

Corporate Governance: Moving from
Aspiration to Actualisation

Corporate Governance Guide

Pull-out II

Guidance on effective
audit and risk
management

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Introduction

Background

This Introduction to **Pull-out II (“Effective audit and risk management”)** is designed to provide companies with broad guidance in making suitable arrangements for their audit and risk management processes as well as to assist directors serving on audit committees in carrying out their role. The Overview also intends to provide companies with direction in implementing the relevant enumerations of **Principle B** in the **Malaysian Code on Corporate Governance** and thus, should be read in conjunction with the write-ups on the individual Practices and Step Ups encapsulated in this Pull-out.

In today’s complex and evolving business environment, an effective audit and risk management process can make a strong contribution to a “no surprises” environment. Being vigilant of uncertainties requires companies to anticipate future challenges, understand what is on the horizon, and address risk more strategically – all of which calls for greater oversight, accountability and transparency.

In this regard, a robust audit committee can be a key feature of a strong corporate governance culture underpinned by effective audit and risk management. In discharging its mandate, it is imperative for audit committees to be supported by fundamental building blocks, namely an appropriate structure and foundation, well-defined responsibilities, an understanding of current and emerging issues as well as a proactive, risk-based approach to its work.

An audit committee’s relationship with the board, management and internal and external auditors plays a pivotal role in driving its effectiveness. The essential features of these interactions are a frank, open working relationship and a high level of mutual respect. The audit committee must be prepared to take a robust stance, and all parties must be prepared to make information freely available to the committee, to listen to their views and to deliberate on the issues candidly.

Every company needs to consider in detail what audit and risk management arrangements are best suited for its particular circumstances as what work bests for one company may not necessarily be ideal for another. These arrangements need to be proportionate to the task, and will vary according to the size, maturity, complexity and risk profile of the company. Nevertheless, there are certain guiding principles and practices which underlie the effectiveness of an audit and risk management process and they can help to ensure that company-specific approaches are applied effectively – that is, by the right people with the right information, procedures and perspectives.

This Introduction is set out over three sections. **Section I** addresses the establishment and effectiveness of the audit committee. **Section II** explores the audit committee’s responsibilities in overseeing the areas of financial reporting, related party transactions and conflicts of interests, internal control environment, internal audit and external audit. **Section III** meanwhile sheds light on the communication of audit, risk management and internal control matters.

Section I

Establishment and effectiveness of the audit committee

Establishment and terms of reference

Given the importance of an audit committee to the governance structure of a company, the establishment of this committee is mandated for listed issuers by **Paragraph 15.09 of Bursa's Listing Requirements**. The need for a charter or written terms of reference and minimum functions of the audit committee (covered in **Section II** of this Overview) is meanwhile set out in **Paragraphs 15.11 and 15.12 of Bursa's Listing Requirements**. Similar provisions are also encapsulated for financial institutions in **Bank Negara Malaysia's Policy Document on Corporate Governance¹**.

The audit committee charter must be approved and adopted by the board and it must set out in sufficient detail the specific duties, responsibilities and authority of the audit committee. Such terms of reference will not only help committee members focus on their roles but the disclosure of such will also enable stakeholders to be apprised of their responsibilities.

Once established, the charter should be assessed, reviewed and updated at least annually by the committee or as and when there are changes to the regulatory requirements and changes to the direction or strategies of the company that may affect the audit committee's role.

The committee should recommend any changes to its terms of reference to the board for the latter's approval. The assessment of the committee's terms of reference should be a rigorous process, taking into consideration the company's circumstances and any new regulations that may have an effect on the audit committee's responsibilities.

Composition and membership

Appointments to the audit committee should be made by the board on the recommendation of the nominating committee, in consultation with the audit committee chairman. In determining the composition and membership of the audit, the board should take into account factors such as size, independence and desired skills and qualities of the members.

Size	Independence	Skills and qualities
<p>The size of the audit committee will vary depending on the needs of the company, the board and the extent of responsibilities delegated.</p> <p>Paragraph 15.09(1)(a) of the Listing Requirements mandates listed issuers to appoint an audit committee comprising no fewer than three members.</p>	<p>As stated in Paragraph 15.09(1)(b) of Bursa's Listing Requirements, the audit committee should comprise non-executive directors with a majority being independent.</p> <p>Paragraph 15.10 of the Listing Requirements also prescribes that the chairman of the audit committee must be an independent director.</p> <p>Considerations on independence are covered in detail in the write-ups to Practice 8.1 and Step Up 8.4.</p>	<p>An appropriate level of expertise, experience and commitment amongst members is essential to the fulfilment of the committee's mandate.</p> <p>At least one member of the audit committee must fulfil the financial expertise requisite of Paragraph 15.09 of Bursa's Listing Requirements.</p> <p>Considerations on financial literacy and other pertinent qualities are covered in detail in the write-up to Practice 8.5.</p>

¹ Standard 12.1 and Appendix I of Bank Negara Malaysia's Policy Document on Corporate Governance.

Meetings

It is for the audit committee chairman, in consultation with the company secretary, to decide the frequency and timing of its meetings. There should be as many meetings as the audit committee's roles and responsibilities require. It is recommended there should be **no fewer than four meetings** during the year, held to coincide with key dates within the financial reporting (quarterly results and annual reporting) and audit cycle. The audit committee should meet prior to the release of the company's quarterly results and annual reports to discuss on the proposed disclosures.

In terms of duration, sufficient time must be allocated to thoroughly address all items in the agenda and for all parties involved to ask questions or provide input. Audit committee members should be assured that they have covered all the agenda items without feeling pressured to rush discussions and decision-making.

The audit committee secretary plays an important role in organising and providing assistance at audit committee meetings. Generally, the company secretary is the audit committee secretary.

Other relevant considerations in organising an audit committee meeting is outlined below:

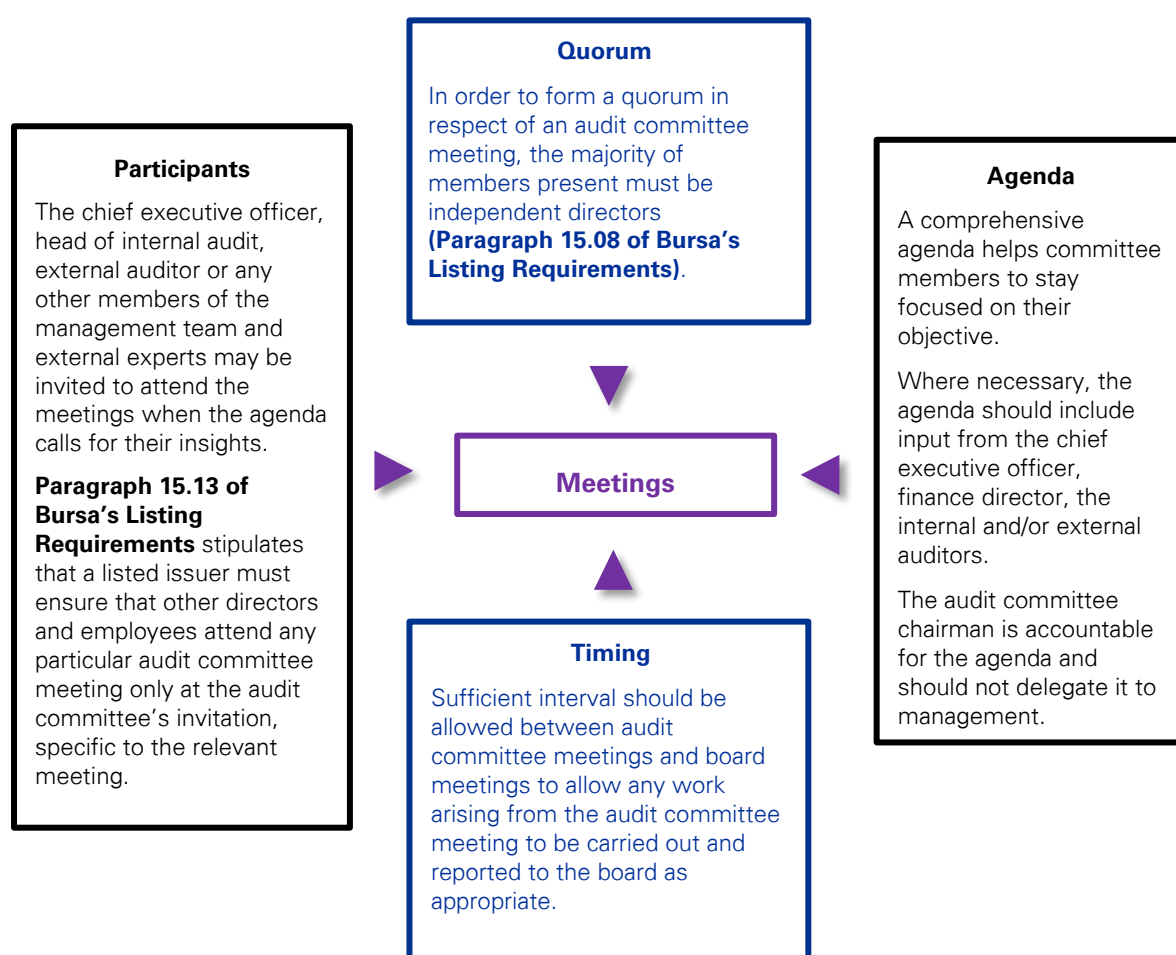


Diagram illustrating relevant considerations in organising audit committee meetings

Rights and resources

Paragraph 15.17 of Bursa's Listing Requirements empowers audit committee with the rights to carry out its work in an unhindered manner.

Paragraph 15.17 of Bursa's Listing Requirements

A listed issuer must ensure that wherever necessary and reasonable for the performance of its duties, an audit committee must, in accordance with a procedure to be determined by the board of directors and at the cost of the listed issuer:

- a) have authority to investigate any matter within its terms of reference;
- b) have the resources which are required to perform its duties;
- c) have full and unrestricted access to any information pertaining to the listed issuer;
- d) have direct communication channels with the external auditors and person(s) carrying out the internal audit function or activity;
- e) be able to obtain independent professional or other advice; and
- f) be able to convene meetings with the external auditors, the person(s) carrying out the internal audit function or activity or both, excluding the attendance of other directors and employees of the listed issuer, whenever deemed necessary.

In furtherance of its duties, audit committees may enlist the services of external experts or advisors such as valuers, engineers or tax consultants at the cost of the company in accordance with a procedure determined by the board.

Performance evaluation

Paragraph 15.20 of Bursa's Listing Requirements states that the nominating committee of a listed issuer must review the term of office and **performance of the audit committee and each of its members annually**. This is to assess whether the audit committee and its members have carried out their duties in accordance with their terms of reference. Sample exhibits on the assessment of the audit committee as a whole and individual audit committee members are provided in **Appendix V** and **Appendix VI** of **Pull-out I**.



Upon completion of the review, the nominating committee should deliberate the outcome and provide suggestions to the board on appropriate remedial actions for the audit committee. For example, relevant training or education programmes may be recommended for audit committee members to carry out their duties in a more informed manner.

Audit committee relationships and communications

The broadening responsibilities, rising complexities of accounting and risk issues as well as the heightening demand of stakeholders call for audit committees to be more focused than ever in enhancing their efficiency and effectiveness. Vital to achieving this is the strength and collegiality of the **audit committee's working relationship with the board of directors, management, internal and external auditors**.

Better practices call for continuous engagement between the audit committee (particularly the chairman of the committee) and senior management (including executive members of the board) of the company, as well as the internal and external auditors. These engagement sessions serve as a platform for relevant issues affecting the company to be surfaced to the attention of the audit committee in a timely manner.

A brief summary of the audit committee's working relationship with the aforementioned parties is outlined below:

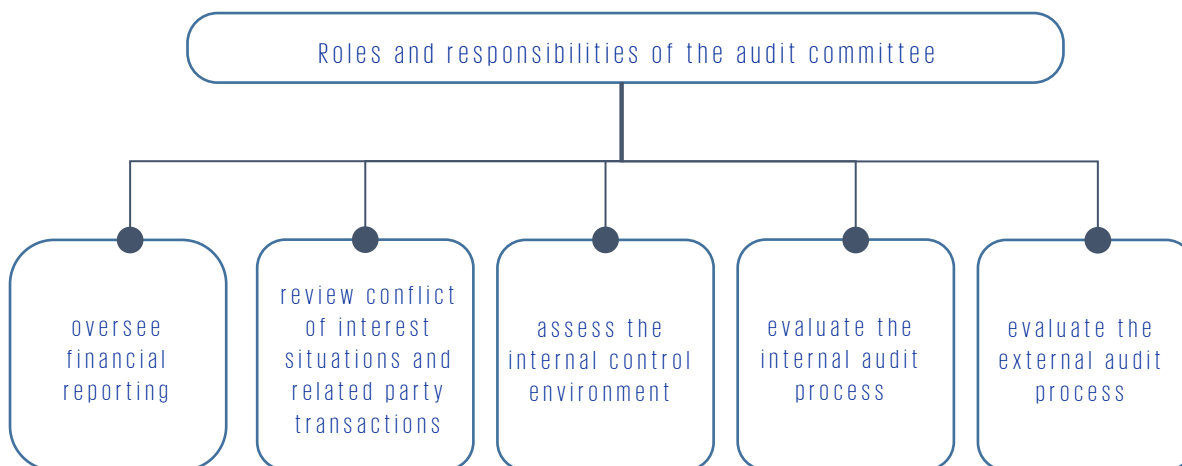
Relationship with the board	Relationship with management	Relationship with internal and external auditors
<p>As the board is ultimately responsible for the oversight of the company, it needs to be consistently kept informed by the audit committee of its activities.</p> <p>Any irregularities, significant findings or matters of concerns under the purview of the audit committee should be communicated to the board immediately.</p> <p>Any relevant proposals requiring substantive action by the board should also be submitted promptly in writing, providing board members ample time to review and consider the proposals.</p>	<p>It is the responsibility of the audit committee to satisfy itself that management has maintained a sound system of internal controls and prepared complete and reliable financial statements and disclosures in accordance with the approved accounting standards.</p> <p>In doing so, the audit committee should continuously apply a critical and probing view as well as effectively challenge the assertions made by management in this regard.</p>	<p>Both internal and external auditors provide integral support to the audit committee by acting as a sounding board.</p> <p>The audit committee should have direct and unrestricted access to the auditors without the presence of management. During these sessions, the audit committee can and should follow up on areas of concern identified by the internal and external auditors,</p> <p>The audit committee should also make inquiries on significant discussions between the management and the auditors.</p>

Section II

Roles and responsibilities of the audit committee

Understanding of roles and responsibilities

An effective audit committee should be critically aware of its responsibilities, fully understand and embrace them and recognise what is necessary to fulfil them. The audit committee must be vigilant, informed and diligent in fulfilling its oversight responsibilities. As outlined in **Paragraph 15.12 of Bursa's Listing Requirements**, every audit committee should at the very least assume the following fundamental responsibilities:



In addition to the aforementioned responsibility areas, audit committees of financial institutions are also required to review the accuracy and adequacy of the chairman's statement in the directors' report and corporate governance disclosures².

Oversight of financial reporting

Paragraph 15.12(1)(g) of Bursa's Listing Requirements requires the audit committee to review the quarterly results and year-end financial statements prior to approval by the board, focusing particularly on:

- changes in or implementation of major accounting policy changes;
- significant and unusual events; and
- compliance with accounting standards and other legal requirements.

It is essential for the audit committee to ensure that the finance function within a company is carried out by the right personnel with the skills, experience, training and authority suitable to the industry and the complexity of the company's business.

Apart from having the right personnel, audit committees should also ensure that the finance function is equipped with adequate resources (i.e. human capital and technology) and the right infrastructure (i.e. financial and accounting systems) to support the financial reporting process.

In reviewing the quarterly results and year-end financial statements, the audit committee should also be vigilant of significant adjustments arising from the external audit (e.g. impairment of assets during the global oil and gas downturn) and the appropriateness of the going concern assumption used in preparation of the financial statements. The audit committee is encouraged to consult the external auditors on these matters if the need arises.

² Paragraph 10, Appendix 1 of Bank Negara Malaysia's Policy Document on Corporate Governance

In general, the audit committee should focus on the following areas when reviewing financial statements of the company:

- monitoring the integrity of the company's financial information, particularly by reviewing the relevance and consistency of the accounting principles used (including criteria and principles used for consolidation) and understanding the effects of any changes in the accounting policies and practices, either as a result of changes in regulatory requirements or mooted by management for better accounting treatment;
- understanding the methods used to account for any complex and unusual transactions where their treatment may be open to different approaches and any significant accounting policy issues or audit adjustments recommended by auditors (those agreed by management and those waived);
- ensuring any significant accounting policy issues or audit adjustments recommended by auditors are communicated early enough to enable appropriate actions to be taken, as needed;
- assessing the company's financial position/condition and considering the question of going concern;
- assessing the process of how transactions are recorded in the system to ensure accuracy, completeness and consistency of financial information, including compliance with the relevant accounting standards and other legal requirements;
- considering related party transactions, the financial reality of such transactions and whether they have been entered into according to terms as stipulated in the shareholders' mandate or in the best interest of the company;
- requesting the external auditors to present their findings on internal control weaknesses noted during their statutory audits and highlighting findings which are disputed by management or where management has not agreed to implement remedial actions to rectify the reported weaknesses; and
- understanding non-financial information which is relevant in assisting the audit committee to gain further insights on the company's performance and enhance the integrity of financial reporting (e.g. capacity utilisation and actions by competitors).

Appendix I of this Pull-out provides a sample questionnaire that can be customised to seek management's representations on a range of financial reporting matters.

Review of conflict of interest situations and related party transactions

The audit committee is tasked under **Paragraph 15.12(h) of Bursa's Listing Requirements** to review and report to the board any related party transactions (including recurrent related party transactions) and conflict of interest situations that may arise within the company or group. This includes any transaction, procedure or course of conduct that raises questions about management's integrity. The audit committee should therefore ensure that the transactions carried out are not prejudicial to the interests of the company or its non-major/substantial shareholders (defined below).

Conflicts of interest situations refer to circumstances when persons connected with a director and/or shareholder ("interested parties") have the opportunity to influence the company's business or other decisions in ways that could lead to personal gain or advantage of any kind. Examples of situations that are likely to give rise to conflicts of interest amongst others include the following:

- where the interested parties have an interest in a business that competes or is likely to compete, either directly or indirectly, with the business of the company or its subsidiaries (collectively "the group");
- where the interested parties conduct or have an interest in business transactions involving goods or services, either directly or indirectly, with the group;
- where the interested parties provide or receive financial assistance from the group; and
- where the interested parties lease property to or from the group.

A related party transaction meanwhile is a transaction entered into by the listed issuer or its subsidiaries which involves the interest, direct or indirect, of a related party. **Paragraph 1.01 of Bursa's Listing Requirements** defines a related party as a director, major shareholder³ or person connected with such director or major shareholder. Transactions that fall within the ambit of related party transactions include the acquisition, disposal or leasing of assets, establishment of joint ventures, provision of financial assistance, provision or receipt of services or any business transaction or arrangement entered into by the listed issuer or its subsidiaries⁴.

The various persons who are included in the definition of a related party as stated in **Chapter 10 of Bursa's Listing Requirements** are depicted below:

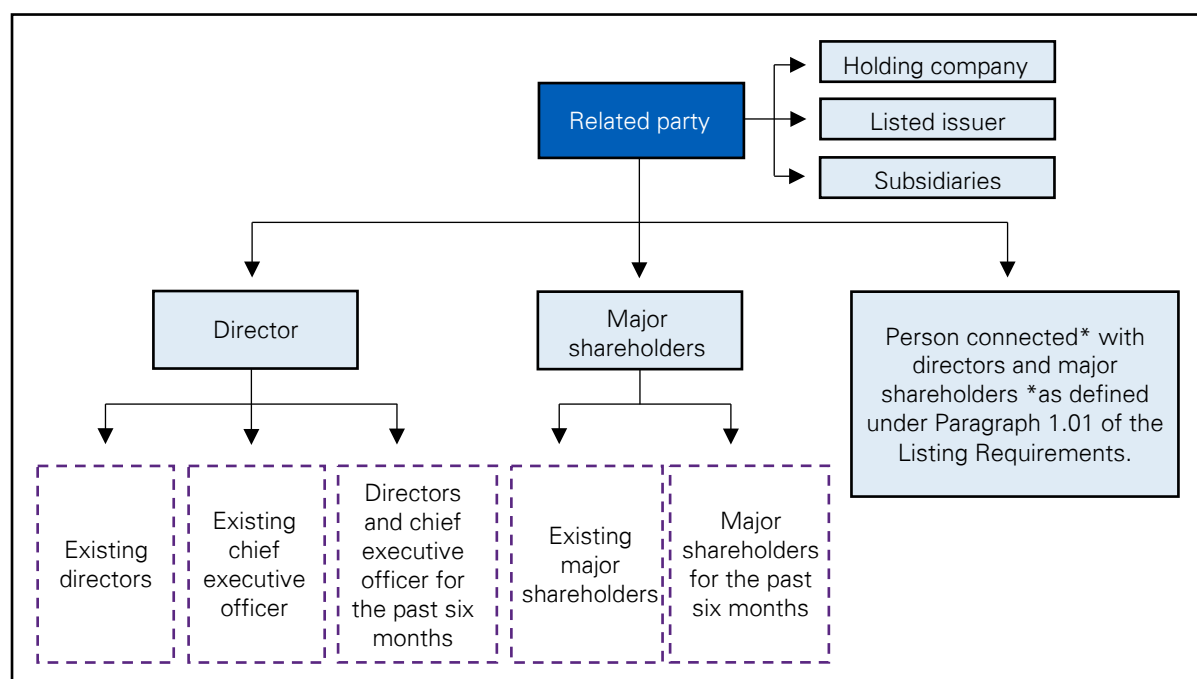


Diagram illustrating persons who are defined as related parties

In addition to **Bursa's Listing Requirements**, companies (including listed issuers) which come under the purview of reporting within the **Malaysian Financial Reporting Standard 124** ("Related Party Disclosures") are required to provide disclosures on related party transactions which are defined as the "transfer of resources, services or obligations between a reporting entity and a related party"⁵, regardless of whether a price is charged⁶.

Companies should also be cognisant of **Section 228 of Companies Act 2016** which prescribes the obligations of a company (i.e. approval by the general meeting of shareholders) in respect of transactions involving directors or substantial shareholders⁶ or persons connected with directors or substantial shareholders.

Taking into account the aforementioned enumerations, it is therefore incumbent on companies, particularly listed issuers through the audit committee, to determine how to address conflict of interest situations and monitor compliance with related party transactions policy and/or mandate, including

³ Major shareholder refers to a person who has an interest in 10% or more of the aggregate of the nominal amounts of all the voting shares in the corporation; or 5% or more of the aggregate of the nominal amounts of all the voting shares in the corporation where such person is the largest shareholder of the corporation.

⁴ **Paragraph 10.02 of Bursa's Listing Requirements**

⁵ An entity is related to a reporting entity if it has control or joint control over the reporting entity; has significant influence over the reporting entity; or is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

⁶ A substantial shareholder is a person who has not less than 5% of the voting shares in the company

transactions or situations that warrant timely internal and regulatory disclosures and appropriate review and reporting.

To this end, the audit committee should ensure that management establishes a comprehensive framework for the purposes of identifying, evaluating, approving, reporting and monitoring such situations and transactions. It is essential to ensure that the framework put in place enables related party transactions and conflict of interest situations to be brought to the attention of the audit committee for its consideration.

Key factors which must be addressed by the audit committee in its oversight of conflict of interest situations and related party transactions are as follows:

- identification of the interested and related parties as well as the nature of such potential transactions; and
- reasonableness of the conflict of interest situations or the related party transactions to ensure that interested parties do not abuse their powers to gain unfair advantage.

In undertaking an assessment on the reasonableness of the conflict of interest situations or the related party transactions, audit committees may be guided by the following considerations:

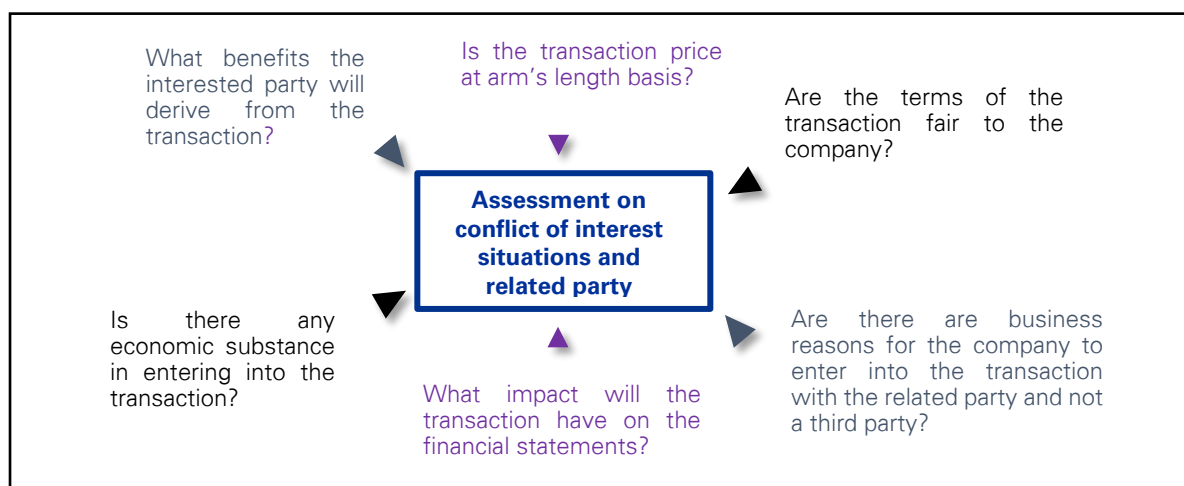


Diagram illustrating the assessment on conflict of interest situations and related party transactions

In addition, it is important for the audit committee to look into transactions that do not neatly fall within the definition of a related party transaction as stated in **Chapter 10 of Bursa's Listing Requirements** but may still involve a certain level of conflict of interest due to the close proximity of the transacting parties. This covers transactional arrangements where the director or major shareholder may derive personal gain or advantage.

In certain instances, the audit committee may be faced with the possibility of undisclosed conflict of interest situations or related party transactions entered into with the objective of managing earnings. In order for the audit committee to identify a potential or a questionable situation or to satisfy itself that the transaction might be a related party transaction, it should request management to provide the following information:

- background information on the company's trading partner and transacting parties;
- information on the trading partner's substantial shareholders;
- identity of related parties; and
- information about the key business partners, major customers, major suppliers and parties to key contracts.

Assessment of internal control environment

The audit committee must determine whether management has implemented effective and adequate internal controls to preserve the company's value creation. The internal control framework of a company should address the following inter-related components:

Control environment	This sets the tone and culture of the company. It is the foundation of all aspects of internal controls, providing discipline and structure. It includes the integrity, ethical values, and competency of the personnel.
Risk assessment	Identifies and analyses relevant risks that prevent the company from achieving its objectives and forms the basis for determining how those risks should be managed.
Control activities	These are the policies and procedures that help ensure the necessary actions are taken to address risks impeding the achievement of the company's objectives, and maintaining these risks within an acceptable risk appetite.
Information and communication	Identifies, captures and communicates information in a form and timeframe that enables personnel to carry out their responsibilities.
Monitoring activities	Assesses the performance of the control system on a continuing basis.

It is important to note that the design of internal controls in silos and without reference to their associated risks can lead to an imbalance and consequently, certain key risk areas may be left unaddressed. It is thus imperative for the internal control system to be embedded in the operations of the company and be capable of responding quickly to evolving business risks, whether they arise from factors within the company or from changes in the business environment. Succinctly put, the internal control system should form an integral part of the company's day to day business processes.

Given the evolving nature of risks in the marketplace and the dense agenda of the audit committee, it is also increasingly regarded as a better practice for companies to have a separate board-level committee, namely, risk management committee to provide dedicated oversight on matters concerning risk management (*note: this is discussed in the write-up to **Practice 9.3***). In assessing the company's risk management framework and policies, the board committee overseeing risk management matters should amongst others consider the following:

- the principal risks and the process of identification, evaluation and management of the principal risks;
- the alignment between risk management execution and the implementation of the company's overall strategy;
- the effectiveness of measures deployed by management to address those risks (i.e. accept, avoid, transfer or mitigate the risks);
- corrective measures undertaken to remedy failings and/or weaknesses;
- ability of the company to meet changes in significant risks and respond to constant changes to the business and/or external environment;
- scope and quality of management's ongoing monitoring of risks and robustness of the risk management process;
- communication and monitoring of risk assessment results to the board; and
- actual and potential impact of any failing or weakness, particularly those related to financial performance or conditions affecting the company.

Considerations on risk management and internal control system are covered in detail in the write-up to **Practices 9.1 and 9.2**.

Evaluation on internal audit

Each listed issuer by virtue of **Paragraph 15.27 of Bursa's Listing Requirements** is required to establish an internal audit function that reports directly to the audit committee. This function serves as an important source of advice for the audit committee by bringing an objective and disciplined approach to evaluate and improve the effectiveness of risk management, internal control and governance processes.

The internal audit function which can either be performed in-house or outsourced, including outsourced to group internal auditors (i.e. internal auditor of the holding company or subsidiary of the holding company) must be premised on the requirements of an **"independent and objective" function**. At all times, the audit committee should ensure that the internal audit function has a reporting line which enables it to be independent of management so as to exercise objectivity. The audit committee should be responsible for deciding on the appointment and removal as well as the performance evaluation and remuneration of those in the internal audit function. The internal audit function should also be accorded with direct and unrestricted access to information, records, physical properties and personnel to enable it fulfill its mandate.

The audit committee should be involved in deciding the **remit of the internal audit function** including its objectives, strategies, roles and responsibilities, scope and reporting line. In order to position and formalise the internal audit function, a mandate in writing (i.e. the internal audit charter or terms of reference) should be established and approved by the audit committee.

In undertaking a review of effectiveness of the internal audit function, the audit committee should satisfy itself that the quality, experience and expertise of the function is appropriate for the business of the company. The audit committee should also consider the actions that management has undertaken to implement the recommendations of the function and whether these properly support the effective working of the internal audit function.

Considerations relating to the internal audit function are covered in detail in the write-up to **Practices 10.1 and 10.2**.

Evaluation on external audit

External auditors play a vital role in the process of accountability to shareholders. Their primary role is to form an opinion on the financial statements of the company, including accounting and other records relating to those financial statements and thereafter report to the shareholders in general meetings. In their course of work, they may identify and, where appropriate, quantify the financial risk that may result in adjustments to the financial statements.

As stated in **Paragraph 15.12(2) of Bursa Listing's Requirements**, the audit committee is required to recommend the nomination of a person or persons as external auditors.

The audit committee's recommendation on the appointment of external auditors should be based on an assessment of the independence and capabilities of the external auditors as well as the effectiveness of the audit process. **Paragraph 15.21 of Bursa's Listing Requirements** outlines the factors (shown below) that a listed issuer must consider amongst others in appointing an external auditor:



In the event of removal or resignation of the external auditors, it is imperative for the audit committee to look into the reasons thereof, especially when the impending removal or resignation arises from an inability to resolve contentious matters that affect financial reporting.

Paragraph 15.22 of Bursa's Listing Requirements stipulates where external auditors are removed from office or give notice to the listed issuer of their desire to resign as external auditors of the listed issuer, the listed issuer must forward to the Exchange a copy of any written representations or written explanations of the resignation made by the external auditors at the same time as copies of such representations or explanations are submitted to the Registrar of Companies pursuant to **Section 284 of Companies Act 2016**.

In overseeing the external audit process, **Paragraph 15.12(1)(a)-(d) of Bursa's Listing Requirements** states that the audit committee must review with the external auditor - the audit plan, external auditor's evaluation of internal controls, audit report and assistance given by the employees of the listed issuer to the external auditor.

The audit committee needs to be aware of the scope and approach of the external audit. Whilst the audit plan is the external auditor's responsibility, it is important that the audit committee fully understands the plan. At the start of each annual external audit cycle, the audit committee needs to consider the external auditor's overall strategy, including planned levels of materiality and proposed resources to execute the external audit plan, and evaluate whether it appears consistent with the scope of the external audit engagement.

In order to accomplish this effectively, the audit committee's should perform the following:

- discuss with the external auditor before the audit commences, the nature and scope of the audit, including the terms as detailed in the external auditor's engagement letter. This will clarify the responsibilities of the company and the external auditor and other logistical matters; and
- study and evaluate the audit plan, especially the approach to be deployed by the external auditor.

The elements encapsulated in a typical audit plan are outlined below:

- scope of the audit, timing of the audit and reporting deadlines;
- audit team;
- key areas of business risk and significant transactions for the group, as appropriate;
- major accounting systems and systems of internal control to be reviewed;
- extent of planned testing of controls;
- areas where contention may arise;
- nature and extent of audit procedures to be performed, including materiality level;
- identification or anticipation of significant changes for the financial report as a result of new or revised accounting policies and/or regulatory requirements;
- locations to be visited and audit procedures to be undertaken in respect of those locations not visited;
- liaison with subsidiaries' auditors on consolidation of financial statements;
- coordination with internal audit to avoid duplication of efforts and to optimise audit efficiency;
- the extent to which the planned audit scope can be relied upon to detect errors or irregularities (i.e. fraud); and
- frequency of meetings with the audit committee and any reports or other deliverables the audit committee and management are likely to receive.

Following the audit and before signing off the financial statements, the external auditor would normally present the following to the audit committee:

- a report, detailing the results and significant findings from the audit;
- the external auditor's audit report on opinion relating to the financial statements; and
- a management letter concerning improvement measures that management should consider pertaining to weaknesses or deficiencies in the internal control system.

In this regard, the audit committee should request the external auditors to present their findings on internal control weaknesses noted during their financial audit and highlight findings which are disputed by management or where management has not agreed to implement corrective actions which would rectify the reported weaknesses.

As part of an ongoing monitoring process, the audit committee should review the management letter issued and consider management's responsiveness to the external auditors' findings and recommendations, particularly on internal control deficiencies that need to be addressed.

Considerations relating to the oversight of external auditors by the audit committee are covered in detail in the write-up to **Practices 8.2 and 8.3**.

Section III

Communication on audit, risk management and control

Pursuant to **Paragraph 15.15(1) and (2) of Bursa's Listing Requirements**, a listed issuer must ensure that its board of directors prepares an **audit committee report** at the end of each financial year with the relevant information clearly set out in the annual report. The audit committee report must at the very least contain the following information as stated in **Paragraph 15.15(3) of Bursa's Listing Requirements**.

Paragraph 15.15(3) of Bursa's Listing Requirements

The audit committee report must include the following:

- a) the composition of the audit committee, including the name, designation (indicating the chairman) and directorship of the members (indicating whether the directors are independent or otherwise);
- b) [deleted]
- c) the number of audit committee meetings held during the financial year and details of attendance of each audit committee member;
- d) a summary of the work of the audit committee in the discharge of its functions and duties for that financial year of the listed issuer and how it has met its responsibilities; and
- e) a summary of the work of the internal audit function.

*Note: As stated in **Paragraph 2, Appendix 4 of Bank Negara Malaysia's Policy Document**, financial institutions are required to disclose the attendance of each director at board and board committee meetings (including audit committee) and discuss the roles and responsibilities of the board and the board committees.*

The audit committee report should describe relevant significant issues in a concise and understandable form, tailored to the specific circumstances of the company. Merely disclosing the audit committee's terms of reference or charter without describing how the committee actually carried out its roles and responsibilities during the financial year would not be particularly useful for stakeholders.

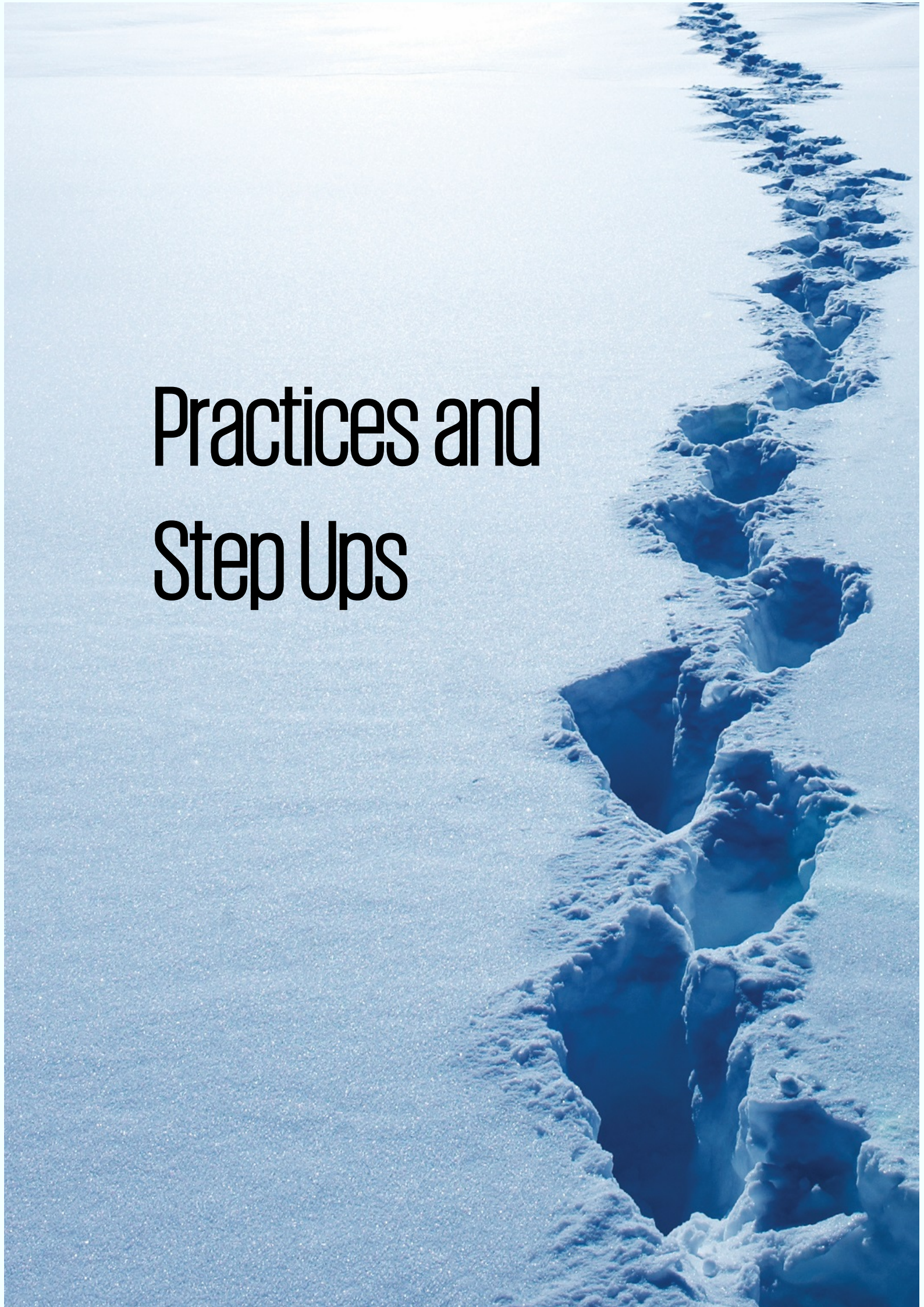
The “Analysis of Corporate Governance Disclosures in Annual Reports” performed by Bursa Malaysia over the last three years has identified the following elements (non-exhaustive) which were encapsulated in the audit committee report of listed issuers that exhibited good disclosures in this regard:

- details such as the dates when the audit committee met with the external and internal auditors without the presence of management and the topics discussed;
- discussion on developments (e.g. changes in accounting standards) which had a significant impact on the listed issuer’s financial statements and analyses of the impact;
- statement that there was assurance provided by the chief financial officer to the audit committee on matters which involve judgments and estimates;
- discussion on how the audit committee reviewed related party transactions and conflict of interest situations;
- details on the policies and procedures in place to assess the suitability and independence of the external auditor;
- discussion on the non-audit services rendered by the external auditor; and
- discussion on the internal audit assignments as well as the independence and competency of the internal audit function (*note: this is covered in the write-up to **Practices 10.1 and 10.2***).

In addition to the audit committee report, **Paragraph 15.26(b) of Bursa’s Listing Requirements** requires the board of the listed issuer to provide a **statement about the company’s state of risk management and internal control** of the listed issuer as a group. The statement should contain sufficient and meaningful information needed by stakeholders to make an informed assessment of the main features and adequacy of the company’s risk management and internal control system. Further, **Paragraph 15.23 of Bursa’s Listing Requirements** provides for the external auditors to review the statement made by the board of directors of a listed issuer, with regards to the state of risk management and internal control of the listed issuer and report the results thereof to the board of directors of the listed issuer. Considerations in relation to the statement about a company’s state of risk management and internal control are covered in detail in the write-ups to **Practices 9.1 and 9.2**.

It is also important to note that the chairman of the audit committee should be present at the Annual General Meeting (“AGM”) to answer questions on the audit committee’s activities and matters within the scope of the audit committee’s responsibilities.

Practices and Step Ups



Chairman of the audit committee



MCCG Intended Outcome 8.0

There is an effective and independent audit committee.

The board is able to objectively review the audit committee's findings and recommendations. The company's financial statement is a reliable source of information.

MCCG Practice 8.1

The chairman of the audit committee is not the chairman of the board.

Why

The case for change

Whilst all directors have a duty to act in the best interests of the company, the audit committee has a specific role which is to provide objective oversight in the areas of financial reporting, related party transactions and conflicts of interests, internal control environment, internal audit and external audit process.

This need for objectivity is particularly imperative for the chairman of the audit committee as the effectiveness of the committee is often dependent on his or her leadership. The chairman is expected to demonstrate **courage to deal with tough issues** and support other members to do the same, especially in probing management on areas where subjectivity is inherent (e.g. choice of accounting policies and estimates made in the arriving at the figures recorded in the financial statements).

Recognising the need for objectivity amongst audit committee members, regulators have placed a heightened focus on the composition of this committee with an emphasis on its chairman. **Paragraph 15.09 of Bursa's Listing Requirements**

A listed issuer must appoint an audit committee from amongst its directors which fulfils the following requirements:

- a) the audit committee must be composed of not fewer than 3 members; and
- b) all the audit committee members must be non-executive directors, with a majority of them being independent directors.

Paragraph 15.10 of Bursa's Listing Requirements

The members of an audit committee must elect a **chairman among themselves who is an independent director**.

Paragraph 15.18 of Bursa's Listing Requirements

In order to form a **quorum** in respect of a meeting of an audit committee, the majority of members present must be independent directors.



What could go wrong:

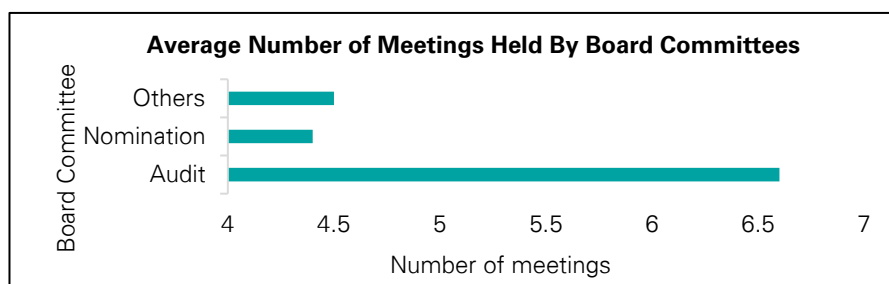
- Lack of objective review and scrutiny on the findings of the audit committee by board.
- Deliberations and decision making of the audit committee is dominated by a single individual.
- Omission of key discussion matters from the agenda of the audit committee.
- Lack of oversight on the effectiveness of the audit committee by the board.

In addition to being independent, it is of paramount importance for the chairman of the audit committee to be distinct from the chairman of the board. Having these positions assumed by the same person may **impair objectivity** of the board's review of the audit committee's findings and recommendations. Such a situation may also potentially lead to concentration of power in a single director. The need for financial institution to maintain a distinction between the chairman of the board and chairman of the audit committee is enumerated in **Standard 12.4 of Bank Negara Malaysia's Policy Document on Corporate Governance** which states that "to promote robust and open deliberations by the board on matters referred by the board committees, the chairman of the board must not chair any of the board committees".

In addition, separation of these dual positions is necessary to enable the chairman of audit committee to **devote sufficient time to the affairs of the committee**. Being the chairman of the board and board committee would result in the said director being subjected to additional responsibilities, thus, making the performance of his or her duties fairly onerous.

Point for reflection

In tandem with global trends, audit committees continue to be the **most time-consuming committee** in corporate Malaysia. A review of annual reports across the top 50 public listed companies (by market capitalisation) in 2016 revealed that audit committees averaged 6.6 meetings a year compared to nominating committees (4.4 meetings) and other board subcommittees (4.5 meetings).



Average number of meetings held by board committees in top 50 public listed companies.

Audit committees are often tasked not only with overseeing a company's financial reporting and internal controls, but also a gamut of other responsibilities which include oversight of risk, compliance and corporate governance matters.

The need for audit committee members to be apprised of relevant developments also demands additional time and professional commitment. Over the recent years, there have been major developments in the accounting and auditing landscape such as the introduction of the New Auditor's Report and revisions to accounting standards, all of which necessitate continuous professional development.



Investors' perspectives

The composition of audit committee, particularly in relation to the independence of the chair is a focus area of institutional investors.

Blackrock for example, has taken the position that the chairman of a committee in its investee companies should be independent. In its voting guidelines, Blackrock further reinforces that it is preferable for the chairman of the board not to chair board committees.

In instances where the audit committee is not comprised solely of independent directors, Blackrock will consider voting against the re-election of the chairman of the audit committee or the non-independent member of the audit committee particularly if there are other corporate governance issues¹.

¹ Corporate governance and proxy voting guidelines 2015, Blackrock

How

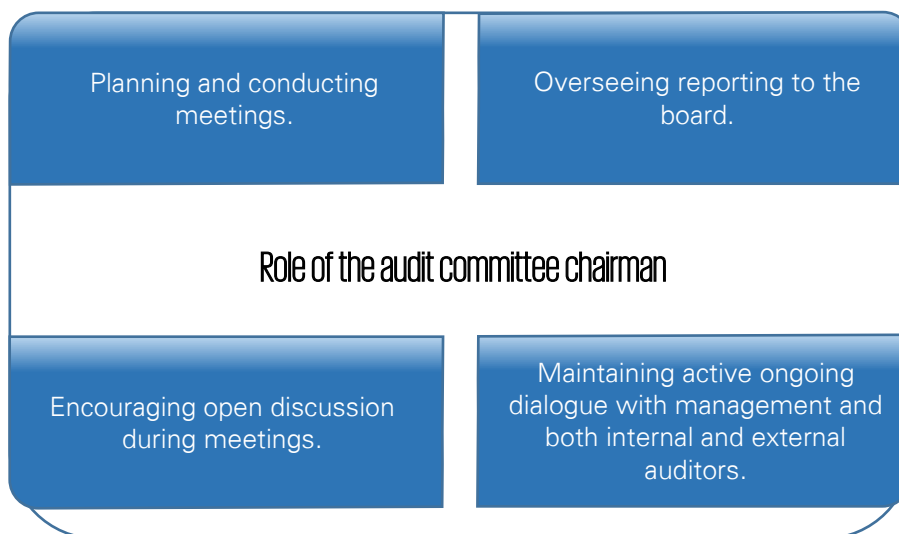
The practice in substance

In structuring its audit committee, the board should therefore ensure that the chairman of audit committee is **distinct from the chairman of the board**. In addition, as stated in **Paragraph 15.10 of Bursa's Listing Requirements**, the chairman of the audit committee should be an independent director.

Key considerations relating to the application of this Practice are discussed below:

What are the key responsibilities of an audit committee chairman?

An audit committee chairman is responsible for ensuring that audit committee meetings run efficiently and each agenda item is thoroughly and thoughtfully discussed by all members of the committee. The committee chairman is often the key contact between the committee members and members of the board, as well as senior management and the auditors. Responsibilities of an audit committee chairman, amongst others, are as in the following page:



What are some of the key attributes of an effective audit committee chairman?

The chairman of the audit committee should be recognised for his or her leadership and vision, and be acknowledged by other committee members and management as being able to set and manage the audit committee's agenda.

Attributes of an effective audit committee chair (non-exhaustive):

- an independent proactive leader with confidence and integrity;
- a highly respected and experienced board member, who possesses strong financial literacy skills and time available to develop and closely monitor the committee's agenda;
- a person with an excellent working knowledge of audit committee practices;
- a good listener and communicator who can facilitate successfully;
- able to champion open and frank discussion with discipline; and
- tenacious and prepared to ask the tough questions.



Dos

- ✓ Setting out the separation between the chairman of the board and the audit committee chairman in the board charter and terms of reference of the audit committee.
- ✓ Outlining the roles and responsibilities of the audit committee chairman in the committee's terms of reference.
- ✓ Developing structured communication channels between the board and audit committee (e.g. reporting the activities of the audit committee to the board and escalation of key issues to the board).



Don'ts

The following would render the application of this practice ineffective:

- × Having a chairman of the audit committee who is unable to devote sufficient time to manage the affairs of the committee.
- × Having a chairman of the audit committee who is not financially literate.

Can the chairman of the audit committee chair another board committee?

There are no restrictions for the chairman of the audit committee to chair another board committee as possibilities of conflicts of interests are minimal under normal circumstances.

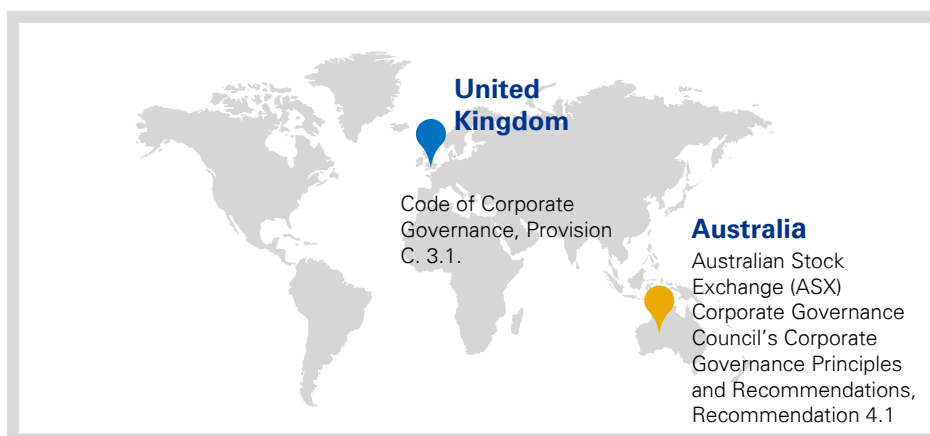
In some instances, companies may find it value-adding for the chairman of the audit committee to chair another board committee, given the synergies that are involved between these two committees (e.g. audit committee and risk management committee or in the case of some financial institutions, audit committee and financing committee).

However, as mentioned above, the board should be cognisant of the workload of the audit committee chairman in deciding if he or she can assume the chairmanship of another board committee without compromising the standard of work performed.

Where

Regional/international perspectives

In order to enable the audit committee chairman to give full commitment and exercise independent judgement, jurisdictions such as Australia and United Kingdom have enumerated prescriptions for the chairman of the audit committee to be distinct from the chairman of the board.



Regional/ international perspectives

Companies in Australia and United Kingdom (smaller companies) are urged to ensure separation in the chairmanship of the audit committee and that of the board.

Country	Provision
Australia	The board of a listed entity should have an audit committee which is chaired by an independent director, who is not the chair of the board (Recommendation 4.1).
United Kingdom	The board should establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors. In smaller companies ² , the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman (Provision C.3.1).

² A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

Oversight of external auditors by the audit committee



MCCG Intended Outcome 8.0

There is an effective and independent Audit Committee.

The board is able to objectively review the Audit Committee's findings and recommendations. The company's financial statement is a reliable source of information.

MCCG Practice 8.2

The Audit Committee has a policy that requires a former key audit partner to observe a cooling-off period of at least two years before being appointed as a member of the Audit Committee.

MCCG Practice 8.3

The Audit Committee has policies and procedures to assess the suitability, objectivity and independence of the external auditor.

Why

The case for change

An audit has value to financial statement users because it is performed by a competent third party who is viewed as having no interest in the financial success of the company¹. Investors take comfort in the fact that independent professionals have performed the required procedures and have a reasonable basis for the opinion that they render in the financial statements.

Given that **audit quality is integral to the informed decision making of investors**, a high level of scrutiny is placed by stakeholders on the work of external auditors. Independent audit regulators across the globe are now increasingly focusing on the drivers of audit quality via their inspection efforts. The Global Annual Survey of Audit Inspection 2016 by the International Forum of Independent Audit Regulators revealed that whilst there is a general decline in the inspection findings, a lack of consistency in the execution of audits and systems of quality control, including in the critical area of external auditors' independence continue to remain as causes for concern.



Enforcement actions on errant external auditors

Enforcing standards on external audit is a **core priority of independent audit regulators**, including the Audit Oversight Board (AOB) of Malaysia.

Over the years, AOB has consistently taken action against errant auditors and firms, including revoking their registration. In an unprecedented case, the audit firm (Roger Yue, Tan & Associates) for United U-Li Bhd since its incorporation was found to be delinquent and its managing partner was imposed with a hefty fine and sentenced to a year of imprisonment in 2015 for abetting United U-Li Bhd to make a misleading statement in relation to its audited financial results for the financial year ended 31 December 2004.

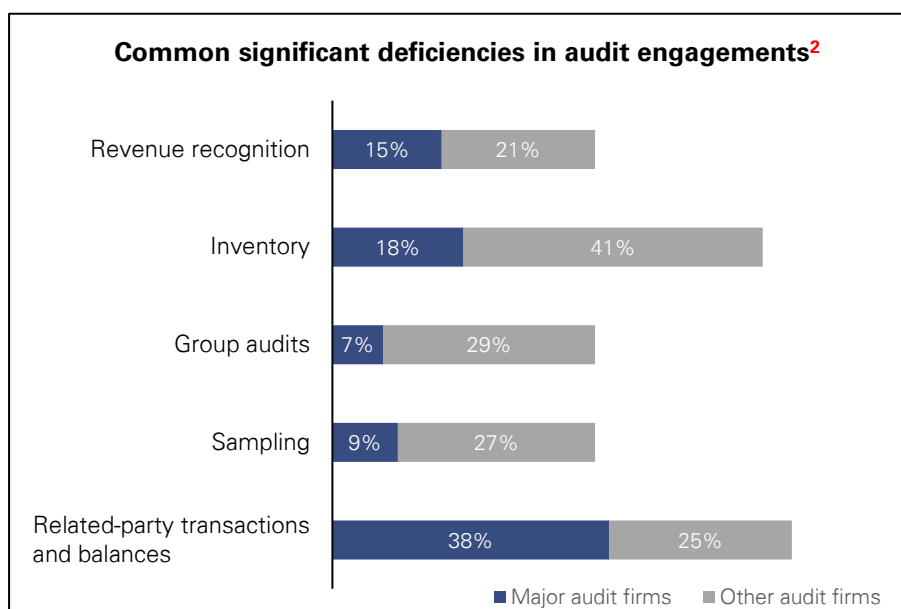
¹ Concept release on auditor independence and audit firm rotation 2011, Public Company Accounting Oversight Board of United States.



Point for reflection

The insights from the inspection efforts carried out by AOB revealed that the quality of auditing in Malaysia has improved over the recent years. Notwithstanding that, the AOB continues to find instances in which it appeared that external auditors did not approach some aspect of the audit with the required objectivity, diligence and professional scepticism.

For example, audit procedures which required a high degree of unpredictability such as those relating to revenue recognition, inventory and related-party transactions showed significant deficiencies in the inspection findings by AOB during the year 2016. Some of the common root-causes which led to these deficiencies included inadequate quality control procedures and the lack of cognisance to the changing circumstances of the company's business, especially for continuing audit engagements.



Note: Major audit firms refer to audit firms with more than 10 partners and audit more than 50 Public Interest Entities (PIE) clients with a total market capitalisation of above RM20 billion.



What could go wrong:

- Compromised objectivity of the external auditor.
- Lack of expertise and experience by the external auditor to conduct the audit process.
- Lack of robust focus on the critical areas of risk concerning financial reporting.
- Lack of value obtained from the external auditor beyond the scope of statutory external audit (e.g. audit findings are not contextualised to the industry and business).

Recognising that promoting audit quality is not within the sole purview of external oversight bodies, regulators have also placed audit governance responsibilities on the audit committee, including in the selection and evaluation of the external auditor. For example, Bursa's Listing Requirements call upon audit committees to be proactive in overseeing the external audit process.

²Annual Report 2016, Audit Oversight Board (Malaysia)

Paragraph 15.12 of Bursa's Listing Requirements

A listed issuer must ensure an audit committee, amongst others, discharge the following functions:

- review the following and report the same to the board of directors of the listed issuer:
 - with the external auditor, the audit plan;
 - with the external auditor, his evaluation of the system of internal controls;
 - with the external auditor, his audit report;
 - the assistance given by the employees of the listed issuer to the external auditor;
 - any letter of resignation from the external auditors of the listed issuer; and
 - whether there is reason (supported by grounds) to believe that the listed issuer's external auditor is not suitable for re-appointment; and
- recommend the nomination of a person or persons as external auditors.

Paragraph 15.17 of Bursa's Listing Requirements

A listed issuer must ensure that wherever necessary and reasonable for the performance of its duties, an audit committee must, in accordance with a procedure to be determined by the board of directors and at the cost of the listed issuer –

- (d) have direct communication channels with the external auditors and person(s) carrying out the internal audit function or activity; and
- (f) be able to convene meetings with the external auditors, the person(s) carrying out the internal audit function or activity or both, excluding the attendance of other directors and employees of the listed issuer, whenever deemed necessary.

Note: Only requirements pertaining to the external auditor are extracted from Paragraphs 15.12 and 15.17.

Paragraph 15.21 of Bursa's Listing Requirements

In appointing an external auditor, a listed issuer must consider, among others –

- (a) the adequacy of the experience and resources of the accounting firm;
- (b) the persons assigned to the audit;
- (c) the accounting firm's audit engagements;
- (d) the size and complexity of the listed issuer's group being audited; and
- (e) the number and experience of supervisory and professional staff assigned to the particular audit.

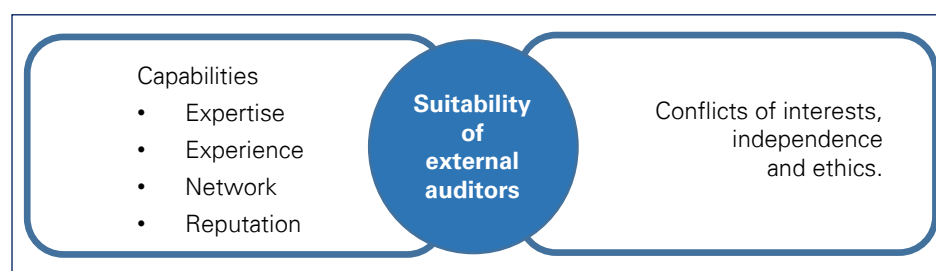
Similar provisions are also encapsulated for financial institutions in **Bank Negara Malaysia's Policy Document on Corporate Governance**. For example, **Appendix 1** of the said documents requires the audit committee to foster a quality audit of the financial institution by exercising oversight over the external auditor, in accordance with the expectations set out in the **Bank Negara Malaysia's Policy Document on External Auditor**³.

How

The practice in substance

In assessing the suitability, objectivity and independence of the external auditor, the audit committee should establish policies and procedures which cover all aspects of the audit service provided by the audit firm.

The audit committee's recommendation on the appointment of external auditors should be based on an assessment of the independence and capabilities of the external auditors as well as the effectiveness of the audit process.



Key considerations relating to the application of these **Practices (Practices 8.2 and 8.3 of MCCG)** are discussed on the following page.

³ **The Policy Document on External Auditor by Bank Negara Malaysia** outlines the qualifications of an external auditor to be appointed by a financial institution.

What are policies and procedures that can be put in place by an audit committee to assess the suitability, objectivity and independence of the external auditor?

Examples of policies and procedures (non-exhaustive) that can be established by the audit committee in this regard are outlined below:

Examples of policies:

- Having in place a policy on the **appointment, re-appointment and removal of external auditor** (including selection and qualification criteria)⁴.
- Establishing a policy on the **types of non-audit services** that are prohibited and **limits to the level of fees for non-audit services** rendered by the external auditor.
- Having in place a policy to govern the **employment of a former key audit partner**.

Examples of procedures:

- **Obtaining written assurance from the external auditors** confirming that they are, and have been, independent throughout the conduct of the audit engagement in accordance with the terms of all relevant professional and regulatory requirements.
- Developing a list of **audit quality indicators** by the audit committee to monitor effectiveness of the external audit process. Examples of such indicators may include:
 - adequacy of audit scope;
 - ability of the external audit firm to meet audit deadlines;
 - timeliness in escalating audit issues to the audit committee;
 - allocation of resources to significant audit risk areas; and
 - effectiveness of the external audit firm's recommendations in addressing weaknesses observed during previous audits, particularly on internal controls relevant to financial reporting process.
- Performing an **annual evaluation on the performance of the external auditor** and undertaking follow-up measures thereafter (note: a sample exhibit on the evaluation of external auditor is provided in **Appendix II** of this Pull-out).

The considerations pertaining to these relevant policies and procedures are discussed below (where applicable).



Dos

- ✓ Establishing private sessions for the external auditor and audit committee to discuss on key audit challenges.
- ✓ Disclosing the policies and procedures to assess the external auditor's suitability, objectivity and independence on the company's website.



Don'ts

The following would render the application of this practice ineffective:

- × Setting an excessively high threshold for the provision of non-audit services.
- × Maintaining that an external audit firm's confirmation on its independence and other relevant regulatory requirements is the be-all and end-all.

⁴ Paragraph 15.21 of Bursa's Listing Requirements outlines the considerations in appointing an external auditor

What are the salient areas that should be considered in evaluating an external audit firm's capabilities to conduct the audit?

In evaluating the external auditor's capability in relation to its expertise, experience, network and reputation, the audit committee should give consideration to a range of factors as set out below.

Relevant considerations in evaluating an external audit firm's capabilities (non-exhaustive):

- the audit firm's reputation and its presence in the industry;
- qualifications of its professionals, including the breadth and depth of resources and experience of the team members;
- networking ability and competency to address overseas subsidiaries not audited by the firm (i.e. its liaison capability with the secondary auditors);
- audit methodology employed by the firm such as the underlying methodology and materiality used to determine the nature, extent and timing of testing required is a key ingredient for an effective audit;
- the internal quality controls process in place (e.g. independent quality control review and approach to audit judgments); and
- how the audit firm delivers value other than through the provision of the statutory audit report.

How can the audit committee avert potential threats to an external auditor's independence?

Two key issues that commonly bear on the external auditor's independence are the **provision of non-audit services** as well as the appointment of **former key audit partners**⁵ as director or an employee of the company who is in a position to exert significant influence over the preparation of financial statements.

As mentioned above, the audit committee should put in place policies and procedures to aid in the safeguarding of the external auditor's independence and objectivity, taking into consideration relevant professional and regulatory requirements.

Provision of non-audit services

Provision of non-audit services by the external auditor to a company may result in misaligned incentives. In such instances, external auditors may be exposed to the possibility of reviewing part of their own work or objectivity may be challenged by over-reliance on the fee generated and the familiarity developed with the company.

Appointment of former key audit partners

There may be serious concerns to objectivity when a member of an audit engagement team joins the company (audit client) and is in a position to exert significant influence over the preparation of the company's financial statements



Audit reform in European Union

The European Union's audit reform culminated in a Directive to replace the existing Statutory Audit Directive and a new Regulation on specific requirements regarding statutory audit of PIEs. The new legislation was introduced in June 2014 and was made effective in June 2016.

In order to improve audit quality and restore investor confidence in financial information, a series of measures were introduced including those relating to the provision of non-audit services.

A prohibition is made to **restrict audit firms from providing certain non-audit services to audited PIEs** (i.e. similar to the nature of non-audit services prohibited in Malaysia).

In addition, fees generated from non-audit services rendered to a PIE audit client is also capped at **70% of the average audit fees** paid for the last three consecutive years, calculated at the group level.

⁵ Former key audit partners refer to the engagement partners, the individuals responsible for the engagement of quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the auditor will express an opinion.

Provision of non-audit services

Prior to the provision of any non-audit services by the external auditor, the audit committee should review and approve the acceptance of such engagements, drawing guidance from the **By-Laws (on Professional Ethics, Conduct and Practice) by the Malaysian Institute of Accountants (MIA)**. If the non-audit service results in concerns on independence to an extent that they cannot be reduced to an acceptable level by the application of safeguards, the non-audit service shall not be accepted.

Examples of non-audit services that shall not be provided by the external auditors of a PIE in pursuant to the **By-Laws (on Professional Ethics, Conduct and Practice of MIA)** are outlined below:

Prohibited non-audit services (non-exhaustive)⁶:

- **accounting and bookkeeping services**, including payroll services and the preparation of financial statements or financial information;
- **valuation services** if the valuations would have a material effect on the financial statements;
- **preparation of tax calculations** of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the financial statements;
- **internal audit services** that relate to a significant part of the internal controls over financial reporting, financial accounting systems or amount or disclosures that are material to the financial statements;
- **design or implementation of information systems** that form a significant part of the internal control or information on financial reporting, accounting records or financial statements;
- acting in an advocacy role on behalf of the company to resolve a **dispute or litigation** when the amounts involved are material to the financial statements;
- **recruiting services** with respect to a director, officer or senior management personnel who would be in a position to exert significant influence over the preparation of accounting records or the financial statements; and
- **corporate finance services** which involve promoting, dealing in, or underwriting shares.

⁶ Provisions 290.172 to 290.219 of By-Laws (on Professional Ethics, Conduct and Practice) by MIA.

In accordance with Bursa's Listing Requirements, disclosure should also be made on the nature and extent of non-audit services if the fees on such services are "**significant**".

Item 18, Part A, Appendix 9C of Bursa's Listing Requirements

The content of an annual report should contain the following particulars in relation to the audit and non-audit services rendered to the listed issuer or its subsidiaries for the financial year:

- a) amount of audit fees paid or payable to the listed issuer's auditors, stating the amount incurred by the listed issuer and the amount incurred on a group basis respectively; and
- b) amount of non-audit fees paid or payable to the listed issuer's auditors, or a firm or corporation affiliated to the auditors' firm, stating the amount incurred by the listed issuer and the amount incurred on a group basis respectively. If the non-audit fees incurred were **significant**, details on the nature of the services rendered. If no non-audit fees were incurred, a statement to that effect.

*Note: **Item 9.47A of the Frequently Asked Questions on Bursa Listing Requirements** clarifies that listed issuers should consider the amount of non-audit fees incurred compared to the amount of audit fees paid to determine if it is "significant". Generally, if the non-audit fees constitute 50% of the total amount of audit fees paid to their external auditors, then such non-audit fees are regarded as significant.*

Appointment of former key audit partners

The company should have in place a policy to govern the circumstances under which former key audit partners of the present and former external auditor(s) can be appointed to the board or be employed by the company. Such policies should include a procedure on a cooling-off period to govern the independence of such appointments.

Applicable provisions for cooling-off periods found in professional requirements are outlined on the following page.



Hot-button issue

One possible approach that can help to promote the independence of external auditors is **audit firm rotation**. It is often argued that setting a limit on the tenure of auditors and the resultant continuous stream of audit fees that an auditor may receive from one client would free the auditor, to a significant degree, from the effects of management pressure.

However, rotation of external auditors is not without its challenges and possible downsides. It has been contended that rotation of external auditors could possibly impact audit quality by unwinding the benefits of accumulated knowledge that have been acquired by auditors throughout the engagement of their respective clients.

Companies should therefore undertake a cost-benefit analysis and make an informed decision on the rotation of external audit firms based on their individual circumstances whilst being guided by the overarching objective of preserving the external auditor's independence, objectivity and professional scepticism.

It is also important to note that whilst legislations in Malaysia do not call for a mandatory audit firm rotation, **Provision 290.151 of the By Laws (on Professional Ethics, Conduct and Practice) by MIA requires individual audit partners to rotate after 5 years** on the audit engagement.

Provision 290.139 of the By-Laws (on Professional Ethics, Conduct and Practice) by Malaysian Institute of Accountants

Familiarity or intimidation threats are created when a key audit partner joins the audit client that is a public interest entity as:

- a) A director or officer of the entity; or
- b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

Independence would be deemed to be compromised unless, subsequent to the partner ceasing to be a key audit partner, the public interest entity had issued audited financial statements covering a period of **not less than two years** and the partner was not a member of the audit team with respect to the audit of those financial statements.

An illustrative disclosure highlighting the policy on employing former employees of the external auditor to the company is shown below with the following elements outlined:

- responsibility of the audit committee to oversee the policy;
- coverage of policy (i.e. applicable to former key audit partners and other audit team members); and
- length of cooling-off period established.



Illustrative disclosure

As part of its remit, the audit committee keeps under review the objectivity, independence and effectiveness of the external auditor. The committee has approved a policy on employment of former employees of external auditors. Under this policy:

- On an ongoing basis, the audit committee agrees with the external auditors which members of the audit team are categorised as the 'key audit partners' and 'other key team members'.
- Key audit partners will not be offered employment by the company or any of its related corporations within **two years** of undertaking any role on the audit.
- Other key team members will not be offered employment by the company or any of its related corporations within **six months** of undertaking any role on the audit.
- Other audit team members who accept employment by the company or any of its related corporations must cease the audit activity immediately and tender their resignation to the audit firm.

Any offer of employment to a former employee of the audit firm must be pre-approved by the audit committee where the offer is made in respect of a senior executive position. Between meetings, the audit committee chairman has delegated authority to deal with such appointments at his discretion. Any such interim approval must be ratified at the next meeting of the committee.

Source: Adapted from KPMG's Audit Committee Institute Handbook 2017

Where

Regional/international perspectives

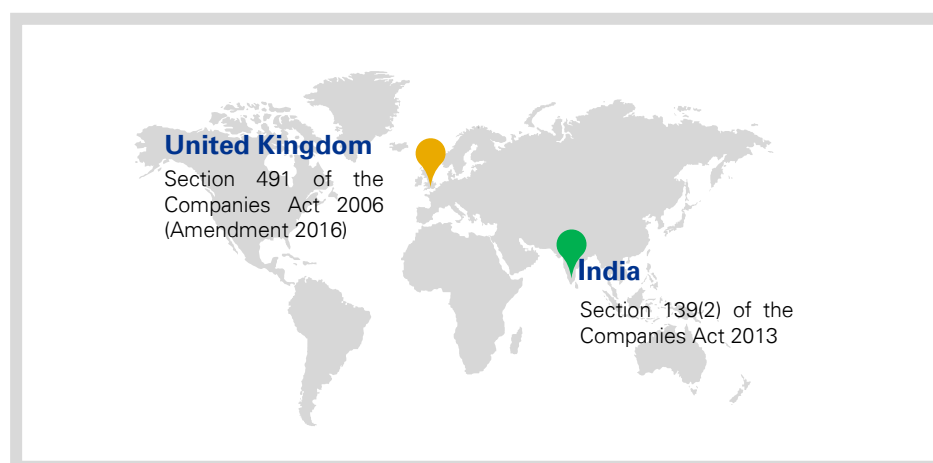
Recognising the importance of high quality external audits, many jurisdictions, including United Kingdom, Australia, Hong Kong and Singapore have called upon audit committees to exercise oversight of the external audit process, including in evaluating the suitability and independence of the external auditor.

Selected regulators have also acted on complementary fronts. United Kingdom (as part of European Union's audit reform efforts), and India for example, have put in place requirements for mandatory audit firm rotation (generally, after a period of twenty years for United Kingdom and ten years for India) with a view of preserving of the external auditor's independence.



Regional/ international perspectives

Jurisdictions such as United Kingdom and India have put in place requirements for mandatory audit firm rotation.



Country	Provision(s)
United Kingdom	<p>The terms of appointment of an auditor or auditors of a public company which is also a public interest entity are subject to the additional requirement that the auditor or auditors cease to hold office at the end of the accounts meeting in respect of the first financial year which ends after the expiry of the maximum engagement period.</p> <p>"the maximum engagement period" means, subject to subsection (1D) and section 491A (which makes transitional provision in relation to auditors appointed before 17th June 2016) whichever of the following periods is longest —</p> <ul style="list-style-type: none"> the period of ten years beginning with the first day of the first financial year in respect of which the auditor was appointed, or the period of twenty years beginning with the first day of the first financial year in respect of which the auditor was appointed if the selection requirements are satisfied for at least one financial year which begins every ten years in that period, or such other period of no more than twenty years beginning with the first day of the first financial year in respect of which the auditor was appointed and ending on the last day of the relevant ten year period.

Country	Provision(s)
	<p>“the relevant ten year period” means the period of ten years beginning with the first day of the last financial year —</p> <ul style="list-style-type: none"> • which begins within ten years of the first day of the first financial year in respect of which the auditor was appointed, and • in respect of which the auditor was reappointed following the carrying out of a selection procedure in accordance with the selection requirements”. <p>(Section 491)</p>
India	<p>No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint —</p> <p>(a) an individual as auditor for more than one term of five consecutive years; and</p> <p>(b) an audit firm as auditor for more than two terms of five consecutive years: Provided that —</p> <p>(i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;</p> <p>(ii) an audit firm which has completed its term under clause (b), shall not be eligible for reappointment as auditor in the same company for five years from the completion of such term.</p> <p>Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.</p> <p>Provided also that every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this subsection within three years from the date of commencement of this Act.</p> <p>Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company</p> <p>(Section 139(2)).</p>

Independence of the audit committee



MCCG Intended Outcome 8.0

There is an effective and independent audit committee.

The board is able to objectively review the audit committee's findings and recommendations. The company's financial statement is a reliable source of information.

Step Up 8.4

The audit committee should comprise solely of independent directors.

Why

The case for change

Independence is the cornerstone of a well-functioning audit committee. The ability of its members to exercise their judgment in an informed and impartial manner is important to the fulfilment of the audit committee's mandate, especially in overseeing the areas of financial reporting, related party transactions and conflicts of interests, internal control environment, internal audit and external audit process.

It should be noted that the core functions of audit committees set out in many, if not all global authoritative governance documents are expressed in terms of "**evaluation**", "**assessment**" or "**review**" of the aforementioned areas. The undertaking of such responsibilities would naturally necessitate audit committee members to critically and objectively apply a probing view on pertinent matters, particularly in areas which involve a high degree of judgment. In many instances, audit committee members are expected to take tough, constructive or even unpopular stances, all of which calls for independence in "**thought and action**".

As a former Senator of the United States, Howard Metzenbaum puts it, "audit committees that lack independence frequently have a fealty to the management that an audit committee shouldn't have"¹. To coin it differently, audit committees should not be having a "debt" to the management which is then "repaid" when a tough issue (e.g. financial reporting issue) arises.

Recognising that objectivity is essential to the proper functioning of the audit committee, regulators have outlined provisions on the composition of the audit committee with due regard to the element of independence.



What could go wrong:

- External and internal auditors are unable to perform their functions in an independent manner due a lack of support from the audit committee.
- Failure of audit committee members to get to the root of pertinent issues that are impacting the company.

¹ Bostelman, JT et.al 2010, *Public Company Deskbook: Sarbanes-Oxley and Federal Governance Requirements*, Practising Law Institute

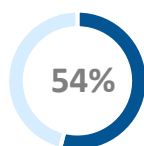
Paragraph 15.09(a) and (b) of Bursa's Listing Requirements

A listed issuer must appoint an audit committee from amongst its directors which fulfils the following requirements:

- (a) the audit committee must be composed of not fewer than 3 members; and
- (b) all the audit committee members must be non-executive directors, with a majority of them being independent directors.

*Note: Similar provisions are also applicable for financial institutions under **Standard 12.3 of Bank Negara Malaysia's Policy Document on Corporate Governance**. The requirements in relation to the composition of audit committees for financial institutions are the same as that of other board committees.*

Whilst not a recommendation prior to the issuance of MCCG, many companies are already having wholly independent audit committees, premised on the proposition that such a committee would be better positioned to perform the functions entrusted to it. A review of annual reports across the top 100 public listed companies (by market capitalisation) in Malaysia as at 31 December 2016 revealed that 54% of them have audit committees which are composed exclusively of independent directors.



Companies with wholly independent audit committees in the top 100 public listed companies (by market capitalisation) as at 31 December 2016.

Point for reflection

Several research studies have shown that the value of having an audit committee comprising solely of independent directors can be **particularly evident when a company is undergoing financial distress**.

For example, a prominent research performed by Bronson et.al highlighted that wholly independent audit committees are more likely to protect external auditor's independence during a dispute with the management of a financially distressed company. The research highlighted that given the negative consequences associated with a going-concern report (an opinion by the auditors that the company may not be viable in the foreseeable future), management may try to pressure the external auditor into not issuing the said report when one is warranted. In such a scenario, having a fully independent audit committee would more likely lead to objective support for the external auditor and mitigate pressure from management relating to the going concern reporting decision. Conversely, audit committees with members who are affiliated to management were found to be more likely in replacing the external auditor in such a circumstance⁵.

In the course of establishing a fully independent audit committee, boards are not expected to compromise on the skill sets and make unwieldy changes to the composition of the audit committee. In order to create a conducive

⁵ Bronson, SN et al. 2009, "Are fully independent audit committee really necessary?", Elsevier

environment for insightful deliberations of the audit committee, boards should ensure that the enlisted independent audit committee members are financially literate and have a sufficient understanding of the company's business (as stated in **Guidance to Practice 8.5 of MCCG**).

Independent audit committee members who possess the aforementioned attributes are able to exercise intelligent reviews of processes, transactions and information on matters under its purview as well as continuously apply a critical view on the assertions made by management.

How

The practice in substance

It is therefore incumbent on the board to assess the independence of its audit committee and consider establishing a wholly independent audit committee with a view of going a step further in strengthening the company's corporate governance practices and processes. Every member's appointment is an occasion for careful deliberation and the board should have a strong understanding of how imperative is independence to the effective functioning of the audit committee.

Key considerations relating to the application of this Step Up are discussed below:

How should the independence of the audit committee members be assessed?

As with other independent directors, independent audit committee members should display a strong element of objectivity, both **in appearance** ("perceived independence") as well as **of mind** ("independence in thought and action").

In assessing "independence in thought and action", the nominating committee or the board should amongst others evaluate if the audit committee members demonstrate **vigilance**, **scepticism** and more importantly, have the **courage** to stand up for an objective point of view.

Characteristics (non-exhaustive) that are commonly exhibited by audit committee members which demonstrate vigilance, scepticism and courage:

- clarifies objectives of the topics for deliberations to understand the issues and set expectations for possible solutions;
- drives for complete and accurate financial and non-financial information disclosures that reflect substance over form which can be issued on a timely basis;
- actively engages with internal and external auditors and fosters candid two-way relationship;
- suspends prevailing assumptions and continues to ask questions until satisfactory responses are obtained;
- changes the angle of debate to probe for further information;
- raises any issues or “red flags” promptly with the audit committee chair; and
- leverages on internal and external audit findings to review the way management manages business risks as well as how the risks are managed to enhance shareholder value.

The consideration of independence is often a matter of substance rather than mere compliance with specific rules. The board should also be cognisant and mindful of situations in which the regulatory definition of independence is met, yet impairment of objectivity or perceived conflicts of interest may still arise.

How should audit committee members deal with conflict of interest situations?

Audit committee members should declare any matter in which they have an interest. Normally, the process for recording declarations of conflicts of interests in the audit committee should mirror that used by the board. Each member of the committee should undertake to declare proactively, at the outset of each meeting, any potential conflict of interest relating to the affairs of the committee or from changes in the member’s personal circumstances.

Depending on the nature, extent and potential duration of the conflict of interest situation, the chairman of the audit committee should then determine an appropriate course of action with the said member. For example, the member might be asked to abstain from deliberation and decision making, or in more extreme cases, the member could be asked to step down from the committee.

If it is the chairman of the audit committee that has a conflict of interest, the board should ask another member of the committee to lead in determining the appropriate course of action.



Dos

- ✓ Putting in place mechanisms for independent directors (including independent audit committee members) to disclose changes in relationships or circumstances that may impact their independence.
- ✓ Ensuring all questions and remarks (including dissenting comments made by audit committee members) are minuted.
- ✓ Developing channels for audit committee members to enlist the services of third party experts, if needed.



Don'ts

The following would render the application of this practice ineffective:

- × Conceding that the element of financial literacy overrides the aspect of independence.
- × Maintaining that adherence to the audit committee’s independence requirements set out in **Paragraph 15.09 of Bursa’s Listing Requirements** is the be-all and end-all.

What are some of the key questions that the audit committee members should ask management in relation to the matters under its purview?

Audit committee members must achieve an adequate understanding of the representations made by management and scrutinise these matters accordingly. If necessary, the audit committee should consult with external counsel and experts to gain further insights.

Some of the key questions that should be posed to management include:

- What is your assessment of the overall control environment?
- What processes do you have in place to ensure material errors will not occur?
- What materiality level did you employ in assessing whether the financial reports presented are of a true and fair view?
- What are the most significant estimates and judgments you made in preparing the financial report? What was the range of values used in those estimates? Justify the appropriateness of the underlying assumptions and the reliability of information/ methodologies/tools used.
- What are the nature and size of year-end adjustments and related party transactions?*(note: example of matters to be tabled to the audit committee on related party transactions are outlined in **Appendix III of this Pull-out**)*
- Did any non-recurring transactions materially impact the financial results? If so, what were they and what was the impact?
- What were the major financial reporting standards and regulatory changes instituted during the year and what was their impact?
- What are the significant differences existing in the financials between the current and prior period? Why have these variances occurred?
- Is the financial result significantly different from the budget? If so, why?
- Which aspects of the company's financial viability and sustainability do you feel least comfortable with?
- Have there been any disagreements between management and the internal or external auditors? If so, what were they and how were they resolved?

Where

Regional/international perspectives

In order to enable the audit committee to exercise independent judgements, jurisdictions such as South Africa and Canada have called upon public listed companies to establish audit committees which comprise solely of independent directors.



Regional/ international perspectives

Public listed companies in the South Africa and Canada are called upon to have a fully independent audit committee.

Country	Provision(s)
South Africa	All members of the audit committee should be independent, non-executive members of the governing body (Recommended Practice 56) .
Canada	Every audit committee member must be independent (Provision 3.1(3)) .

Financial literacy of audit committee members



MCCG Intended Outcome 8.0

There is an effective and independent Audit Committee.

The board is able to objectively review the Audit Committee's findings and recommendations. The company's financial statement is a reliable source of information.

MCCG Practice 8.5

Collectively, the Audit Committee should possess a wide range of necessary skills to discharge its duties. All members should be financially literate and are able to understand matters under the purview of the Audit Committee including the financial reporting process.

All members of the Audit Committee should undertake continuous professional development to keep themselves abreast of relevant developments in accounting and auditing standards, practices and rules.

Why

The case for change

Financial literacy is a key cornerstone of a well-functioning audit committee. As a committee that is specialised and focused, the audit committee is relied upon by the board to, amongst others, provide advice in the areas of financial reporting, external audit, internal control environment and internal audit process, review of related party transactions as well as conflict of interest situations.



Point for reflection

As businesses become more complex, globalised, and increasingly face new risks, the breadth and complexity of the audit committee responsibilities similarly continue to increase. The need for audit committee members to possess sound financial understanding is now made more important than ever by the **changes in business models and financial reporting requirements**.

A recent KPMG Audit Committee Institute's Global Pulse Survey in 2017 revealed that a lack of understanding of business drivers (e.g. changes in the industry) and poor oversight of the implementation of new accounting standards (e.g. revenue recognition and leasing) were amongst the main weak spots of audit committees.



What could go wrong:

- Financial statements do not serve as a reliable source of information.
- Transactions carried out are detrimental to the interests of the company.

The changing landscape of the financial reporting environment is exemplified by a review of the recent amendments to International Financial Reporting Standards (IFRS) which revealed that there were a total of 29 changes made between the years 2014 to 2016 (depicted in the following chart). The changes to IFRS, to a large extent, have resulted in more subjective judgments on accounting estimates and valuations. It is therefore now incumbent on the audit committee to be more informed and increasingly scrutinise the risk for management bias in the application of these judgments.

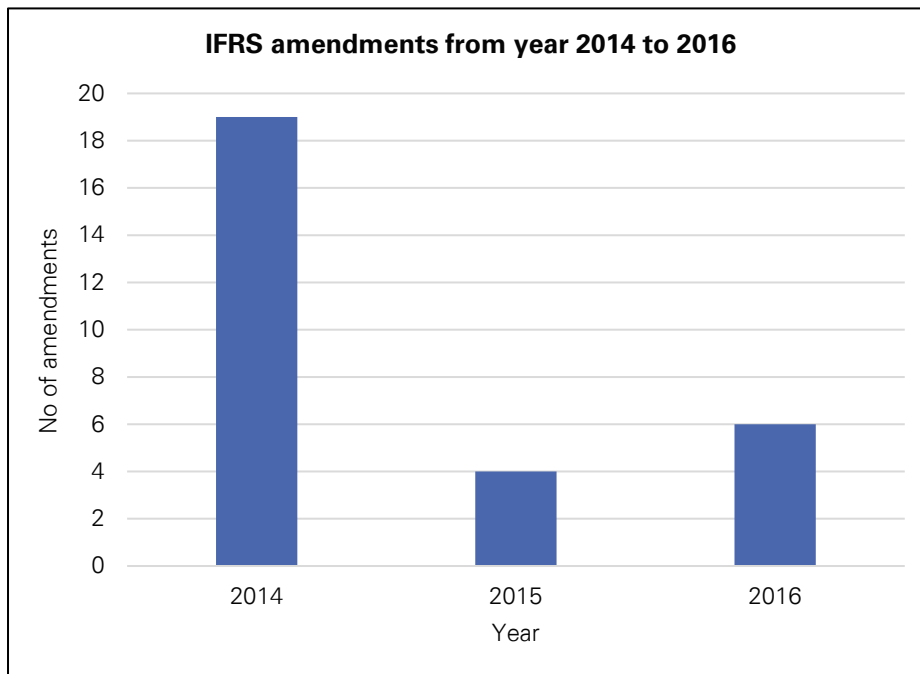


Chart illustrating the number of IFRS amendments from year 2014 to 2016¹.

In order to ensure that the audit committee is well-equipped to carry out its mandate, regulators have emphasised the importance of having members with accounting or financial acumen.

Paragraph 15.09(1)(c) of Bursa's Listing Requirements

At least one member of the audit committee –

- i. must be a member of the Malaysian Institute of Accountants; or
- ii. if he is not a member of the Malaysian Institute of Accountants, he must have at least 3 years' working experience and –
 - (aa) he must have passed the examinations specified in Part I of the First Schedule of the Accountants Act 1967; or
 - (bb) he must be a member of one of the associations of accountants specified in Part II of the First Schedule of the Accountants Act 1967; or
- iii. fulfils such other requirements as prescribed or approved by the Exchange.

It is important to note that financial literacy is a prerequisite for each member to deliver tangible value to the functions of the audit committee. Having only a single audit committee member with special knowledge or skills in accounting would place **undue reliance** on one individual and render the deliberations of the audit committee ineffective. To this end, the audit committee as a whole should consist of financially-literate members who would be able to challenge, encourage and support each other in a more meaningful manner.

¹ Effective dates of IFRS and amendments 2017, IASPlus

How

The practice in substance

In considering the composition of the audit committee, the board should have regard to the range of skills, experience, knowledge and qualifications possessed by the committee members. It is imperative for the audit committee to comprise members with a sound understanding of the language of accounting and finance in order to perform the duties that have been entrusted to it by the board.

Key considerations relating to the application of this Practice are discussed below.

What constitutes a financially literate audit committee member?

Financial literacy goes beyond basic familiarity with financial statements and would include the following:

Attributes of a financially-literate audit committee member

- ability to read and understand financial statements, including a company's statement of financial position, statement of comprehensive income, statement of changes in equity, cash flow statement, notes to the statements, cost accounting, budgets and management's discussion and analysis ("MD&A");
- ability to understand and assess the general application of accounting principles and apply a critical view on the underlying assumptions;
- ability to analyse financial statements and challenge management's assertions on financials;
- awareness of, and familiarity with, new financial reporting standards and how they impact the company's financial performance to enable the directors to ask pertinent questions;
- ability to assess the effectiveness of the audit process and the company's finance functions in generating reliable and timely financial information; and
- ability to ask probing questions about the company's operations against internal controls and risk factors.

Adapted from the Guidebook for Audit Committees in Singapore (2014) issued by the Audit Committee Guidance Committee.

*Note: A sample questionnaire is provided in the **Appendix IV** of this Pull-Out in order to further understand and assess who may qualify as a financially literate member.*



What are the potential indicators which may signal that a lack of financial literacy is impeding the effective functioning of the audit committee?

Examples of indicators which may highlight concerns in relation to the financial literacy of audit committee members are as follows:

- inability of the audit committee to critically probe highly risky transactions as well as key accounting policies and judgments adopted by the company in its financial reporting;
- undue reliance by the audit committee on management, auditors and experts to ensure the reliability of the financial statements; and
- lack of strategic input from the audit committee to the board on the drivers of financial performance.



Dos

- ✓ Inducting directors with sector-specific financial literacy into the audit committee.
- ✓ Having in place a comprehensive induction programme for new audit committee members, covering the business and financial dynamics of the company.
- ✓ Establishing structured professional development programmes for members of the audit committee on an ongoing and timely basis.



Don'ts

The following would render the application of this practice ineffective:

- × Maintaining that the collective expertise and experience of the audit committee serves as a substitute for not having individual members that are financially literate.
- × Accepting that adherence to the Listing Requirement (i.e. at least one member of the Audit committee to be a member of MIA or equivalent) is the be-all and end-all.

What are the other qualities that should be considered in selecting audit committee members?

An audit committee's effectiveness is certainly enhanced by, and is often dependent upon the personal and professional attributes of individual members.

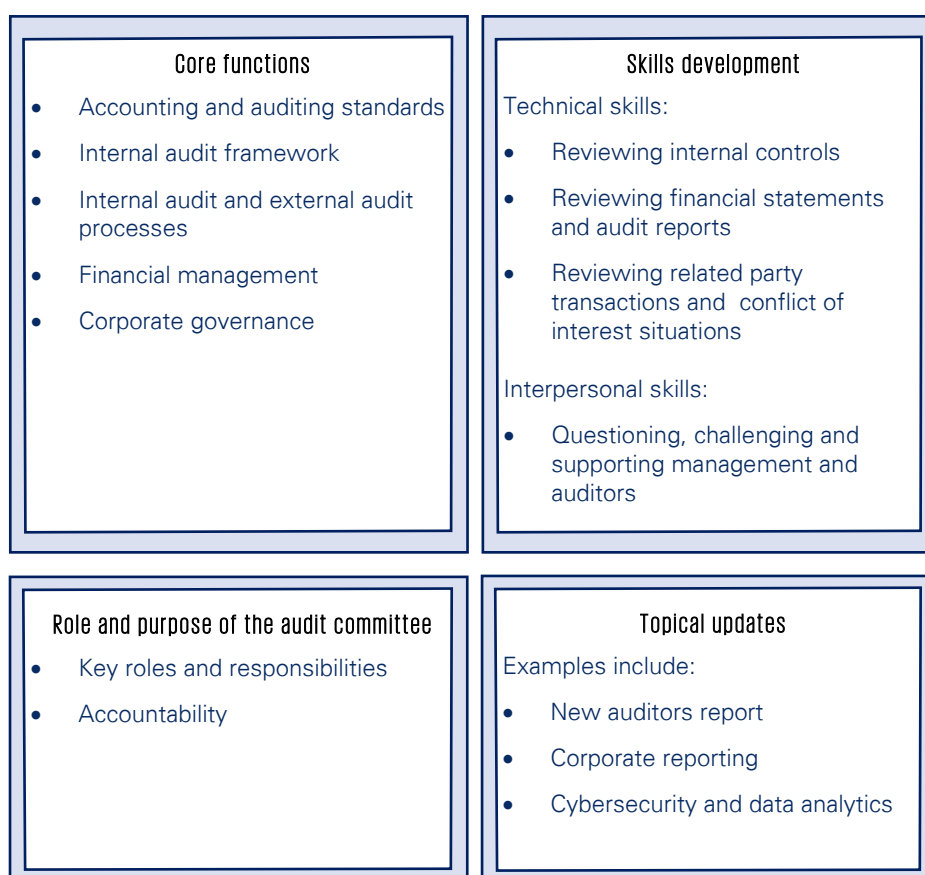
Personal and professional qualities that should be considered in selecting audit committee members:

- ability to be proactive in advising the board of any concerns;
- ability to ask tough and incisive questions, evaluate the responses and continue to probe for information until completely satisfied with the feedback provided;
- ability to appreciate the company's values and a determination to uphold these values coupled with a thoughtful approach to the ethical issues that may be faced;
- a professional approach to duties, including an appropriate commitment of time and effort;
- courage to take and stand by tough decisions and high ethical standards; and
- encouragement of openness and transparency which is demonstrated by the ability to accept mistakes and not ascribe blame.

In addition to financial literacy, it would be desirable for members to have experience that is relevant to the business. For example, given the complex nature of the banking industry, it would be highly value adding for audit committee members to have previous experience of that particular sector with a granular understanding of the pertinent nuances such as financial instruments and credit models.

What is the nature of continuous professional development programmes that should be undertaken by the audit committee members?

Given the ever changing financial reporting and corporate landscape, it is essential for members of the audit committee to undertake continuous professional development to keep themselves abreast of relevant developments, as outlined in the following areas:



Suggested areas for professional development of audit committee members (Source: Adapted from United Kingdom's Chartered Institute of Public Finance and Accountancy).

How can the deliberations of the audit committee be enriched?

Effective audit committee deliberations necessitate members to get to the root of the issues that is impacting the company's financial reporting process. They are demanded to apply an inquiring mind and make informed inquiries. Whilst audit committee members are entitled to avail themselves to external advisors, they should take a diligent and an informed interest in the information that is presented to them.

Applying an inquiring mind and making informed inquiries are key aspects of effective audit committee oversight. **One of the world's distinguished investors, Warren Buffet is known for three key questions he developed for audit committees to consider, and he suggests the discussion of these matters be documented in the minutes of their meetings².**



Hot-button issue

The length of term that each audit committee member should serve warrants careful consideration by the board. Rotation of members refreshes and introduces new perspectives to the processes of the audit committee. Rotation also creates opportunities for a greater number of board members to gain better understanding of the functioning of the committee.

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.

² Herdman, RK 2002, *Making Audit Committees More Effective*, Securities and Exchange Commission

Question I	Question II	Question III
If the auditor were solely responsible for preparation of the company's financial statements, would they have been prepared in any way different than the manner selected by management? The audit committee should inquire as to both material and non-material differences.	If the auditor were an investor, would he have received the information essential to a proper understanding of the company's financial performance during the reporting period?	Is the company following the same internal audit procedure that would be followed if the auditor himself were CEO? If not, what are the differences and why?

Case study: Centro Properties Group (Australia)



Background:

- Section 295(A) of the Companies Act 2001 in Australia obligates directors to ensure the integrity of financial statements while Section 180(1) and 344(1) of the Corporations Act 2001 enumerate provisions on statutory duty of care and diligence pertaining to directors.



Facts:

- The Australian Securities and Investment Commission (ASIC) brought proceedings against the directors of certain companies in the Centro Properties Group on grounds that the directors failed to take all reasonable steps to ensure compliance with the financial reporting obligations of the Corporations Act 2001, and breaches of their statutory duty of care and diligence.
- The allegations related to disclosures in the 2007 annual financial statements of companies within Centro Properties Group. Those financial statements wrongly classified liabilities of about AUD \$ 2.1 billion as non-current liabilities instead of current liabilities and failed to disclose certain post balance date related party guarantees.
- The court held that notwithstanding the fact that neither Centro management nor the auditors had detected the error, the erroneous disclosure could have been identified by the directors if they had carried out a careful and diligent review of the financial statements.



Lessons Drawn:

- Scepticism: Directors must question the information provided to them. There is no defence for wilful blindness.
- Accounting knowledge: Directors are expected to have financial literacy and accounting knowledge.
- Accountability and control: It is up to directors to ensure that management has put in place systems, protocols and controls to ensure sound corporate governance.

Where

Regional/international perspectives

In order to enhance the effectiveness of the audit committee, many jurisdictions including Canada and India have enumerated prescriptions for the committee as a whole to possess financial literacy.

Selected jurisdictions including United Kingdom and Australia have also placed emphasis on industry knowledge.



Regional/ international perspectives

United Kingdom and Australia call upon audit committees as a whole to have industry knowledge.



Country	Provision
United Kingdom	The audit committee as a whole shall have competence relevant to the sector in which the company operates (Provision C.3.1) .
Australia	The members of the Audit Committee between them should have the accounting and financial expertise and a sufficient understanding of the industry in which the entity operates, to be able to discharge the committee's mandate effectively (Commentary to Recommendation 4.1) .

Risk management and internal controls



MCCG Intended Outcome 9.0

Companies make informed decisions about the level of risk they want to take and implement necessary controls to pursue their objectives.

The board is provided with reasonable assurance that adverse impact arising from a foreseeable future event or situation on the company's objectives is mitigated and managed.

MCCG Practice 9.1

The board should establish an effective risk management and internal control framework.

MCCG Practice 9.2

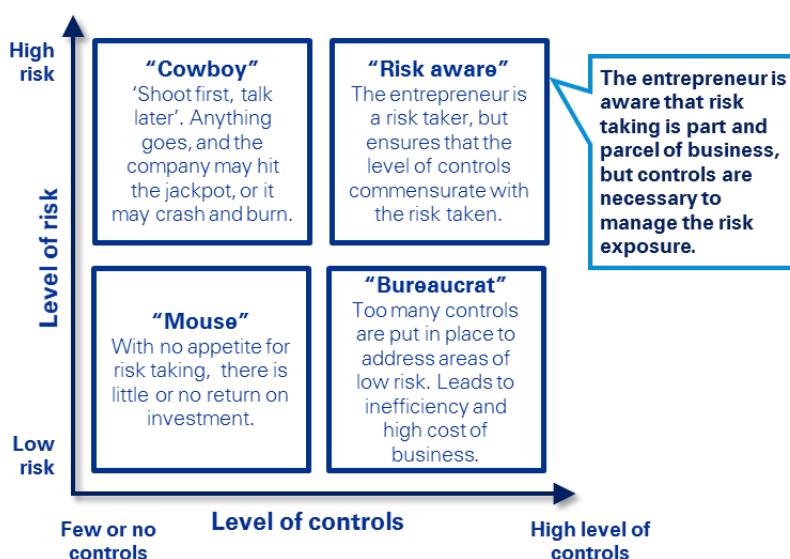
The board should disclose the features of its risk management and internal control framework, and the adequacy and effectiveness of this framework.

Why

The case for change

Risk management and internal controls are often repeated buzzwords of regulators and corporate governance commentators alike. Although there is widespread agreement that the practice of risk management and internal controls is beneficial, such concepts are often perceived as elements that are disrupting the spirit of entrepreneurship, and advocates of risk management and internal controls are often viewed with suspicion by front line staff, who view them as "wet blankets".

The following diagram is commonly used to illustrate the relationship between entrepreneurship and risk management, and how they are complementary and not mutually exclusive:



What could go wrong:

- Failure to detect unknown risk exposures or "blind spots".
- Inability of the company to adapt to changing business circumstances.
- Inability of the company to contain high impact risks in a timely manner, resulting in adverse consequences to the company's value-creation.

Therefore, **running a business with an appropriate risk management and internal control framework can be equated to driving fast whilst equipped with brakes**. Running a business without risk management is just driving fast. It is true that a sports car without a brake system is much faster, simply because it is lighter, but it is also probably a one-way ticket into oblivion.

Some of the benefits of risk management and internal controls are as follows:

- sharpens corporate strategy and heightens strategic focus;
- frees up capital to be invested in activities with higher returns;
- reduces costs;
- improves the risk finance portfolio;
- improves regulatory and legal compliance; and
- enhances reputation and the company's attractiveness to investors.



Point for reflection

Is risk management necessary?

The 9/11 attacks caused significant and tragic loss of lives. Beyond that, damage to property and business was immense, with one estimate of US\$3.2 billion alone for information technology infrastructure and assets (servers, workstations, storage, hubs and wiring) belonging to securities firms impacted by the attacks¹.

Did it:

American Express Bank: The Bank operated a network of servers on a "hot backup" basis. Although headquartered at the World Trade Centre, it lost neither a transaction nor was its customer service interrupted.

Did not do it:

The Pentagon: The Pentagon had a secure server and the back-up of this server was located just down the hall. Needless to say, neither survived the attack.

Before moving on it would be helpful to clarify a few conceptions and misconceptions:

- When an entity does not have a formal risk management and internal control, it is often and erroneously assumed that the directors do not practise risk management. This is not necessarily true – for a company to be successful over a period of time, some form of risk management would have been in place, even if this is in an unwritten form;
- Risk management and internal controls may take many forms. For example, insurance is a risk management tool, and rules around occupational safety and health are meant to protect workers from injury. Likewise, disposal of hazardous waste in the prescribed manner reduces chances of polluting the environment; and
- Risk management is largely a quantifiable process, particularly in the financial services sector. However, not all risks can have an absolute value assigned to it. Reputational risk, for example, is notoriously difficult to quantify especially in the age of social media, where unflattering news travel at light speed relative to the olden days whereby there is a time gap between an event and it appearing in the newspapers.



Hot-button issue

Management frequently agonises over the level of risk management oversight and the associated internal controls. On one hand, expediency and efficiency are highly valued in the business world. On the other hand, dispensing with controls exposes the organisation to an unacceptably high level of risk.

In the case of United Airlines in April 2017, having a doctor forcibly thrown off an overbooked plane was bad enough. What made the situation worse was that the airline, led by its CEO, was clearly unprepared to handle the media storm that enveloped it in the days that followed the viral video of the doctor bloodied and injured being dragged out of the aeroplane.

In forcibly removing the passenger and failing to weather the media storm, United Airlines created an unexpected and huge reputational risk. The exposure to nuanced risks such as reputational risks is often overlooked and not integrated as part of a company's risk management framework, much to a company's detriment.

¹ Estimate on the Impact of the World Trade Centre Disaster to the Securities Industry's Technology Infrastructure, 2001, TowerGroup.

How

The practice in substance

As with the MCGG, the **Companies Act 2016** and **Bursa's Listing Requirements** outline prescriptions on internal controls and risk management.

Section 246 of Companies Act 2016

The directors of a public company or a subsidiary of a public company shall have in place a system of internal control that will provide reasonable assurance that –

- (a) the assets of the company are safeguarded against loss for unauthorised use or disruption and to give a proper account of the assets; and
- (b) all transactions are properly authorised and that the transactions are recorded as necessary to enable the preparation of true and fair view of the financial statements of the company.

Paragraph 15.12 of Bursa's Listing Requirements²

Without limiting the generality of **Paragraph 15.11³**, a listed issuer must ensure an audit committee, amongst others, discharge the following functions:

- (1) review the following and report the same to the board of directors of the listed issuer:
 - (b) with the external auditor, his evaluation of the system of internal controls;
 - (e) the adequacy of the scope, competency and resources of the internal audit functions and that it has the necessary authority to carry out its work; and
 - (f) the internal audit plan, processes, the internal audit reports, recommendations raised, investigation undertaken and whether or not appropriate action is taken on the recommendations of the internal audit function.

Paragraph 15.23 of Bursa's Listing Requirements

A listed issuer must ensure that the external auditors review a statement made by the board of directors of a listed issuer pursuant to **subparagraph 15.26(b)** below, with regard to the state of risk management and internal control of the listed issuer and report the results thereof to the board of directors of the listed issuer.

Paragraph 15.26 of Bursa's Listing Requirements

A listed issuer must ensure that its board of directors makes the following additional statements in its annual report:

- (b) a statement about the state of risk management and internal control of the listed issuer as a group.



Do's

- ✓ Being aware of emerging risks that may threaten the business (e.g. cyber-security risk).
- ✓ Providing necessary support to the risk management and internal audit functions (e.g. access to information physical properties, and personnel)
- ✓ According adequate attention to the recommendations raised on risk management and internal controls as well as implementing the recommendations where appropriate.
- ✓ Providing balanced disclosures in relation to risk management and internal controls (highlighting areas of strengths as well as improvement considerations).



Don'ts

The following would render the application of this practice ineffective:

- × Paying lip service to concerns raised on risk and internal controls.
- × Omitting mention of significant incidences or risk events in the annual report (e.g. the entity may have been involved in a large legal case during the year).
- × Turning risk and internal control into static activities – a risk profile can even change from day to day.

² As per the proposed amendments contained in Bursa's Public Consultation (Paper 3/2017)

³ Requirement for audit committee to have written terms of reference

Enumerations in this regard for financial institutions are encapsulated in **Bank Negara Malaysia's Policy Document on Corporate Governance⁴**.

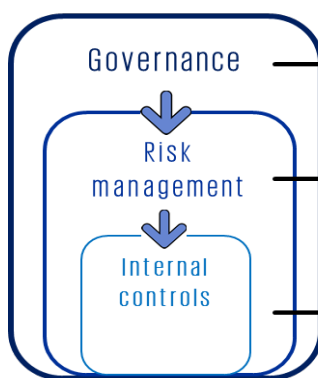
It is helpful to view risk management and internal controls in the context of governance, and how each element relates to the other:



The entity's governance framework is always the starting point for its risk management and internal control processes. This is simply because the board will articulate the entity's strategy, set the values and shape its culture.

These elements will influence the entity's risk management appetite and in turn, the risk management appetite will dictate the kind of controls the entity will integrate into its business processes.

As such, risk management and internal controls should not be viewed as "wet blankets" but rather as important lines of defence, as follows:



The board sets the strategy and defines the culture of the company. The risk-taking tone and philosophy is defined.

The risk management process works out risks associated with the company's strategic direction and also for its day-to-day operational processes. How much risk can the entity bear at any one time without impacting its status as a going concern?

Internal controls are designed to address and manage risks identified. Stronger internal controls are assigned to areas of high risk whilst controls are moderated for processes that have a lower risk profile.

A number of methodologies have been developed to help companies approach risk management and internal controls in a systematic manner. Some of these have been widely accepted and include the following:

- ISO 31000 on principles and guidelines for risk management;
- The internal control environment framework suggested by the Committee of Sponsoring Organisations of the Treadway Commission (the "COSO framework" which is now known as "Internal Control – Integrated Framework"); and
- Other globally recognised internal control and risk management frameworks developed by professional organisations (e.g. Criteria of Control Framework developed by the Canadian Institute of Chartered Accountants or widely known as "CoCo Framework" and KPMG's Risk Management Methodology).

Examples of key aspects contained in a frame of reference to drive the governance of risk management and internal controls in a systematic manner is outlined on the following page.

⁴ Paragraphs 7 and 12 of Appendix 1, Bank Negara Malaysia's Policy Document on Corporate Governance and Paragraph 3 of Appendix 1, Bank Negara Malaysia's Policy Document on Corporate Governance.



Risk strategy and appetite

Conscious collective decision to use risk management to support strategic objectives. It includes risk appetite statements and tolerance limits.

Risk governance

A structure through which the companies directs, manages and reports its risk management activities. It encompasses clear roles and responsibilities, decision rights, the risk governance operating model, and reporting.

Risk assessment and measurement

Tools and techniques to identify, measure and quantify current and emerging risks. It allows companies to consider the extent to which potential events may have an impact on achievement of objectives.

Risk management and monitoring

Management's risk strategies and responses to manage risks and improve risk and business performance. Continuous monitoring against established metrics permits proactive and timely response where warranted.

Risk reporting and insights

Reporting of risk information provides insights on significant risks and the strengths and weaknesses in managing them. Disclosure of risk management information to key stakeholders also supports timely

Data and technology

Information and associated storage and delivery mechanisms which provide management with a real time view of the key risks and how these are being managed (including risk register).

Risk culture

Values and behaviours that shape risk decisions. Risk culture influences the decisions of management and employees. A strong risk culture helps to encourage strategic decisions and long term value for all stakeholders.

Adequacy and effectiveness review

Internal processes by which management and the Board derives assurance on the overall adequacy and effectiveness of the internal controls and risk management systems.

Diagram depicting key aspects of a risk management framework (Source: KPMG's risk management framework)



Point for reflection

How much is too much, how little is too little?

Not only are risk management and internal controls important, getting the right balance can be challenging. Examples of real case scenarios are highlighted below:

Example I (Trustee company)

At a trustee company, the board was so risk averse that practically every transaction carried out on behalf of a beneficial owner required the CEO's signature. As the CEO was frequently away on business, this disrupted day-to-day efficiency and eventually, operational staff resorted to "breaking the law" and proceeding with transactions without the CEO's authorisation.

Whilst it may seem innocuous, could this have unnecessarily exposed the company to claims by clients if transactions were erroneously carried out?

Example II (Financial institution)

At a major financial institution, the board exercised a high level of controls for investments in equities and debt by the bank's dealing team, and this has been documented in the bank's limits of authority matrix. Somewhat inexplicably, the same matrix grants the senior management team with unlimited authority on operational expenses.

Needless to say, the bank was soon caught in a fraud incident amounting to millions of ringgit, perpetrated through the loophole in the matrix.

Whilst the board remains responsible over risk management and internal controls, the task of scrutinising the framework (i.e. its design) and outworking (i.e. its effectiveness) is often taken up by a board committee, typically the risk management committee and the audit committee. In some entities, these committees are combined. It is pertinent for the committee members to have sound knowledge of risk management and internal control concepts, and to be able to assess risk in an objective manner – given the element of self-interest and pressure to achieve returns, representations made by management may not represent the true picture.

Key considerations relating to the application of these Practices (**Practices 9.1 and 9.2**) are discussed below:

In what practical ways can a risk aware and control optimised culture be embedded?

Risk management is often an unwritten process particularly during a company's start-up phase of its life. As the company progresses along its life cycle and the number of stakeholders increase, risk management and internal controls should receive appropriate consideration and be embedded as part of the company's culture.

Some guidance are provided below:

- Internal controls if well designed, will support the objective of managing identified risks. Risks may differ from entity to entity, likewise an internal control may be necessary in one entity but not required in another;

- In board papers on proposals, investments, etc., designating a section on risk promotes a culture of risk awareness and can assist directors in identifying “blind spots”;
- The internal audit function is regarded as a key line of defence after day-to-day management and bolsters the defence provided by the risk management function. A well-supported internal audit function can greatly benefit the entity by way of advising the board on where it can minimise avoidable losses; and
- Small steps can help to inculcate a risk aware culture over time. For example, it is customary for construction companies to hold a “toolbox talk” prior to commencement of work. Such talks focus on safe working practices and hazards to look out for.

Examples of questions to be posed to management on controls and compliance are outlined in **Appendix V**.

What are the key considerations that should be taken into account in establishing an adequate and effective internal control and risk management framework?

An adequate and effective internal control and risk management framework provides companies with a structured approach to implement, monitor, review and improve internal control and risk management in tandem with the changing business circumstances.

Examples of overarching components and key considerations that should be taken into account in establishing an adequate and effective internal control and risk management framework are outlined in the following page:

Five components of an internal control and risk management framework

Note: The term “objectives” in the explanations below refer to objectives relating to operations, reporting and compliance.

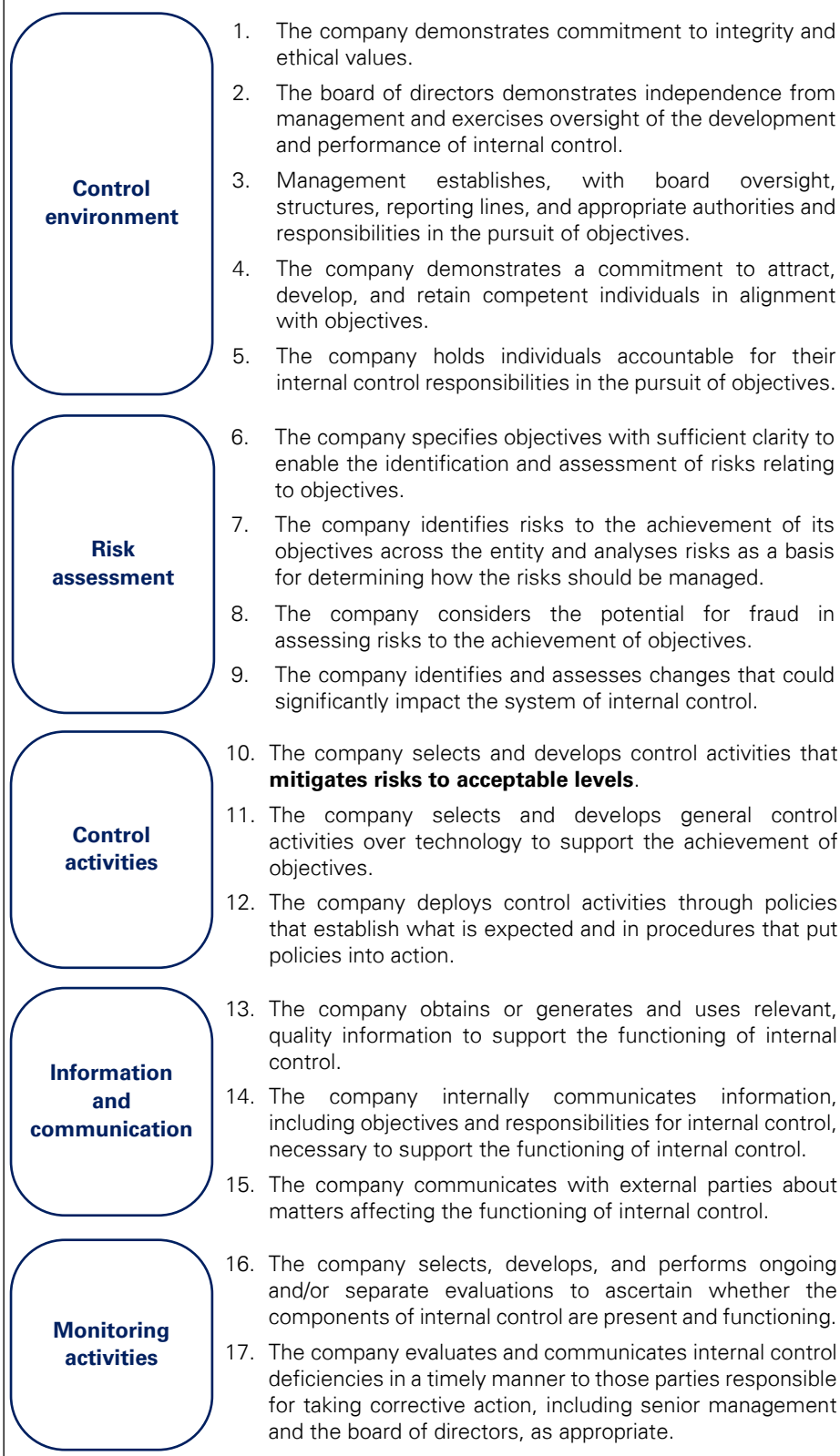


Diagram depicting key considerations of adequate and effective internal control and risk management [Source: Adapted from the COSO Internal Control – Integrated Framework⁵]

How can the board assess the adequacy and effectiveness of the risk management and internal control framework?

The board should define the processes to be adopted for its on-going monitoring and review, including specifying the requirements, scope and frequency for reporting and assurance. The board should form its own view on effectiveness and adequacy of the risk management and internal control, based on the evidence it obtains.

The board's assessment should, in particular, consider⁵:

- the company's willingness to take on risk (its "risk appetite"), the desired culture within the company and whether this culture has been embedded;
- the operation of the risk management and internal control systems, covering the design, implementation, monitoring and review, and identification of risks and determination of those which are principal to the company;
- the integration of risk management and internal controls with considerations of strategy and business model, and with business planning processes;
- any changes since the last assessment in the nature and extent of significant risks, and the company's ability to respond to changes in its business and the external environment;
- the work of its internal audit and risk management (where applicable) units and other assurance providers;
- the extent and frequency of the communication of the results of the monitoring to the board [or board committee(s)];
- the incidence of significant control failings or weaknesses that were identified at any time during the period and their impact on the company's performance or condition (financial or otherwise); and
- any events that impacted the achievement of objectives that were not anticipated by management.

⁵ COSO is a framework that is developed by the International Committee of Sponsoring Organizations of the Treadway Commission to guide companies in designing, implementing and evaluating internal controls in response to the risks that are being faced by the company.

⁶ Guidance on Risk Management, Internal Control and Related Financial and Business Reporting 2014, Financial Reporting Council of United Kingdom

What are the common pitfalls that should be avoided in the management of risks?

The following are some of the issues the board should be wary of:

Common pitfalls in risk management:

- a) box-ticking rather than business-led assessment of risk approach;
- b) failure and/or the inability to prioritise principal risks in relation to their mitigating measures leading to unidentified strategic risks turning into emerging risks without a preparedness to respond;
- c) risks are managed in silos and their impact is not considered across business units and functions;
- d) inadequate attention is given to the ever changing internal and external market environment;
- e) merely discussing risk issues without integrating them into the board's own decision making process, since strategic risks can be difficult to identify;
- f) general failure to embed risk management in the culture and processes of the company and its workforce, leading to the lack of a sustainable risk identification system in place across business units and functions;
- g) there is no precise documented accountability for managing risks;
- h) level of investment is not always a reliable proxy for the level of enterprise risk;
- i) the board does not have a sense of assurance arising from risk management implementation; and
- j) bad news is not easily communicated to the top.

Can internal controls be designed independently outside the risk management process?

The design of internal controls in silos and without reference to their associated risks can lead to an imbalance and consequently, certain key risk areas may be left unaddressed.. For example, too many controls (and thus, resources) are put in place over petty cash, which in the grand scheme of things is hardly material to a company's survival.

What are some of the more common ways in which a company's appetite for risk can be articulated?

Risk appetite must support a company's risk management activities. Some companies prefer the distinction between **risk tolerance** (i.e. maximum risk that can be taken before financial distress) and **risk appetite** (amount of risk that is actually taken for risk reward benefits). Risk appetite is generally understood to be "how much risk a company is willing to take" as opposed to a maximum threshold before financial sufferings (i.e. risk tolerance). Risk appetite should be a sub-set of risk tolerance.

A company's risk appetite can be articulated in the following ways:

Common ways to articulate risk appetite (non-exhaustive):

(a) Setting a boundary on the "impact vs likelihood" grid.

Established through the use of risk matrices where a risk appetite line is drawn to demarcate the boundary between those risks that are deemed to be "high" and those which are not. Typically identified through an "Enterprise Risk Management" process.

(b) Economic capital measures/ balance sheet based expressions

Achieved by the ability to absorb losses by holding surplus capital against the desire to invest capital to generate a positive return. The higher the risk premium, the lower the appetite for risk.

(c) Changes in credit ratings

Based on probability of default by a rating agency, companies with "AA" rating may not wish to take any risks that may cause a downgrade to an "A" rating.

(d) Profit and loss measures

Profit and loss based expressions, e.g. companies that set maximum loss figures.

(e) Value based measures

To set limits around the volatility of its share price or against a target share price. Thus, allowing companies to direct its attention to investments, projects and activities that are likely to achieve these targets/ limits.

(f) Develop effective targets or thresholds for key risk indicators

The simplest method. Setting a range of key risk indicators (monitors changes in exposure to a specific risk event), key control indicators (monitors to determine whether specific controls are operating effectively) and key performance indicators ('KPIs') (monitors to keep track on the financial performance or operational efficiency). Examples of common risk indicators are outlined in Appendix VI.

(g) Qualitative statements

Expressions of statements that cannot be articulated numerically. Also applied to areas of risk that are difficult to quantify effectively, such as reputation risks. Often easy to understand and communicate and integrate within the organisation's culture or statement of values, e.g. "We have zero tolerance for fraud".

An illustrative non-exhaustive list of risk appetite threshold (quantitative and qualitative) are provided below:

Quantitative	
Measure	Risk Appetite (Variance Range)
Revenue	1% - 2.5%
Earnings per share	3% - 5%
Cashflow	5% - 10%
Credit rating	To maintain grade of XX

Qualitative	
Measure	Risk Appetite (Target)
Energy efficiency	Reduce consumption per unit
Safety measures e.g. recorded accident rates	To achieve recordable case
Reputation exposures	Zero tolerance for negative press coverage or customer satisfaction improvements
Greenhouse gas	X% reduction per tonne

What should be considered from a disclosure perspective?

The state of internal control system of the group (the listed entity and its subsidiaries) is articulated primarily through the “Statement of Risk Management and Internal Control” within the entity’s annual report. In essence, directors are to comment amongst others on the following:

- What are the features of the risk management process and internal control system – for example, how are risks identified? Were risks flagged during a workshop session or during a board session? How are risks, as they evolve, tracked and managed?
- Did the board assess the design of the risk management process and internal control system and test their effectiveness?
- If weaknesses surfaced during the process, how did the board treat such weaknesses? Were any deficiencies corrected?
- In summary, what does the board think of the risk management process and internal control system?

In making the Risk Management and Internal Control Statement, a listed issuer should be guided by the **Statement on Risk Management and Internal Control: Guidelines for Directors of Listed Issuers** which is issued by the Taskforce on Internal Control (“SORMIC Guidelines”) with the support and endorsement of Bursa Malaysia Berhad.

Paragraphs 41 and **42** of the said document in the following page outlines the key elements that a listed issuer should provide in its narrative statement so as to enable stakeholders to make an informed assessment of the main features and adequacy of the company’s risk management and internal control system.

Paragraph 41 of SORMIC Guidelines

In its narrative statement, the board should disclose the following:

- The main features of the company's risk management and internal control system;
- The ongoing process for identifying, evaluating and managing the significant risks faced by the company in its achievement of objectives and strategies;
- That such process has been in place for the year under review and up to the date of approval of this statement for inclusion in the annual report;
- The process it (or where applicable, through its committees) has applied in reviewing the risk management and internal control system and confirming that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review;
- That a review on the adequacy and effectiveness of the risk management and internal control system has been undertaken;
- Commentary on the adequacy and effectiveness of the risk management and internal control system;
- The process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and financial statements; and
- Where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these guidelines, this should be disclosed.

Paragraph 42 of SORMIC Guidelines

In its narrative statement, the board should also include whether it has received assurance from the CEO and CFO on whether the company's risk management and internal control system is operating adequately and effectively, in all material aspects, based on the risk management and internal control system of the company.

Where

Regional/international perspectives

Risk management and internal controls are well-established concepts and therefore key jurisdictions have long incorporated them into governance codes.



Regional/ international perspectives

The Report on Corporate Governance for South Africa 2016 ("King IV Code") is the first major code to explicitly relate the company's actions and the consequent risks to society and the environment. There is also a significant emphasis on ethical risks.

However, King IV Code should not be viewed as being conservative on risk. In fact, it uses bold words and exhorts directors to "exercise courage in taking risks and capturing opportunities".

Country	Provision(s)
Singapore	<p>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 (Principle 11).</p> <p>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.</p> <p>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 (Guidelines 11.2 and 11.3).</p>
Australia	<p>A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework (Principle 7).</p> <p>The board or a committee of the board should:</p> <ul style="list-style-type: none"> (a) review the entity's risk management framework at least annually to satisfy itself that it continues to be sound; and (b) disclose, in relation to each reporting period, whether such a review has taken place (Recommendation 7.2).

Country	Provision(s)
	<p>A listed entity should disclose:</p> <ul style="list-style-type: none"> (a) if it has an internal audit function, how the function is structured and what role it performs; or (b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes (Recommendation 7.3)
United Kingdom	<p>The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems (Principle C.2).</p>
South Africa	<p>The governing body should exercise ongoing oversight of risk management and, in particular, oversee that it results in the following:</p> <ul style="list-style-type: none"> (a) An assessment of risks and opportunities emanating from the triple context⁷ in which the organisation operates and the capitals that the organisation uses and affects. <p>In addition, the following should be disclosed in relation to risk:</p> <ul style="list-style-type: none"> (a) An overview of the arrangements for governing and managing risk. (b) Key areas of focus during the reporting period, including objectives, the key risks that the organisation faces, as well as undue, unexpected or unusual risks and risks taken outside of risk tolerance levels. (c) Actions taken to monitor the effectiveness of risk management and how the outcomes were addressed. (d) Planned areas of future focus (Recommended Practices 6 and 9 under Principle 11). <p>The governing body should assume responsibility for assurance by setting the direction concerning the arrangements for assurance services and functions. The governing body should delegate to the audit committee, if in place, the responsibility for overseeing that those arrangements are effective in achieving the following objectives:</p> <ul style="list-style-type: none"> (a) Enabling an effective internal control environment (Recommended Practice 40 under Principle 15). <p>In addition to the statutory disclosure and the disclosures recommended in Paragraph 50⁸, the following should also be disclosed in relation to the audit committee:</p>

⁷ Triple context in the Report on Corporate Governance for South Africa 2016 refers to the economy, society and the environment.

⁸ Disclosure in relation to each committee of the governing body.

Country	Provision(s)
	(e) The audit committee's views on the effectiveness of the design and implementation of internal financial controls, and on the nature and extent of any significant weaknesses in the design, implementation or execution of internal financial controls that resulted in material financial loss, fraud, corruption or error (Recommended Practice 59 under Principle 8).

Establishment of board risk committee



MCCG Intended Outcome 9.0

Companies make informed decisions about the level of risk they want to take and implement necessary controls to pursue their objectives.

The board is provided with reasonable assurance that adverse impact arising from a foreseeable future event or situation on the company's objectives is mitigated and managed.

MCCG Step up 9.3

The board establishes a Risk Management Committee, which comprises a majority of independent directors, to oversee the company's risk management framework and policies.

Why

The case for change

The marketplace is becoming increasingly complex as new waves of change are reshaping numerous industries.

Key changes in the current business context:



Source: On the 2017 board agenda, KPMG



What could go wrong:

- Inadequate attention and focus on risk management issues.
- Risks that do not fall neatly into the scope of a particular board committee may be overlooked.
- Undue reliance placed by the board on management and external experts for input on risk management.
- Deliberations on risk management are isolated from strategy and corporate culture.

The greater sophistication and complexity of businesses have significantly affected the way in which management implements key decisions. Being able to challenge management on how the company is responding to these signals and exposures necessitates greater attention at the oversight level.

Given the ongoing developments, it may be value-adding to institute a board committee to deal with the unique, complex, and volatile risks the company faces. A dedicated company-wide risk oversight by the board committee could go a long way in heightening scrutiny on risk management matters and thus, enabling a more effective anticipation of and reaction to events and trends that could lead to disruptive changes in the business model. It also provides an opportunity to coordinate and monitor all key risk discussions in a transparent manner at a central point.



Point for reflection

A key driver for the establishment of a dedicated board risk management committee is the need for comprehensive views as opposed to silo perspectives.

At present, most of the committees and other governance mechanisms are **focused on one specific aspect of the company's risks**. For example, audit committees typically oversee financial reporting risks and certain compliance-related risks that can have financial reporting implications. Remuneration committees oversee risks related to how the remuneration structure drives behaviour within the company.

This oversight model commonly leaves other critical risks such as technological, litigation and environmental risks unattended, thus, giving rise to the scenario dubbed as "**orphan risks syndrome**".

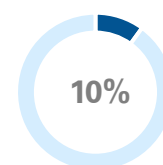
In the case of financial institutions, the need for a stand-alone board risk committee is even more compelling as **the nature of risks inherent in their operating models are varied and nuanced**. Exposures such as market, credit and liquidity risks are closely related to the fluctuating macroeconomic environment, thus rendering them volatile. These exposures elicit the deployment of complex risk infrastructures and call for greater scrutiny at the board level.

Recognising the significance of dedicated risk oversight in financial institutions, Bank Negara Malaysia has mandated the establishment of a board risk management committee².



Investors' perspectives

The focus on risk management is a top governance priority of institutional investors. A 2016-2017 United States' National Association of Corporate Directors (NACD) survey revealed that 10% or one in ten boards that met with institutional investors specifically discussed risk oversight.



This heightened scrutiny on risk management can also translate into shareholder campaigns and adverse voting recommendations. For example, in connection with the investigation on breaches of Foreign Corrupt Practices Act at Wal-Mart during the year 2014, a proxy advisory firm, namely, the Institutional Shareholder Services (ISS) recommended voting against the Chairman, Managing Director and Audit Committee Chair of Wal-Mart due to the board's failure to adequately communicate material risk factors to shareholders and assure shareholders that there is proper risk oversight in place¹.

¹ Lipton et. al 2017, *Risk Management and the Board of Directors*, Harvard Law School Forum on Corporate Governance and Financial Regulation

² Standard 12.1(c) of Bank Negara Malaysia's Policy Document on Corporate Governance

How

The practice in substance

It is clear that whilst ultimate responsibility for a company's risk management framework rests with the board, having a board risk committee can be an efficient and effective mechanism to bring the transparency, focus and independent judgement needed to oversee the company's risk management framework.

Key considerations relating to the application of this Step Up are discussed below:

What are the key responsibilities of board risk committee?

A risk committee should have a charter that clearly sets out its role and provides it with all the necessary powers to perform that role. Some of the suggested responsibility areas that can be considered when outlining the terms of reference of a board risk committee are outlined in the following page.

Suggested risk oversight responsibilities (non-exhaustive)³:

- Determine that there is a robust process in place for identifying, managing, and monitoring critical risks; oversee execution of that process; and ensure it is continuously improved as the business environment changes.
- Provide timely input to management on critical risk issues.
- Engage management in an ongoing risk appetite dialogue as conditions and circumstances change and new opportunities arise.
- Oversee the conduct of, and review the results of company-wide risk assessments, including the identification and reporting of critical risks.
- Oversee the management of certain risks having regard to the complexity and significance of these exposures.
- Provide advice to the board on risk strategies and coordinate the activities of the various standing board committees for risk oversight.
- Promote a healthy risk culture and watch for dysfunctional behaviour that could undermine the effectiveness of the risk management process (e.g. excessive risk-taking due to misaligned key performance indicators and remuneration schemes).

Care should be exercised to minimise overlaps in relation to specific risks that the board risk committee is assigned to oversee (e.g. oversight of compliance risk by both the audit committee and risk committee).

³ Board perspectives- risk oversight 2015, Protiviti

Can a combined board committee lead to focussed or dedicated oversight of risk management as envisaged by Step Up 9.3 of MCCG?

In determining whether there is dedicated oversight by the committee, the test would be the **balance of work performed by the committee and whether matters of risk are accorded with due attention**.

Under normal circumstances, a combined committee (e.g. audit and risk management committee) would not be considered as an application of **Step up 9.3 of MCCG**. Combined committees are commonly overwhelmed with their primary agenda and may not have the expertise to oversee risk management matters in an impactful manner.

What are the factors that should be taken into account in establishing the composition of a board risk committee?

In order to be able to discharge the committee's mandate effectively, a risk management committee should be of sufficient size and independence (majority independent directors) and its members between them should have a sufficient understanding of the industry in which the company operates. Having directors who have little knowledge of industry or the business environment would not add value to the committee and its function, leading to substandard risk assessment.

Key factors in determining the committee's composition are outlined below:

<p>Size</p> <p>The board risk committee should be of an appropriate size so that members can deliberate in an effective manner and any changes to the composition can be managed without undue disruption.</p>	<p>Independence</p> <p>The board risk committee should comprise a majority of independent directors to enable objective oversight of risk matters. Whilst executive directors have more in-depth knowledge on the exposures that the company is subjected to, it is widely held that executive directors have a greater propensity to take risks given that their evaluation and remuneration are usually linked to the company's performance.</p>
<p>Business/industry knowledge</p> <p>Directors with risk management experience and strong industry or business knowledge can significantly add value to the deliberations of the risk committee, particularly on operational risks. Their knowledge on the subject matter relating to the industry and the external environment may help to provide a better understanding of business-specific issues or growing exposures.</p>	<p>Time commitment</p> <p>The establishment of an additional committee demands the time of directors. As such, consideration should be given in appointing members who are able to devote the time and attention to the affairs of the board risk management committee.</p>



Dos

- ✓ Setting out the terms of reference which deals with the authority and duties and disclosing these terms on the company's website.
- ✓ Developing focused agenda items for the board risk committee and its reporting to the board.
- ✓ Establishing platforms for periodic engagement sessions between the board risk committee and senior management.



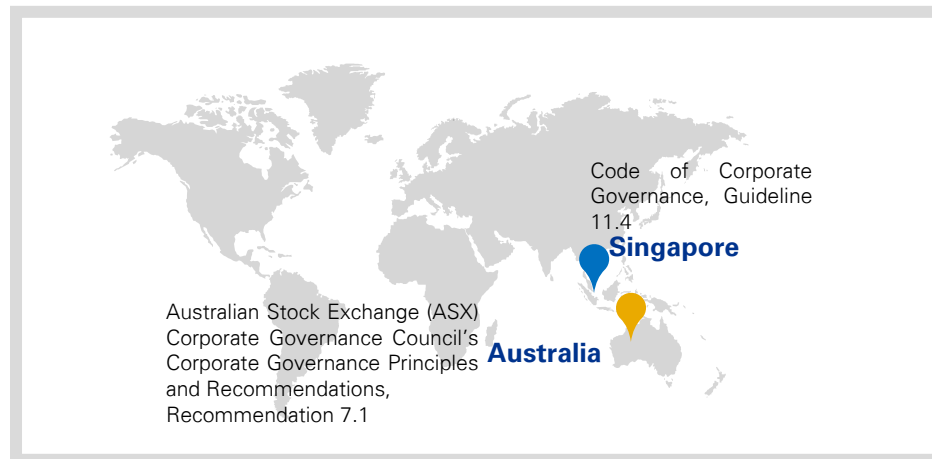
Don'ts

- × Having excessive overlaps in the responsibilities of a board risk committee and that of another board committee.

Where

Regional/international perspectives

In tandem with the evolving nature of risks in the corporate landscape which necessitates more focussed oversight on risks, selected jurisdictions including Australia and Singapore have also placed emphasis on the establishment of board risk committees in public listed companies.



Regional/ international perspectives

Board of public listed companies in Singapore and Australia are called upon to establish a board risk committee.

Country	Provision
Australia	<p>The board of a listed entity should have a committee or committees to oversee risk, each of which:</p> <ul style="list-style-type: none"> • has at least three members, a majority of whom are independent directors; and • is chaired by an independent director. <p>(Recommendation 7.1)</p>
Singapore	<p>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 (Guideline 11.4).</p>

Effectiveness of an internal audit function



MCCG Intended Outcome 10.0

Companies have an effective governance, risk management and internal control framework and stakeholders are able to assess the effectiveness of such a framework.

MCCG Practice 10.1

The Audit Committee should ensure that the internal audit function is effective and able to function independently.

MCCG Practice 10.2

The board should disclose:

- whether internal audit personnel are free from any relationships or conflicts of interest, which could impair their objectivity and independence;
- the number of resources in the internal audit department;
- name and qualification of the person responsible for internal audit; and
- whether the internal audit function is carried out in accordance with a recognised framework.

Why

The case for change

An internal audit function helps a company to accomplish its goals by bringing an objective and disciplined approach to evaluate and improve the effectiveness of **risk management**, **internal control** and **governance** processes. The internal audit function is essentially the “eyes and ears” of the audit committee, serving as a sounding board on deficiencies in the aforementioned areas and providing advice on the remedial measures to be meted out by the company.



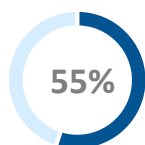
Evolution in the role of internal auditors

The assessment of soft controls is relatively nuanced and varied as compared to hard controls which involve organisational structures, reporting lines, formal processes, and authority limits for decision making. Therefore, internal auditors cannot rely solely on the traditional testing approaches (e.g. verifying documents), but rather, internal auditors are called upon to undertake root-cause analysis to identify cultural weaknesses.

Point for reflection

The internal audit function has changed considerably over time to meet the challenges of modern economy and the complexities of business. Stakeholders are increasingly looking to the internal audit function for insights regarding the future and to provide advisory services **earlier in the life cycle of business initiatives**.

A global survey titled “Evolution or Crossroads” which was conducted by Deloitte in 2016 revealed that 55% of Chief Internal Auditors expect the proportion of advisory services rendered by internal auditors to expand over the next three to five years.



Internal auditors are now deploying enhanced methodologies such as predictive risk analysis and advice on risk mitigation in the planning stages of a business initiative. This is expected to deliver more value rather than noting what management could have done differently after the initiative has been launched or completed.

Given the significance of this function in safeguarding a company against weaknesses in risk management, internal control and governance, a facilitative environment should be created to enable the internal audit function to carry out its responsibilities in an effective manner.

To this end, the need for listed issuers to establish an internal audit function and the responsibilities of the audit committee in overseeing the effectiveness of this function are well codified in Bursa’s Listing Requirements.

Paragraph 15.27 of Bursa’s Listing Requirements

- (1) A listed issuer must establish an internal audit function which is independent of the activities it audits.
- (2) A listed issuer must ensure its internal audit function reports directly to the audit committee.

Paragraph 15.12(1)(e) and (f) of Bursa’s Listing Requirements¹

A listed issuer must ensure an audit committee, amongst other discharge the following functions:

- review the following and report the same to the board of directors of the listed issuer:
 - a) the adequacy of the scope, competency and resources of the internal audit function and that it has the necessary authority to carry out its work; and
 - b) the internal audit plan, processes, the internal audit reports, recommendations raised, or investigation undertaken and whether or not appropriate action is taken on the recommendations.

¹ As per the proposed amendments contained in Bursa’s Public Consultation (Paper 3/2017)

Similar provisions are also encapsulated for financial institutions in **Bank Negara Malaysia's Policy Document on Corporate Governance**. For example, **Appendix 1** of the said document requires audit committees of financial institutions to oversee the effectiveness of the internal audit function in relation to its scope, procedures and frequency, key audit reports, disagreements between the chief internal auditor and the senior management team as well as the performance evaluation of the function. *Note: Detailed supervisory expectations on an effective internal audit function are outlined in the **Guidelines on Internal Audit Function for Licensed Institutions 2010** issued by Bank Negara Malaysia.*

Recognising that the value of internal audit lies in the objectivity of its process and the trust placed on this function by stakeholders, regulators have also enumerated prescriptions to enhance **transparency** in this regard. It is therefore important for companies to appreciate that the disclosed information serves as the basis for constructive dialogue with stakeholders.

Paragraph 15.15(3)(e) of Bursa's Listing Requirements

The audit committee report must include a summary of the work of the internal audit function.

Item 30, Part A, Appendix 9C of Bursa's Listing Requirements

The contents of an annual report must include a statement relating to the internal audit function of the listed issuer, i.e. whether the internal audit function is performed in-house or is outsourced and the costs incurred for the internal audit function in respect of the financial year.



What could go wrong:

- Key control failures and potential fraud issues are unsurfaced.
- Internal audit personnel succumb to pressure from management to reconsider audit issues and make them more "user friendly", thus, diminishing the actual level of risk that the company is exposed to.
- Limitation on the scope of internal audit (e.g. excluding the coverage of Managing Director or Chief Executive Officer's office from the scope of the audit)
- Lack of co-ordination between the internal auditors and external auditors which leads to gaps in the audit coverage.
- The internal audit work performed is not sufficiently responsive to changes in business strategies and risk profile of the company.
- Corrective actions recommended by the internal audit function are not acted upon and addressed in a timely manner by management.

How

The practice in substance

In order for the internal audit function to provide objective assurance on the quality of a company's risk management, internal control and governance processes, it is imperative to ensure that this function is well-equipped to deliver the depth and quality of the work that is expected of it.

Key considerations relating to the application of these Practices (**Practices 10.1 and 10.2 of MCCG**) are discussed below:

What are the key activities undertaken by an internal audit function?

It is the responsibility of the audit committee to decide on the remit of the internal audit function including its objectives and activities. The internal audit function is normally involved in carrying out the following:

- a review and objective evaluation of the governance, risk and control environment of the company and entities across the group;
- a systematic analysis of business processes to identify the associated controls in place;
- an assessment of how information on fraud and irregularities is reported including providing feedback on adherence to the company's code of conduct and/or code of ethics;
- ad-hoc reviews of other areas where there is a concern that affects financial reporting or a threat on the safeguarding of the company's assets;
- reviews of the compliance framework and specific compliance issues;
- follow-up visits to determine the status of management implementation of plans to address observations reported in preceding internal audit visits; and
- value-added recommendations for more effective and efficient use of resources within the company.



Dos

- ✓ Establishing an internal audit charter to set forth the purpose of the internal audit function, its responsibilities and the necessary authority that it has been conferred with to carry out its work.
- ✓ Formalising the qualifications and competencies that are expected of those carrying out the internal audit work.
- ✓ Establishing platforms for external auditors and internal auditors to communicate and co-ordinate.
- ✓ Keeping close tabs on the resignation of internal auditors so as to ascertain if it is indicative of broader issues.



Don'ts

The following would render the application of the practice ineffective:

- × Disclosing adherence to a professionally recognised internal audit framework when the company only adopted a minimal number of standards or practices encapsulated in the said framework.
- × Maintaining that an outsourced internal audit provider's confirmation on independence and other regulatory requirements is the end-all and be-all.

What are the key attributes of an effective internal audit function?

The salient characteristics which are commonly exhibited by an effective internal audit function are outlined below:

<p>Objective and free from undue influence</p> <p>Internal audit personnel should be able to exercise objectivity by being free from conflicts of interest or the undue influence of others that will override professional and business judgement.</p> <p>In order to preserve the independence of this function, the head of internal audit should report directly to the audit committee. The audit committee should also be responsible for deciding on the appointment and removal as well as the performance evaluation and remuneration of those in the internal audit function.</p>	<p>Adequately resourced</p> <p>The internal audit function should be resourced with adequate manpower and supporting infrastructure, such as auditing tools and knowledge repositories. The resources and budget allocated should be proportionate with the envisaged extent and complexity of the audit work, in line with the company's size and circumstances.</p> <p>The audit committee should ensure that internal audit personnel, particularly the head of internal audit is competent to carry out the work.</p>
<p>Appropriately positioned</p> <p>The internal audit function should be appropriately positioned within the company to be recognised as an authoritative voice. In this regard, as stated in Guidance to Practice 10.1 of MCCG, the audit committee should ensure that the head of internal audit has sufficient standing and authority to discharge his/her functions effectively.</p> <p>The function should be accorded with unrestricted access to the necessary information, records, physical properties and personnel to perform its agreed-upon objectives and responsibilities.</p>	<p>Aligned with the strategies and risks of the company</p> <p>The internal audit coverage should be tailored in response to changes in the company's business, risks and operations.</p> <p>The evaluation performed by the internal auditor should be contextualised to the business and industry, identify root-causes of issues and offer new insights with a consideration of the future impact.</p>



Hot-button issue

The **low entry barriers** to become an internal auditor is often regarded as the biggest challenge to the quality of internal auditing in Malaysia. At present, there are no minimum requirements for an individual to act as an internal audit practitioner.

In the absence of any governing regulation on internal auditors, it is incumbent on the audit committee to ensure that internal auditors, particularly the head of internal audit possess appropriate qualifications and expertise to carry out the work. In addition, the audit committee should reinforce the need for continuous professional development as a means for internal auditors to keep themselves abreast of the evolving developments.

The adoption of a professionally recognised framework such as the International Professional Practices Framework (IPPF) by the Institute of Internal Auditors would also go a long way in fostering the need for proper adherence to independence and ethical standards as well as technical standards on execution of internal audits and quality assurance (discussed in the following page).

What are the key factors that should be taken into account in evaluating the capability and adequacy of resources of the internal audit function?

In evaluating the resources of the internal audit, due cognisance should be given (as a minimum) to the aspects of **people** and **process**.

As mentioned above, the quality of the **people** (i.e. internal audit personnel) should reflect the extent and complexity of internal audit coverage. This would amongst others entail:

- the relevant academic and professional accreditation;
- the experience that is crucial to enable them to carry out internal audit work;
- reasonably strong interpersonal skills in discussing with the auditee and writing reports, articulating issues in no uncertain terms;
- maturity of the personnel in engaging with management on contentious issues encountered when carrying out the internal audit projects; and
- the ability to provide recommendations that are not only practical for implementation but also take into consideration the “cost-benefit” aspects of the suggestions.

In terms of **process**, the evaluation should focus on how structured and robust is the approach deployed by internal audit personnel in achieving the internal audit objective. Internal audit programmes should be clear and objective enough to enable the personnel to execute the work procedures and obtain as well as evaluate the audit evidence for reliability and sufficiency.

What are some of the questions that may be posed by the audit committee to evaluate the internal audit function?

Examples of questions (non-exhaustive) that may be raised in this regard are as follows:

- What is your assessment of the overall control environment? Have ethical and moral values been considered?
- What is your assessment of the company’s internal and external financial reporting processes?
- Have you performed the audit on the strategic and operational risks faced by the company?
- What processes are in place to assure that material errors in the financial report, if any can be reasonably detected? Do you consider these to be robust and effective?
- Have you had sufficient access to all areas of the company and appropriate resources to facilitate your reviews and assessments?
- What is your assessment of the company’s compliance with regulations?
- Has there been any attempt to limit the scope of your work in any way?
- Has there been any modification to the original audit plan due to deficiencies in internal controls?
- Have there been any disagreements between you and management and/or the external auditors? If so, what were they and how were they resolved?
- Have there been any circumstances where you were placed under undue pressure?
- Are there any other concerns that should be considered by the audit committee?

A sample exhibit outlining a checklist to evaluate the internal audit function is provided in **Appendix VII** of this Pull-out.

International Professional Practices Framework (IPPF) by the Institute of Internal Auditors (IIA).

The IPPF is the conceptual framework that organises the authoritative guidance promulgated by the IIA. The mandatory elements encapsulated in the IPPF are as follows:

- Core Principles for the Professional Practice of Internal Auditing;
- Definition of Internal Auditing;
- Code of Ethics; and
- International Standards for the Professional Practice of Internal Auditing (Standards)³.

The framework as a whole provides direction and guidance for companies to carry their internal audit work in a systematic, disciplined and credible manner. Succinctly put, the framework establishes a basis for the internal audit work.

³ The standards are principle focused and outline statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of the internal audit function.

Should an internal audit function be conducted in-house or outsourced⁴?

Companies may choose to have an in-house internal audit function or outsource it (in full or in part), depending on the circumstances of the company.

It is commonplace for audit committees to consider outsourcing the internal audit work when there is a **lack of specialised expertise** to carry out the audit. For example, an in-house internal audit function may not have the appropriate information technology skills to conduct an audit of information technology systems, thus, necessitating the need to commission specialised information technology auditors to perform the necessary audit work.

In the event the audit committee decides to outsource the internal audit function, it is pertinent that the audit committee assesses the remit of the outsourced internal audit provider to ensure that relevant criteria, such as independence, qualification, skills and experience have been considered for the work to be carried out effectively.

Key considerations in outsourcing the internal audit function:

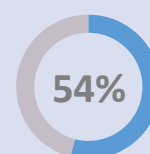
- assessment of outsourcing risks (e.g. contracts and confidentiality agreements including any sub-contracting arrangements);
- scope of internal audit work to be outsourced;
- service provider selection process including the independence, qualification, skills and experience, as well as knowledge;
- internal audit framework adopted by the outsourced service provider;
- roles and responsibilities of the outsourced service provider;
- access to information, records, physical properties, and personnel as well as the reporting workflow; and
- effectiveness of the internal audit service rendered by the outsourced service provider and continuity of such service (for subsequent outsourcing arrangements).

How do the disclosures in relation to “number of resources” and “person responsible for internal audit” (on Practice 10.2 of MCCG) vary for an outsourced function vis-à-vis an in-house function?

Disclosure on “number of resources” and “person responsible for internal audit” should be made in the manner set out in the following page:

Outsourcing of internal auditors

A study conducted by the Institute of Internal Auditors Malaysia in 2017 across 785 public listed companies on the Main Market found that approximately 54% of the companies outsourced their internal audit functions.



The study also found that the practice of enlisting outsourced service providers was more prevalent amongst smaller-sized public listed companies

It is important to note that the responsibility for an effective internal audit function rests with the board and its audit committee even if the entire or part of the function is outsourced. The audit committee, in line with its oversight responsibility, must satisfy itself that the outsourced service provider is able to carry out the internal audit work effectively.

⁴ References to outsource includes outsourcing in full or in part (“co-source”)

If the function is conducted in-house, disclosure shall include:

- name and qualification of the head of internal audit; and
- number of resources (number of personnel in the internal audit department).

or

If the function is outsourced, disclosure shall include:

- name of the outsourced service provider/external firm;
- name and qualification of the lead individual in charge of the engagement (from the outsourced service provider/external firm); and
- number of resources deployed by the outsourced service provider/external firm for the said engagement.

As for partially outsourced (co-sourced) internal audit engagements, a more prudent approach can be adopted by providing disclosure on both the name and qualification of the head of internal audit as well as that of the lead individual in charge of the engagement from the outsourced service provider/external firm. A statement should also be made on the nature of work that is outsourced.

The following illustrative disclosure outlines an example with regards to the following (in-house internal audit function):

- name and qualification of the head of internal audit (*note: experience of the said individual was also provided*); and
- number of resources (*note: general description of their qualifications was also provided*).



Illustrative disclosure (in-house internal audit function)

Disclosure on the name and qualification of the head of internal audit:

Ms. Say Nee was appointed as the Acting Head of Internal Audit of Singapore Press Holdings Limited ("SPH") in October 2014. She subsequently took over as **Division Head** in April 2015.

Ms. Say Nee has been with the Division for 10 years, having joined in October 2005. Say Nee's 15 years of experience in the profession spanned across both public and commercial sectors. She began her career in the Auditor-General's Office in 2000, where she was involved in the financial audit and system controls review at the Ministry of Manpower and Central Provident Fund Board, after graduating from Nanyang Technological University with a Bachelor of Accountancy degree. She was an Internal Auditor with United Engineers Ltd before joining SPH.

Disclosure on the number of resources:

IAD is staffed by nine audit executives, including the Head of Internal Audit. Most of the IAD staff have **professional qualifications**, and are members of the Institute of Internal Auditors, Inc. ("IIA"). Some are qualified IT auditors and/or Certified Fraud Examiners.

Illustrative disclosure on the name and qualification of the head of internal audit as well as the number of resources. Source: Annual Report of Singapore Press Holdings Limited for the financial year ended 31 December 2015.

In addition to the **number of resources** in the internal audit department and the **name and qualification of person responsible for internal audit**, boards should also disclose the following elements as stated in **Practice 10.2 of MCCG**:

- whether internal audit personnel are free from any relationships or conflicts of interest, which could impair their **objectivity and independence** (e.g. annual confirmation by the head of the internal audit to the audit committee on the objectivity and independence of the internal audit function); and
- whether the internal audit function is carried out in accordance with a recognised **framework** (e.g. IPPF).

Is there a distinction in disclosure requirement for the cost of internal audit [item (30) of Part A, Appendix 9C, Bursa's Listing Requirements] when the internal audit is outsourced as opposed to being conducted in-house?

The cost is to be disclosed regardless of whether the internal audit function is performed in-house or outsourced. Such cost should include all costs involved in performing the internal audit function, including but not limited to salary of personnel, overhead expenses (e.g. expenses on training and knowledge repositories) and other ancillary expenses incurred.

What should a disclosure on the summary of the work of the internal audit function [Paragraph 15.15(3)(e) of Bursa's Listing Requirements] include?

In providing disclosures on the summary of activities performed by the internal audit function, companies should provide meaningful insights into the **actual areas** that were audited during the financial year and **how internal audit performed its function**. A mere statement that the "internal audit function has reviewed the state of internal control of various operating cycles within the company" would not be particularly useful for stakeholders.

The "Analysis of Corporate Governance Disclosures in Annual Reports" performed by Bursa Malaysia in 2016 across 280 listed issuers has identified the following elements (non-exhaustive) which were encapsulated in the annual reports of listed issuers that exhibited good disclosures in this regard:

- number of internal audit assignments completed during the year and a statement as to whether these were aligned to the audit plan;
- specific areas that were audited such as finance, sales, marketing and procurement, with details of the specific aspects audited;
- a statement or discussion that the scope of internal audit engagements were aligned with the companies' risk management profile (i.e. the audited areas were identified as key risk areas);
- a statement or discussion that the internal audit's reports were deliberated at the senior management level and that action plans were put in place to complete the necessary preventive and corrective actions;
- a statement or discussion that the internal audit's findings and management's responses were tabled to the audit committee to ensure that management undertakes the agreed remedial actions;
- detailed breakdown of data to show how many internal audit personnel were involved in specific areas audited; and
- analysis of the variations in the internal audit costs or fees with explanations.

Where

Regional/international perspectives

Premised on the importance of a robust internal audit process, many jurisdictions have called upon companies to establish an internal audit function with the audit committee being responsible for immediate oversight of this function.

Selected regulators such as Singapore and South Africa have also enumerated additional stipulations in this regard. For example, companies in Singapore are urged to adopt professionally recognised internal audit standards (i.e. Standards for the Professional Practice of Internal Auditing set by the Institute of Internal Auditors (IIA)) in carrying out their internal audit function. The King IV Report on Governance for South Africa meanwhile urges the governing body of companies to ensure that an external, independent quality review of the internal audit function is conducted at least once every five years.



Regional/ international perspectives

Companies in Singapore are called upon to adopt professionally recognised internal audit standards in carrying out their internal audit function.

In South Africa, companies are urged to undertake an independent quality review of the internal audit function at least once every five years.

Country	Provision(s)
Singapore	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 Internal Auditors (IIA) (Guideline 13.4) .
South Africa	The governing body should ensure that an external, independent quality review of the internal audit function is conducted at least once every five years (Recommended Practice 60 of Principle 15) .

Appendices



Appendix I:

Questions to be posed to management – financial reporting

Directors should consider what further actions or information they require on financial reporting and tailor the questionnaire accordingly. For example, all “No” answers may require further explanation. Also, directors may wish to organise a series of detailed presentations from relevant senior management on specific issues.

The questionnaire, which is not meant to be exhaustive, covers a broad range of issues, some of which may not be applicable or only relevant to certain types of companies. Accordingly, the scope and nature of the questions should be adapted to suit the circumstances of the company’s activities, relevant legislation (including overseas reporting requirements) and perceived contentious reporting issues. The questionnaire would typically be completed by the chief financial officer.

A. Overall

1. Do the company’s financial statements comply in all respects with applicable approved accounting standards and other relevant reporting requirements? ☐ Yes ☐ No

B. Accounting policies

2. Are there any new applicable approved accounting standards or other authoritative pronouncements in the current period? ☐ Yes ☐ No
3. Are there any changes to the company’s accounting policies this year? ☐ Yes ☐ No

C. Going concern

4. Does the company or any of its controlled entities have a liquidity or solvency problem? ☐ Yes ☐ No
5. Have cash flow forecasts been prepared to determine whether the company’s liabilities can be met as and when they fall due? ☐ Yes ☐ No

D. Cash

6. Have bank reconciliations been performed regularly and reviewed by an appropriate person? ☐ Yes ☐ No
7. Are any cash balances of controlled entities or those held in foreign countries subject to any restrictions? If yes, please describe. ☐ Yes ☐ No

E. Investments

- | | | |
|---|------------------------------|-----------------------------|
| 8. Is the company trading in shares? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 9. Are there established authority limits covering investments? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 10. Have there been incidences where the limits of authority were not adhered to? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |

F. Account receivable

- | | | |
|--|------------------------------|-----------------------------|
| 11. Are there any new types of transactions giving rise to complex revenue recognition considerations? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 12. Is the provision for doubtful receivables adequate? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 13. Has adequate provision been raised for sales returns? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 14. Has the company observed a correct cut-off for its sales transactions? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |

G. Inventories

- | | | |
|---|------------------------------|-----------------------------|
| 15. Do the relationships between inventory movements, inventories at year-end, trade receivables and sales revenue appear reasonable? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 16. Are there material adjustments made to the book inventory to reflect the physical inventory? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 17. Is the company's method of valuing inventories consistent with most companies in the industry and in line with applicable approved accounting standards? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 18. Is the provision for obsolete and excess inventory adequate? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 19. Have all anticipated variations and claims relating to construction contracts and other service contracts been considered in the determination of contract outcome? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 20. Have expected losses on construction contracts and other service contracts been recognised immediately? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 21. Have profits on construction contracts and other service contracts been properly determined in accordance with appropriate accounting standards? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |

H. Property, plant and equipment

- | | | |
|--|------------------------------|-----------------------------|
| 22. Have all major acquisitions of property, plant and equipment been subject to a duly authorised approval process? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|--|------------------------------|-----------------------------|

23. Has the latest valuation of land and buildings been obtained within the last 3 years and is it appropriately disclosed in the financial statements, where required? ☐ Yes ☐ No
24. Are the useful lives and methods used to depreciate plant and equipment reasonable? ☐ Yes ☐ No
25. Has a review of idle plant and surplus premises, including leased assets and premises, been performed for possible impairment? ☐ Yes ☐ No
26. If borrowing costs have been capitalised in property, plant and equipment, has the capitalisation been carried out as allowed by applicable approved accounting standards? ☐ Yes ☐ No
27. If the company has capital commitments on the purchase of property, plant and equipment, have appropriate disclosures required by the CA been made in terms of amounts approved but not contracted for; and amount contracted but not provided for in the financial statements? ☐ Yes ☐ No
28. Does the company periodically take a physical inventory of property, plant and equipment? ☐ Yes ☐ No
29. Were there any significant adjustments made to the carrying value of property, plant and equipment? ☐ Yes ☐ No
- If yes, provide details of the adjustments:

I. Intangible assets

30. Have the intangible assets been impaired to reflect the useful life of the asset? ☐ Yes ☐ No
31. Is the impairment policy clearly disclosed in the financial statements? ☐ Yes ☐ No

J. Other non-current assets

32. Do all other non-current assets satisfy the definition of "asset" as defined in "The Framework for Preparation and Presentation of Financial Statements"? ☐ Yes ☐ No
33. Is the impairment policy appropriate? ☐ Yes ☐ No
34. Does the company have contingent assets and have these been disclosed according to applicable approved accounting standards? ☐ Yes ☐ No

K. Liabilities

35. Have provisions only been raised when there is a legal, equitable or constructive obligation present as a result of past transactions or events? ☐ Yes ☐ No
36. Are any assets pledged to secure borrowings? ☐ Yes ☐ No

37. If yes, have they been properly disclosed in the financial statements? ☐ Yes ☐ No
38. Has the company entered into any significant sale and lease back transactions during the year? ☐ Yes ☐ No
39. Has the company adequately disclosed any contingent liabilities and off-balance sheet items according to applicable approved accounting standards? ☐ Yes ☐ No

L. Shareholders' equity

40. Have there been any share buybacks during the period? ☐ Yes ☐ No
41. Has the amount of any asset revaluation reserve attributable to assets disposed of been transferred to retained earnings or to a capital reserve, as appropriate? ☐ Yes ☐ No
42. Have issues of financial instruments, other than ordinary shares, been properly classified as equity or debt in accordance with applicable approved accounting standards? ☐ Yes ☐ No

M. Revenue and expenses

43. Are the methods of recognising major items of income/expense appropriate in the circumstances? ☐ Yes ☐ No
44. Are the company's methods of recognising income/expense consistent with methods used in the industry? ☐ Yes ☐ No
45. Has the gross profit on sales percentage changed significantly during the year? ☐ Yes ☐ No
46. Are the financial results of the company in line with analysts' expectations? ☐ Yes ☐ No
47. Have intra-group transactions been appropriately eliminated, including unrealised profits? ☐ Yes ☐ No

N. Taxation

48. Has the current tax liability in the financial report been calculated in accordance with current income tax laws and applicable approved accounting standards, including deferred tax? ☐ Yes ☐ No
49. Have the tax calculations been reviewed by a party independent of the preparer and who has appropriate knowledge of the tax requirements? ☐ Yes ☐ No
50. Are there any significant tax balances in dispute? ☐ Yes ☐ No
51. Has the effective tax rate been reconciled with the statutory tax rate? ☐ Yes ☐ No

O. Acquisitions/disposals

52. Have all acquisitions and disposals been subject to due diligence procedures and board's/ shareholders' approvals, where required? ☐ Yes ☐ No
53. Has the company carried out post acquisition reviews to assess the actual performance against the proposed business case? ☐ Yes ☐ No
54. Have all discontinuing operations been properly identified and disclosed only in accordance with applicable approved accounting standards? ☐ Yes ☐ No

P. Earnings per share

55. Have any changes in capital structure or accounting policies during the year significantly affected the earnings per share? ☐ Yes ☐ No
56. Have basic and diluted earnings per share been accurately computed and disclosed in accordance with applicable approved accounting standards? ☐ Yes ☐ No

Q. General

57. Are assumptions regarding the determination of carrying value of assets and liabilities subject to significant risks? ☐ Yes ☐ No
58. Have all major suspense, clearing or inter-office general ledger accounts been reconciled and cleared at reporting date? ☐ Yes ☐ No
59. Are there any significant post reporting date events that have a bearing on the financial report? ☐ Yes ☐ No

R. Bursa's Listing Requirements

60. Does the annual report comply with all the Bursa's Listing Requirements disclosures? ☐ Yes ☐ No
61. Do the quarterly announcements contain the required disclosures as prescribed by the Bursa's Listing Requirements and applicable approved accounting standards? ☐ Yes ☐ No

S. Directors' Report

62. Have all disclosures required by the Companies Act 2016 been made in the directors' report, including principal activities, review of operations, significant changes in the state of affairs, etc? ☐ Yes ☐ No



The following is a non-exhaustive list of red flags in relation to financial reporting of which audit committees should be aware:

- sharp fall in the company's share price
- overly complex transactions and company structures
- deterioration in the collection of debts and/ or quality of debtors
- increase in amounts owing to creditors
- ongoing or previous investigations by regulators
- unusual rapid growth
- regular deferral of capital expenditure
- unrealistic earning expectations by the financial community
- excessive or inappropriate performance-based compensation
- gearing or liquidity forecast to be a problem
- loan agreement covenants not being complied with
- results appear unrealistically high given industry and economic conditions
- key ratios deteriorating
- last minute transactions that result in significant revenue
- delay in the issuance of financial reports

Appendix II:

External auditor evaluation form

This sample exhibit, which is not exhaustive in nature, illustrates key questions which may be used to assist the process for the evaluation of external auditor, prior to its appointment and/or re-appointment. The external auditor by definition includes its network member firms and companies based on the By Laws (on Professional Ethics, Conduct and Practice) by the Malaysian Institute of Accountants.

This sample evaluation form may be customised, depending on the peculiar circumstances of the companies concerned.

The Evaluation Form provides ratings from one (1) to four (4), or 'yes' and 'no', with the indicators illustrated below, to be responded in relation to the nature of the questions:

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Yes, always	Yes, most of the time	Yes, but seldom	No
or			
4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Above average	Average	Below average	Poor
or			
Yes <input type="checkbox"/>			No <input type="checkbox"/>
Yes			No

Where any criterion is deemed not applicable, it shall be indicated as 'Not Applicable' in the comment box.

Name of External Auditor:

Section A: Calibre of external audit firm

1. Are there recent or current litigation cases against the firm?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

2. Does the external audit firm have the size, resources and geographical coverage required to audit the company?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

Section B: Quality processes/performance

3. How are the quality control processes maintained in the external audit firm? Factors to be considered include the level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and the external audit firms approach to risk.

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

4. How have key risks, including fraud risk and financial misstatement risk, being discussed and factored into the audit plan?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

5. How is the external audit firm's process for internal review of accounting judgments, including an understanding of the key issues?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

6. How are relevant specialists/ experts being employed by the external audit firm and how are these linked to the audit process?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

7. How are multiple-location audits and/or overseas audits controlled and are their audit effectiveness regarded as consistent internationally?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

8. Are the reporting processes for subsidiary audit teams¹ effective?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

9. How is the external audit firm's approach to seeking and assessing management representations?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

¹ Group engagement team (i.e. audit team from the parent company's external auditor) or component external auditor (i.e. audit team from a different external audit firm) that performs the external audit on the subsidiaries of the parent company.

10. In cases where there are any differences in views between management and the external auditor, does the external auditor communicate its views clearly and accurately from an accounting perspective?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

11. Does the audit committee agree with the bases and extent of reliance external auditors place on management and internal audit testing, if any? (Comment as 'Not Applicable' if none)

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

12. Comment on the external auditor's working relationship with internal audit.

Comment:			
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13. Did the auditors meet the performance targets, i.e. audit scope, audit plan, timing, etc.?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

14. Does the external audit function include detection and investigation of fraud? If it does not, please comment on its role in relation to investigation of fraud?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

Section C: Audit team

15. Rate whether audit engagement partner and individuals assigned to the external audit team have the requisite skills and expertise, including industry knowledge, to effectively audit this company and meet its requirements.

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

16. Is the lead engagement partner able to provide a clear and understandable explanation on auditing and accounting issues faced by the company?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

17. How is the audit engagement partner's/other senior personnel's involvement in the audit process and is this sufficient?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

Section D: Independence and objectivity

18. Does the external audit firm communicate to the company on any matters which might reasonable be perceived to affect the independence of the firm and/or of individuals assigned to the external audit team (e.g. provision of services to entities that are related to directors and Large Shareholders² of the company)?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

19. Does the external audit firm have adequate key member succession plans in place, which meet the relevant audit partner rotation requirements and facilitate the maintenance of objectivity?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

20. Is the audit committee of the opinion that the external audit function is independent and objective?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

21. Prior to approval by the audit committee on non-audit services to be rendered by the external audit firm, does the lead engagement partner explain and discuss safeguards in place to protect against impairment to independence and objectivity of the external audit firm?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

22. Does the external auditor communicate to the audit committee about new and applicable accounting practices and auditing standards and its impact on the company's financial statement?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

² As stated in **Guidance to Practice 4.2 of MCCG**, Large Shareholder means a person who is entitled to exercise, or control the exercise of, not less than 33% of the voting shares in the company; is the largest shareholder of voting shares in the company; has the power to appoint or cause to be appointed a majority of the directors of the company; or has the power to make or cause to be made, decisions in respect of the business or administration of the company, and to give effect to such decisions or cause them to be given effect to.

Section E: Audit scope and planning

23. Does the external audit firm, with the audit engagement partner present, agree the audit scope and plan with the audit committee?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

24. Is the external audit scope and plan adequate to address company/ industry-specific areas of accounting risks, audit risks and financial reporting risks facing the company?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

25. In planning the audit, are adequate considerations given to geographical coverage, allocate resources, level of audit testing and nature of audit reports issued at each location?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

26. Is specialist input to the audit in areas such as taxation, pensions and regulation at an appropriate level?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

27. Are all key operations covered by the external audit?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

28. Did the auditors maintain or update the audit plan to respond to changing risks and circumstances, in a manner agreeable and determined appropriate by the audit committee?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

Section F: Audit fees

29. How does the audit fee compare with other similarly sized companies in this industry? (Note: In this context, a rating of "4" indicates a relatively high fee whilst a rating of "1" indicates a relatively low fee. A fee that is either too high or too low can be of concern).

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

30. Rate how the differences between actual and estimated fees are handled.

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

31. Is an assessment conducted on the amounts and relationship of audit and non-audit fees and services?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

32. Does the audit committee consider the fee for the external audit practical and sufficient for the scope, size, complexity and risks of the company?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

Section G: Audit communications

33. Does the external audit firm meet freely, regularly, and on a confidential basis with the audit committee, including being able to communicate to the audit committee if not being provided with sufficient cooperation during the audit?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

34. Does the external audit engagement partner maintain professional and open dialogues with the audit committee and communicate findings and discussions in a frank and complete manner (including matters on management's reporting process, internal control over financial reporting, etc.)?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

35. Does the external audit firm advise the audit committee about significant issues and new developments regarding risk management, corporate governance, financial accounting and related risks and controls on a timely basis?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

36. Does the external auditor discuss the critical accounting policies and whether the accounting treatment is conservative or aggressive?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

37. Does the external audit firm discuss with the audit committee the quality of the Company's financial reporting, including the reasonableness of accounting estimates and judgments?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

38. Does the external audit firm resolve accounting issues in a timely manner?

4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>
Comment:			

39. Does the external audit firm seek feedback on the quality and effectiveness of the service they are providing?

Yes <input type="checkbox"/>			No <input type="checkbox"/>
Comment:			

Evaluation carried out by:

Checked and compiled by:

Name:
Designation:

Name:
Designation:

Appendix III:

Matters to be tabled to the audit committee on related party transactions

The following is an illustrative list. It is not exhaustive but is intended to stimulate thought as to the type of matters that should be tabled to the audit committee in relation to the related party transactions/ recurrent related party transactions.

- i. A description of the transaction;
- ii. Parties to the transaction, including who the related party is and the relationship involved;
- iii. Relevant details of the transaction, including value and percentage ratio, calculations based on the Listing Requirements. The percentage ratio should be calculated against all 8 methods listed in Bursa's Listing Requirements and the calculations disclosed to the audit committee;
- iv. The nature of the transaction, including an explanation of the related party's interest and if it is a recurrent related party transaction, how the transaction meets the relevant criteria for being considered a recurrent related party transaction;
- v. Whether advisors are to be appointed;
- vi. Whether any other approvals are required;
- vii. Rationale for the transaction and cost and benefit to the company/ group;
- viii. Comparative quotes, if available, including sources, methods and procedures through which transaction prices are determined;
- ix. Justification as to why the transaction must be undertaken with the related party, for example that the services provided by a related party cannot be obtained elsewhere or if need be, an independent valuation report annexed for that purpose;
- x. An explanation of how "arm's length" was maintained during negotiations and in ensuring negotiations and terms to the related party transactions/ recurrent related party transactions were carried out were on a commercial basis;
- xi. An explanation of why the terms are considered fair and reasonable;
- xii. An explanation of why the transaction is considered in the best interests of the company/group;
- xiii. An explanation of why the terms are not detrimental to the minority shareholders;
- xiv. If the transaction has gone through the usual tender process, to state so and the recommendation of the tender committee;
- xv. Management recommendation; and
- xvi. Revision/ changes to the related party transactions/ recurrent related party transactions policy and procedures relating to compliance with mandates arising from the nature and volume of transactions.

Appendix IV:

Financial literacy questionnaire

Financial literacy, which signifies the ability and competency to read, analyse and interpret financial statements, including a company's statement of financial position, statement of comprehensive income, statement of changes in equity, cash flow statement, notes to the statements, cost accounting, budgets and management's discussion and analysis ("MD&A") can be acquired through education either formal or self-guided.

Below is a sample questionnaire to gauge the level of financial literacy of an audit committee member. If the answer is "No", that does not mean that the member cannot serve but that training and education for of the said audit committee member becomes imperative.

Name of director/ candidate: _____

- | | | |
|---|------------------------------|-----------------------------|
| 1. Ability to read, analyse and interpret the company's financial statements. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 2. General understanding of approved accounting standards relevant to the company's business environment and related industry. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 3. Competency to understand accounting principles, for example revenue recognition, valuation of assets, provisions, accruals, etc. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 4. Ability to assess whether management's judgments/estimates in financial statements are consistent with the industry. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 5. Ability to assess clarity and completeness of disclosures in the financial statements (e.g. significant judgments have been explained in the notes to the financial statements). | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 6. Ability to analyse financial statements to quantify the overall financial condition of the company, i.e. use of profitability ratios, liquidity ratios, debt ratios, etc. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 7. Ability to interpret the implications of significant or non-recurring transactions, events or adjustments made in the financial statements. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 8. Ability to understand, analyse and enquire about potential manipulation of financial reporting i.e. did management make an estimate (or change an accounting treatment) to meet earnings target. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 9. Ability to assess whether the external audit work plan focuses on the company's key audit risks. | <input type="checkbox"/> Yes | <input type="checkbox"/> No |

10. What seems to be the main cause for significant or non-recurring transactions or financial reporting adjustments? Please state below and the rationale thereof:

11. Please provide an example of a potential red flag that can adversely affect the quality of financial statements.

12. What are the purposes of holding private meetings between the audit committee and the auditors, both external and internal, without the presence of any other directors and employees?

Appendix V:

Controls and compliance – Questions to be posed to senior management

This sample exhibit, which is not exhaustive in nature, illustrates key questions that the board may require senior management to complete or discuss.

Additional questions may need to be included, depending on the peculiar circumstances of the companies concerned.

Reference for additional questions can be made to the *Appendix 2* of the *Statement on Risk Management and Internal Control: Guidelines for Directors of Listed Issuers* which is issued by the Taskforce on Internal Control with the support and endorsement of Bursa Malaysia Berhad.

The Evaluation Questionnaire provides ratings of 'yes' and 'no', with the indicators illustrated below, to be responded in relation to the nature of the questions:

Yes <input type="checkbox"/>	No <input type="checkbox"/>
------------------------------	-----------------------------

Where any criterion is deemed not applicable, it shall be indicated as 'Not Applicable' in the comment box.

Section A: Overall Control Environment

A.1 Identification and Evaluation of Business Risks

1. Are the company's business risks identified and assessed on an ongoing basis?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

2. Do the company's accounting policies appropriately reflect the nature of its operational and business risks?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

3. Are employees informed of what is required of them to act in the best interest of the company so as to achieve its strategic objectives?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

A.2 Internal Controls

4. Are delegations of authority and responsibility to individuals appropriately determined and notified?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

5. Are internal controls documented, approved and communicated to employees?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

6. Does any one person initiate and approve significant transactions? If yes, does this represent an unacceptable level of risk?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

7. Are there policies on competitive bidding for all significant purchases and contracts?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

8. Is there a response plan for prompt and effective action when fraud or an illegal act is discovered?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

A.3 Information Systems

9. Are computers, programs and data adequately protected from improper use, loss or destruction?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

10. Have employees been informed of their responsibilities and accountabilities relating to the secure and confidential use of information technology assets, including data?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

11. Have company officers assessed the business impact in the event of a computer breakdown resulting in a sustained loss of processing capability?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

12. Is there a disaster recovery/contingency/business continuity plan, which is periodically tested?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

A.4 Insurance

13. Is there adequate insurance coverage over assets and potential liabilities, in terms of perils covered and sum insured?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

14. Have all known reportable incidents, circumstances or events that may give rise to an action against the company reported to the insurers and company lawyers?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

A.5 Communications

15. Is there a defined and approved media policy that includes discussions on performance, strategies and progress with market analysts, media rating agencies and similar bodies?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

16. Do procedures exist to ensure that all relevant matters are reported to Bursa Malaysia Securities Berhad, Securities Commission, Companies Commission of Malaysia, Bank Negara Malaysia, etc.?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

A.6 Corporate Code of Conduct

17. Does the company have a policy on the establishment and maintenance of appropriate ethical standards?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

18. Does the company have appropriate procedures to continuously inform and update its employees of the company's ethical standards and monitor their performance?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

Section B: Other Regulatory Areas

B.1 Tax & Duties

19. Has the company complied with relevant tax legislations?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

20. Have all tax payments been paid on time?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

21. Have tax issues been considered in all due diligence procedures for acquisitions and divestments, including tax implications on dividends paid by the company?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

22. Have all relevant employees been adequately trained on tax matters?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

B.2 Corporate Social Responsibility

23. Is there a formal economic, environmental and social ("EES") policy endorsed by senior management and directors?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

24. Have significant EES aspects or impacts been identified and processes put in place to address the aspects?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

25. Have EES provision and the company's obligations under legislation been identified?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

26. Have the directors been made aware of all EES reporting requirements under legislation?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

27. Does the annual report disclose the details of the company's performance in relation to EES activities?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

Section C: Secretarial

28. Have all required documents, including annual returns been lodged with the Companies Commission of Malaysia?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

29. Have all relevant Bursa's Listing Requirements been complied with?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

30. Have certificates of title for all owned properties, trademarks, patents, intellectual property, etc., been verified and safely stored?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

31. Have all property lease agreements, contracts, agreements, etc., been approved in accordance with delegated authorities and reviewed by legal experts?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

32. Have all dividends been declared and paid only in accordance with Companies Act 2016 and the company's Constitution?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

33. Have all share issues, buybacks and cancellations been approved by the board/shareholders, entered in the registers and notifications provided to the Exchange and Companies Commission of Malaysia?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

Checked and compiled by:

Name:

Appendix VI:

Examples of risk indicators

The following is an illustrative list. It is not exhaustive but is intended to stimulate thought in relation to risk indicators.

- Lack of oversight and inadequate attention on risk management matters by the board;
- High turnover of senior management;
- Autocratic management;
- Untimely reporting and responses to audit committee inquiries;
- Exposure to rapid technological changes;
- Industry “softness” or downturns;
- Interest rate and currency exposures;
- Overly complex company structures or transactions;
- Late surprises/high frequency of accounting adjustments;
- Ongoing or prior investigations by regulators or others;
- Bad news not escalated to the top;
- Deteriorating employee morale;
- Excessive or inappropriate performance-based compensation;
- Lack of succession planning;
- Inexperienced management;
- Lack of management oversight;
- Over-ambitious growth goals;
- Unusually rapid growth;
- Inappropriate focus on the importance of maintaining trends and achieving forecasts;
- Unusual results or trends;
- Lack of transparency in the business model and purposes of transactions;
- Results appearing unrealistically high given the industry and economic conditions;
- Key ratios deteriorating;
- Regular deferral of capital expenditure;
- Inadequate explanations for budget variances; and
- Significant projects having a strategic objective or high market profile such as acquisitions or information technology system implementations.

Appendix VII:

Evaluation of internal audit function

This sample exhibit, which is not exhaustive, illustrates key questions which may be used to assist the process of evaluating the internal audit function. The internal audit function may be performed in-house or outsourced, as the company deems fit.

This sample Evaluation Questionnaire may be customised, depending on the circumstances of the company.

The Evaluation Questionnaire provides ratings of 'yes' and 'no', with the indicators illustrated below, to be responded in relation to the nature of the questions:

Yes <input type="checkbox"/>	No <input type="checkbox"/>
-------------------------------------	------------------------------------

Where any criterion is deemed not applicable, it shall be indicated as 'Not Applicable' in the comment box.

Name of Audit Committee member:

1. Is the head of internal audit a member of:

IIAM¹ ☐

MIA² ☐

Any other professional body

2. Does the audit committee decide on the scope and functions of the internal audit as required in the Listing Requirements? If not, please comment on who makes that decision and why.

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

3. Does the internal audit function understand the company's business and the peculiarities of the industry(ies) of which the company operates in?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

¹ Institute of Internal Auditors Malaysia

² Malaysian Institute of Accountants

4. Do internal auditors meet with the audit committee without the presence of non-audit committee members whenever deemed necessary in relation to the operations of the company?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

5. Does internal audit function perform regular reviews to test the effectiveness of the financial, operational and compliance controls and processes of the company?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

6. Does the internal audit function test the effectiveness of risk management framework and policies?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

7. Does the internal audit function have sufficient resources and competency to carry out its work?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

8. Do the internal auditors undertake their functions according to the standards set by recognised professional bodies?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

9. Does the internal audit function provide input into developing action plans to monitor risks and internal controls based on the internal audit plan and processes undertaken?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

10. Is the scope of internal audit limited to certain areas only? If so, please state the reason for the limitation.

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

11. Does the internal audit function include detection and investigation of fraud?
If it does not, please comment its role in relation to investigation of fraud?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

12. Has the listed issuer carried out a Quality Assessment Review (QAR) of the internal audit function?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

13. Do the listed issuer's external auditors rely on the internal audit assessment? If not, why?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

14. Does the internal audit function work in collaboration with external auditors, particularly in the area of evaluation of internal controls?

Yes <input type="checkbox"/>	No <input type="checkbox"/>
Comment:	

Evaluation carried out by:

Checked and compiled by:

Name:
Designation:

Name:
Designation:



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