate steps have been taken by the AC / Board to review / approve the committee's terms of reference on a timely basis?				
2. AC members, both individually and collectively, understand what is expected of them and the committee (eg how the committee supports the Board in discharging its responsibilities with regard to financial reporting, risk management and control)?				
3. AC members are independent of the organisation's Management and exercise their own judgement; voice their own opinions; and act freely from any conflicts of interest?				
4. The process by which AC members are appointed is appropriate?				
5. Appropriate succession planning is in place?				
6. AC members, as a whole, have sufficient skills, experience, time and resources to undertake their duties?				
7. The AC includes at least two members, including the AC chairman, with sufficient recent and relevant financial experience?				

<sup>100</sup> KPMG UK Audit Committee Institute Handbook 2013

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	Actual	Ideal	N/A	Comments
8. The AC is not over reliant on any individual member (eg the committee member with recent and relevant financial experience)?				
9. AC members have a sufficient understanding of the organisation and the sector in which it operates?				
10. AC members demonstrate the highest level of integrity (including maintaining utmost confidentiality and identifying, disclosing and managing conflicts of interest)				
11. The level of 'secretarial support' placed at the AC's disposal is appropriate?				
12. The process by which funds are made available to the AC to take independent legal, accounting or other advice (when it reasonably believes it necessary to do so) is appropriate?				
13. AC members are provided with continuing training to keep abreast of significant financial, regulatory and corporate governance developments relevant to their role and responsibilities. <sup>101</sup>				
<b>B. Running an Effective AC</b>				
1. The AC chairman's leadership style is appropriate (eg, they are decisive, open minded and courteous; do they set a good example, allow members to contribute and hold members to high standards; do they relate well to other members/attendees, deal effectively with dissent and work constructively towards consensus)?				
2. The AC's workload is dealt with effectively?				
3. AC members work together constructively as a team?				
4. The AC maintains constructive working relationships with those individuals who attend AC meetings?				

<sup>101</sup> Guideline 12.8 of the Code



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	Actual	Ideal	N/A	Comments
5. The relationship between a) the AC and b) the CEO, CFO and members of the senior Management team strikes the right balance between challenge and mutuality?				
6. The AC's discussions enhance the quality of Management's decision making (eg, the committee engages those reporting to the committee in dialogue that stimulates and enhances their thinking and performance)?				
7. The AC provides effective support to the Board in fulfilling its responsibilities and adds value to the organisation?				
8. The AC's work plan covers the committee's main responsibilities and maps across to any regulatory requirements?				
9. The AC's meeting arrangements (eg, frequency, timing, duration, venue and format) enhance its effectiveness?				
10. AC meetings allow sufficient time for the discussion of substantive matters?				
11. AC meeting agendas and related background information are circulated in a timely manner to enable full and proper consideration to be given to the important issues?				
12. AC papers are of an appropriate quality (eg, not overly lengthy and clearly explain the key issues and priorities)				
13. Sufficient time is allowed between AC meetings and meetings of the full Board to allow any work arising to be carried out and reported to the Board as appropriate?				
14. AC meetings are free from inappropriate Management influence?				
15. All meeting attendees (e.g. AC members, Executive Directors, Management and auditors) are appropriately involved in AC meetings?				
16. Appropriate arrangements are in place for the AC to meet with external / internal audit without Management being present?				

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	Actual	Ideal	N/A	Comments
17. Are private meetings with the internal and external auditors useful?				
18. The AC's meeting minutes are clear, accurate, consistent, complete and timely? They include key elements of debates and appropriate details of recommendations and any follow up action?				
20. Outstanding actions arising from AC meetings are properly followed up?				
21. The AC takes appropriate steps to ensure IA and EA cooperate appropriately to ensure the completeness of assurance coverage?				
22. There is an appropriate dialogue between IA / EA and Management? Is 'bad news' communicated to the AC in a timely manner?				
22. Appropriate processes are in place for ensuring the AC is kept fully informed on all material matters between meetings (including appropriate external information eg emerging risks and material regulatory changes)?				
23. The AC reports to the Board on a timely and accurate basis and that such communications are comprehensive, meaningful and focused?				
<b>C. Professional Development</b>				
1. New AC members are given an appropriate induction covering issues like: the role of the AC; its terms of reference; members' expected time commitment; an overview of the organisation; and the main operational and financial dynamics and risks?				
2. The ongoing professional development received by the AC (e.g. regulatory matters, accounting and financial reporting, audit and risk) is both appropriate and timely?				

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	Actual	Ideal	N/A	Comments
3. AC members are given appropriate opportunities to attend formal courses and conferences, internal talks and seminars, and briefings by external advisers such as the auditors and legal advisers?				
4. The induction and professional development programmes adequately equip AC members to understand the business environment in which organisation operates?				
<b>D. Overseeing Financial Reporting</b>				
1. Appropriate processes are in place to enable members to understand:				
<ul style="list-style-type: none"> <li>the appropriateness of the organisation's critical accounting policies, estimates and judgements?</li> </ul>				
<ul style="list-style-type: none"> <li>the clarity and completeness of disclosures in the financial statements?</li> </ul>				
<ul style="list-style-type: none"> <li>the impact on the financial statements of any developments in accounting standards or generally accepted accounting practice?</li> </ul>				
2. The AC robustly challenges the proposed financial reporting and seeks appropriate changes where necessary?				
3. The AC understands and approves the degree of Management bias inherent within the financial statements and other documents within its remit?				
<b>E. Overseeing Risk Management and Internal</b>				
1. The AC fully understands its role in providing oversight over internal financial controls; the wider aspects of internal control; and risk management systems?				
2. Does the AC understand the organisation's risk appetite for each material category of risk falling within the AC's remit?				

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	Actual	Ideal	N/A	Comments
3. Does the AC have an appropriate understanding of the processes in place to identify, evaluate and monitor the key risks facing the organisation?				
4. Appropriate processes are in place to enable the AC to understand how each material risk will impact the organisation's operations and financial condition?				
5. Appropriate processes are in place to monitor changes in the organisation's risk profile?				
6. Appropriate processes are in place to provide the AC with suitable reports on the effectiveness of the systems of internal control?				
7. Appropriate processes are in place to ensure the risk management and internal control systems are fit for purpose and working as intended?				
8. The reports presented to the AC are sufficient and timely? The focus on risk trends and Management action is appropriate?				
9. The AC splits its time appropriately between focusing on risk identification and assessment, and time spent focused on the effectiveness of the risk management framework itself? (e.g. time spent on reports and risk content v time on whether executives are taking the right approach.)				
<b>F. Overseeing External Audit</b>				
1. The AC plays an appropriate role in recommending the appointment of the external auditor?				
2. EA staff are appropriately qualified and experienced (taking into account the skills and the breadth and depth of experience necessary to cover the organisation's operations)?				

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	Actual	Ideal	N/A	Comments
3. The AC takes appropriate steps to ensure the external auditor has direct access to the AC and makes appropriate use of that access through informal as well as formal meetings?				
4. The AC has taken the appropriate steps to ensure the independence and objectivity of the external auditor is not compromised – including where the EA provides non-audit services?				
5. The process by which the AC reviews and assesses the EA work plan is appropriate?				
6. The EA work plan focuses on the organisation’s key audit risks?				
7. The quality of the EA reports (and other documents) presented to the AC is appropriate?				
8. The AC has an appropriate dialogue with the external auditor regarding the major issues that arose during the course of the audit; the key accounting and audit judgements; and the levels of errors identified during the audit?				
9. The AC takes appropriate steps to ensure Management respond to the external auditor’s enquiries and recommendations in a timely and fitting manner?				
10. The process by which the AC reviews the effectiveness of the EA is both timely and rigorous?				
<b>G. Overseeing Internal Audit</b>				
1. The AC plays an appropriate role in approving the appointment of the IA provider?				
2. The outsourced IA function is appropriately resourced taking into account the skills and the breadth and depth of experience necessary to cover the organisation’s operations?				

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## APPENDIX B (AC AGENDA)

	Actual	Ideal	N/A	Comments
3. The AC takes appropriate steps to ensure the IA partner has direct access to AC and makes appropriate use of that access through informal as well as formal meetings?				
4. The process by which the AC reviews and approves IA's remit is appropriate?				
5. The independence and objectivity of IA is not compromised in any way?				
6. The process by which the AC reviews and assesses the IA work plan is appropriate?				
7. The IA work plan focuses on the key risks and controls?				
8. The quality of IA reports (and other documents) presented to the AC is appropriate?				
9. The AC takes appropriate steps to ensure Management respond to IA recommendations in a timely and fitting manner?				
10. The process by which the AC reviews the effectiveness of the IA is both timely and rigorous?				

### H. Comparison of Audit Committee with other Audit Committees you have experience of

Issue	Comments

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### (B) Audit Committee Self-Assessment Guide<sup>102</sup>

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
<p><b><i>Financial Reporting and Disclosures</i></b>  <b><i>Your committee:</i></b>                      Adequately understands the company's <b><i>business</i></b> and the <b><i>industry</i></b> in which it operates</p>	
<p>Is satisfied the company adequately <b><i>addresses</i></b> the <b><i>risk</i></b> that the financial statements may be <b><i>materially misstated</i></b>, intentionally or unintentionally</p>	
<p>Understands how Management and the external auditors <b><i>evaluate materiality</i></b>, both <b><i>quantitatively</i></b> and <b><i>qualitatively</i></b>, for financial reporting purposes</p>	
<p>Assesses <b><i>reasonableness</i></b> and <b><i>appropriateness</i></b> of <b><i>critical accounting policies</i></b> the company follows, discussing with Management and external auditors</p>	
<p>Reviews the <b><i>reasons</i></b> for and <b><i>implications</i></b> of <b><i>changes</i></b> in <b><i>accounting principles</i></b> made at <b><i>Management's discretion</i></b>, understanding stakeholders' potential reaction before approving</p>	
<p><b><i>Scrutinizes</i></b> areas involving <b><i>Management estimates</i></b> that have a material impact on the financial statements and understands the reasonableness of the <b><i>underlying assumptions</i></b> and whether the amount recorded is closer to the <b><i>conservative or aggressive</i></b> end of the spectrum</p>	

<sup>102</sup> Adapted from *Audit Committee Effectiveness – What Works Best*, 4<sup>th</sup> edition, by The Institute of Internal Auditors Research Foundation (“IIARF”). Copyright © 2011 by The IIARF strictly reserved. No parts of this document may be reproduced, stored in any retrieval system, or transmitted in any form, or by any means electronic, mechanical, photocopying, recording, or otherwise, without prior written permission of IIARF. Permission has been obtained from the copyright holder, The IIARF to publish this reproduction, which is the same in all material respects, as the original unless approved as changed.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
Reviews with Management transactions that are <b>unusual, complex</b> , or have increased volume near period ends and their <b>accounting treatment</b> , evaluating <b>appropriateness</b> and <b>consistency</b> with members' <b>knowledge</b> of the company	
Understands Management's process to identify any significant <b>related party transactions</b> that occur during a reporting period and is satisfied with the related disclosures	
Reads <b>annual financial statements</b> , assessing their <b>completeness and consistency</b> with operational and other information known to members and discussing also with Management and the external auditors	
Reviews <b>interim financial statements</b> and related disclosures, understanding consistency with annual reporting, <b>before filing</b> with regulators	
Understands and is comfortable with <b>press releases</b> and other <b>financial information</b> (e.g., earnings guidance, forward-looking information, information for rating agencies) routinely <b>disclosed</b> by the company, including separate reporting of <b>special items</b> or <b>non-GAAP</b> disclosures	
Reads, before publication, <b>narrative reporting</b> and related information, ensuring <b>consistency</b> with <b>financial statements, completeness</b> , and appropriate <b>transparency</b> for issues such as <b>liquidity and financing needs</b>	
Discusses <b>audit results</b> with <b>external auditors</b> , considering Management's handling of corrected or <b>uncorrected misstatements</b>	



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## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
Meets periodically with <b>counsel</b> to discuss <b>litigation, claims, contingencies</b> , or other <b>significant issues</b> and their <b>impact</b> on the financial statements	
Understands how Management captures <b>all relevant information</b> in the financial statements, including how the <b>Management disclosure committee</b> functions	
Reviews any correspondence between the company and <b>regulators</b> regarding financial statement filings and disclosures	
Considers the impact of any identified <b>subsequent events</b> on financial disclosures	
<p><b>Risk Management and the System of Internal Control</b></p> <p><b>Your committee:</b></p> <p>Is comfortable with the <b>effectiveness</b> of the company's <b>risk management</b> process</p>	
Clearly <b>understands</b> and agrees with the Board on <b>which</b> of the <b>key risks</b> — likely those covering financial reporting and compliance with laws and regulations — <b>it oversees</b> on behalf of the Board. Agrees with the Board on the <b>specific scope</b> of the committee's oversight responsibilities for <b>monitoring risks</b> .	
Reviews the <b>approach</b> to and <b>extent</b> of <b>internal control testing by Management, IA, and external auditors</b> and how the testing supports any related <b>reporting</b> the company does	
Discusses with Management, IA, and external auditors their <b>observations, issues, and findings</b> on <b>internal control effectiveness</b> . Understands any <b>significant</b> or <b>material control weaknesses</b> as well as Management's plans to <b>remediate</b> any <b>control deficiencies</b> .	

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
Reads Management's <b>external reports</b> on the <b>effectiveness</b> of internal control and/or risk management and any related reports from external auditors	
Understands whether <b>compensation incentives</b> could create <b>risk</b> for financial reporting	
Understands any factors that <b>increase financial reporting fraud</b> risk and how Management addresses the risk	
Understands the risks of <b>bribery</b> and <b>corruption</b> and how Management is minimizing those risks	
<p><b>Culture and Compliance</b>  <b>Your committee:</b>            Evaluates the <b>"tone at the top"</b> and the <b>company's culture</b>, understanding their relevance to financial reporting and compliance</p>	
<b>Understands</b> the effectiveness of the company's <b>programs</b> for ensuring <b>compliance with laws and regulations</b> , considers any <b>significant compliance issues</b> identified, and is satisfied with Management's <b>actions</b>	
Ensures Management has an <b>appropriate code of conduct</b> . Makes sure that Management provides the code, along with <b>related training</b> , to employees and periodically requires employees to <b>certify</b> their <b>compliance</b> .	
Is satisfied that the company's <b>ethics</b> and <b>conduct policies</b> properly address <b>culturally</b> or <b>regionally sensitive</b> issues	
Sees that appropriate <b>support channels</b> are <b>available</b> to help employees address <b>compliance</b> and <b>ethics issues</b>	

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
<i>Meets periodically</i> with IA, general counsel, the <b>compliance officer</b> , and Management, among others, to discuss sensitive issues	
Ensures procedures are in place to <b>receive, retain, and address complaints</b> regarding accounting, internal controls, or auditing matters. Considers the potential impact and resolution of any significant issues raised through the <b>whistle-blower</b> program.	
<p><b>Oversight of Management and Internal Audit</b></p> <p><b>Your committee:</b></p> <p>Maintains a <b>productive relationship</b> with Management through open lines of communication and <b>candid, continual dialogue</b>, including between committee meetings</p>	
Strikes the <b>right balance</b> between <b>advising</b> Management and <b>monitoring</b> Management and is ready to <b>increase its engagement</b> if changes in circumstances warrant	
Ensures Management obtains the AC's <b>input</b> before making <b>key decisions</b>	
Assesses senior finance Management's <b>performance</b> and <b>competence</b> , obtaining feedback from IA and external auditors	
Monitors <b>succession plans</b> for the <b>CFO</b> and senior finance team members	
Involves Management appropriately in <b>meetings</b> and ensures <b>emphasis</b> on <b>discussion</b> , not presentation	
<b>Meets privately</b> with Management on a <b>regular</b> basis	
Builds a <b>trusting relationship</b> with <b>IA</b> that includes <b>candid</b> and <b>continual communication</b> between meetings, facilitating ability to raise sensitive issues	
Ensures the role IA plays <b>meets</b> the <b>committee's needs</b> for assurance and provides <b>value</b> to <b>Management</b>	

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## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
Approves IA 's <b>charter</b> and reviews <b>annual plans</b> and any <b>significant changes</b> ensuring appropriate coverage of risks and coordination of work with external auditors	
Ensures IA has <b>adequate resources</b> and <b>budget</b> , including quality and continuity of <b>staff</b> , with ability to supplement skills as needed	
Discusses <b>significant IA findings</b> , reported to the committee at an appropriately <b>summarized</b> level, as well as the <b>status</b> of Management's remediation actions	
Ensures IA <b>reports directly</b> to the <b>committee</b> , as well as to an appropriately <b>senior position</b> within the company, promoting IA 's stature and <b>objectivity</b>	
Plays a <b>central role</b> in <b>appointing</b> or replacing the <b>IA director</b> , <b>evaluating</b> his or her <b>performance</b> and <b>determining compensation</b>	
Evaluates IA 's <b>performance</b> and operational <b>independence</b> by weighing results of any quality control reviews as well as feedback from Management and external auditors	
<b>Meets privately</b> with the IA director on a <b>regular</b> basis	
<b>Relationship with External Auditors</b> <b>Your committee:</b> Builds a <b>trusting</b> and <b>professional relationship</b> with external auditors, ensuring <b>open</b> lines of <b>communication</b>	
Drives the <b>selection, oversight,</b> and <b>evaluation</b> of external auditors, obtaining Management's and IA 's input and considering replacement when appropriate	
Ensures external auditors' <b>independence</b> by <b>preapproving</b> audit and non-audit <b>services</b> , understanding impact of fees, and evaluating type of <b>non-audit services</b>	

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## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
Reviews the <b>EA scope</b> , understanding <b>risk coverage</b> and significant plan changes	
Receives <b>information required</b> to be <b>communicated</b> under <b>auditing</b> and <b>regulatory standards</b> and seeks insight on how the company's practices compare to those of peers	
Reviews <b>Management's representation letters</b> to the auditors and inquires about any nonstandard representations	
Understands any <b>disagreements</b> between the auditors and Management and determines whether <b>outside advice</b> is needed for <b>resolution</b>	
Understands Management's rationale for <b>using other audit firms</b> for audit work or other services	
<b>Meets privately</b> with external auditors on a <b>regular</b> basis	
<p><b>What to Do When Things Go Wrong</b>  <b>Your committee:</b>            Understands any significant <b>identified errors</b> in previously issued financial statements and agrees with Management conclusions regarding the need for <b>restatement</b></p>	
Ensures Management conducts a <b>thorough investigation</b> to identify and resolve all errors	
Understands its <b>role</b> and key considerations in overseeing <b>investigations</b> (for possible fraud or illegal acts) and is prepared to <b>take charge</b> when needed	
Has <b>authority</b> and makes the appropriate decision on whether to engage <b>outside advisers</b>	
Actively <b>monitors</b> investigation progress and ensures Management captures <b>lessons learned</b> and applies them in future investigations	

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
Is satisfied a <b>crisis management plan</b> exists and enables the company to <b>respond quickly</b> and appropriately to an emerging crisis	
<p><b>Committee Composition</b>  <b>Your committee:</b>            Has its <b>new members</b> selected by the <b>nominating committee</b> based on <b>skills</b> and <b>attributes</b> the committee needs</p>	
Considers, with the nominating committee, a need for <b>balancing continuity</b> with <b>fresh perspective</b> when addressing member turnover	
Has a <b>succession plan</b> for its members and chair	
Has a <b>chair</b> who possesses <b>strong leadership</b> qualities, ability to promote effective discussion and working relationships, and <b>time</b> and <b>financial expertise</b> to direct the committee appropriately	
Has <b>members</b> who <b>possess</b> critical <b>characteristics</b> such as integrity, courage, skepticism, independent judgment, and industry knowledge and have the available <b>time</b>	
Has members who are <b>independent</b> and possess requisite levels of <b>financial literacy</b> and financial <b>expertise</b>	
Is the <b>right size</b> , bringing requisite knowledge, abilities, and skills to the table, yet <b>small enough</b> to <b>act cohesively</b>	
<p><b>Meetings</b>  <b>Your committee:</b>            Uses a <b>scheduling calendar</b> to ensure it <b>addresses all its responsibilities</b> over the course of a year, while balancing its workload</p>	
Holds a <b>sufficient number</b> of meetings, <b>scheduled at appropriate points</b> , to address its responsibilities on a timely basis	

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Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
Ensures meetings are of <b>adequate length</b> to allow the committee to accomplish its agenda, with <b>time</b> to <b>fully discuss</b> issues	
Plans meetings properly — with the <b>chair driving the agenda</b> and members providing input	
Is satisfied it receives appropriate <b>advance material</b> for agenda topics, providing the <b>right</b> information and <b>insight</b> , and that material is received in a <b>timely</b> manner and <b>reviewed</b> by <b>members</b> before meetings	
Requires meeting attendance by the <b>right individuals</b> , those with <b>meaningful input</b> on agenda items, and <b>limits</b> the number of <b>observers</b> whose presence may hinder discussion	
Meets in separate <b>private sessions regularly</b> with the <b>CFO, IA Director</b> , and <b>external auditors</b> and periodically with <b>general counsel, compliance officer, chief risk officer</b> , and other Management — allowing <b>full and frank discussion</b> of potentially sensitive matters	
Has members meet <b>regularly</b> in <b>private session</b> , allowing <b>confidential discussion</b> of Management's and auditors' performance and reflection on other issues	
Communicates effectively with Management about issues that arise between meetings, thereby avoiding surprises	
Allows time at meetings for dialogue, with the discussion focusing on relevant topics	
Ensures <b>minutes</b> provide <b>accurate descriptions</b> of meetings, at the <b>right level of detail</b> , and reviews and approves them in a timely manner	
Reports regularly to the <b>Board</b> to discuss <b>activities, key issues, major recommendations</b> , and action plans	

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

Characteristics of Effective Audit Committees	Comments and Follow-up Actions (including any personal plans)
<p><b>Supporting Committee Effectiveness</b>  <b>Your committee:</b>            Has a <b>written charter</b>, which has been <b>approved</b> by the <b>Board</b> of Directors, that it <b>assesses</b> annually for any <b>updates</b></p>	
<p>Ensures annually that it has <b>carried out all</b> the <b>responsibilities</b> outlined in its charter</p>	
<p>Assesses <b>performance</b> of the <b>committee</b> as a <b>whole</b> annually, taking decisive corrective action and considering improvements</p>	
<p><b>Evaluates individual members' performance</b> regularly, considering training and other needed support</p>	
<p>Has proper <b>administrative support</b> on an ongoing basis and the <b>authority</b> to engage <b>additional resources</b> when needed</p>	
<p>Ensures <b>new members</b> receive <b>robust orientation</b> to enable them to understand their role and get up to speed quickly</p>	
<p>Ensures that <b>all members</b> have access to <b>continuing education</b> on business and accounting developments and other matters relevant to new responsibilities or changes in the business</p>	



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B4: Effective orientation programme topics<sup>103</sup>

#### Topics for Orientation Programmes

##### Financial Reporting and Control Reporting

- **Standard financial reports:** Information that flows through to financial reports, what key line items represent, and how to read reports and recognise issues
- **Critical accounting policies:** What they are, why they were selected, the level of estimation involved in their determination, and their impact on financial reports
- **Areas involving a high degree of judgement:** Which areas require the use of estimates and how they can impact reported results
- **Internal Control over financial reporting:** The control environment, security and integrity of information systems, how Management addresses key risks (including fraud risk), how Management monitors control effectiveness, public reports on internal control and status of control deficiencies
- **Earning trends:** Financial position and prospects of the company, as well as analysts' expectations and the achievability of forecasts
- **Financial and liquidity:** The company's debt and financing structure, availability of capital, and timing of near-term refinancing

##### Other responsibilities

- **Statutory and regulatory requirements:** Nature of such requirements, background of current issues, including restrictions placed on the company and on the AC
- **Compliance:** Elements of the compliance programme and AC's oversight role
- **Whistle-blower programme:** Procedures for handling complaints about accounting, internal control, or auditing matters: reporting to the AC; and whistle-blower history/experience
- **Code of conduct:** Provisions; how it is communicated and enforced
- **Legal issues:** Legal matters that could have financial reporting implications

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<sup>103</sup> Adapted from *Audit Committee Effectiveness – What Works Best*, 4<sup>th</sup> edition, by The Institute of Internal Auditors Research Foundation ("IIARF"). Copyright © 2011 by The IIARF strictly reserved. No parts of this document may be reproduced, stored in any retrieval system, or transmitted in any form, or by any means electronic, mechanical, photocopying, recording, or otherwise, without prior written permission of IIARF. Permission has been obtained from the copyright holder, The IIARF to publish this reproduction, which is the same in all material respects, as the original unless approved as changed.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Audit Committee Processes

- **The Committee's charter:** Outline of key responsibilities and authority
- **Meeting schedule and agendas:** Meeting frequency, length and typical topics
- **Support and resources:** Who supports the AC
- **AC assessment:** Self-assessment and charter review processes
- **AC Chairman:** Role, special activities, reporting to full Committee and to the Board

### Key relationships

- **Management:** Identity of key finance and business unit management, backgrounds, and experience
- **Internal audit:** Responsibilities, capabilities, reporting relationship with the Committee, nature of audit plans, and reports
- **External auditors:** Relationship with the Committee, audit scope, and reports
- **Others:** Identity and credentials of other key personnel reporting periodically to the Committee (e.g. chief compliance officer, chief risk officer, ethics officer, legal counsel)

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B5: Differences between IPT and RPT<sup>104</sup>

	Related party transactions (RPT)	Interested person transactions (IPTs)
Definition	<p><b>RPT includes transactions with key Management personnel.</b> RPT includes persons who have control or joint control over the reporting entity, have significant influence over the reporting entity, or are a member of the key Management personnel of the reporting entity or of a part of the reporting entity.</p> <p><b>The related parties may not necessarily be a director, Chief Executive Officer, or controlling shareholder of the issuer.</b> The main intention is presumably to ensure that transactions with persons with responsibilities similar to those of directors and the compensation paid to such person, do not escape disclosure simply because they are not directors.</p>	<p><b>IPT means transactions between an entity at risk and a director, Chief Executive Officer, or controlling shareholder of the issuer; or an associate of such director, Chief Executive Officer, or controlling shareholder.</b></p> <p><b>Entity at risk means:</b></p> <ul style="list-style-type: none"> <li>(a) The listed company;</li> <li>(b) A subsidiary of the listed company that is not listed on the SGX or on an approved exchange; or</li> <li>(c) An associated company of the listed company that is not listed on the SGX or on an approved exchange, provided that the listed company and/or its subsidiaries, or the listed group and its interested person, has control over the associated company.</li> </ul> <p>where</p> <ul style="list-style-type: none"> <li>(i) approved exchange means a stock exchange that has rules which safeguard the interests of</li> </ul>

<sup>104</sup> KPMG Risk Consulting, Singapore 2014

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

		<p>shareholders against interested person transactions<sup>105</sup></p> <p>(ii) control refers to the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of a company<sup>106</sup></p> <p>(iii) associated company means a company in which at least 20% but not more than 50% of its shares are held by the listed company or group<sup>53</sup></p>
Governing Regulation	Singapore Financial Reporting Standards (FRS) 24 (implemented 1 January 2011).	Listing Manual Chapter 9.

<sup>105</sup> SGX Listing Rule 904(1)

<sup>106</sup> SGX Mainboard Rules – Definitions and Interpretations

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	Related party transactions (RPT)	Interested person transactions (IPTs)
Entities Applicable	All entities which adopt FRS24 (partial exemption of paragraph 18 for government-related entities as per paragraph 25)	Companies listed on SGX and their entities at risk
Rationale for Disclosure	Enable <b><u>users of the financial statements</u></b> to form a view about the effects of related party relationships on an entity.	Guard against the risk that interested persons could influence the entity at risk, to enter into transactions with interested persons that may adversely affect <b><u>the interests of the issuer or its minority shareholders</u></b>
Transactions Covered	<p>FRS 24 requires entities to disclose these transactions:</p> <p>(a) Key Management personnel compensation includes:</p> <ul style="list-style-type: none"> <li>• Short-term employee benefits - wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses and non-monetary benefits for current employees</li> <li>• Post-employment benefits - pensions, other retirement benefits, post-employment life insurance and post-employment medical care</li> </ul>	<p>Listing Rule 904 defines 'transactions' as including:</p> <p>(a) provision or receipt of financial assistance;</p> <p>(b) acquisition, disposal or leasing of assets;</p> <p>(c) provision or receipt of services;</p> <p>(d) issuance or subscription of securities;</p> <p>(e) granting of or being granted options; and</p> <p>(f) establishment of joint ventures or joint investments;</p> <p>whether or not in the ordinary course of business and whether or not entered into directly or indirectly (for example, through one or more interposed entities)</p>

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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	Related party transactions (RPT)	Interested person transactions (IPTs)
Transactions Covered (continued)	<ul style="list-style-type: none"> <li>• Other long-term benefits - long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within 12 months after the end of the period, profit sharing and deferred compensation                             <ul style="list-style-type: none"> <li>- Termination benefits</li> <li>- Share-based payment</li> </ul> </li> <li>(b) Other transactions</li> </ul> <p>FRS 24 requires that if there have been transactions between related parties, an entity shall disclose the nature of the related party relationships as well as information about the transactions and outstanding balances, including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements.</p>	<p>An issuer must disclose the aggregate value of IPTs entered into during the financial year under review in its annual report. The name of the interested person and the corresponding aggregate value of the IPTs entered into with the same interested person must be disclosed in the format prescribed.</p> <p>The company will make an immediate announcement<sup>107</sup> of:</p> <ul style="list-style-type: none"> <li>(a) IPTs of a value equal to, or more than, 3% of the group's latest audited net tangible assets (NTA); and</li> <li>(b) the latest IPT, if the aggregate value of all transactions entered into with the same interested person during the same financial year amounts to 3% or more of the group's latest audited NTA, and of all future transactions entered into with that same interested person during that financial year.</li> </ul>

<sup>107</sup> SGX Listing Rule 905

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

	<b>Related party transactions (RPT)</b>	<b>Interested person transactions (IPTs)</b>
Transactions Covered (continued)	<p>At minimum, the disclosure shall include:</p> <ul style="list-style-type: none"> <li>• The amount of the transactions</li> <li>• The amount of outstanding balances, including commitments and: <ul style="list-style-type: none"> <li>– their terms and conditions, including whether they are secured and the nature of the consideration to be provided in settlement and</li> <li>– details of any guarantees given or received</li> </ul> </li> <li>• Provisions for doubtful debts related to the amount of outstanding balances</li> <li>• The expense recognised during the period in respect of bad or doubtful debts due from related parties</li> </ul>	<p>The company will obtain shareholder approval<sup>108</sup> of:</p> <p>(a) IPTs of a value equal to, or more than, 5% of the group's latest audited NTA; or</p> <p>(b) IPTs of a value equal to, or more than, 5% of the group's latest audited NTA, when aggregated with other transactions entered into with the same interested person during the same financial year.</p>
Materiality for Disclosure	<p>In determining whether RPT need to be disclosed in financial statements, the general concept of 'materiality' should be applied.</p>	<p>The Listing Manual only requires transactions that are S\$100,000 and above to be taken into consideration.</p>

<sup>108</sup> SGX Listing Rule 906

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B6: Sample IPT Policy and Procedures<sup>109</sup>

#### **Policy:**

It is the policy of the Board of Company A ('Company') that all interested person transactions with an interested person, as those terms are defined in this statement of policy, should be at arm's length and on terms generally available to an unaffiliated third-party under the same or similar circumstances.

This is to guard against risk that interested persons could influence the Company, its subsidiaries or associated companies, to enter into transactions with interested persons that may adversely affect the interests of the Company or its shareholders<sup>110</sup>.

#### **Policy Requirements:**

To achieve this, the Company will adopt the following policies:

##### **(i) Identify IPTs**

- *Require interested persons to declare their interests, shareholdings and directorships periodically*

This enables the Company to keep abreast of potential situations that could give rise to IPTs and provides a base for proactive monitoring.

- *Maintain a register or list of interested persons, Entity-at-Risk ("EAR") and IPTs*

This enables the Company to maintain awareness of interested persons, EAR and IPTs to monitor transactions, adhere to review and approval requirements and facilitate announcements and disclosures as required.

##### **(ii) Establish IPT oversight framework**

- *Establish a Delegation of Authority (DoA) framework for IPTs*

This enables the Company to formalise and communicate to key stakeholders (including but not limited to the Board and Management employees) the review and approval requirements regarding IPTs (in terms of dollar limits, percentage of audited NTA and timing of review/approvals).

- *Make immediate announcement of IPTs not covered by existing General Mandate<sup>111</sup>*

The Company will make an immediate announcement of:

- (a) any IPTs of a value equal to, or more than, 3% of the group's latest audited net tangible assets (NTA); and

<sup>109</sup> KPMG Risk Consulting, Singapore 2014

<sup>110</sup> SGX Listing Rule 901

<sup>111</sup> SGX Listing Rule 905



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- (b) the latest IPT, if the aggregate value of all transactions entered into with the same interested person during the same financial year amounts to 3% or more of the group's latest audited NTA, and of all future transactions entered into with that same interested persons during that financial year.

This policy does not apply to any transaction below S\$100,000.

- *Obtain shareholder approval for IPTs not covered by existing General Mandate*<sup>112</sup>  
The Company will obtain shareholder approval of:
  - (a) IPTs of a value equal to, or more than, 5% of the group's latest audited NTA;  
or
  - (b) IPTs of a value equal to, or more than, 5% of the group's latest audited NTA, when aggregated with other transactions entered into with the same interested person during the same financial year.

However, a transaction which has been approved by shareholders, or is the subject of aggregation with another transaction that has been approved by shareholders, need not be included in any subsequent aggregation.

This policy does not apply to any transaction below S\$100,000.

- *General Mandate from shareholders for recurrent transactions*<sup>113</sup>  
A general mandate can be sought from shareholders for recurrent IPTs of a revenue or trading nature or those necessary for its day-to-day operations such as the purchase and sale of supplies and materials, but not in respect of the purchase or sale of assets, undertakings or businesses. Such general mandate is subject to annual renewal. If a general mandate has been obtained, the Company shall comply with the review procedures for IPTs therein.

### **(iii) Announce and disclose**

- *Announce the details of IPTs*<sup>114</sup>  
The Company shall announce details of IPTs, the nature of the relevant interested person's interest in the transaction, the relevant terms of the transaction and the bases on which the terms were arrived at, as well as the rationale for and benefit to the EAR.

A statement will also announce whether or not the AC is of the view that the transaction is on normal commercial terms. If necessary, the AC will seek an opinion from an independent financial adviser before forming its view. The statement will also include the current total for the financial year of all transactions

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<sup>112</sup> SGX Listing Rule 906

<sup>113</sup> SGX Listing Rule 920(1)

<sup>114</sup> SGX Listing Rule 917

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with the particular interested person, as well as the current total of all IPTs for the same financial year.

- *Disclose the aggregate value of IPTs entered into during the financial year*  
The Company will disclose the aggregate value of IPTs in accordance with Chapter 9 of the SGX-ST Listing Manual. Refer to Appendix B6B: Sample IPT Procedures for the disclosure format.

### **Procedures<sup>115</sup>:**

[The following procedures are provided as a guide to assist companies in considering the factors necessary to operationalise the IPT Policy. Companies should develop procedures applicable to their own circumstances. These are illustrative in nature, and are not exhaustive.]

Pursuant to the IPT Policy, the following procedures will be adopted by the company:

#### **(i) Identify IPTs**

- *Ensure interested persons are fully briefed (where practicable) on IPT requirements*

The company will establish a program (e.g. briefings, training) to ensure that interested persons and other key stakeholders (such as management/directors and employees involved in the oversight and monitoring requirements) are informed of the requirements (outlined in the company's IPT Policy (Appendix B6A) and Chapter 9 of the SGX-ST Listing Manual).

- *Identify and maintain interested persons listing (including method of declaration), EAR listing and IPTs listing*

The company will establish a process that requires all interested persons to make a declaration regarding their associates and IPTs involving them and their associates. The declaration should be made by interested persons upon joining the company and reviewed on a [periodic] basis and/or in changing circumstances.

#### **(ii) Establish IPT oversight framework**

- *Review of IPTs*

The company's relevant business process owners will review the IPT in accordance with normal business procedures (e.g. sales and procurement). This review will include consideration of whether a transaction was made at arm's length and on normal commercial terms. The company should consider the role of the IA function in assisting the AC to conduct independent assessments of IPTs.

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<sup>115</sup> KPMG Risk Consulting, Singapore 2014

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

- *Approval procedures for IPTs*

The company will formalise and implement the IPT review and approval requirements. The table below may assist in clarifying the delegated authorities:

	No action	Immediate announcement		Obtain shareholder approval	
Authority	<\$100,000	>\$100,000 Less than 3% of NTA	>\$100,000 More than or equal to 3% of NTA	>\$100,000 More than or equal to 5% of NTA	Aggregated value more than or equal to 5% of NTA
Board					
Audit Committee					
CEO					
Management					

- *Monitor the above procedures to ensure interested persons make timely declarations*

The company will assign a senior executive to be responsible for the monitoring and oversight of the IPT policies and procedures framework. There should be a formally established program that involves a balance of proactive and detective monitoring of IPTs. This should also involve developing protocols for determining whether a transaction was made at arm's length and on normal commercial terms.

- *Management reporting procedures to AC*

The company shall establish [periodic] reporting to the AC on IPTs – in terms of compliance with requirements of the IPT policies and procedures framework and identification, escalation and resolution of IPT breaches.

### (iii) Announce and disclose

- *Announcement procedures<sup>116</sup>*

The company shall establish procedures to identify, assess and review relevant IPT disclosures. These should include the involvement of the AC to satisfy themselves that transactions are on normal commercial terms (which may involve seeking an opinion from an independent financial adviser).

<sup>116</sup> SGX Listing Rule 917

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

- *Procedures relating to items to be included in disclosures*

The company shall identify the IPTs that require disclosure and adhere to the requirements of Chapter 9 of the SGX-ST Listing Manual. The following IPT disclosure template<sup>117</sup> shall be used:

Name of interested person	Aggregate value of all IPTs during the financial year under review (excluding transactions less than \$100,000 and transactions conducted under a shareholders' mandate pursuant to Listing Rule 920 of the Listing Manual)	Aggregate value of all IPTs conducted under a shareholders' mandate pursuant to Listing Rule 920 of the Listing Manual (excluding transactions less than \$100,000)

### **Definitions:**

For the purposes of this policy, the following definitions apply:

**“Approved exchange”** means a stock exchange that has rules which safeguard the interests of shareholders against IPTs according to similar principles to Chapter 9 of the SGX-ST Listing Manual.

**“Associate”**<sup>118</sup> has the following definition:

In the case of a company,

- (a) in relation to any director, chief executive officer, substantial shareholder or controlling shareholder (being an individual) means:
  - (i) his immediate family;
  - (ii) the trustees of any trust of which he or his immediate family is a beneficiary or, in the case of a discretionary trust, is a discretionary object; and
  - (iii) any company in which he and his immediate family together (directly or indirectly) have an interest of 30% or more;
- (b) in relation to a substantial shareholder or a controlling shareholder (being a company) means any other company which is its subsidiary or holding company or is a subsidiary of such holding company or one in the equity of which it and/or such other company or companies taken together (directly or indirectly) have an interest of 30% or more;

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<sup>117</sup> SGX Listing Rule 907

<sup>118</sup> SGX Mainboard Rules – Definitions and Interpretations

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In the case of a REIT, “associate” shall have the meaning defined in the Code on Collective Investment Schemes issued by the MAS; and in the case of a business trust,

- (a) in relation to any director, chief executive officer, or controlling shareholder of the trustee-manager, substantial unit-holder or shareholder of the trustee-manager, substantial unit holder or controlling unit-holder of the business trust (being an individual) means:
  - (i) his immediate family;
  - (ii) the trustees of any trust of which he or his immediate family is a beneficiary or, in the case of a discretionary trust, is a discretionary object; and
  - (iii) any company in which he and his immediate family together (directly or indirectly) have an interest of 30% or more; and
- (b) in relation to the controlling shareholder of the trustee-manager or substantial unit-holder or controlling unit-holder of the business trust (being a company) means any other company which is its subsidiary or holding company or is a subsidiary of such holding company or one in the equity of which it and/or such other company or companies taken together (directly or indirectly) have an interest of 30% or more.

“**Entity at risk**” (“EAR”) means:

- (a) The Company;
- (b) A subsidiary of the Company that is not listed on the SGX or an approved exchange; or
- (c) An associated company of the Company that is not listed on the SGX or an approved exchange, provided that the Company and its subsidiaries (the “group”), or the group and its interested person(s), has control over the associated company.

“**Financial assistance**” includes:

- (a) The lending or borrowing of money, the guaranteeing or providing security for a debt incurred or the indemnifying of a guarantor for guaranteeing or providing security; and
- (b) The forgiving of a debt, the realising of or neglect in enforcing an obligation of another, or the assuming of the obligations of another.

“**Interested person**<sup>119</sup>” means a director, chief executive officer or controlling shareholder of the Company or an associate (as defined in the Listing Manual) of such director, chief executive officer or controlling shareholder.

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<sup>119</sup> Refer to Chapter 9 Part II of the Listing Manual for the definitions of “Interested Person” in the contexts of REIT, business trust and investment fund which is not a REIT or business trust.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

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“**Interested person transaction**” (“IPT”) means a transaction between an EAR and an interested person.

“**Listing Manual**<sup>120</sup>” refers to the Listing Manual of the SGX-ST, which sets out the requirements which apply to companies, the manner in which securities are to be offered, and the continuing obligations of companies.

“**NTA**” refers to the group’s latest audited Net Tangible Assets.

“**Subsidiary**<sup>121</sup>” shall bear the meaning set out in the Singapore Companies Act (Chapter 50).

“**Transaction**” includes the provision or receipt of financial assistance; the acquisition, disposal or leasing of assets; the provision or receipt of services; the issuance or subscription of securities; the granting of or being granted options; and the establishment of joint ventures or joint investments, in each of the cases above, whether or not entered into in the ordinary course of business, and whether entered into directly or indirectly.

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<sup>120</sup> SGX Listing Rule 102

<sup>121</sup> Refer to Part I Section 5 of Chapter 50 (Singapore Companies Act) for the full definition of “Subsidiary”.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B7: Sample Template on Disclosure of Director Interests

#### DECLARATION BY DIRECTORS AND CHIEF EXECUTIVE OFFICER

<b>Name of Listed Company</b>	
<b>Name of Reporting Person</b>	

1. I have direct and/or deemed interests (as defined in Section 4 of the Securities and Futures Act and Section 7 of the Companies Act) in the shares / debentures of the corporations as listed in Annex A.
2. I am currently serving as a member of the Board or an Executive Officer of the corporations listed in Annex B.
3. I have provided, in Annex C, details of the trusts of which I and/or members of my immediate family (as defined in the Listing Manual) are beneficiaries or, in the case of discretionary trusts, a discretionary object.
4. I confirm that the disclosure made herein is complete and accurate.

Signed: \_\_\_\_\_

Date: \_\_\_\_\_

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### ANNEX A

#### INTERESTS IN SHARES AND DEBENTURES

Particulars of my direct and deemed interests (as defined in Section 4 of the Securities and Futures Act and Section 7 of the Companies Act) in shares and debentures:

Name of Corporation	Class of Shares/ Debentures (par value of each share and whether fully paid or otherwise)	Number/ Amount (% of total)	Options in shares and warrants	Number
Interest registered in own name:				
Deemed interest <sup>1(a), 1(b) and 2.</sup>				
Other deemed interest:				

**Notes:**

- (1) (a) See Securities and Futures Act Sections 4 and 130(5).
- (b) See Companies Act Section 7.
- (2) A director / Chief Executive Officer is deemed interested in the shares and debentures in which his immediate family (i.e. spouse and children under 21 years, including step-children and adopted children, provided such person is not also a director or Chief Executive Officer) has an interest. Relevant details of how the deemed interest arises should be provided.



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### ANNEX B

#### LIST OF OTHER DIRECTORSHIPS / APPOINTMENTS

Name of Corporation	Nature of Appointment

**Note:**

No disclosure of the Directorship on the Board of the company and its subsidiaries and associated companies is required.

### ANNEX C

#### LIST OF TRUSTS

Name of trust	Name of trustee and other relevant details

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B8: Examples of indicators of potential RPTs<sup>122</sup>

#### Understating Expenses

- **Agreements in which one party pays** expenses on behalf of another party. A related party may pay certain expenses on behalf of the company and then pass through the expenses back to the company. In this way, the company may understate its expenses by deferring such pass through and expense recognition in the books.
- **Services or goods purchased** from a party at little or no cost to the entity

#### Inflating Revenue

- **Selling real estate/property/asset** at a price that varies significantly from its appraised value
- **Sales without substance**, including funding the other party to the transaction so that the sales price is fully remitted
- **Sales with a commitment** to repurchase that, if known, would preclude recognition of all or part of the revenue
- **Sales at below market rates** to an unnecessary 'middle man' related party, who in turn sells to the ultimate customer at a higher price with the related party (and ultimately its principals) retaining the difference
- **Circular arrangements** whereby the arrangements between related parties have concurrent obligations to buy and sell and where the purchase transaction is essentially funded by the sale transaction
- **Repetitive quarter or year-end transactions** with the same party

#### Inflating/Deflating Assets

- **Exchanging property for similar property** in a non-monetary transaction
- **Purchases of assets** at prices in excess or below fair market value
- **Advancing the company funds** that are subsequently transferred to a debtor and used to repay what would otherwise be an uncollectible loan or receivable
- **Loans advanced ostensibly** for a valid business purpose and later written off as uncollectible

#### Transactions Against Company's Interests

- **Borrowing or lending on an interest-free basis** or at an interest rate that is significantly above or below prevailing market rates
- **Making unsecured loans** with no scheduled repayment terms
- **Accruing interest at above market rates** on loans
- **Loans to parties** that do not possess the ability to repay
- **Payment for services rendered** or not even rendered, at inflated prices
- **Engage in business deals** that are not at market value

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<sup>122</sup> Adapted from American Institute of Certified Public Accountants, Inc. Professional Standards AU-C Section 550 Related Parties. Copyright 2010, American Institute for CPAS. Used by permission.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B9: Examples of motivations for RPT<sup>123</sup>

- **Lack of sufficient working capital or credit** to continue the business
- **An urgent desire for a continued favourable earnings** record in the hope of supporting the price of the company's stock
- **Trying to justify an overly optimistic earnings forecast**
- **Dependence on a single or relatively few products**, customers, or transactions for the continuing success of the venture
- **A declining industry** characterised by a large number of business failures
- **Excess capacity**
- **Significant litigation**, especially litigation between stockholders and Management
- **Significant obsolescence dangers** because the company is in a high-technology industry

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<sup>123</sup> American Institute of Certified Public Accountants, Inc. Professional Standards AU-C Section 550 Related Parties. Copyright 2010, American Institute for CPAS. Used by permission.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B10: Examples of indicators of fraud in RPT<sup>124</sup>

- **Entities formed to accomplish specific purposes** and that are controlled by Management might be used to facilitate earnings management
- **Transactions between the entity and a known business partner** of a key member of Management could be arranged to facilitate misappropriation of the entity's assets
- **The form of a related party transaction may mask its substance.** For example, equity distributions or capital contributions may be structured as loans
- **Related party transactions may be subject to period-end window dressing.** For example, a stockholder may pay a loan shortly before period-end, but the entity loans the same amount to the stock-holder shortly after period-end.
- **Certain entities**, such as government entities or entities operating in regulated industries **may circumvent laws or regulations** that limit or restrict their ability to engage in transactions with related parties.
- **Significant related party transactions** not in the ordinary course of business or with related entities not audited or audited by other firms
- **Significant, unusual, or highly complex transactions**, especially those close to year-end, that pose difficult 'substance over form' questions
- **Significant bank accounts or subsidiary or branch operations** in tax-haven jurisdictions for which there appears to be no clear business justification
- **Overly complex organisational structure** involving numerous or unusual legal entities, managerial lines of authority, or contractual arrangements without apparent business purpose
- **Difficulties in determining the organisation** or individual(s) that control(s) an off-balance sheet entity

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<sup>124</sup> Adapted from American Institute of Certified Public Accountants, Inc. Professional Standards AU-C Section 550 Related Parties. Copyright 2010, American Institute for CPAS. Used by permission.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B11: Elements of a good whistle-blowing policy<sup>125</sup>

#### Good Policy

It is recommended a whistle-blowing policy should make these points clear:

- **The organisation takes malpractice seriously**, giving examples of the types of concerns to be raised, so distinguishing a whistle-blowing concern from a grievance
- **Staff have the option to raise concerns** outside of line Management
- **Staff are enabled to access confidential advice** from an independent body
- **The organisation will, when requested, respect the confidentiality of a member of staff** raising a concern
- **When and how concerns may be properly raised** outside the organisation (e.g. with a regulator)
- **It is a disciplinary matter** both to victimise a bona fide whistle-blower and for someone to maliciously make a false allegation

#### Good Practice

However good the written policy is, how it works in practice is critical. Good practice should:

- **Ensure staff of the company and any other persons are aware** of and trust the whistle-blowing avenues
- **Make provision for realistic advice** about what the whistle-blowing process means for openness, confidentiality and anonymity
- **Continually review** how the procedures work in practice
- **Regularly communicate** to staff about the avenues open to them

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<sup>125</sup> Adapted from Public Concern At Work, *Best Practice Guide*, <http://www.pcaw.co.uk/>

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Good Audit

It is recommended that these questions be included when the whistle-blowing policy is reviewed:

- **Are there issues or incidents** which have otherwise come to the Board's attention which they would have expected to have been raised earlier under the company's whistle-blowing procedures?
- **Are there adequate procedures** to track the actions taken in relation to concerns made and to ensure appropriate follow-up action has been taken to investigate and if necessary, resolve problems indicated by whistle-blowing?
- **Have confidentiality issues** been handled effectively?
- **Is there evidence of timely and constructive feedback?**
- **Have any events come to the AC's or the Board's attention** that might indicate a staff member has not been fairly treated as a result of their raising concerns?
- **Is there a review of staff awareness of the procedures needed?**

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Appendix B12: Example of a whistle-blowing policy

#### WHISTLE-BLOWING POLICY<sup>126</sup>

All employees of the company and any other persons are encouraged to raise genuine concerns about possible improprieties in matters of financial reporting and other malpractices at the earliest opportunity, and in an appropriate way<sup>127</sup>.

This policy is designed to:

- support our values;
- ensure employees and any other persons can raise concerns without fear of suffering retribution; and
- provide a transparent and confidential process for dealing with concerns.

This policy not only covers possible improprieties in matters of financial reporting, but also:

- fraud;
- corruption, bribery or blackmail;
- criminal offences;
- failure to comply with a legal or regulatory obligation;
- miscarriage of justice;
- endangering the health and safety of an individual; and
- concealment of any of the above.

#### Principles

- All concerns raised will be treated fairly and properly.
- We will not tolerate the harassment or victimisation of anyone raising a genuine concern.
- Any individual making a disclosure will retain their anonymity unless they agree otherwise.
- We will ensure that any individual raising a concern is aware of who is handling the matter.
- We will ensure no one will be at risk of suffering some form of retribution as a result of raising a concern even if they are mistaken. We do not however extend this assurance to someone who maliciously raises a matter they know to be untrue.

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<sup>126</sup> KPMG Singapore, 2014

<sup>127</sup> Guideline 12.7 of the Code

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX B (AC AGENDA)

### Grievance procedure

If any employee believes reasonably and in good faith that malpractice exists in the work place, then he or she should report this immediately to their own line manager. However, if for any reason they are reluctant to do so, then they should report their concerns to either the:

- group company secretary; or
- director of human resources.

Employees and any other persons concerned about speaking to another member of staff can speak, in confidence, to an independent third party by calling the **whistle-blowing hotline** on [ ]. This is provided through the independent party who provide the employee care counselling and legal advice service. Your concerns will be reported to the company without revealing your identity.

If these channels have been followed and employees and any other persons still have concerns, or if employees and any other persons feel the matter is so serious that it cannot be discussed with any of the above, they should contact the senior Independent Director on [ ].

Employees and any other persons who have raised concerns internally, will be informed of who is handling the matter, how they can make contact with them and if there is any further assistance required. We will give as much feedback as we can without any infringement on a duty of confidence owed by us to someone else.

Employees' and any other persons' identities will not be disclosed without prior consent (except where disclosure obligations are required under law and regulations). Where concerns are unable to be resolved without revealing the identity of the employee and any other persons raising the concern, (e.g., if their evidence is required in court), we will enter in to a dialogue with the employee and any other persons concerned as to whether and how we can proceed.



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Appendix C1: Possible types of risks faced by a company

(Note: These risks may be considered by the AC if they are relevant to the company. The list is not exhaustive).

Strategic/external		
<ul style="list-style-type: none"> <li>• Reputation</li> <li>• Competition</li> <li>• Innovation</li> <li>• Terrorism</li> <li>• Environment</li> <li>• Business continuity/pandemic</li> <li>• Business market environment</li> <li>• Political and economic risk</li> <li>• Emerging technologies</li> </ul>		
Financial	Operational	Compliance
<ul style="list-style-type: none"> <li>• Capital availability</li> <li>• Credit/counterparty</li> <li>• Financial market risk (including interest rates and liquidity)</li> <li>• Foreign Exchange risk</li> <li>• Complex instruments such as market-price sensitive financial instruments, embedded financial derivatives and leveraged financial instruments</li> </ul>	<ul style="list-style-type: none"> <li>• Social media</li> <li>• Employee health and safety</li> <li>• Mergers and acquisitions/restructuring</li> <li>• Outsourcing</li> <li>• Information support systems</li> <li>• HR/ Succession planning</li> </ul>	<ul style="list-style-type: none"> <li>• Regulatory/ legislative compliance</li> <li>• Liability lawsuits</li> <li>• Health and safety</li> </ul>
	Information Technology	

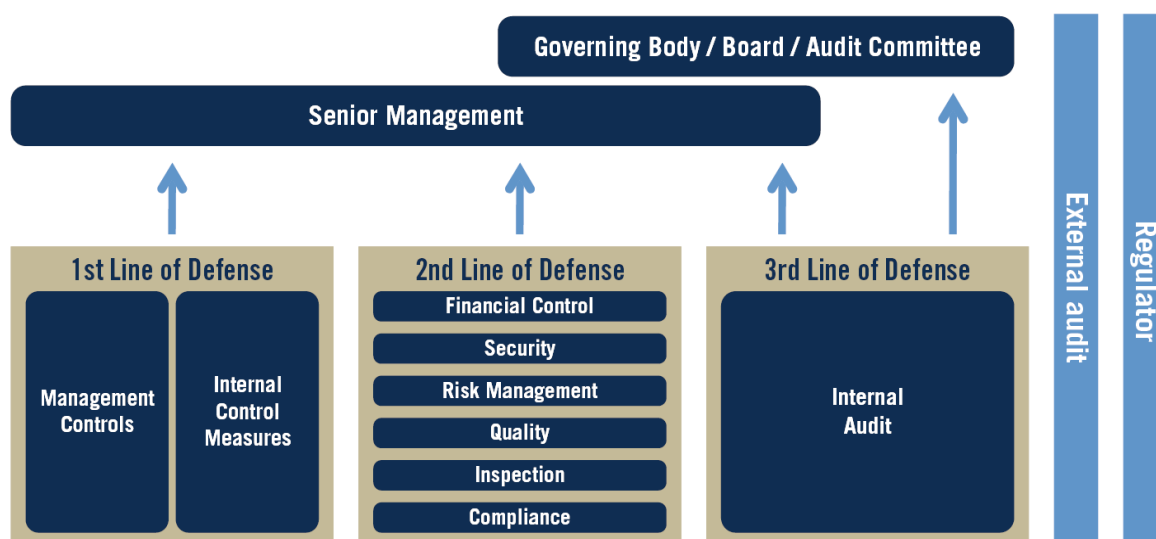
# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Appendix C2: Risk governance and oversight structures

The following diagram depicts the Institute of Internal Auditors (IIA) “Three Lines of Defence Model”

### The Three Lines of Defense Model



Adapted from ECIIA/FERMA *Guidance on the 8th EU Company Law Directive, article 41*

FIRST LINE OF DEFENSE	SECOND LINE OF DEFENSE	THIRD LINE OF DEFENSE
<b>Risk Owners/Managers</b>	<b>Risk Control and Compliance</b>	<b>Risk Assurance</b>
<ul style="list-style-type: none"> <li>operating management</li> </ul>	<ul style="list-style-type: none"> <li>limited independence</li> <li>reports primarily to management</li> </ul>	<ul style="list-style-type: none"> <li>internal audit</li> <li>greater independence</li> <li>reports to governing body</li> </ul>

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

The following diagram depicts KPMG “Four Lines of Defence Model”

### KPMG Four Lines of Defence Model



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Appendix C3: Internal control framework overview

COSO – Internal Control - Integrated Framework, May 2013<sup>128</sup>



### Objectives

The *Framework* provides for three categories of objectives, which allow organizations to focus on differing aspects of internal control:

- *Operations Objectives* – These pertain to effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
- *Reporting Objectives* – These pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, recognized standard setters, or the entity's policies.
- *Compliance Objectives* – These pertain to adherence to laws and regulations to which the entity is subject.

### Components of internal control

Internal control consists of five integrated components as set out below:

#### *Control Environment*

The Board of Directors and senior Management establish the tone at the top regarding the importance of internal control including expected standards of conduct. Management reinforces expectations at the various levels of the organization. The control environment comprises the integrity and ethical values of the organization; the parameters enabling the Board of Directors to carry out its governance oversight responsibilities; the organizational structure and assignment of authority and

<sup>128</sup> Copyright 2013, Committee of Sponsoring Organizations of the Treadway Commission. Used by permission.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

responsibility; the process for attracting, developing, and retaining competent individuals; and the rigor around performance measures, incentives, and rewards to drive accountability for performance. The resulting control environment has a pervasive impact on the overall system of internal control.

### *Risk Assessment*

Every entity faces a variety of risks from external and internal sources. Risk is defined as the possibility that an event will occur and adversely affect the achievement of objectives. Risk assessment involves a dynamic and iterative process for identifying and assessing risks to the achievement of objectives. Risks to the achievement of these objectives from across the entity are considered relative to established risk tolerances. Thus, risk assessment forms the basis for determining how risks will be managed.

### *Control Activities*

Control activities are the actions established through policies and procedures that help ensure that Management's directives to mitigate risks to the achievement of objectives are carried out. Control activities are performed at all levels of the entity, at various stages within business processes, and over the technology environment. They may be preventive or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews. Segregation of duties is typically built into the selection and development of control activities. Where segregation of duties is not practical, Management selects and develops alternative control activities.

### *Information and Communication*

Information is necessary for the entity to carry out internal control responsibilities to support the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of other components of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which information is disseminated throughout the organization, flowing up, down, and across the entity. It enables personnel to receive a clear message from senior Management that control responsibilities must be taken seriously. External communication is twofold: it enables inbound communication of relevant external information, and it provides information to external parties in response to requirements and expectations.

# **GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE**

## **APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)**

### *Monitoring Activities*

Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the five components of internal control, including controls to effect the principles within each component, is present and functioning. Ongoing evaluations, built into business processes at different levels of the entity, provide timely information. Separate evaluations, conducted periodically, will vary in scope and frequency depending on assessment of risks, effectiveness of ongoing evaluations, and other management considerations. Findings are evaluated against criteria established by regulators, recognized standard-setting bodies or Management and the Board of Directors, and deficiencies are communicated to Management and the Board of Directors as appropriate.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Appendix C4: Evaluating Control Deficiencies

For organisations requiring further information in evaluating control deficiencies, the following illustrative guidance has been prepared. The guidance has been developed based on better practices in this area, with some parts and sections of the guidance being adapted from the US Sarbanes-Oxley Act (SOX) and Public Company Accounting Oversight Board Auditing Standards. There are many ways that organisations can evaluate control deficiencies, the guidance contained in this appendix represents one way of defining and applying it in practice.

It is important that ACs ensure that Management have developed relevant and meaningful guidance for their organisation (leveraging any existing enterprise risk management definitions for likelihood, potential magnitude and severity). Factors to be considered when tailoring such guidance include the size, scope, complexity and nature of business/industry they operate within and the organisation's risk appetite.

#### Definitions

The following definitions provide additional guidance on concepts already defined in the main section. They are illustrative in nature but could be used by organisations as a base to clarify and confirm key concepts should they wish to explore these areas further.

- **Adequacy and effectiveness**

**Adequate** – having enough of something or sufficient i.e. are the risk management and internal control systems designed appropriately?

**Effective** – producing the intended or desired results i.e. are the risk management and internal control systems operating as intended?

- **Categorising control deficiencies**

When considering the type of control deficiency that arises from assessing the adequacy and effectiveness of the risk management and internal control systems, organisations may consider classifying control deficiencies according to the following definitions:

- (a) **Gap** - A control may not be considered 'adequate' where it does not exist or is not designed appropriately to mitigate the risk. Gaps typically arise due to process related factors.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

- (b) **Enhancement** - A control may not be considered 'adequate' where it only partially mitigates the risk. Enhancements typically arise due to process related factors, and if implemented, would generally address the key risk areas.
- (c) **Lapse** - A control may not be considered 'effective' where it is not performing as intended. Lapses typically arise due to people related factors.
- **Control deficiency** – a control deficiency exists when it fails, in terms of adequacy (design) and/or effectiveness (operation), to prevent or detect events, on a timely basis, impacting the achievement of objectives. Control deficiencies may be classified as follows (based on likelihood and potential magnitude):
  - (a) **Low to moderate deficiency** – a low to moderate control deficiency is not systemic in nature and is not likely to influence the economic decision of users.
  - (b) **Significant deficiency** – a significant deficiency is a control deficiency, or a combination of related low to moderate control deficiencies that may influence the economic decision of users. A significant deficiency is where there is a reasonable possibility that an event with more than inconsequential but less than material consequences (financial and/or non-financial) will not be prevented or detected on a timely basis.
  - (c) **Material deficiency** – a material deficiency is a control deficiency, or a combination of related significant control deficiencies that is likely to influence the economic decision of users. A material deficiency is where there is a reasonable possibility that an event with material consequences (financial and/or non-financial) will not be prevented or detected on a timely basis.
- **Control evaluation** – the evaluation of the materiality of the control deficiency should include both quantitative and qualitative considerations. Qualitative factors that might be important in this evaluation include the nature of the risk management and internal control systems objectives involved and the possible consequences of the deficiency.

Furthermore, in determining whether a control deficiency, or combination of deficiencies, is a significant deficiency or a material deficiency, the effect of compensating controls and whether such controls are adequate and effective should be evaluated and tested.



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

- **Internal control** – a process designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance<sup>129</sup>. Internal control includes control environment, risk assessment, control activities, information and communication and monitoring activities<sup>130</sup>. A key control is a control (with a defined objective including, but not limited to, completeness, existence, accuracy, valuation, occurrence and/or presentation) that mitigates the risk of a potential impact to the achievement of the organisation's objectives (e.g. strategic, financial, operational and compliance) and can exist at a process, entity and/or group level.
  
- **Likelihood** – the chance of the key controls failing to prevent or detect a financial/non-financial consequence within the reporting period. Definitions for likelihood may already exist within the company (such as the enterprise risk likelihood definitions). Examples of likelihood descriptors include (but are not limited to):
  - (a) **Likely** – highly probable to occur
  
  - (b) **Reasonable possibility** – could occur
  
  - (c) **Remote possibility** – unlikely to occur; surprised if it happens
  
- **Potential magnitude** – the consequence or impact of the control deficiency should it occur. Definitions for consequences may already exist within the company (such as the enterprise risk consequence definitions and/or audit materiality). The impact of a control deficiency(ies) may be considered in terms of financial and non-financial terms. Examples include (but are not limited to):
  - (a) **Inconsequential** – an event that could result in a non-material financial misstatement, minor regulatory non-compliances, minor operational disruption.
  
  - (b) **Significant** – an event that could result in a significant financial misstatement, regulatory fines, adverse reputational damage, significant operational disruption, project delays with significant cash flow impact.
  
  - (c) **Material** – an event that could result in a material financial misstatement, material regulatory fines, adverse sustained reputational damage, sustained operational disruption, major project delays with severe cash flow impact.

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<sup>129</sup> COSO Internal Control - Integrated Framework 2013

<sup>130</sup> Adapted from the COSO Internal Control - Integrated Framework 2013

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Evaluating Control Deficiencies with Respect to the Risk Management and Internal Control Systems

As highlighted in the main section, the AC should ensure that Management has established a process to evaluate control deficiencies. The key steps involved are outlined below with references to additional guidance, examples and tools to assist define and develop the process to implement:

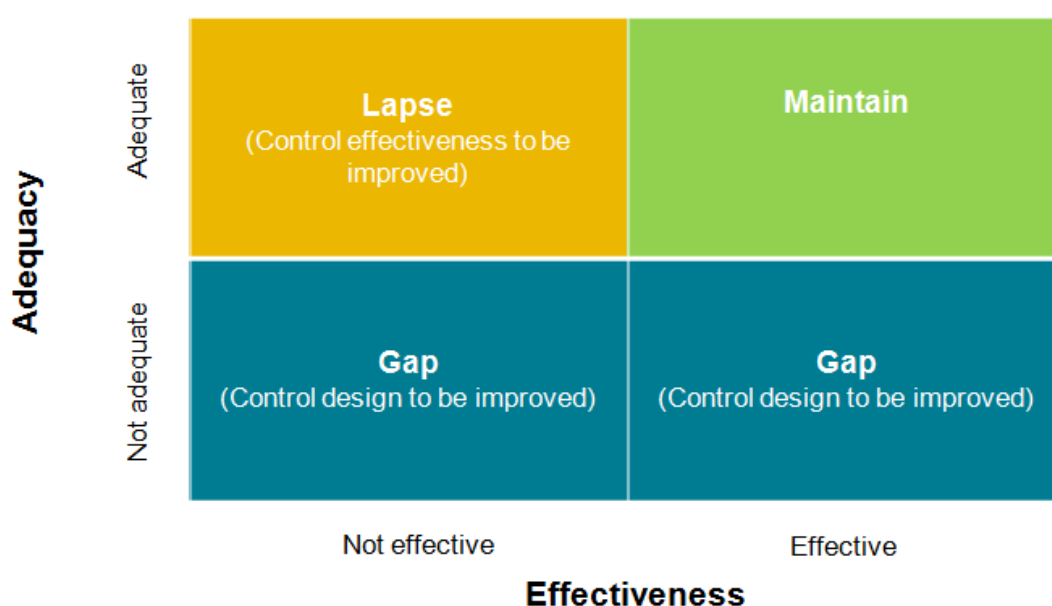
#### Step 1: Identify and categorise control deficiencies

To address the requirements of the SGX LR (1207 (10)) and CG Code (Principle 11) there needs to be a clear understanding of the concepts of adequacy and effectiveness of risk management and internal controls.

Some organisations may also wish to consider further defining the types of control deficiencies into gaps, enhancements and lapses to enable categorisation, presentation and rectification of deficiencies (as this drives greater analysis of root causes and addressing similar/related deficiencies).

One way of analysing deficiencies further is to examine the relationship between adequacy and effectiveness. Diagram A provides an illustrative guidance that could be used for categorising deficiencies (either at a process, entity and/or Group level) to determine the appropriate response for maintaining or enhancing the risk management and internal control systems.

**Diagram A: Evaluation and Categorisation of Control Deficiencies**



Source: KPMG Risk Consulting Singapore 2014

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Step 2: Evaluate the severity of control deficiencies

There should be a process in place to evaluate the severity of an internal control deficiency.

Some organisations may wish to define severity of control deficiencies by considering:

- **Likelihood** i.e. whether there is a reasonable possibility that the Company's or the Group's (where subsidiary structures exist) internal controls will fail to prevent or detect events on a timely basis impacting the achievement of objectives, relating to the risk management and internal control systems; and
- **Potential magnitude** i.e. the potential impact of the event resulting from the deficiency or combination of deficiencies.

#### (i) Assessing likelihood

There should be clearly defined likelihood descriptors that are relevant to the organisation. Please refer to the definitions section for a high-level overview of likelihood descriptors.

Consideration should also be given to other factors which could increase the chance of an event occurring that will impact the achievement of objectives:

- The nature of the financial statement accounts, disclosures, operations and regulations involved;
- The susceptibility of the related asset or liability, operations and regulations to loss or fraud;
- The subjectivity, complexity, or extent of judgment required to determine the amounts or magnitude of the event involved;
- The interaction or relationship of the control with other controls, including whether they are interdependent or redundant;
- The interaction of the internal control deficiencies; and
- The possible future consequences of the internal control deficiency.

It is important to note that the assessment of likelihood **does not** require a specific percentage or range indicating the probability of whether an internal control deficiency would lead to the failure of preventing or detecting events on a timely basis.

### **(ii) Assessing potential magnitude**

There should be clearly defined potential magnitude descriptors that are relevant to the organisation. Please refer to the definitions section for a high-level overview of likelihood descriptors.

Consideration should also be given to factors that affect the potential magnitude of the event that might result from an internal control deficiency or deficiencies. These factors include, but are not limited to, the following:

- The financial statement amounts, total of transactions or significance and severity of operational, regulatory non-compliance and IT consequences arising from the deficiency; and
- The volume of activity in the financial account balance or business operations or IT activities exposed to the deficiency that has occurred in the current period or that is expected in future periods.

The maximum amount that a financial account balance or total of transactions, business operations or IT activities can be overstated is generally the recorded or potentially exposed amount/level of activities, while understatements could be larger.

It is important that there is a consistent understanding of the potential magnitude that is being assessed. The likelihood of an event with a smaller consequence may be higher than the likelihood of an event with a larger consequence.

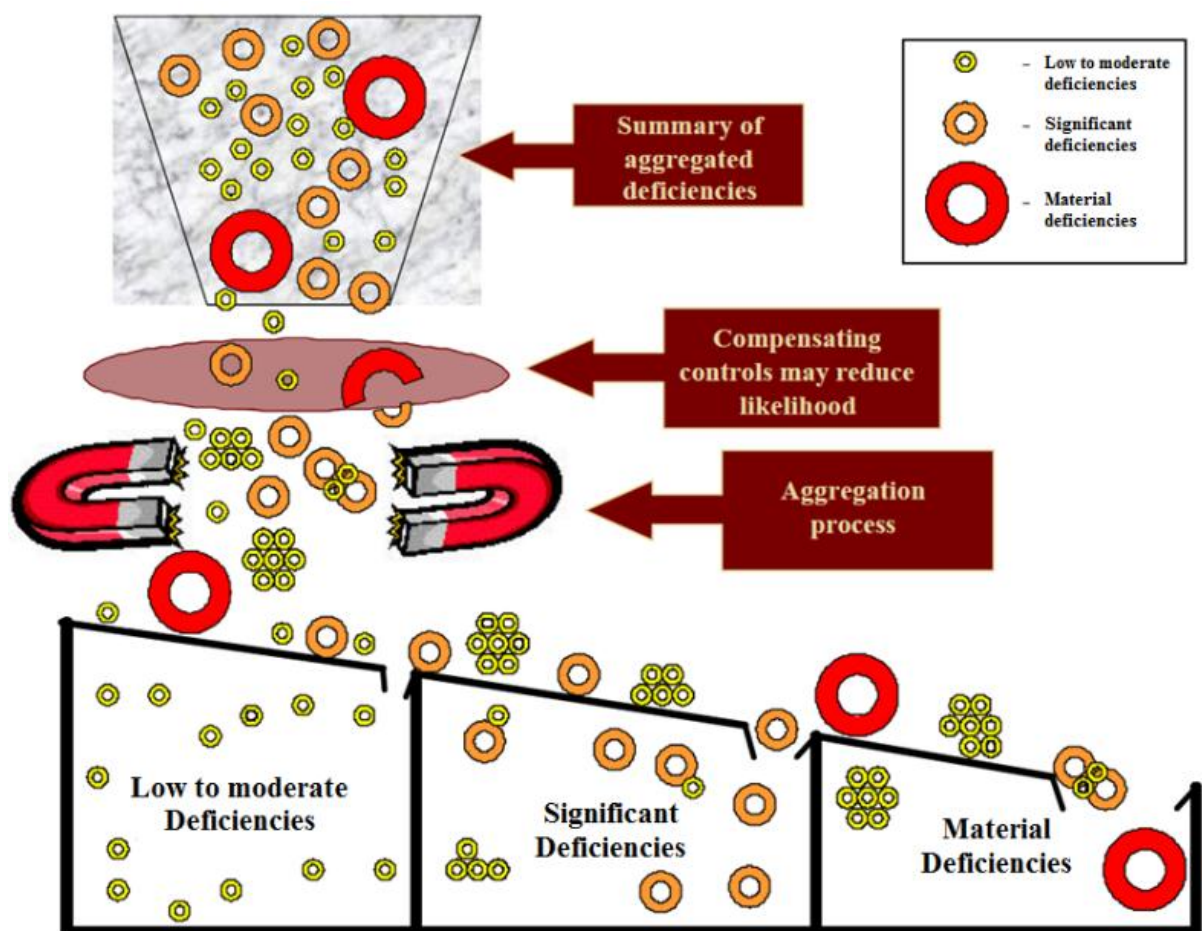
There should be a process in place to evaluate the effect of compensating internal controls when determining whether an internal control deficiency or combination of deficiencies is a material deficiency. The compensating internal control should operate at a level of precision that would prevent or detect a misstatement that could have a material consequence in order to have a mitigating effect.

### (iii) Aggregation

There should be a process in place to aggregate control deficiencies.

It is important to note that multiple internal control deficiencies that affect the same event increase the likelihood that a material deficiency may occur, even though such internal control deficiencies may be less severe individually. Diagram B provides an overview of how this may be performed.

*Diagram B: Aggregation of Control Deficiencies*



Source: PricewaterhouseCoopers LLP All rights reserved. Reproduced with permission

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Step 3: Action, report and disclose control deficiencies

There should be a process in place to evaluate the severity of control deficiencies. Some organisations may wish to use descriptors of severity to aide in the classification process. The table outlined below provides illustrative guidance about how this may be documented.

Severity	Classification	Characteristics	Examples (not exhaustive)
Low	Low to moderate deficiency	<ul style="list-style-type: none"> <li>- Not systemic in nature</li> <li>- Not likely to influence the economic decision of users</li> <li>- Remote possibility of occurrence</li> </ul>	<ul style="list-style-type: none"> <li>- Non-material financial misstatement</li> <li>- Minor regulatory non-compliances</li> <li>- Minor operational disruption</li> </ul>
Medium	Significant deficiency	<ul style="list-style-type: none"> <li>- A significant control deficiency; or</li> <li>- A combination of related low to moderate control deficiencies</li> <li>- May influence the economic decision of users</li> <li>- Reasonable possibility of occurrence</li> </ul>	<ul style="list-style-type: none"> <li>- Significant financial misstatement</li> <li>- Regulatory fines</li> <li>- Adverse reputational damage</li> <li>- Significant operational disruption</li> <li>- Project delays with significant cash flow impact</li> </ul>
High	Material deficiency	<ul style="list-style-type: none"> <li>- A material control deficiency; or</li> <li>- A combination of related moderate significant control deficiencies</li> <li>- Likely to influence the economic decision of users</li> <li>- More than reasonable possibility of occurrence</li> </ul>	<ul style="list-style-type: none"> <li>- Material financial misstatement</li> <li>- Significant regulatory fines</li> <li>- Adverse sustained reputational damage</li> <li>- Sustained operational disruption</li> <li>- Major project delays with severe cash flow impact</li> </ul>

Some organisations may wish to establish a more structured approach to evaluating the severity of control deficiencies.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

Organisations may also wish to use the severity of control deficiencies to define timeframes for rectifying the deficiency, reporting and escalation mechanisms and impact on disclosure obligations.

Diagram C is illustrative in nature and can be used as a guide to develop a consistent view and assessment on the severity of control deficiencies (in terms of likelihood and magnitude), with respect to risk management and internal control systems. It could also be used to clarify the reporting and escalation protocols to Management, Audit Committee and/or Board.

**Diagram C: Evaluating Severity of Control Deficiencies**

<b>Likelihood</b>	Likely	Low to moderate deficiency	Material deficiency (series of related significant events)	Material deficiency	
			Significant deficiency (isolated significant event)		
	Reasonable possibility	Low to moderate deficiency	Significant deficiency		Material deficiency
			Significant deficiency		
	Remote possibility	Low to moderate deficiency	Significant deficiency (series of related low to moderate events)	Material deficiency (series of related significant events)	
			Low to moderate deficiency (isolated significant event)	Significant deficiency (isolated material event)	
		Inconsequential	Significant	Material	
		<b>Magnitude</b>			

Severity	Primary oversight
Material deficiency	Board and Audit Committee
Significant deficiency	Audit Committee (exceptions to Board)
Low to moderate deficiency	Management (exceptions to Audit Committee)

Source: KPMG Risk Consulting Singapore 2014

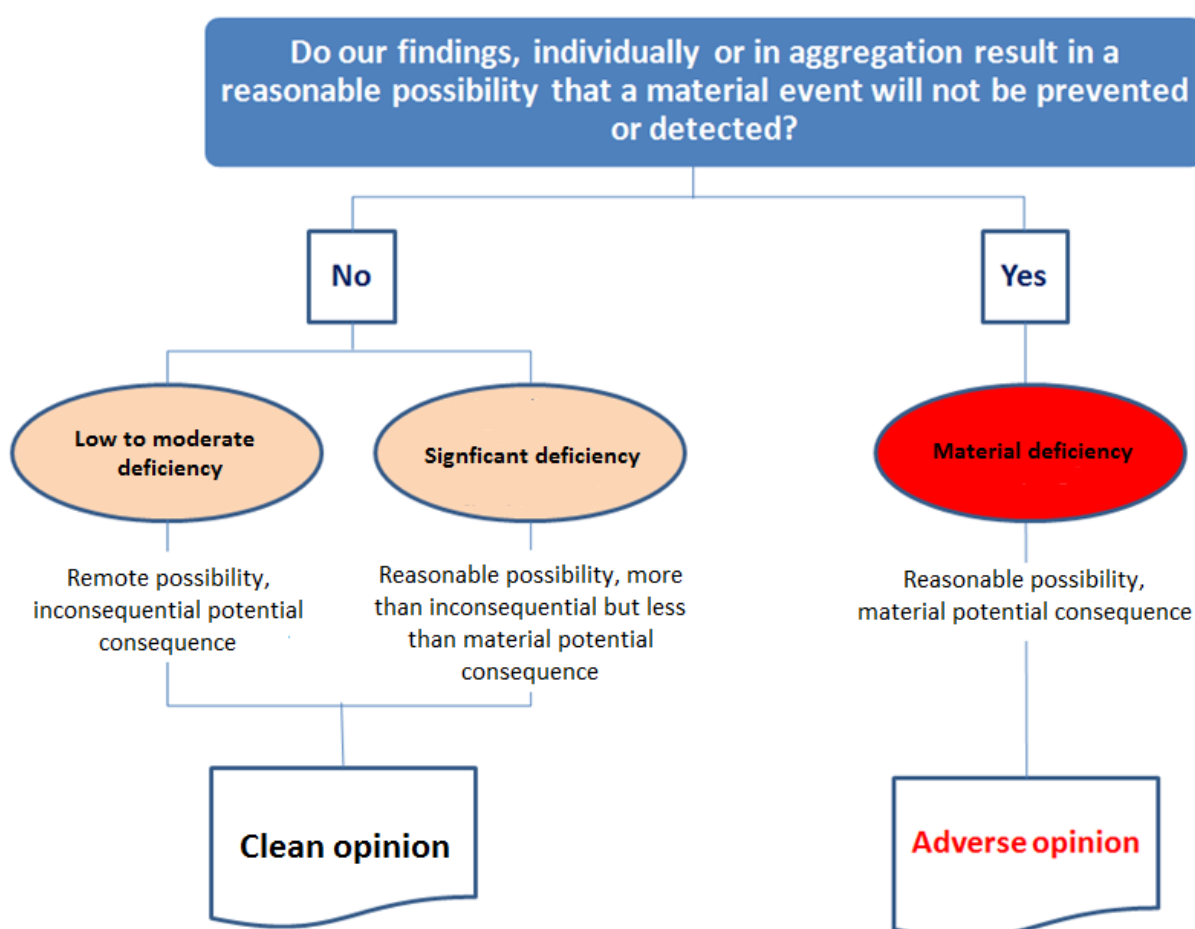
# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX C (RISK MANAGEMENT AND INTERNAL CONTROLS)

### Appendix C5: Disclosure requirements

Determining what and how much to disclose is a common challenge faced by Boards, ACs and Management. There should be a structured process in place to demonstrate a consistent and logical process has been followed to satisfy disclosure obligations.

The diagram below provides illustrative guidance that incorporates the likelihood, potential magnitude and severity of control deficiencies in connection with forming either a clean or adverse opinion on the adequacy of internal controls.



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# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

### Appendix D1: Benefits and drawbacks on various options for setting up of an Internal Audit function<sup>131</sup>

Sourcing Model	Pros	Cons
In-house function	<ul style="list-style-type: none"> <li>✓ Continuity of staff</li> <li>✓ Certain and controllable cost</li> <li>✓ Full control of the function</li> <li>✓ A resource pool for the business</li> <li>✓ Training ground for employees</li> <li>✓ Greater cultural alignment</li> <li>✓ Insiders</li> </ul>	<ul style="list-style-type: none"> <li>✗ May not be fully employed effectively and efficiently</li> <li>✗ Difficult to acquire necessary/maintain all skills and experience to meet the risk profile of the business</li> <li>✗ Need to continually invest in training and development</li> <li>✗ Recruitment hassles</li> <li>✗ Ineffective/inefficient start up</li> <li>✗ Retention and development strategies required</li> <li>✗ Reduces opportunity to provide fresh perspective/risk of complacency or familiarity</li> </ul>
Co-source	<ul style="list-style-type: none"> <li>✓ Long term permanent on-site presence through HIA (Head of Internal Audit)</li> <li>✓ Access to broad range of skills through the partner</li> <li>✓ Draw on specialist skills as and when, and only when, needed</li> <li>✓ Continuity through HIA</li> <li>✓ Pull in up to date skills and experience as needed</li> <li>✓ Quick to implement</li> <li>✓ Skills transfer to in house team</li> <li>✓ Flexible approach, clearly defined service level and KPI measures</li> <li>✓ Credibility to third parties</li> <li>✓ No or reduced training cost</li> </ul>	<ul style="list-style-type: none"> <li>✗ Time taken to recruit HIA</li> <li>✗ Possible cost impact</li> <li>✗ Management resource needed in recruitment and relationship development</li> <li>✗ Dependency on 3rd party</li> <li>✗ Possible lack of staff continuity</li> <li>✗ Other challenges for in house resource as above</li> </ul>

<sup>131</sup> KPMG Audit Committee Institute UK Handbook 2013

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

Sourcing Model	Pros	Cons
Full outsource	<ul style="list-style-type: none"> <li>✓ Established methodologies and benefit of refreshment based on experiences across different organisations</li> <li>✓ Up to date, skilled staff</li> <li>✓ Ability to draw on a wide range of skills as and when required</li> <li>✓ No time taken up by managing service and resources</li> <li>✓ Clearly defined service level and performance measures</li> <li>✓ Easily established and quickly effective</li> <li>✓ Credibility to third parties</li> <li>✓ Ability to manage costs by avoiding non-productive periods</li> </ul>	<ul style="list-style-type: none"> <li>✗ No permanent on-site resource to help other areas of the business</li> <li>✗ Potential cost impact</li> <li>✗ Possible lack of staff continuity</li> <li>✗ Remote from business developments, the culture and politics</li> <li>✗ Management time to establish and maintain relationships</li> </ul>

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

### Appendix D2: Sample Internal Audit Activity Charter<sup>132</sup>

#### **INTRODUCTION:**

Internal Auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of an organisation. It assists the organisation in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organisation's governance, risk management, internal control.

#### **ROLE:**

The internal audit activity is established by the Board of Directors, Audit Committee, or highest level of governing body (hereafter referred to as the Board). The internal audit activity's responsibilities are defined by the Board as part of their oversight role.

#### **PROFESSIONALISM:**

The internal audit activity will govern itself by adherence to The Institute of Internal Auditors' mandatory guidance including the Definition of Internal Auditing, the Code of Ethics, and the *International Standards for the Professional Practice of Internal Auditing (Standards)*. This mandatory guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the internal audit activity's performance.

The Institute of Internal Auditors' Practice Advisories, Practice Guides, and Position Papers will also be adhered to as applicable to guide operations. In addition, the internal audit activity will adhere to the organisation's relevant policies and procedures and the internal audit activity's standard operating procedures manual.

#### **AUTHORITY:**

The internal audit activity, with strict accountability for confidentiality and safeguarding records and information, is authorized full, free, and unrestricted access to any and all of the organisation's records, physical properties, and personnel pertinent to carrying out any engagement. All employees are requested to assist the internal audit activity in fulfilling its roles and responsibilities. The internal audit activity will also have free and unrestricted access to the Board.

#### **ORGANISATION:**

The Chief Audit Executive will report functionally to the Board and administratively (i.e. day to day operations) to the Chief Executive Officer.

The Board will

- Approve the internal audit charter.

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<sup>132</sup> *Model Internal Audit Activity Charter*, May 2013 by The Institute of Internal Auditors Research Foundation, 247 Maitland Avenue, Altamonte Springs, Florida 32701-4201 U.S.A.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

- Approve the risk based internal audit plan.
- Approve the internal audit budget and resource plan.
- Receive communications from the Chief Audit Executive on the internal audit activity's performance relative to its plan and other matters.
- Approve decisions regarding the appointment and removal of the Chief Audit Executive.
- Approve the remuneration of the Chief Audit Executive.
- Make appropriate inquiries of Management and the Chief Audit Executive to determine whether there is an inappropriate scope or resource limitations.

The Chief Audit Executive will communicate and interact directly with the Board, including in executive sessions and between Board meetings as appropriate.

### **INDEPENDENCE AND OBJECTIVITY:**

The internal audit activity will remain free from interference by any element in the organisation, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude.

Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditor's judgment.

Internal auditors will exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors will make a balanced assessment of all the relevant circumstances and not be unduly influenced by their own interests or by others in forming judgments.

The Chief Audit Executive will confirm to the Board, at least annually, the organisational independence of the internal audit activity.

### **RESPONSIBILITY:**

The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organisation's governance, risk management, and internal controls as well as the quality of performance in carrying out assigned responsibilities to achieve the organisation's stated goals and objectives. This includes:

- Evaluating risk exposure relating to achievement of the organisation's strategic objectives.
- Evaluating the reliability and integrity of information and the means used to identify, measure, classify, and report such information.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

- Evaluating the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on the organisation.
- Evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- Evaluating the effectiveness and efficiency with which resources are employed.
- Evaluating operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.
- Monitoring and evaluating governance processes.
- Monitoring and evaluating the effectiveness of the organisation's risk management processes.
- Evaluating the quality of performance of external auditors and the degree of coordination with internal audit.
- Performing consulting and advisory services related to governance, risk management and control as appropriate for the organisation.
- Reporting periodically on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan.
- Reporting significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by the Board.
- Evaluating specific operations at the request of the Board or Management, as appropriate.

### INTERNAL AUDIT PLAN:

At least annually, the Chief Audit Executive will submit to senior Management and the Board an internal audit plan for review and approval. The internal audit plan will consist of a work schedule as well as budget and resource requirements for the next fiscal/calendar year. The Chief Audit Executive will communicate the impact of resource limitations and significant interim changes to senior Management and the Board.

The internal audit plan will be developed based on a prioritization of the audit universe using a risk-based methodology, including input of senior Management and the Board. The Chief Audit Executive will review and adjust the plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls. Any significant deviation from the approved internal audit plan will be communicated to senior Management and the Board through periodic activity reports.

### REPORTING AND MONITORING:

A written report will be prepared and issued by the Chief Audit Executive or designee following the conclusion of each internal audit engagement and will be distributed as appropriate. Internal audit results will also be communicated to the Board.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

The internal audit report may include Management's response and corrective action taken or to be taken in regard to the specific findings and recommendations. Management's response, whether included within the original audit report or provided thereafter (i.e. within thirty days) by Management of the audited area should include a timetable for anticipated completion of action to be taken and an explanation for any corrective action that will not be implemented.

The internal audit activity will be responsible for appropriate follow-up on engagement findings and recommendations. All significant findings will remain in an open issues file until cleared.

The Chief Audit Executive will periodically report to senior Management and the Board on the internal audit activity's purpose, authority, and responsibility, as well as performance relative to its plan. Reporting will also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior Management and the Board.

### **QUALITY ASSURANCE AND IMPROVEMENT PROGRAM:**

The internal audit activity will maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. The program will include an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the *Standards* and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

The Chief Audit Executive will communicate to senior Management and the Board on the internal audit activity's quality assurance and improvement program, including results of ongoing internal assessments and external assessments conducted at least every five years.

### **Internal Audit Activity Charter**

Approved this \_\_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_.

\_\_\_\_\_  
Chief Audit Executive

\_\_\_\_\_  
Chairman of the Board / Audit Committee

\_\_\_\_\_  
Chief Executive Officer

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

### Appendix D3: Internal Audit Activity Measurement Criteria

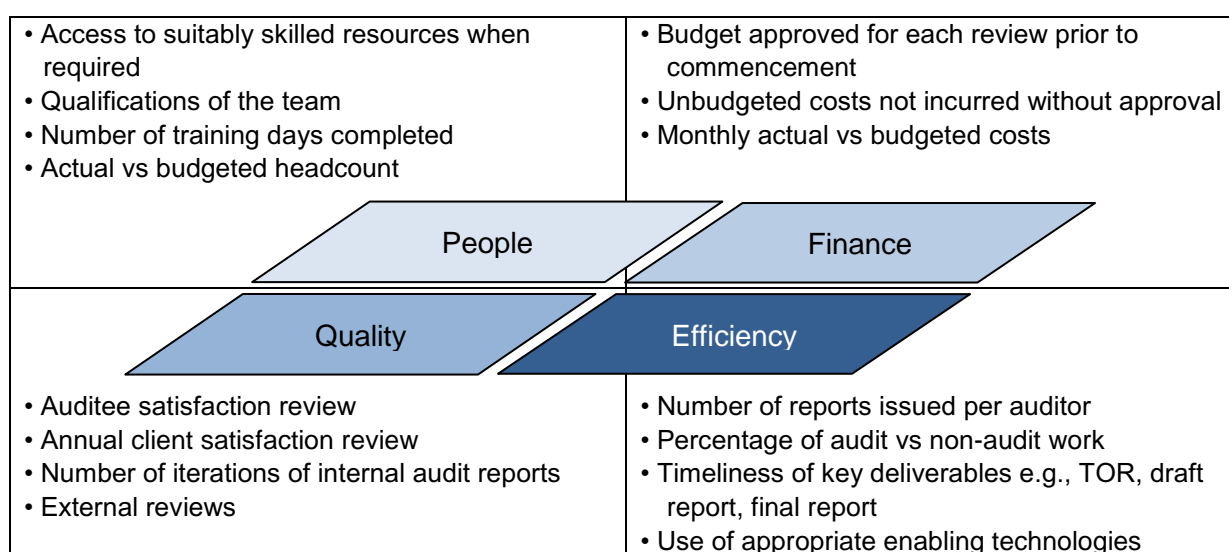
#### **Example 1 - Assessing the internal audit function's performance**<sup>133</sup>

The AC should monitor the performance and effectiveness of internal audit on an annual basis. This should include any matters affecting the audit function's independence and objectivity.

Self-assessment by the head of internal audit is a useful assessment tool, but it should not be the sole means of assessing the effectiveness of internal audit. The AC should draw its own conclusions based on its experience and contact with internal audit as well as the views of others such as the CFO, divisional heads and EA. In evaluating the work of internal audit, the AC should review the annual internal audit work plan, receive periodic reports on the results of the internal auditor's work and monitor Management's responsiveness to the internal auditor's findings and recommendations.

In light of recent regulatory changes, the AC should also require internal audit to confirm on an annual basis, all 'significant' audit findings have been followed up and that there are no open issues. This is to enable the AC and/or Board to be able to provide an opinion on the adequacy and effectiveness of risk management and internal controls.

When agreeing appropriate performance measures for internal audit, the AC should recognise that such measures need to be adapted to each organisation's circumstances. The following diagram illustrates some of the more common measures used to monitor the performance of internal audit.



<sup>133</sup> KPMG Audit Committee Institute UK Handbook 2013

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

### *Example 2 - Internal audit performance metrics*<sup>134</sup>

This performance metrics intend to assess performance from four perspectives, rather than from a single, traditional bottom-line measure. These measures aim to apply the right mix of measures to drive the right changes at the right time.

Risk Management	People
<ul style="list-style-type: none"> <li>▪ Percentage of departments having undergone control self-assessment or risk self-assessment workshops</li> <li>▪ Frequency of risk communication between process owners and internal audit</li> <li>▪ Number of risks identified in the company's risk framework</li> <li>▪ Percentage of employees educated in risk assessment</li> <li>▪ Number of actual fraud-related transactions identified</li> <li>▪ Percentage of employees who believe fraud is a significant issue</li> <li>▪ Percentage of customers who believe the company operates ethically</li> <li>▪ Number of control weaknesses identified by IA</li> <li>▪ Number of meetings between AC and audit executives without Management present</li> <li>▪ Ratio of IA policy and procedures that align with IIA standards to procedures that do not align with the standards</li> <li>▪ Percentage of audit projects sanctioned by the audit charter</li> <li>▪ Percentage of audit projects devoted to corporate governance</li> </ul>	<ul style="list-style-type: none"> <li>▪ Percentage of auditors certified in internal auditing or other related disciplines</li> <li>▪ Percentage of turnover in core auditing staff</li> <li>▪ Percentage of IA budget devoted to continuing education</li> <li>▪ Customer survey satisfaction ratings of IA reports and performance</li> <li>▪ Average number of years' experience of IA staff</li> <li>▪ Percentage of audit staff who receive annual, communication-based training</li> <li>▪ Percentage of auditees expressing surprise with audit report results</li> <li>▪ Percentage of employees and managers aware of IA's mission</li> </ul>

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# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

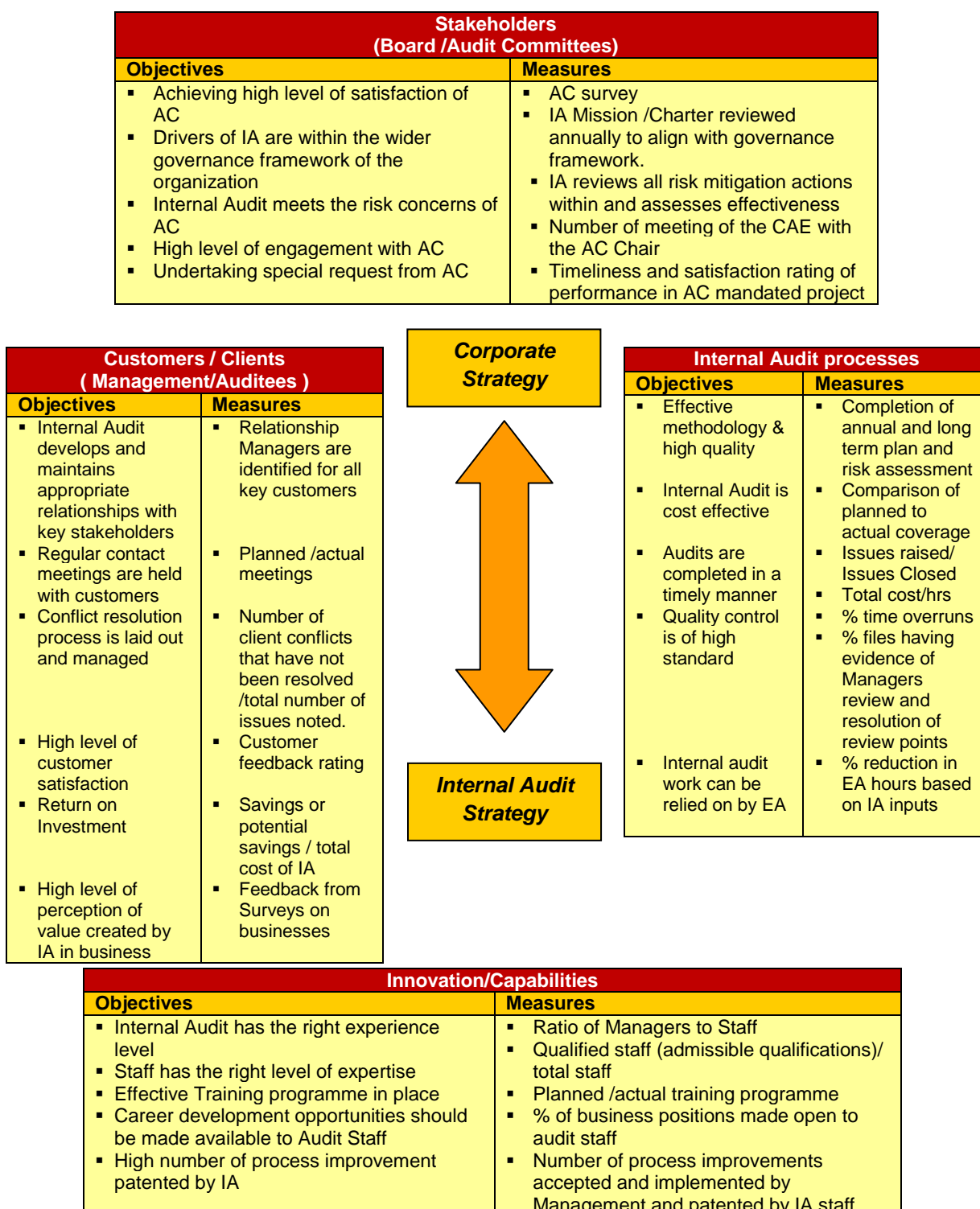
## APPENDIX D (INTERNAL AUDIT)

Audit Process Effectiveness	Value to the Business
<ul style="list-style-type: none"><li>▪ Percentage of providers, vendors, and other third-party affiliates audited by IA or similar functions</li><li>▪ Percentage of company contracts vetted by internal audit</li><li>▪ Percentage of IT projects evaluated with a post-implementation audit</li><li>▪ Percentage of employees with insufficient IT security awareness training, as identified by IA</li><li>▪ Number of IT access points discerned by IA and the percentage of these assessed for risk</li><li>▪ Ratio of unscheduled audits to scheduled audits</li><li>▪ Percentage of audit projects directly related to strategic company initiatives</li><li>▪ AC's satisfaction rating of IA projects</li><li>▪ Ratio of company risks identified by IA to unanticipated risks</li><li>▪ Frequency and duration of meetings between CAE and AC</li><li>▪ Percentage of audit recommendations implemented</li><li>▪ Time to complete audit process</li><li>▪ Number of false or erroneous audit findings</li><li>▪ Percentage of audit time devoted to high-risk areas</li></ul>	<ul style="list-style-type: none"><li>▪ Percentage of audit stakeholders who have received controls, risk, and governance training</li><li>▪ Percentage of internal controls documented and stored in databases</li><li>▪ Cost savings due to implementation of audit recommendations and best practices</li><li>▪ Time to distribute updated risk-and-control data to appropriate stakeholders</li><li>▪ Time to publish audit reports</li><li>▪ Reductions in fieldwork time</li></ul>

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

### Example 3 - Internal audit performance metrics<sup>135</sup>



For each of the above parameters, the organisation can set specific targets to measure actual performance.

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# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

### Appendix D4: Evaluating the effectiveness of the Internal Audit team<sup>136</sup>

Questions that the AC should ask itself in evaluating the performance and effectiveness of the internal audit team and where the AC members should ask follow-up questions as appropriate

Evaluation of Internal Audit Team	Yes	No	Not Sure	Comments
1. Does the internal audit department have a formal audit methodology focusing on risks?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. Does the audit methodology drive the development of an annual or long range audit plan?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. Is the audit plan reviewed by the AC at least annually?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. Does the audit plan contain sufficient flexibility to adjust for any unforeseen risks that may surface during the year?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
5. Does the chief audit executive and his or her staff assess Management's "tone at the top" in developing the audit plan?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
6. Does senior Management have professional respect for the internal audit function?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
7. Does the department appear to be using its time and resources effectively and efficiently in performing the audit plan?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
8. Are the department's size and structure adequate to meet its established objectives?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
9. Is the experience level of the internal auditors adequate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
10. Does the department appear to be objective? Describe the procedures that are performed to ensure objectivity.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
11. Is the technical knowledge of the department members sufficient to ensure that duties are performed appropriately?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
12. Does the department have an appropriate continuing education program?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
13. Are there department members with sufficient information systems auditing expertise to address the level of technology used by the organization?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

<sup>136</sup> *Evaluating the Internal Audit Team*, American Institute of Certified Public Accountants. Copyright 2010, American Institute for CPAs. Used by permission.

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

Evaluation of Internal Audit Team	Yes	No	Not Sure	Comments
14. Is the department's work planned appropriately?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
15. Does planning include written audit plans and programs?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
16. What types of reports are issued by the internal audit department and to whom?				
<i>Notes:</i>				
17. Are the internal audit reports issued on a timely basis?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
18. Do the internal audit reports include sufficient detail for effective action by Management or the AC, or both?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
19. Does Management respond in an appropriate and timely fashion to significant recommendations and comments made by the internal auditors?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
20. Do internal audit procedures encompass operational as well as financial areas?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
21. To what extent does the internal audit team perform certain preparatory audit procedures, including internal control grids, for the external auditors that would alleviate Management from this task?				
<i>Notes:</i>				
22. To what extent does the internal audit team "dialog" with the organization's external auditors, including review of Management letter comments and regulatory audit reports, for example, Office of Management and Budget Circular A-133?				
<i>Notes:</i>				
23. To what extent is the internal audit team involved with Management and the external auditors to plan the scope of the EA, with reference to IA areas reviewed by the team since the last EA?				
<i>Notes:</i>				

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

Evaluation of Internal Audit Team	Yes	No	Not Sure	Comments
24. Was the department's involvement in the annual audit effective?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
25. What could be done in the future to maximize the department's effectiveness and efficiency?				
<i>Notes:</i>				
26. To what extent is outsourcing used in the internal audit function, what areas are outsourced, and to whom are they outsourced?				
<i>Notes:</i>				
27. Is outsourcing done to gain expertise not found in the internal audit department?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
28. Is outsourcing done to minimize costs?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
29. Does the internal audit team have a periodic peer review performed and, if so, what were the results of the latest review?				
<i>Notes:</i>				
30. What criteria are used to establish and prioritize the annual and long-range internal audit plan?				
<i>Notes:</i>				
31. Is the department's work concentrated in areas of high risk, judgment, and sensitivity?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
32. To what extent does the internal audit team keep itself informed about, and involved in, professional activities?				
<i>Notes:</i>				
33. What are the internal auditors' views regarding controls, the risk of fraud, and compliance matters?				
<i>Notes:</i>				

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

Evaluation of Internal Audit Team	Yes	No	Not Sure	Comments
34. Has the charter of the internal audit department been evaluated to determine that it is still appropriate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
35. To what extent is the internal audit team itself informed about the not-for-profit environment by membership and leadership in industrywide monitoring and watchdog groups?				
<i>Notes:</i>				
36. To what extent does the internal audit team react to news and information about industrywide events and possible areas of exposure posed by other not-for-profit organizations?				
<i>Notes:</i>				
37. To what extent is the internal audit team involved with the exit conferences between Management and regulatory and compliance auditors?				
<i>Notes:</i>				
38. To what extent does the internal audit team "sign off" on resolutions of Management comments by outside external auditors?				
<i>Notes:</i>				
<b>Other Questions or Comments</b>				

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX D (INTERNAL AUDIT)

### Appendix D5: Private Session with the Internal Auditor<sup>137</sup>

Many ACs want to meet the Head of IA in a private session where Management is not present. This approach allows the AC to ask questions on matters that might not have been specifically addressed by the IA function's formal work programme – nevertheless, the Head of IA might, as a result of his/her work, have valuable views and opinions. A private session allows the Head of IA to provide candid, often confidential, comments to the AC on such matters.

This is a list of illustrative questions. It is not an exhaustive list but is intended to stimulate thought as to the type of issues that could be raised with the internal auditor.

#### Attitudes

- What is your assessment of the tone from the top?
- What is your assessment of the ethics, values and integrity of Management?
- What is Management's attitude towards risk management and internal controls?
- How does this company's attitude toward financial reporting/risk management/internal controls compare to other companies?
- Was Management fully supportive of the internal audit findings?
- What is your assessment of the quality of the company's financial/non-financial reporting, narrative reporting, and press releases?
- Is there excessive pressure on Management or operating personnel to meet financial targets including sales or profitability incentive goals?
- Is there excessive pressure to meet unrealistic or aggressive profitability expectations by investment analysts or others?

#### Resources

- Are you confident that your IA function is adequately resourced/ experienced?
- Is the IA function subject to undue pressure from any source?
- Do key areas of the business and control functions have adequate resources?
- Has Management adequately responded to your management recommendations?

#### Relationships

- How constructive is the relationship between the IA function and EA?
- Did you receive full cooperation during the IA programmes and did you get full, honest answers to all questions that were asked?
- Have any requests for information been denied or otherwise obstructed?
- Was Management forthcoming, open and candid in discussions with you?
- How are your relationships with financial management personnel? EA? CEO? CFO? Management/operations?

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<sup>137</sup> KPMG Risk Consulting, Singapore 2014

# **GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE**

## **APPENDIX D (INTERNAL AUDIT)**

- What was the nature of any consultations that were held with other service providers?

### **Other issues**

- Did you receive everything you requested on a timely basis?
- Did you have adequate time to carry out all your IA procedures?
- On what issues was the most amount of internal audits time spent?
- What is the most complex issue that was encountered during the IA programme that has not been discussed at the AC meeting?
- What were the two or three issues that you spent the most amount of time discussing with Management?



# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX E (FINANCIAL REPORTING)

### Appendix E1: Assessing fair values and estimates in financial reports<sup>138</sup>

AC members are required to keep abreast of the processes that are in place to establish fair values and estimates in financial reports. The following table provides an overview of the key questions that AC members need to consider to discharge their duties in this area.

Top 10 questions on fair values and estimates		Yes/No
<b>Performance and reliance</b>		
1	Are the use of fair values and estimates extensive in our financial statements?	
2	Are they aligned with our objectives and the economic environment?	
<b>Governance and compliance</b>		
3	Do we have adequate controls over the fair valuation and estimation process?	
4	Has the auditor sufficiently reviewed our fair values and estimates?	
<b>Fair valuation and estimation methodology</b>		
5	Are we comfortable with the models, inputs and assumptions?	
6	Have we considered alternative results?	
7	With the recent and upcoming changes in accounting requirements that may have an impact on fair values and estimates, have we assessed the potential impact on us?	
<b>Business impact</b>		
8	What risks do we face and how sensitive are we to these risks?	
<b>Systems and process</b>		
9	Are our systems and process adequate in supporting the sophistication and complexities of our fair valuation and estimation process?	
<b>People</b>		
10	Are we up-to-date on the rapid changes in requirements?	

<sup>138</sup> Source: KPMG Singapore - Guidance for assessing fair values and estimates adapted from KPMG's Financial Reporting Assessment Toolkit (FRAT) and Quicksan, 2013

# GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

## APPENDIX F (EXTERNAL AUDIT)

### Appendix F1: Possible questions for the private session with the external auditor<sup>139</sup>

- Did you recommend any changes to the financial statements or press releases that were not made? If so, what were the areas and nature of the suggested changes?
- What areas of our financial reporting do you believe could be challenged or scrutinized by regulators?
- What do you believe is the quality of our reported earnings for the current period?
- What is your perception of the tone at the top and at the middle Management levels?
- How capable is our finance team?
- Do you believe that pressure is placed on individuals in the financial reporting group to achieve a desired outcome when addressing an accounting issue?
- Do you believe that Management has appropriately dealt with individuals involved in fraudulent or questionable behaviour?
- Does anything causes you concern about the way the company operates?
- What areas of the audit take the most time, are subject to budget overruns, or lead to recurring disagreements with Management?
- What questions should we be asking of you and of Management? Where should we be spending more time?
- How rehearsed and scripted are the presentations to the AC?

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## Appendix F2: Sample checklist for evaluation of external auditors<sup>140</sup>

<b>Tone at the top</b>	Yes	No	Not applicable	Comment
1. Does the audit firm have systems and processes in place to ensure it maintains both actual and perceived independence from your organisation?				
2. Does the audit firm confirm its independence to you at least on an annual basis?				
3. Is audit quality embedded in the culture, values and code of conduct of the audit firm? Is the approach shared with you?				
4. Are the audit firm's core values and investment in and commitment to audit quality evident through interactions and communications?				

<b>Association with the right clients</b>	Yes	No	Not applicable	Comment
5. Do your auditors have formalised evaluation policies and procedures on client acceptance/ continuance and engagement acceptance?				

<b>Clear standards and robust audit tools</b>	Yes	No	Not Applicable	Comment
6. Do your auditors have policies and procedures and robust systems that ensure compliance with the relevant regulatory, ethical and professional requirements?				
7. Has your audit firm set clear standards for the performance of the audit and demonstrated the robustness of their audit methodology?				

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	Yes	No	Not Applicable	Comment
8. Is technology and tools leveraged to support the effective and efficient performance of the audit as well as the audit firm's compliance with the relevant regulatory, ethical and professional requirements?				
9. Have there been any negative reports against your auditors or where the audit firm is involved in any civil or criminal litigation matters?				
10. Are there cases where the reports issued by the audit firm in prior years have been restated/qualified subsequently?				
11. Are there any positions taken by your auditors with respect to accounting and auditing matters with regulators that could be viewed as controversial?				

<b>Recruitment, development and assignment of appropriately qualified personnel</b>	Yes	No	Not Applicable	Comment
12. Do the key personnel in the EA team have relevant experience, industry focus and sufficient time to commit to the EA?				
13. Do your auditors demonstrate sufficient knowledge of your organisation's risks and industry?				
14. Do the audit engagement partner and managers have experiences in auditing companies of the similar industry, size and risk profile?				
15. Are there industry training and references provided by the audit firm to your auditors?				
16. Do your auditors ensure continuity of the audit team members assigned to your organisation?				

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	Yes	No	Not Applicable	Comment
17. Are sufficient resources included to execute the audit, given the scope of the audit engagement, the nature and complexity of the organisation's operations?				
18. Is proper planning done for transition to new engagement partner for rotation purpose?				
19. Do your auditors have representation and network with the right team and expertise in the other jurisdictions that your organisation has operations in?				

<b>Commitment to technical excellence and quality service delivery</b>	Yes	No	Not Applicable	Comment
20. Do your auditors proactively engage with you on emerging or future accounting and regulatory changes impacting your business and the financial statements, as well as insights on the organisation's financial reporting process?				
21. Does the audit firm produce high quality audit and accounting publications, showing their depth of understanding and adding value to your business?				
22. Does the audit firm have adequate technical support responsible for conducting technical research and providing technical guidance and support to the audit teams?				
23. Do your auditors consistently demonstrate professional excellence in technical and industry specific matters to address the demands of your audit?				
24. Is there an established protocol in the audit firm for your auditors to escalate complex issues and differences of opinions, to appropriate specialists or experts, for resolution in a timely manner?				

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	Yes	No	Not Applicable	Comment
25. Do your auditors remain objective when dealing with difficulties, including significant disagreements with Management, faced during the audit?				

<b>Performance of effective and efficient audits</b>	Yes	No	Not Applicable	Comment
26. Do your auditors share with you their considerations on the audit scope, the level of materiality, areas of focus and what are the planned audit procedures to address the areas of significant risk?				
27. Do your auditors communicate to you significant matters arising from the audit and is the communication sufficient and timely?				
28. Did your auditors note any material weaknesses or control deficiencies over financial reporting process? Do they provide valuable insights on how such material weaknesses or control deficiencies negatively affect the organisation's operation and financial reporting and suggestions on how Management can improve the internal controls?				
29. Have your auditors been able to effectively coordinate with your internal auditors and rely on their work under appropriate circumstances?				
30. Do your auditors clearly explain their determination of the audit scope and approach for your organisation's subsidiaries and associates?				
31. If other network firms or other audit firms are involved, do your auditors perform adequate procedures to be satisfied that the other auditor's work is acceptable and that they are independent?				

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	Yes	No	Not Applicable	Comment
32. Are reports presenting the audit approach and findings timely, thorough and demonstrate a good understanding of your business and the issues faced?				
33. Do the audit partners and staff demonstrate a constructive communication style, showing their professional scepticism to constructively challenge matters of audit significance?				
34. During the audit, are the areas of significant judgement and estimates being given appropriate consideration before agreement on final positions?				
35. Does the partner who is leading the audit demonstrate timely support and oversight?				
36. Were there any significant audit adjustments or unadjusted audit differences raised by your auditors in relation to the financial statements?				
37. Has there been an increase or decrease of audit fee compared to the previous year and are the reasons shared by the auditors?				
38. Are the audit fees at a reasonable level to allow the auditors to discharge their work adequately?				

<b>Commitment to continuous improvement</b>	Yes	No	Not Applicable	Comment
39. Do your auditors actively seek feedback, addressing any observations with maturity, honesty and integrity?				
40. Is it clear that your auditors have a supportive environment with significant investment in continuous improvement?				
41. Do your auditors explain its mechanisms for monitoring audit quality?				

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	Yes	No	Not Applicable	Comment
42. Do your auditors keep you informed of the outcome of any regulatory review of the audit engagement including any significant inspection findings as reported by the regulator and the description of actions taken by the firm in response to the findings? Inspection findings raised in both detailed engagement reviews and firm-level reviews should be considered in the response to the above query.				