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## **AUDIT COMMITTEE GUIDANCE COMMITTEE**

## **GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE**

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## **DISCLAIMER**

This guidebook is issued by the Audit Committee Guidance Committee (**ACGC**) to provide practical guidance and recommendations of best practices for audit committees of companies listed on the Singapore Exchange. The guidance is not exhaustive and prescriptive. Audit committees should exercise their own judgement on the manner and extent to which the guidance would be applicable to them, having regard to their own circumstances.

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

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## Foreword

Good corporate governance is about maximizing performance with accountability to shareholders. Listed companies have a greater duty as they have a diverse and large base of shareholders. It is in the self-interest of companies to institute good corporate governance. This will attract and retain the loyalties of investors in good times and bad, which in turn will lower the cost of capital. High corporate governance standards also uphold the integrity of the market and investor confidence. Accordingly, MAS, ACRA and SGX are strongly committed to maintaining and strengthening standards and practices of corporate governance of all listed companies in Singapore.

Audit committees play an important role in the governance and oversight of companies. They are central to establishing good internal controls and, as appropriate, risk management systems as well as delivering quality financial reporting and instituting strong processes for the proper review of interested person transactions. The growing complexities of the business environment impose even greater demands on audit committees. This guidebook provides timely assistance for audit committee members.

The Audit Committee Guidance Committee (ACGC) has contributed considerable time and effort to develop this *Guidebook for Audit Committee's in Singapore*. The guidebook identifies the audit committees' key regulatory responsibilities and addresses practical issues of concern to audit committee members. Drawing on the knowledge and experiences of ACGC members, this comprehensive guide covers a broad spectrum of issues and provides audit committee members with practical guidance on dealing with the many complex situations which they are likely to face. It acknowledges that actual practices would have to be tailored to the unique characteristics of companies, such as the differences in size, complexity and circumstance.

The guidebook is a culmination of months of hard work by the ACGC. Research was conducted and inputs of stakeholder groups were sought in its formulation. We would like to thank all members of the ACGC for their dedication in contributing to this initiative, and commend their commitment towards raising the standards of corporate governance in Singapore. In particular, we would like to thank Mr Bobby Chin for his outstanding leadership in chairing the ACGC. The guidebook was developed with significant contributions from many industry participants. We are also encouraged by the support from the wider business community and stakeholder groups in the various dialogue sessions and focus groups conducted by the ACGC.

How well the best practices are applied depends not only on audit committees, but also the support they receive from the parties they interact with to achieve effective corporate governance oversight. We hope that all stakeholders, from the board of directors and management of companies, to internal and external auditors, will find the best practices in the guidebook helpful in discharging their responsibilities in line with the spirit of the law.

This guidebook is a further step to encourage and help companies address practical issues in instilling and maintaining good corporate governance. We look forward to more of such industry-led initiatives in the future and wish to congratulate the ACGC for their excellent work.

TEO MING KIAN  
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**Accounting and Corporate  
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*Managing Director,*  
**Monetary Authority of  
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*Chairman,*  
**Singapore Exchange Limited**

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## Chairman's Message

The Audit Committee Guidance Committee (ACGC) was established by the Monetary Authority of Singapore (MAS), the Accounting and Corporate Regulatory Authority (ACRA), and the Singapore Exchange Ltd (SGX) in January 2008. The ACGC comprises AC members from the business community and representatives from various stakeholder groups. The ACGC was tasked to develop practical guidance to assist ACs in better appreciating their responsibilities, enhancing their effectiveness and helping them perform their role better.

This guidebook was developed with inputs from, and in consultation with, industry. The ACGC conducted dialogue sessions with various stakeholder groups to identify key areas where guidance for ACs was needed. This was supplemented with a survey of AC members on the practical difficulties and challenges ACs face in discharging their duties, as well as the areas in which they would welcome practical guidance. Finally, three focus-group discussions were held with members of the stakeholder groups and selected respondents from the survey to seek feedback on the draft guidebook.

This guidebook sets out guidance, case studies and best practices taken from industry, the ACGC members' own experiences and those obtained from a focus group-based feedback process. Reference has also been made to the best practices from other jurisdictions as well as guidance and publications from various professional organisations.

In developing this guidebook, the ACGC adopted a 'sharing approach' with the objective of sharing experiences, knowledge and practices. This guidebook is neither intended to be exhaustive nor prescriptive. ACs are encouraged to adapt the guidance and practices to their particular circumstances as they consider appropriate.

It has been heartening to see the level of support and interest in the work of the ACGC. It shows that AC members are keen to do their part in raising corporate governance standards, not just in their companies but also in the wider business community in Singapore.

Ultimately, AC members have to set the right tone. This requires AC members to maintain an independent state of mind and to observe the spirit of the relevant laws, regulations and rules.

Many parties have contributed tremendous time and effort to the development of this guidebook. I would like to acknowledge the contributions of all the ACGC members and the Secretariat staff including staff seconded from KPMG, Ernst & Young and the SGX. I would also like to express my thanks to the SMU School of Accounting for conducting the survey and to the MAS, ACRA and SGX for their support and advice. Finally, on behalf of the ACGC, I would like to thank the various stakeholder groups, all the participants of the dialogue and focus group discussions, and the respondents of the survey.

I hope AC members as well as Board members will find this guidebook useful.

Bobby Chin  
*Chairman, Audit Committee Guidance Committee*

## Acknowledgements

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Institute of Certified Public Accountants of Singapore  
Law Society of Singapore  
Singapore Business Federation  
Singapore Institute of Directors  
Singapore Association of the Institute of Chartered Secretaries and Administrators

## How to use this guidebook

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

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

The guidebook has two main sections:

### 1 AC Composition section

The 'AC Composition' section aims to provide guidance for current and prospective AC members to assess their independence and suitability for membership in the AC. The section opens with an extract of key regulatory requirements and guidelines relevant to ACs for easy reference. However, as these are extracts and are not meant to be exhaustive, AC members are advised to refer to the relevant sections in the Companies Act, SGX-ST Listing Manual and the Code as appropriate.

The guidance in this section aims to get the AC started off on the right footing, with Directors who have the appropriate qualities to handle the job and the time and resources to focus on their responsibilities and duties as AC members.

### 2 Roles and Responsibilities of ACs

The 'Roles and Responsibilities of ACs' section is divided further into sub-sections, each focusing on the key roles and responsibilities of the AC. As with the AC Composition section, each sub-section opens with an extract of relevant regulatory requirements and guidelines for ACs with respect to that particular topic. The best practices that follow attempt to clarify areas in which ACs often face uncertainty, as well as provide practical solutions and guidance to issues ACs commonly face.

It is important to emphasise that some of the issues and guidance provided may need further professional advice. Accordingly, you are encouraged to obtain the necessary professional advice as you consider appropriate.

### References

The regulatory requirements and guidelines referred to in this guidebook can be accessed via the following websites:

- The Companies Act (Chapter 50) can be accessed via this link:  
<http://agcvldb4.agc.gov.sg/>
- The Listing Manual of the SGX-ST can be accessed via this link:  
[http://info.sgx.com/SGXRuleb.nsf/VwCPForm\\_Listing\\_Manual?Openview&sidenav=issuers](http://info.sgx.com/SGXRuleb.nsf/VwCPForm_Listing_Manual?Openview&sidenav=issuers)

- The Code of Corporate Governance can be accessed via this link:  
[http://www.mas.gov.sg/fin\\_development/corporate\\_governance/code\\_of\\_corporate\\_governance.html](http://www.mas.gov.sg/fin_development/corporate_governance/code_of_corporate_governance.html)
- The Financial Reporting Standards can be accessed from the Accounting Standards Council website via this link:  
<http://www.asc.gov.sg/frs/index.htm>

## Table of abbreviations

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

Abbreviations	Description
AC or Committee	Audit Committee
Board	Board of Directors
CA or Companies Act	Companies Act (Chapter 50)
CEO	Chief Executive Officer
CFO	Chief Financial Officer
FAQ	Frequently Asked Question
FRS	Financial Reporting Standards
IA	Internal Audit
IPT	Interested Person Transaction
KPI	Key Performance Indicator
Listing Manual	Listing Manual of the SGX-ST
Listing Rule	SGX-ST Listing Rule
RPT	Related Party Transaction
SGX	Singapore Exchange Limited
SGX-ST	Singapore Exchange Securities Trading Limited
The Code	Singapore Code of Corporate Governance

# AC COMPOSITION



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- 1.1.2 **CA Section 201B(3):** The members of an AC shall elect a Chairman from among their number who is not an Executive Director or employee of the company or any related corporation.
- 1.1.3 **CA Section 201B(4):** If a member of the AC resigns, dies or for any other reason ceases to be a member with the result that the number of members is reduced below 3, the Board of Directors shall, within 3 months of that event, appoint such number of new members as may be required to make up the minimum number of 3 members.
- 1.1.4 **The Code Guideline 2.1:** There should be a strong and independent element on the Board, with Independent Directors making up at least one-third of the Board. An "independent" Director is one who has no relationship with the company, its related companies or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of the Director's independent business judgement with a view to the best interests of the company. Examples of such relationships, which would deem a Director not to be independent, include:
  - (a) A Director being employed by the company or any of its related companies for the current or any of the past three financial years;
  - (b) A Director who has an immediate family member who is, or has been in any of the past three financial years, employed by the company or any of its related companies as a senior Executive Officer whose remuneration is determined by the Remuneration Committee;
  - (c) A Director, or an immediate family member, accepting any compensation from the company or any of its subsidiaries other than compensation for Board service for the current or immediate past financial year; or
  - (d) A Director, or an immediate family member, being a substantial shareholder of or a partner in (with 5% or more stake), or an Executive Officer of, or a Director of any for-profit business organisation to which the company or any of its subsidiaries made, or from which the company or any of its subsidiaries received, significant payments in the current or immediate past financial year. As a guide, payments aggregated over any financial year in excess of S\$200,000 should generally be deemed significant.
- 1.1.5 **The Code Guideline 2.2:** The relationships set out above are not intended to be exhaustive, and are examples of situations which would deem a Director to be not independent. If the company wishes, in spite of the existence of one or more of these relationships, to consider the Director as independent, it should disclose in full the nature of the Director's relationship and bear responsibility for explaining why he should be considered independent.
- 1.1.6 **The Code Principle 11:** The Board should establish an AC with written terms of reference which clearly set out its authority and duties.
- 1.1.7 **The Code Guideline 11.1:** The AC should comprise at least three Directors, all non-executive, the majority of whom, including the Chairman, should be independent.
- 1.1.8 **The Code Guideline 11.2:** The Board should ensure that the members of the AC are appropriately qualified to discharge their responsibilities. At least two members should have accounting or related financial management expertise or experience, as the Board interprets such qualification in its business judgement.

## 1.2 Best Practices:

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

### Independence and Objectivity

- 1.2.1 An AC is required to have a minimum of 3 members, although it is common for an AC to comprise more than 3 members, depending on the scope and complexity of its work.

#### FAQ 1

##### **Q: Can the CEO (also a Director) be a member of the AC?**

A: The Companies Act does not prohibit the CEO from being a member of the AC.

However, the Code recommends that the AC comprises only Non-Executive Directors. Therefore, the CEO, being an Executive Director, should not be a member of the AC. The presence of the CEO as a member, may compromise the Committee's objectivity and ability (real or perceived) to exercise independent judgement.

In most companies, the CEO or Managing Director and the CFO would be invited to attend AC meetings to provide Management input as required by the Committee.

### Case Study 1

**This case study illustrates the factors AC members could consider in determining their independence:**

An AC comprises the following 3 members:

- Member A is an employee of a related company of a major shareholder
- Member B is a Director of a company that is a subsidiary of the major shareholder
- Member C is the partner of a professional services firm that currently provides services to the company

#### **Q: What factors could the AC members consider in determining if they are independent?**

Guideline 2.1 of the Code sets out examples of relationships which would deem a Director not to be independent. While the Code has set out these guidelines, the Board and AC members may wish to consider some other factors in evaluating their independence. These include:

- The nature of the employment position and seniority of Member A, the reporting lines that he has as an employee and the extent of his employment duties to the major shareholder, e.g. whether he would be accustomed to act according to the wishes and direction of the major shareholder
- Whether Member B is an independent or non-independent Director of the subsidiary of the major shareholder
- Whether Member C's firm is financially dependent on the fees paid by the company. Generally, this may not be an issue unless the fees received by the member are significant

In determining whether a shareholder is a major shareholder, the size and stake of the shareholder, relative to other shareholders, and the extent of the shareholder's direct or indirect influence on the company's decision-making process should be considered.

In practice, many companies obtain annual confirmations of independence from their Directors. **Appendix A1** provides a sample confirmation of independence form that a Director is usually required to complete upon his appointment and on an annual basis. This sample has been prepared based on Guideline 2.1 of the Code which provides examples of relationships which could deem a Director not to be independent. These relationships are not intended to be exhaustive.

**1.2.2** The consideration of independence is often a matter of substance rather than of strict compliance with specific rules. The individual Director would be in the best position to determine his independence having regard to his circumstances and relationships with the company and related parties. Below are some additional factors Directors could consider when confirming their independence:

- **Shareholding interest:** A shareholding interest in the company beyond a certain limit. This shareholding interest should include share options and other convertible securities, as well as, all shareholdings held by the Director's immediate family members

- **Gift or financial assistance:** The receipt of shares or other securities in the company by way of a gift or financial assistance from the company or its major shareholders for the purchase of shares/securities in the company other than pursuant to an approved scheme
- **Past association:** Past association with a professional adviser as a Director, partner, principal or employee who has, in the immediate past, before the Director's appointment, provided professional services of a significant or material nature or scope to the listed company (and related parties where the listed company has close business or operational interactions with such related parties). An intervening period of one year is sometimes applied for this assessment. Whether such a period is appropriate depends on the circumstances, which the AC member is in the best position to judge
- **Business dealings:** Material business dealings or involvement with the company or its related parties in the recent past
- **Representative of shareholder:** A representative of a shareholder appointed specifically to represent or protect the interest of that shareholder whose interests are not the same as those of the shareholders as a whole
- **Financial dependence:** Financial dependence on the listed issuer or its related parties, e.g. if a Director has no other major sources of income and is financially dependent on the fees, he would need to carefully consider whether he can indeed exercise the independent judgement required of him

1.2.3 The factors set out in 1.2.2 are not intended to be exhaustive. The Nominating Committee would still need to conduct its own assessment of the individual's independence. Correspondingly, the prospective Director should be diligent in disclosing relationships significant to the company or himself that might potentially compromise his independence (real or perceived), that of the AC or the Board.

### Qualification for membership

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

- **The ability to read and understand financial statements**, including a company's balance sheet, income statement and cash flow statement
- **The ability to understand and assess the general application** of local or other generally accepted accounting principles
- **The ability to ask pertinent questions** about the company's financial reporting process
- **The ability to effectively challenge Management's assertions** on financials and Management's responses when appropriate
- **The ability to understand internal controls and risk factors** relevant to the company's operations, including those relating to complex financial instruments that are in use
- **Experience gained through executive responsibility** for a sizeable business including having or having had responsibility for the finance function, such as being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities
- **Education or professional qualifications** relating substantially to accounting or finance

- **Experience in working** within the areas of corporate finance, financial reporting or accounting
- 1.2.5 AC members should have complementary knowledge and experience in financial matters as well as an understanding and appreciation of the company's business. Each AC member should generally seek to understand:
- **The company's major economic, operating, and financial risks**
  - **The company's financial reporting process**
  - **The business operations** of the company
  - **The social, political, ethical, economic and legal framework** within which the company operates
  - **The difference between the oversight function** of the AC and the decision-making function of Management
- 1.2.6 The combination of skills within the AC should reflect broad experience and knowledge relevant in assisting the AC in discharging its responsibilities as set out in its Terms of Reference.
- 1.2.7 Members should be given the opportunity to attend technical and professional development courses to keep abreast of legislative, accounting and other relevant issues. *For additional guidance on AC training, please refer to the section on Training.*
- 1.2.8 The AC should have the authority to retain external legal counsel, accounting or other advisers, when it considers necessary, without the prior permission of the Board or Management. The AC should be provided the necessary resources to support its work.

### **Selection of Audit Committee Chairman**

- 1.2.9 The Chairman is pivotal in ensuring the overall effectiveness of the AC and the efficient planning and conduct of meetings. The Companies Act requires the AC Chairman to be independent, with no involvement in any executive functions in the company or its related companies. Although there are no restrictions, in practice, a Non-Executive Chairman of the Board would not normally assume the role of AC Chairman.
- 1.2.10 The Chairman should have significant financial management related experience, and should be sufficiently knowledgeable about the entity's business and its financial reporting and auditing requirements.
- 1.2.11 The tenure of appointment of the Chairman's office should be determined by the Board.

## Terms of Reference

### FAQ 2

**Q: Can the Board delegate duties to the AC, in addition to its statutory responsibilities? To what extent can the AC accept such responsibilities?**

A: Where necessary and appropriate, the Board can delegate duties to the AC in addition to its statutory responsibilities. The AC should only accept these duties to the extent members have the necessary time and skills to discharge them. The Terms of Reference for the AC which spell out all its responsibilities should be updated accordingly.

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

- **Roles and responsibilities** of the Committee, Chairman and the Committee Secretary
- **Authority for the AC to seek independent professional advice**, at the company's expense
- **Provision of direct access** to anyone in the organisation to conduct any investigation to fulfill AC responsibilities
- **Non-Executive role of the AC** which does not include making business or commercial decisions on behalf of Management (these rest with the Board of Directors)
- **Role of the AC to arbitrate** between Management, external auditors and internal auditors
- **Responsibility in fraud prevention and detection**

1.2.13 **Appendix A2** provides a sample of an AC Terms of Reference.

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

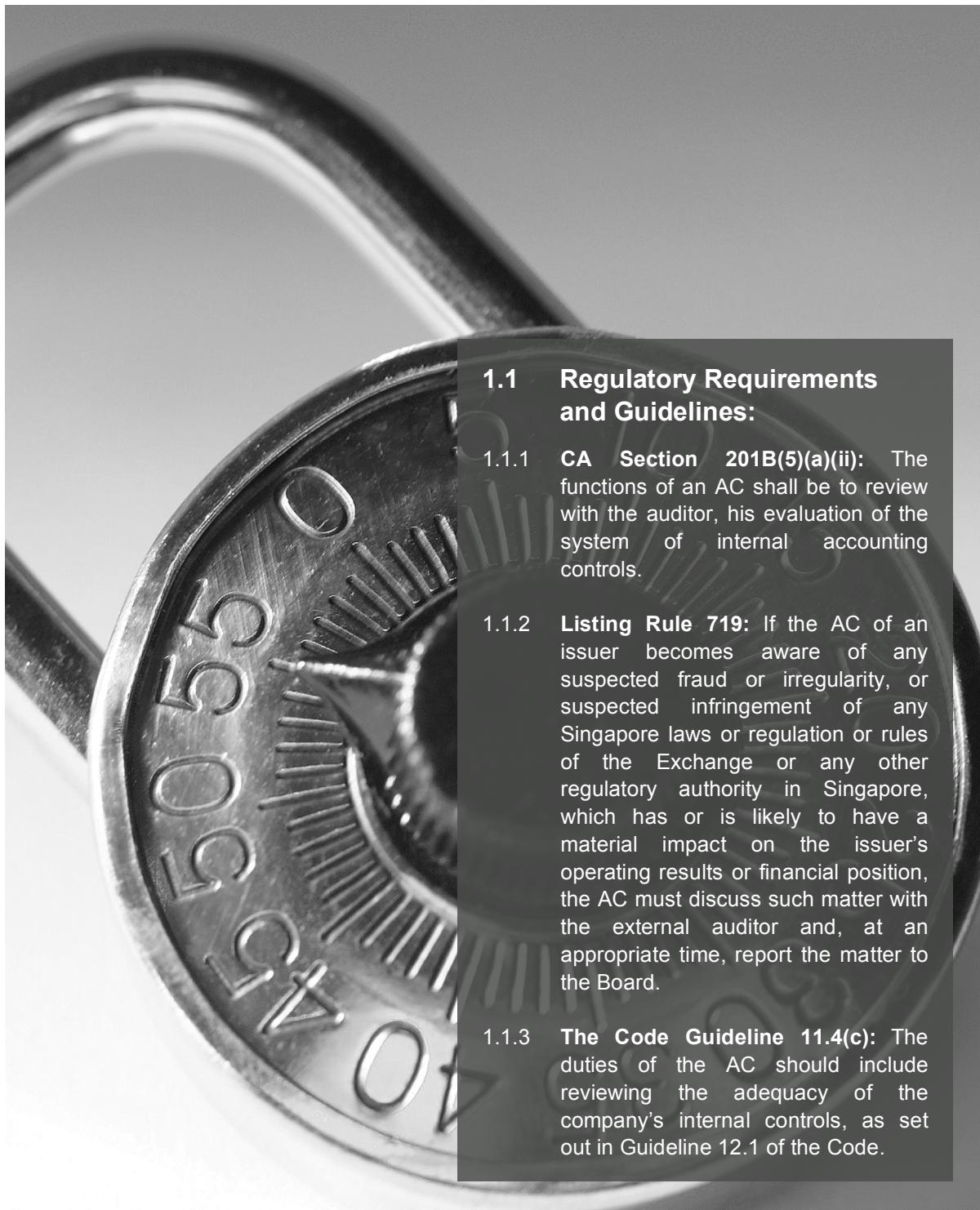
### Tenure of the AC

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

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

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# SECTION I: INTERNAL CONTROLS



## 1.1 Regulatory Requirements and Guidelines:

- 1.1.1 **CA Section 201B(5)(a)(ii):** The functions of an AC shall be to review with the auditor, his evaluation of the system of internal accounting controls.
- 1.1.2 **Listing Rule 719:** If the AC of an issuer becomes aware of any suspected fraud or irregularity, or suspected infringement of any Singapore laws or regulation or rules of the Exchange or any other regulatory authority in Singapore, which has or is likely to have a material impact on the issuer's operating results or financial position, the AC must discuss such matter with the external auditor and, at an appropriate time, report the matter to the Board.
- 1.1.3 **The Code Guideline 11.4(c):** The duties of the AC should include reviewing the adequacy of the company's internal controls, as set out in Guideline 12.1 of the Code.

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- 1.1.4 **The Code Guideline 12.1:** The AC should review the adequacy of the company's internal financial controls, operational and compliance controls, and risk management policies and systems established by the Management (collectively "internal controls"). The AC should ensure that a review of the effectiveness of the company's internal controls is conducted at least annually. Such review can be carried out by the internal and/or public accountants, provided that where the public accountant is also the external auditor of the company, the AC should satisfy itself that the independence of the public accountant is not compromised by any other material relationship with the company.

## 1.2 Best Practices:

### The AC's scope of responsibility for internal controls

1.2.1 Management is responsible for designing and implementing internal controls. Internal controls can help safeguard the business by ensuring that:

- **Approval processes are in place** such that assets are used and liabilities are incurred for legitimate purposes which further business objectives
- **Transactions are fully recorded** to allow the preparation of true and fair financial statements
- **The company complies** with the relevant laws and regulations

The AC has an obligation under the Companies Act to review the external auditor's evaluation of internal accounting controls. The Code recommends that the AC extends its oversight to operational and compliance controls and to risk management policies and systems established by Management. This set of controls is collectively referred to as 'internal controls'.

1.2.2 In assessing the design and operating effectiveness of internal controls, the AC should establish whether these objectives have been addressed:

- **Assets are safeguarded**, and this refers to the risk of assets being misappropriated or diverted for use by other parties, misused or otherwise squandered, rather than the risk of physical damage or the business operating at a loss
- **Fraud or errors in the accounting records** are prevented or detected
- **Accuracy and completeness** of accounting records are ensured
- **Reliable financial information** prepared in a timely manner
- **Compliance** with applicable internal policies, laws and regulations relating to the financial reporting process

1.2.3 The AC should highlight to the Board any serious concerns felt over the design or operating effectiveness of internal controls that could have a material impact on the financial statements.

1.2.4 The flow of information between the Board and its committees should be as seamless as possible. As such, it is good practice for the AC to circulate its meeting minutes to the Board on a timely basis for the Board's information.

### The AC's oversight of the system of internal controls

1.2.5 The AC should seek assurance on the design and operating effectiveness of internal controls through feedback from various parties. These parties include Management, internal auditors, external auditors and any other external consultants.

***Obtain Management's assurance on the state of internal controls***

- 1.2.6 To enhance accountability, the AC could arrange for the CEO and the CFO to sign an undertaking confirming their awareness and respective responsibilities for internal controls, that they have designed internal controls that are appropriate for the business and that these internal controls are operating effectively. In addition, the AC could discuss with Management significant deficiencies in the design or operation of internal controls and changes in internal control systems. Depending on the complexity of the business, some ACs extend this discipline to other selected management executives of the Group.
- 1.2.7 The undertaking could confirm that, to the best of the CEO's and CFO's knowledge, nothing has come to their attention which may render their declarations to be false or misleading. These declarations could confirm that the CEO and CFO<sup>1</sup>:
- **Are responsible for establishing and maintaining internal controls**
  - **Have designed such internal controls** to ensure that material information relating to the company, its consolidated subsidiaries and equity-accounted associates is made known on a timely basis to the CEO and CFO by others within those entities, particularly for the purpose of preparing financial reports
  - **Have evaluated the effectiveness** of the company's internal controls and reported to the AC based on an up-to-date evaluation of the controls
  - **Have disclosed to the company's auditors and the AC** (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the company's ability to record, process, summarise, or report financial data and (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the company's internal controls; and
  - **Have indicated in their report** whether or not there are significant changes in internal controls or other factors that could significantly affect internal controls to the date of evaluation, including any corrective action with regard to significant deficiencies and material weaknesses
- 1.2.8 Where Management has carried out internal control self assessment exercises, to validate the design and/or operating effectiveness of internal controls, the AC could request that Management report on the nature of the self assessment procedures performed, as well as the results of such self assessments, at least once a year.
- 1.2.9 Should there be significant control weaknesses identified in the internal control self assessment exercise, the AC could request Management to explain the impact and the actions taken to rectify them. Such discussions should be documented in the AC meeting minutes.
- 1.2.10 To assess the reliability of the internal control self assessment results, the AC could engage internal auditors or an external adviser to conduct an independent review of a sample of the self assessment responses. The independent reviewer's findings would provide the AC with an understanding of Management's attitude towards risk and control issues.

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### **FAQ 3**

**Q: Other than relying on Management's representations on the state of controls, what other ways could the AC assess the adequacy of internal controls?**

A: To confirm Management's assertions, the AC could engage internal auditors or a public accountant to conduct an independent assessment of the internal controls. The AC could also obtain feedback from the external auditors on their observations of control weaknesses arising from their statutory financial audits.

In reviewing the internal and external auditors' findings, the AC could satisfy itself that their work meets the needs of the AC. The AC could do so by questioning the basis and depth of the auditors' analysis, particularly in relation to control deficiencies, residual risks and uncertainties identified as well as, observations regarding the company's control environment and observed changes in internal controls during the period.

- 1.2.11 **Appendix B1** sets out a list of high-level questions that the AC can pose to Management to obtain a better understanding of the internal controls.

#### ***Review of internal auditors' evaluation of internal controls***

- 1.2.12 The AC is responsible for directing the IA function. Balancing other matters, this requires that the AC decides on the extent of IA resources required and approves the scope of work proposed by the internal auditors. The AC could require the internal auditors to benchmark their evaluation of internal controls against an internationally recognised framework, such as the Committee of Sponsoring Organizations of the Treadway Commission. This benchmark may help identify and address major risk and control issues.
- 1.2.13 Where the company has complex operations or systems and specialised skills are not available within the IA team, the expertise of the IA team could be augmented by the addition of external specialists (e.g. forensic and information technology specialists). These specialists could be engaged on a project or retainer basis.
- 1.2.14 Should there be significant control weaknesses identified in the IA reports, the AC should take additional steps to understand the root cause of each weakness. The AC could request Management officials directly involved to explain the underlying causes and ask senior Management to report on the actions planned to rectify them.
- 1.2.15 The AC should also request the internal auditors to confirm, on an on-going basis, the implementation of actions agreed by Management in response to previous reports by the internal auditors, the external auditors or the regulators. Their reporting on these remedial actions should be presented at each AC meeting.
- 1.2.16 At each AC meeting or upon request by the internal auditors, the AC should have a private discussion with the internal auditors, without the presence of Management to discuss any sensitive issues arising from the internal auditors' work.

1.2.17 Generally, the AC should consider the following when reviewing the internal auditor's reports<sup>2</sup>:

- **What the significant risks are and how these risks are identified, evaluated and managed**
- **Effectiveness of the related system of internal controls** in managing the significant risks. Particular attention should be paid to any significant failings or weaknesses in internal controls which have been reported
- **Whether Management has taken the necessary actions** promptly to remedy any significant failings or weaknesses
- **Whether the findings indicate a need for more extensive** study and monitoring of the system of internal controls

#### ***Review of internal control issues raised by external auditors***

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

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

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

The AC plays an important role in ensuring that the Board and Management put in place an appropriate culture promoting ethical behaviour.

#### **FAQ 4**

##### **Q: How does the AC assess the control environment of a company?**

A: The AC could engage internal auditors, or a public accountant, to assess the 'tone-at-the-top' in relation to the control environment and the extent of compliance with the company's code of ethics.

The internal auditors or a public accountant could also be asked to assess the awareness of the company's policies and code of ethics among Management and staff, and also their responses to ethical issues.

<sup>2</sup> The UK Turnbull Report of 1999 *Internal Control: Guidance for Directors on the Combined Code*, paragraph 31.

**1.2.20** In assessing the control environment, the AC could consider these factors <sup>3</sup>:

- Integrity, ethical values and behaviour of key executives
- Management's control consciousness and operating style
- Management's commitment to competence
- Board and/or AC participation in governance and oversight
- Organisational structure, assignment of authority and responsibility
- Human resource policies and procedures

**Appendix B2** provides further guidance on the matters that the AC could look out for in each of the factors listed above.

### **Case Study 2**

**This case study illustrates the approach an AC could take to oversee a company's weak control environment and internal controls system:**

A company reported the loss of several million dollars in unauthorised swap trades that were carried out by a trader over the past two years. The trades were not known to the AC and the losses were not recorded during the past two years.

Investigations by external forensic and treasury specialists revealed the following:

- **Weak control environment**
  - Previous limit breaches by the trader were detected by management but not escalated to the Board due to the profits being made from the unauthorised trades
  - The policy for mandatory annual leave for traders was not strictly enforced due to operational constraints
  - There was high staff turnover at the Middle Office. As a result,
    - Not all alerts of limit breaches were followed up by Middle Office
    - Existing risk personnel were not sufficiently experienced to spot attention-diverting techniques used by the traders
- **Gaps in internal controls**
  - The risk management system tracked net positions, allowing losses to be offset against fictitious hedge trades.
  - The fictitious hedge trades were supported by forged counterparty confirmations and had these characteristics:
    - Counterparties were related parties of the company
    - Margin calls were not required
    - Names of counterparties were omitted from the trades and marked as 'pending'
    - Advance purchases and sales of shares or warrants could not be confirmed until a few days before the valid date

<sup>3</sup> Ernst & Young LLP, Audit Committee Member Toolkit, *Consideration of Internal Control at the Entity Level*, United States

- Trades were cancelled before confirmation was due and replaced with new fictitious trades
- Trades were executed on over-the-counter contracts which were not settled on a daily basis
- The trader's Middle Office access rights to risk and control systems were not removed after his transfer to front office, enabling him to manipulate risk and position reports
- There was a lack of password discipline where passwords were shared, written, easily guessed or embedded within software applications and spreadsheets

**Q: How could the AC have exercised its oversight on the control environment?**

The AC could have assessed whether the right 'tone-at-the-top' had been set such that policy breaches and control lapses were taken seriously.

In assessing the control environment, the AC could have sought feedback from external and internal auditors on Management's attitude towards control issues, as well as regulatory and corporate compliances.

For high-risk activities such as market trading, the AC could have engaged internal auditors to conduct regular audits on the adequacy of control design and effectiveness. The audits could have focused on:

- **Trend analysis** of exceptions or unusual behaviour by trading staff
- **Security of computer systems and access codes**
- **Monitoring of activities** of individual traders, their positions and alterations to their deals
- **Following up on status** of alerts received and anomalies of material sums
- **Limit breaches** even if the positions yield profit
- **Confirmation of operations** with all counterparties
- **Trading staff who did not take the mandatory holiday breaks** or who allowed other traders to monitor their portfolios when they took time off
- **Red flags of fraud risk** identified and monitored such as:
  - A trade with maturity that falls on a Saturday
  - Bets without identified counterparties ("pending" trades)
  - Trades with counterparties with no margin calls required
  - Trades that exceed authorised limits with counterparties
  - Missing broker names and large increases in broker fees
  - Sizeable margin calls disproportionate to authorised volume limit
  - Hedge trades through sale of over-the-counter contracts (i.e. non exchange-traded contracts) that are not settled on a daily basis

The AC could have requested Management to present periodic reports in these areas:

- **Gross exposure limit per trader and total per company**
- **Findings from investigations following alarms from stock exchange**
- **Breach of trading threshold even if the positions yield profit**
- **Non-compliance with company policies**

- 1.2.21 To assess whether top Management sets the right tone that supports risk-conscious attitudes, the AC could consider whether these concerns exist<sup>4</sup>:
- **The Board thinks that risk management is ‘not its problem’**
  - **The company is focused only on internal financial controls** rather than the wider scope of internal control
  - **Reviewing internal controls is regarded only as a regulatory exercise** for the purpose of making a public statement, rather than embedded as part of the business
  - **Risk management is seen as a narrow area of the business** where responsibility is delegated to a specified function, e.g. internal auditors or insurance
  - **The company has not identified any key risks**
  - **Employees have no training or experience** in risk management
- 1.2.22 The AC could engage the internal auditors or a public accountant to assess the effectiveness of and compliance with the company's code of ethics. The internal auditors or public accountants should report their findings directly to the AC. Management should report to the AC on the actions proposed to address any internal control weaknesses reported.
- 1.2.23 Regular meetings with key Management, internal and external auditors and the company's compliance staff can also facilitate the AC's understanding of the company's control environment.

### **The AC's responsibilities in dealing with specific risks**

#### **Fraud**

##### Framework for Fraud Prevention and Detection

- 1.2.24 The Board and Management are collectively responsible for the prevention and detection of fraud and errors in financial reporting. They need to set the right tone, create and maintain a culture of integrity complemented by sound ethics, and establish appropriate controls to prevent and detect fraud or errors in financial reporting. **Appendix B3** provides an example of a policy statement on fraud.
- 1.2.25 The AC should review the existing internal controls implemented by Management so that anti-fraud programmes are adequately established within the company. This provides the Board with reasonable assurance that frameworks are in place to identify fraud risks. It may include a whistleblowing policy and procedures for escalating suspicious transactions or behaviour to the Board and Management. *For further guidance on whistleblowing, please refer to the section on Whistleblowing.*

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<sup>4</sup> Hong Kong Institute of Certified Public Accountants, June 2005, ‘Chapter C: Responsibilities for Internal Control and Risk Management, and the Process of Review’, *Internal Control and Risk Management – A Basic Framework*, Section 2.0 ‘Board Policies’, paragraph 2.5 pg 21.

### Case Studies 3

#### A) This case study illustrates how an AC could raise to Management its concerns regarding the company's customers:

The company's sales increased three-fold compared to the previous quarter, mainly attributable to three new customers. Two of the customers are registered in tax havens. The remaining customer is a local-based retailer.

#### Q: What could the AC enquire into?

The AC could consider whether there are other indicators that may point to strong motivation on the part of Management to inflate sales. The AC could discuss these questions with Management:

- What are the reasons for the sudden and significant increase in sales volume to the new customers?
- Who are the new customers' major shareholders and key people within Management?
- What other relationships do these customers have with the company?
- Do these customers have special settlement terms, and are the sales being paid for promptly in cash?
- Are the credit limits to these customers consistent with those granted to other similar customers?
- Did the cash inflow match the amount payable from these customers?

For companies incorporated in tax havens where statutory audits are not required, the AC can ask Management how the company has satisfied itself on the background of these companies, their shareholders and their management.

#### B) This case study illustrates examples of when fraud could occur and the steps the AC could take to address these scenarios:

A 70% held subsidiary has been profitable, until this financial year when it reported losses in two consecutive quarters and is expected to turn in a significant loss for the entire year. Three days before the announcement for the first half-year results, Management is seeking approval to sign a sale agreement for the reduction in the stake to 15%, backdated to the beginning of the year. Management has explained that the sale is consistent with the company's redesignation of this business as non-core and that the sale had been agreed in principle since the beginning of the year but the actual signing has been delayed by regulatory considerations.

#### Q: What concerns should the AC have and what could the AC do about them?

Major transactions, whether routine sales in the ordinary course of business or non-routine transactions, which are timed just before a year-end or other critical date are often part of a window-dressing exercise or a larger fraudulent attempt to manipulate financial statements.

Back-dating of transactions also has the effect of falsifying financial statements, and in some cases could be illegal. The AC could consider whether it should accept Management's explanations at face value, or whether it needs to consider whether the explanations might conceal Management's intentions. If the AC does not fully accept Management's explanations, it could consider whether it is appropriate to consult with the Chairman of the Board. Further, it could seek advice from lawyers on the proposal to backdate the legal documentation, and from the external auditors on the accounting implications of the transaction. The AC will then have to make its own determination of the appropriate accounting to be applied and announcements to be made.

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

## **FAQ 5**

### **Q: What should the AC do if fraud is discovered?**

A: In accordance with the Listing Rule 719, the AC should discuss the facts of the case with the external auditors and seek legal advice. The AC should also escalate the issue to the Board at an appropriate time.

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

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

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

- **Internal control weakness**

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

- **Management override**

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

- **Override by the Controlling Shareholder, Executive Chairman or other Board members**

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

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

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

### Internal Auditor's Role in Fraud Prevention and Detection

- 1.2.27 The AC could engage the internal auditors to critically evaluate the framework designed by Management to identify and assess potential fraud risks and override of controls. In situations where there are specific concerns, the help of external forensic specialists may be required to supplement the work of the internal auditors. Management should report to the AC the actions developed to address weaknesses highlighted in the review. This exercise should be carried out at least once a year.
- 1.2.28 The AC could also consider whether there are any areas of particular fraud risk that require special attention or monitoring by the internal auditors. Examples of red flags and warning signals that the AC should be mindful of are listed respectively in **Appendix B4** and **Appendix B5**.
- 1.2.29 In evaluating the review performed by internal auditors in connection with potential fraud, the AC could consider the following questions:
- Do the audit procedures address fraud risks?
  - What are the fraud risks identified by the auditors?
  - What is the auditor's assessment of fraud based on their enquiries with Management?
  - How has the risk of Management override of internal controls been addressed in the audit procedures?
- 1.2.30 *For guidance on financial reporting fraud, please refer to the section on Financial Reporting and for more information on the AC's role in fraud investigations, please refer to the Whistleblowing section.*

#### Case Studies 4

##### A) This case study illustrates actions an AC could take if it notices unusual sales figures:

For the past two quarters, the company has reported an unusually high rate of sales returns in the month following the end of the quarter. The Board has not been informed of any factors that could explain this.

##### Q: What actions could the AC take?

The AC could consider whether such returns could indicate inflated sales being reported in earlier months. The AC could ask Management to explain the higher rate of returns and request for detailed information that identifies the customers who are returning goods, as well as the customers' ownership and Management. The AC could also ask for details of Management officials who initiated and approved the sales, as well as the sale returns. The internal auditors could be asked to examine the transactions in detail in a special unplanned audit project.

##### B) This case study illustrates what an AC can do in response to allegations against the CEO:

An anonymous letter had been received by the AC Chairman alleging that the CEO was awarding a contract to a company belonging to his son, providing details of the contract. The CEO was sent a copy of the letter. When approached by the AC Chairman, the CEO denied that the contract was being awarded to his son's company. The CEO produced a quotation and a purchase order from a regular supplier that the AC Chairman knows is unrelated to the CEO. All details from the quotation and the purchase order matched the details set out in the letter. The company proceeded to award the contract to the regular supplier. The AC Chairman left the matter to rest.

In a subsequent meeting with the external auditors as part of the planning for the audit, the AC Chairman related the incident to the external auditors. The audit partner said that he had known a similar situation where Management concealed an RPT. When challenged, contract documentation was arranged with an unrelated party. However, this was a sham contract that had never been exchanged. The real supply contract had proceeded with the related party. Payments made on the contract had then been settled using cash cheques sent to the related party.

##### Q: What could the AC do to confirm how the contract had been handled?

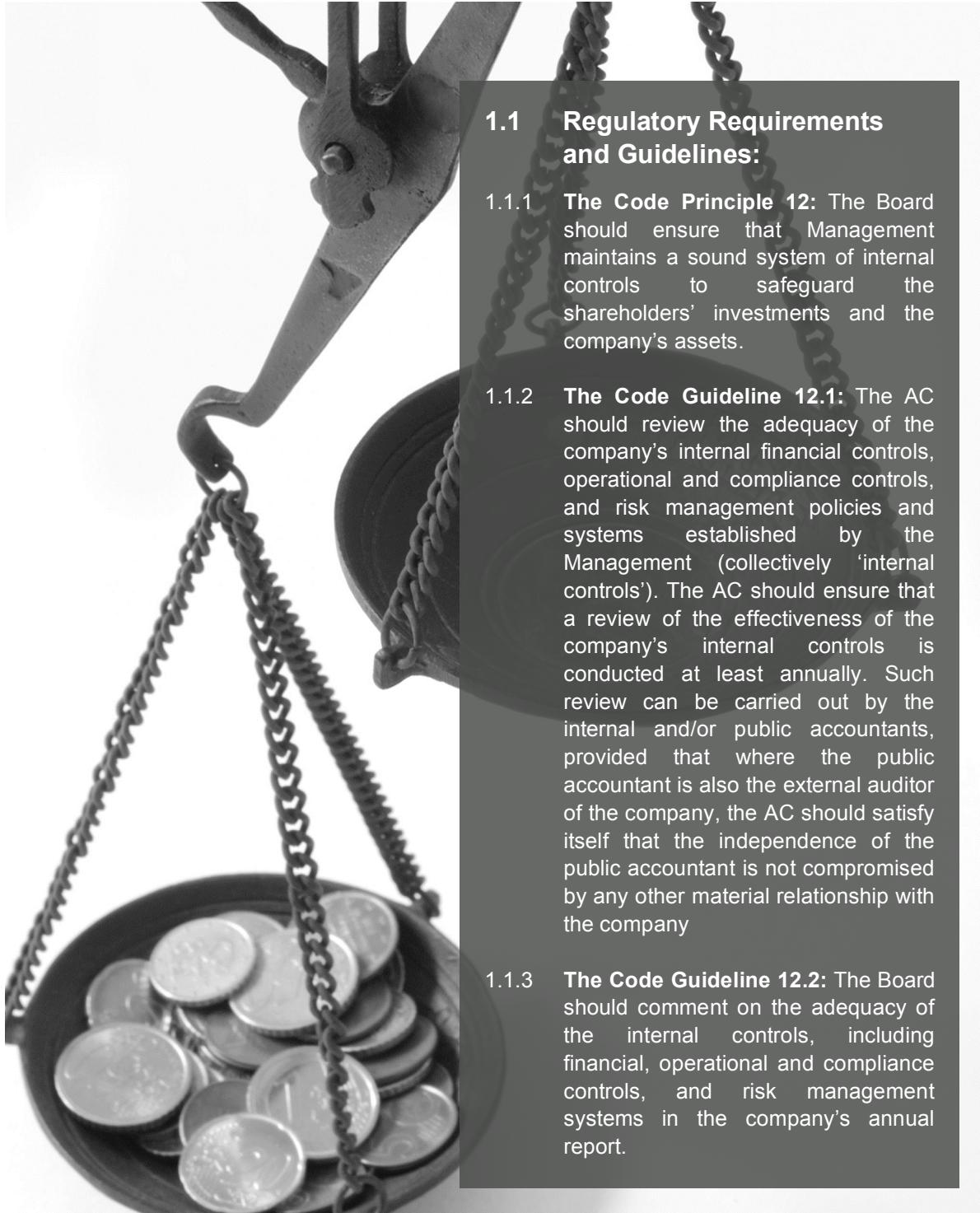
The AC could discuss its concerns further with the internal auditors, and direct them to investigate the details of the shipments of goods and the destination of payments made. The AC could evaluate whether external specialised expertise is required to uncover evidence in this instance, taking in account the possibility that Management may be concealing evidence and forging documents.

### **Information Technology (IT)**

- 1.2.31 The AC should request Management and internal auditors identify the critical IT systems and functions supporting the financial reporting process (where practical) and assess the adequacy of the controls in these systems. The internal auditors should audit these controls regularly and report the findings to the AC.
- 1.2.32 For companies whose key operations are reliant on sophisticated integrated systems, the AC should consider having a member who is knowledgeable about IT systems and controls or organise a panel of experienced persons to review the IT areas.
- 1.2.33 To evaluate the adequacy and effectiveness of the company's IT controls, the AC could require Management to either recruit an IT-trained internal auditor or outsource the IT system-related audits to third parties.
- 1.2.34 In addition to the regular IT audits, the AC could engage the internal auditors to conduct system development reviews and pre-implementation or post-implementation audits of new IT systems to ascertain whether the system controls as designed are adequate to address potential risk issues.
- 1.2.35 The AC could play an enabling role in IT governance by encouraging Management efforts in these areas:
  - **Update the Board periodically** with a basic overview of general IT control issues and key application control/ risk areas
  - **Focus IT governance reviews on** information quality and business implication of IT risks
  - **Provide regular updates** to the Board on key system development projects relating to risks arising from system design, testing, implementation delays, costs overrun, etc.
  - **Establish a checklist of IT risk indicators** for IT risk assessment. Some of these risk indicators include:
    - Extensive use of manual spreadsheets
    - Numerous standalone systems
    - Complex IT structure
    - Multiple locations in processing of information

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## SECTION II: RISK MANAGEMENT



**1.1 Regulatory Requirements and Guidelines:**

1.1.1 **The Code Principle 12:** The Board should ensure that Management maintains a sound system of internal controls to safeguard the shareholders' investments and the company's assets.

1.1.2 **The Code Guideline 12.1:** The AC should review the adequacy of the company's internal financial controls, operational and compliance controls, and risk management policies and systems established by the Management (collectively 'internal controls'). The AC should ensure that a review of the effectiveness of the company's internal controls is conducted at least annually. Such review can be carried out by the internal and/or public accountants, provided that where the public accountant is also the external auditor of the company, the AC should satisfy itself that the independence of the public accountant is not compromised by any other material relationship with the company

1.1.3 **The Code Guideline 12.2:** The Board should comment on the adequacy of the internal controls, including financial, operational and compliance controls, and risk management systems in the company's annual report.

## 1.2 Best Practices:

### The AC's scope of responsibility for risk management

#### FAQ 6

##### **Q: What is the AC's responsibility with regard to risk management?**

A: The Board is ultimately responsible for ensuring that Management establishes sound risk management policies and systems that safeguard shareholders' investment and the company's assets. Management is responsible for putting in place processes for identification, assessment, management, monitoring and reporting of risk and for providing assurance to the Board that it has done so.

To fulfill its oversight responsibility, the Board could adopt one of three models:

- **The AC reviews the adequacy** of the company's risk management processes (Recommended by the Code)
- **The AC works with separately constituted committees** (e.g. the Risk Committee) to review the adequacy of the company's risk management processes
- **The Board, as a whole, reviews the adequacy** of the company's risk management processes

The AC should make sure that its documented Terms of Reference is consistent with the agreed mandate with the Board.

### When the AC is responsible for oversight of risk management

#### *Appropriateness of Oversight Structure*

- 1.2.1 Where the Board has delegated the oversight responsibility to the AC, the AC needs to assess its ability to discharge this responsibility. The AC should take into consideration its size and composition, the scale, diversity and complexity of the company's operations and the nature of the significant risks that the company faces. Conversely, the composition of the AC and the way it operates should be dependent on the type of risks that the AC is responsible for overseeing. **Appendix C1** provides a list of possible types of risks faced by companies.
- 1.2.2 The AC should consider having at least one member who has relevant experience related to the oversight function for risk management. Collectively, the AC should have relevant experience with the company's industry and also be familiar with the company's business operations.

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

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

#### **Case Study 5**

**This case study illustrates how an AC may respond when being tasked to oversee a company's risk management process:**

The newly formed AC of a pharmaceutical research and development company is made up of three Independent Directors, all of whom have significant experience as Independent Directors. They hold directorships on several other listed boards but have limited experience or knowledge in the field of pharmaceutical research.

At the first Board meeting, the Chairman requested the AC oversee the company's overall risk management process. Although the AC members agreed to undertake this oversight responsibility, they were not confident that they could fully discharge this responsibility given their lack of detailed knowledge of the industry.

**The AC deliberated on the Chairman's request and decided to take these steps:**

- **Carry out a follow-up discussion** with the Chairman on their concern that they may not have the required industry knowledge to effectively oversee the overall risk management process
- **Review the composition of the AC** and consider whether new AC members with relevant experience could help the AC carry out the oversight responsibility
- **Identify relevant training programmes** that the AC members could attend to close the knowledge gap
- **Discuss with the Chairman** the possibility of the AC engaging external professionals to advise them
- **Review the need for a separate Risk Committee** to oversee the management of non-financial risks and make recommendations to the Board

#### ***Assessment of the Risk Management Framework***

1.2.4 In assessing the robustness of the risk management framework, the AC should target its activities to achieve these objectives:

- **Provide direction for the adequate allocation of resources** (such as manpower and capital) for risk management processes
- **Build consensus among the Board members and Management** on acceptable risk levels (in terms of risk likelihood and its impact) and monitor current risk levels
- **Assess whether the risk management framework** is appropriate and adequate. The framework should address these elements or processes, which should be defined:
  - Risk identification
  - Risk assessment/measurement
  - Risk monitoring
  - Risk reporting structure
  - Risk capacity and risk appetite (at both the strategic and operational levels)
- **Monitor Management accountability for risk management processes** and compliance with risk policies.
- **Promote the establishment of a ‘risk-aware’ culture**

**1.2.5** To assess the adequacy of Management’s efforts in risk management, the AC should request Management present an update of risk management efforts. The update should cover the following areas:

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

#### FAQ 7

**Q: How can the AC review Management’s representations of their risk management efforts?**

**A:** The AC can take these steps to assess the robustness of the risk management processes:

- **Establish a two-way dialogue with Management** on risk management efforts, to widen the AC’s understanding of processes to identify, assess, manage, monitor and report risks (See **Appendix C2** for a list of high-level questions that the AC could pose to Management to obtain a better understanding of the risk management system).
- **Direct Management to report regularly** to the AC on the company’s risk profile and the status of risk mitigation action plans.
- **Consider if Management’s process to manage risks is adequate** e.g. Has Management mapped out the key risk areas? Are internal controls adequate to mitigate these risks?
- **Consider the need to engage external advisers to review the risks** and assess the adequacy of the risk management framework or process

- 1.2.6 The AC could assess the adequacy of the process established by Management to continuously identify and monitor new risks, in the following ways:
- Where significant changes in business strategies or operating environment have taken place, the AC should request that Management present and explain the impact of these changes on the risk profile of the company
  - The AC could have Management report on the potential exposure arising from the adoption of aggressive growth strategies and their impact on controls, financial reporting and disclosures
- 1.2.7 Depending on the scale and complexity of business operations, the AC should consider the need to engage internal auditors or external consultants to conduct an independent review of the risk management framework and the effectiveness of existing risk management controls or risk mitigation plans and to make recommendations to enhance these controls. The need and frequency of such a review varies, depending on the circumstances of the business and its risk environment.
- 1.2.8 The business environments in different countries could pose different risks that Management at the head office may not be familiar with. The AC should consider whether the risk management process adequately takes account of unknown country risks and the need for local country advisers to assist Management in this process.

#### ***Promoting a ‘Risk-Aware’ Culture***

- 1.2.9 Given that risk is inherent in everything that a company does, every person in the company should be involved in identifying, assessing, managing and monitoring risks. Whilst the Board is ultimately responsible for the company’s management of risk, a ‘risk-aware’ culture needs to be in place throughout the organisation for risk management to be effective.
- 1.2.10 The AC should assess Management’s efforts in promoting such a ‘risk-aware’ culture. Steps in this direction would include the existence of a control self assessment programme, risk workshops and other risk discussion forums which together promote awareness of risks and controls for staff at all levels. Management can either conduct training on risk management themselves, or with the assistance of external consultants. An effective knowledge Management programme promoting and heightening risk awareness should also be put in place.
- 1.2.11 A control self assessment programme is a tool that Management can use to assess the control effectiveness as well as business processes within the organisation. The programme allows Management and staff directly responsible for the business function, to work together in the identification and assessment of risk, as well as the design of internal controls and business processes to address these risks. By empowering staff with participation in a risk management process, this increases their awareness for risk and reinforces their responsibility and accountability for internal controls.

***'Near-Miss' Programme as a Risk Reduction Tool***

- 1.2.12 The AC could recommend Management set up a 'near-miss' programme. Management could then provide regular reports to the AC on remedial actions taken on incidents identified in the company's 'near-miss' programme.
- 1.2.13 A 'near-miss' programme involves the identification of events or conditions that indicate system or process weaknesses, which if not remedied, could in the future result in major consequences. The collection and analysis of such 'near-miss' data, together with the subsequent identification of required remedial actions, can potentially reduce the frequency or likelihood of a similar future risk event occurring. Such an organised base of risk incidents helps Management to focus on risk exposures in its operations and thereby improve the management of those risks.
- 1.2.14 For a 'near-miss' programme to be implemented effectively, the AC would need to support Management in creating a culture that encourages staff to disclose 'near-misses', without fear of reprisals or pressure from colleagues to conceal such information. Management could consider rewarding individuals who identify such current and potential problems and should also consider publicising the resultant system improvements and risk mitigation plans.
- 1.2.15 The AC can make a recommendation to Management to include responsibilities of risk ownership and management as part of an individual's KPIs or job description
- 1.2.16 The elements of a good risk management framework are described in **Appendix C3**.

## Where the AC works with a Risk Committee on the oversight of Risk Management

### FAQ 8

**Q: How could the AC work with another committee that is responsible for oversight of risk management?**

A: Where the overall supervision of risk management rests with another Board committee (commonly referred as the Risk Committee), the AC could be actively involved in monitoring Management's efforts in managing financial reporting-related risks, and liaise closely with the Risk Committee to make sure that the Risk Committee understands the work done by the AC.

To assess Management's risk management efforts over financial reporting-related risks, the AC can perform similar steps as set out in section 1.2.4.

The AC can engage internal auditors or external consultants to conduct an independent review on the effectiveness of the risk management policies and processes approved by the Risk Committee and make recommendations to enhance the controls.

Information between the AC and Risk Committee can be shared in different ways such as:

- Having common Directors on the AC and the Risk Committee
- Having arrangements for the Risk Committee and AC to share information on a regular basis

The minutes of the Risk Committee could be circulated to the AC and the Board for their information. It is also not uncommon for a Board member to be a member in both the AC and Risk Committee.

### Where the Board is responsible for the oversight of Risk Management

- 1.2.17** For the Board to effectively discharge its oversight responsibilities on risk management, the Board needs to undertake the activities, as set out in sections 1.2.1 to 1.2.16, which are typically carried out by the AC.

#### **Managing Specific Risks**

##### Financial risk

#### **Case Study 6**

**This case study illustrates some lessons relating to the management of financial risk arising from a company's failure:**

A company collapsed due to its inability to honour commodity options it had entered into. Traders who prepared the position reports adjusted the figures to hide breaches in stop-loss limits. Large volumes of trades were not recorded in the books by the back office as counterparty confirmations were sent to the traders. The Independent Directors only realised the severity of the situation when the company could not meet its financial obligations.

**Q: What are some of the key lessons to be learnt?**

The AC could have:

- **Considered if the instruments used were appropriate** for the company and if they had been duly approved and were being properly accounted for
- **Understood the rationale and the risk implications** of the financial instruments and trading contracts used
- **Asked the company how it dealt with price fluctuations** and been aware of the types of financial instruments and trading contracts in use
- **Considered if the systems and processes** designed to mitigate, report and monitor the risks of such instruments were adequate (e.g. segregation of conflicting duties)
- **Considered if the accounting treatments for reporting these instruments comply** with relevant accounting standards and had been discussed with the external auditors, including specialists within the audit team
- **Obtained independent professional advice if they did not fully understand** the company's trading activities or the complex financial instruments, or were not assured of the appropriateness of the controls put in place nor the accounting treatments adopted

- 1.2.18** The AC should be mindful of the risk exposure arising from:

- Financial instruments which are susceptible to market price fluctuations
- Complex financial derivatives embedded in plain-looking instruments
- Leveraged financial instruments and trading contracts

- 1.2.19** As part of the standard AC meeting agenda, Management should present its trading and hedging strategies, explain the nature and risk implications of the financial instruments used

and justify the need to engage in such financial instruments. The Board should set authorisation limits for financial derivative transactions and require the CFO to report breaches to the AC.

- 1.2.20 The AC should assess if Management has the relevant expertise to manage risk exposures adequately. Where Management does not appear to be knowledgeable or competent in the use of the financial instruments, the AC should direct Management to re-evaluate its decision to engage such financial instruments and reconsider the planned magnitude of risks and the controls required.
- 1.2.21 Management should report the risk exposure arising from all financial derivatives transactions.
- 1.2.22 For the AC to exercise effective oversight over management of the risks relating to such financial instruments, the AC should consider whether its members have the necessary expertise to understand and evaluate the adequacy of controls over these risks.
- 1.2.23 Where the AC does not fully understand the risk implications arising from the financial instruments, the AC should consider engaging external expertise to help it understand the risks posed by these financial instruments.
- 1.2.24 It is a good practice for the AC to engage the internal auditors, the external auditors or external consultants, to conduct an independent assessment of the effectiveness and adequacy of financial reporting controls over the financial derivatives transactions, preferably at least annually if the volume of such transactions is significant.
- 1.2.25 To facilitate the AC's review of quarterly results, Management should explain the accounting treatments adopted for these transactions in the quarterly results. The AC, together with Management and the external auditors, should consider whether the accounting treatments are consistent and in compliance with the relevant accounting standards.

### Concentration risk on key business partners

#### **Case Studies 7**

**These case studies highlight the possible issues that ACs may consider in reviewing RPTs and their impact on companies' performances:**

Strong growth in revenue has been reported in FY2008:

**A) Company A:**

90% of the company's earnings were earned from RPTs with the parent company and other fellow subsidiaries.

**Q: What could the AC do?**

The AC could consider taking these steps:

- **Review whether the business model** is sustainable in the long term
- **Discuss the concentration risk** with Management, the steps taken to address it in the risk management process and report on the status of risk mitigation plans
- **Consider whether the financial statements adequately disclose** the nature of these transactions, considering their commercial rationale and motivation

**B) Company B:**

Revenue earned from RPTs increased from 20% to 80% during the year.

**Q: What could the AC do?**

The AC could take these steps:

- **Understand the nature of the RPTs** and the business motivation for entering into such transactions
- **Review whether the RPTs have any commercial substance** and if they have been properly approved and accurately reported
- **Consider whether the financial statements adequately disclose** the nature of these transactions, considering their commercial rationale and motivation

- 1.2.26** The AC should be mindful of the concentration risk relating to key business partners. The AC should discuss with Management the need to develop plans to reduce reliance on such parties. The AC should, together with the Board, understand Management's view of such risks and review periodic updates on these risks.

### Business continuity risk

#### **Case Study 8**

**This case study provides an example of a business continuity plan dealing with a pandemic situation and highlights possible considerations when reviewing business continuity plans:**

During the outbreak of severe acute respiratory syndrome (SARS) in 2003, Management and Board of a company were caught off-guard when half of the key Management team (including the CEO) were either hospitalised or quarantined on suspicion of having been infected. The number of company personnel infected with or suspected of SARS doubled in a week.

The Board and Management noted that the company's existing business continuity plans were developed mainly to deal with information technology failures and loss of business premises. These plans did not address the loss or unavailability of key personnel. Consequently, the Board and Senior Management convened an emergency meeting to approve a new business continuity plan.

The approved plan addressed these factors:

- **Identification of critical business functions** and its operational arrangement, including key external dependencies
- **Impact on the closure of contaminated premises** and availability of alternate sites
- **Awareness and education of personnel** on prevention and detection measures
- **Communication with business partners** on revised operational protocols
- **Measures to reduce spread of a pandemic outbreak** (e.g. temporary cessation of business travel, restrictions on external party contact, hygiene standards)
- **Crisis Management procedures and contact tracing**
- **Operational continuity plans** (e.g. Dispersal or separation of staff, remote access, staff and data backup)

#### **Q: What could the AC have done to prevent a similar occurrence?**

The AC could have asked these questions:

- **Has Management considered all possible scenarios** that could affect business continuity and are there plans in place to address them?
- **Are these plans adequate** and are crisis management staff familiar with their roles and responsibilities?
- **Are these plans tested periodically?**

**1.2.27** Although uncertainty-based risks are difficult, if not impossible, to predict, there are ways in which businesses can prepare for a significant adverse outcome. The AC should understand the situations which may be considered disastrous to the company and the corresponding plans put in place by Management to recover from such situations and, where practical, mitigate the negative impact on its operations.

1.2.28 The AC should request Management report on the steps that have been taken to manage business continuity risk:

- **Crisis or emergency management planning**

The company identifies the events that could happen in a crisis or emergency, such as a fire or health or physical threat and then plans the steps necessary to respond to the event. This may include maintaining a list of emergency contact details, or conducting training on disaster evacuation and emergency response procedures

- **Business continuity planning**

The company plans beyond the initial response of a crisis or emergency and prepares for recovery of business processes with minimal disruption. This may include ensuring that there is sufficient documentation of work procedures and policies to enable staff to cover duties for one another, or identifying off-site storage facilities for critical operational data

1.2.29 The AC should review Management's plans to carry out periodic tests on business continuity plans and also the results of these tests.

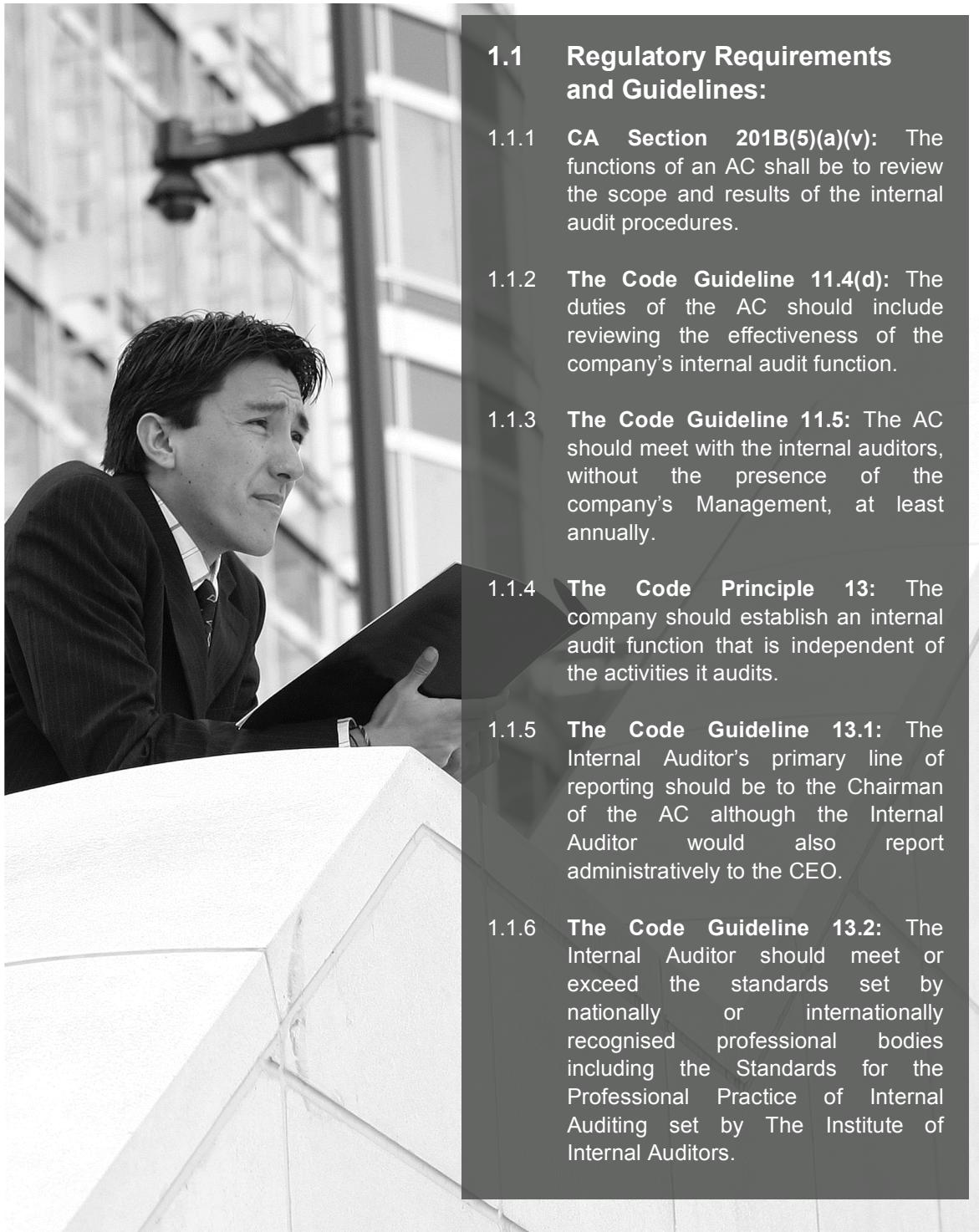
1.2.30 Where the company's operations rely heavily on a particular outsourcing service provider, the AC should obtain assurance from Management that the service provider's business continuity plan is robust enough so that the company will not be adversely affected by any disaster having an impact on the service provider.

#### Key-man risk

1.2.31 The success of family-run or owner-controlled businesses is typically dependent on one key individual or a few top individuals who possess niche skills and experience and who are the focal point for the relationships with key business partners. These key employees are critical to the long term performance of the company and the loss of any one individual could potentially paralyse business operations.

1.2.32 The AC should review the adequacy of the succession plans in place for key positions in the company. However, recognising that suitable successors for these positions may not be easily identified in the short term, the AC should discuss with Management the need for key-man insurance for key positions. The insurance would provide the company with the financial means to stabilise operations during the transition period preceding or following the loss of a key individual.

## SECTION III: INTERNAL AUDIT



**1.1 Regulatory Requirements and Guidelines:**

- 1.1.1 **CA Section 201B(5)(a)(v):** The functions of an AC shall be to review the scope and results of the internal audit procedures.
- 1.1.2 **The Code Guideline 11.4(d):** The duties of the AC should include reviewing the effectiveness of the company's internal audit function.
- 1.1.3 **The Code Guideline 11.5:** The AC should meet with the internal auditors, without the presence of the company's Management, at least annually.
- 1.1.4 **The Code Principle 13:** The company should establish an internal audit function that is independent of the activities it audits.
- 1.1.5 **The Code Guideline 13.1:** The Internal Auditor's primary line of reporting should be to the Chairman of the AC although the Internal Auditor would also report administratively to the CEO.
- 1.1.6 **The Code Guideline 13.2:** The Internal Auditor should meet or exceed 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.

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- 1.1.7 **The Code Guideline 13.3:** The AC should ensure that the IA function is adequately resourced and has appropriate standing within the company. For the avoidance of doubt, the IA function can either be in-house, outsourced to a reputable accounting/auditing firm, or performed by a major shareholder, holding company, parent company or controlling enterprise with an IA staff.
- 1.1.8 **The Code Guideline 13.4:** The AC should, at least annually, ensure the adequacy of the IA function.

## 1.2 Best Practices:

### Establishing an IA Function

#### FAQ 9

##### **Q: Should a listed company have an IA function?**

A: The Code recommends the establishment of an IA function to assist the AC in discharging its responsibilities. The Companies Act envisages that each listed company has in place an IA function and tasks the AC with the review of the scope and results of the IA procedures.

##### **Many companies have an IA function set up in one of these ways:**

- In-house function
  - IA team set up within the company
  - Parent company IA function utilised on a cost-sharing basis
- Outsourced IA function

For a company that does not have IA arrangements in place, or is in the process of establishing such arrangements, it is critical for the AC to obtain assurance on the internal controls over financial reporting. In the short term, the AC could consider requesting the external auditor (subject to their agreement) perform additional procedures in areas where the AC has concerns. In the longer term, the AC needs to consider how it discharges its responsibility in reviewing the adequacy of internal controls, if the company does not have IA arrangements.

There are relatively few situations where a listed company would not have an IA function.

### Case Study 9

**This case study illustrates some of the factors an AC could consider when deciding whether to have an in-house or outsourced IA function:**

The AC has decided that the company needs to have an IA function, following its rapid expansion into joint ventures in several new markets. It is not sure whether to engage in-house resources or to outsource the function to an external service provider.

**Q: What are some of the factors that the AC could consider when making its decision?**

The AC could consider the following factors:

- **Scale** of the company's operations
- **Corporate culture** towards the outsourcing of non-core business operations
- **Role of the IA function** as a training ground for operational or Management positions
- **Availability of relevant expertise** in-house
- **Ability to recruit and retain** competent and skilled internal auditors
- **Need to maintain institutional knowledge and culture**
- **Right given to the company** in the joint venture agreement with respect to conducting IAs

Where an in-house IA function has been established, the AC can still, on an ad-hoc basis, outsource limited areas of complex or specialised work, or co-source work in respect of overseas or high risk operations.

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

### Case Study 10

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

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

The AC could seek to understand the rationale for Management or the Chairman's view that the investment in IA ought to be more limited. Where necessary, the AC could escalate this to the Board for resolution. If the Board's decision is not acceptable to the AC, the AC could insist on an acceptable solution and make sure that their concerns are documented in the Board minutes.

The AC needs to be independently minded with regard to its duty of making sure that the IA function is adequately resourced. In the absence of required support from the IA function, the AC should consider its ability to discharge its duties effectively in the long term, especially as to how it can be assured that the quality of controls in high risk areas within the company are being evaluated and reported.

### Considerations for an in-house IA function

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

*An in-house IA function provides the AC with a ready pool of IA professionals who have in-depth knowledge of the business and who are available to conduct reviews at short notice or investigations of a sensitive nature. Being an integral member of the company's Management team, the IA department also provides the AC with timely feedback on control gaps, compliance lapses and where appropriate, Management performance.*

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

## FAQ 10

### **Q: How can the AC support independence in an in-house IA function?**

A: To empower the IA function with an appropriate level of independence and authority, the Head of IA should report functionally to the AC.

The AC can further support the IA function by assuming these responsibilities:

- **Provide the Head of IA with open and direct access** to the AC Chairman and its members at all times
- **Ensure an audit charter is approved by** the Board setting out the purpose, authority, responsibility and reporting line for the Head of IA
- **Conduct private discussion sessions** with the Head of IA, without Management's presence
- **Review the performance** of the Head of IA and approve his annual compensation package within the company's guidelines
- **Interview, select and appoint** the Head of IA
- **Have the final say** in the removal of the Head of IA
- **Carry out an exit interview** with a departing Head of IA to understand the reasons for his departure

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

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

1.2.3 As the governing authority of the IA function, the AC should assume these functional responsibilities<sup>5</sup>:

- **Approve the overall charter** of the IA function (See **Appendix D2** for a sample of an IA charter)
- **Approve the IA risk assessment** and related audit plan
- **Receive communications from the Head of IA** on the results of the IA activities or other matters that the Head of IA determines are necessary, including private meetings with the Head of IA without Management present
- **Approve all decisions regarding the appointment** (including remuneration package) or removal of the Head of IA
- **Provide input to the annual performance appraisal** and the salary adjustments for the Head of IA

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- **Make appropriate enquiries of Management and the Head of IA**, to determine whether there are limitations in scope or budget which may impede the ability of the IA function to execute its responsibilities
- 1.2.4 The IA's primary line of reporting should be to the Chairman of the AC. For administrative purposes, the Head of IA should report to the CEO or any executive with sufficient authority and stature who can provide the IA function with appropriate support. The IA function has to be well-placed in the organisation to access the proper flow of information and key executives and managers needed to carry out its duties effectively.
- 1.2.5 In evaluating the appropriateness in selecting the individual responsible for the administrative reporting line for the IA function, the AC should consider these questions<sup>6</sup>:
- **Does the individual have sufficient authority and stature** to ensure the effectiveness of the function?
  - **Does the individual have an appropriate control and governance** mindset to assist the Head of IA in his role?
  - **Does the individual have the time and interest** to actively support the Head of IA on audit issues?
  - **Does the individual understand the functional reporting relationship** and support it?
- 1.2.6 The administrative reporting role should be limited to the facilitation of the day-to-day operations of the IA function which typically includes<sup>7</sup>:
- Budgeting and Management accounting
  - Human resource administration, including personnel evaluations and compensation
  - Internal communication and information flow
  - Administration of the organisation's internal policies and procedures
  - Internal communication and information flow
  - Administration of the organisation's internal policies and procedures

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### **FAQ 11**

**Q: In some companies, the IA function reports administratively to the Chief Financial Officer or his designate in the finance department.**

A: How can the AC support the IA function in maintaining its independence when it audits the activities performed or is supervised by the officer to whom the IA department reports?

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

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

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

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

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

- 1.2.7 During the annual review of the IA plan, the AC should assess whether the in-house team has the appropriate skills to address the audit needs.
- 1.2.8 Where the in-house team lacks the necessary specialised skills to audit areas such as information technology, treasury operations and financial derivatives trading, the AC could ask the Head of IA to explore how the company can meet immediate needs by outsourcing certain audits or engaging relevant specialists (internally or externally) to support the in-house team.
- 1.2.9 Where there are longer-term needs for such specialised skills, the AC could ask the Head of IA to recruit the necessary specialists into the team or to send the existing team for training in the specialised area. Co-sourcing, involving an internal team working together with external specialists, can also provide an avenue for upgrading of specialised skills.
- 1.2.10 As part of its annual review of the IA budget, the AC should request the Head of IA to report on the nature and frequency of training and seminars attended by the staff to enhance their skill sets in specialised areas and professional IA standards. Based on the training needs, the AC should assess the adequacy of the budget set aside for the in-house team to upgrade their skills.

- 1.2.11 The Head of IA could consider engaging the external auditors to provide the requisite training on accounting standards and technical skills updates.

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

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

- 1.2.12 To maintain a stable and experienced team of in-house internal auditors, the AC could work with Management to develop a staff rotation programme where high performers spend a specific period in IA and are also rotated to other departments in the organisation. In some companies, the IA function is positioned as a training ground for operational and managerial executive positions. There are also other companies which establish a ‘guest auditors’ programme where a manager or staff from an operations or business department participates in an IA of another department. This programme enables staff outside of the IA function to appreciate the work of the IA function and build better rapport.
- 1.2.13 As good practice, the AC should ask Management to conduct a benchmarking exercise to assess the competitiveness of the remuneration packages offered to IA staff as and when necessary.

#### ***Considerations for an Outsourced IA Function***

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

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

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

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

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

- 1.2.14 To ensure that the outsourced IA service provider is not beholden to Management, the AC has to visibly lead the process of interviewing, selecting and approving the appointment of service providers.

#### **FAQ 12**

**Q: What could the AC consider when selecting a vendor for outsourced IA services?**

- A:
- **Expertise, experience and resources** in providing IA services
    - Firm's capability and experience of similar engagements
    - Knowledge and IA experience in the industry, including knowledge of Singapore regulatory requirements, if appropriate
    - Experience and qualifications of IA team members
    - Size of the vendor's IA practice
    - Firm's IA service support in the regional or global market
  - **Audit methodology and approach** (including the audit approach towards IT systems, where appropriate)
    - Proposed IA methodology, approach and technology
    - Quality assurance procedures and commitment
    - Proposed deliverables (i.e. the form of the audit report)
  - **Understanding service requirements**
    - Understanding the company's operating environment, businesses and key risks
    - Proposed IA plan
  - **Fees and fee assumptions**
    - Estimated hours expected to be incurred
    - Annual fee
    - Policy on out-of-pocket expenses
    - Staff-mix, i.e. proportion of senior level resources in the team
  - **Contract terms**
    - Disclaimer clauses
    - Exclusions and limitation of liability
    - Indemnity clauses
    - Ownership of intellectual property
    - Access to working papers
    - Use of the company's name for the firm's marketing purposes
    - Termination
    - Distribution of audit report
    - Independence of internal auditors

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

- 1.2.15 The AC should consider the need to conduct open or closed tenders for the sourcing of an IA service provider. Where the AC has a consensus on the criteria for the service provider, Management could conduct a closed tender by inviting those firms that meet the criteria to submit bids.
- 1.2.16 The invitation to quote should clearly set out relevant information on the company's businesses and the expectations of the IA role to ensure that the fee quotes from the outsourced service providers reflect the complexity and scope of the company's business. Fees should not be the overriding sole criterion used to select and engage an IA outsourced provider. Where practical, Management and/or the AC should arrange for a session with each interested firm to brief them on the scope of services required and the expected role.

#### FAQ 13

##### **Q: How much should a company spend on IA activities?**

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

- **Budget allocated by comparable companies for the IA function** This is information that the IA service provider can help to compile
- **Fee estimates provided by different bidders** in a competitive bid process
- **Feedback from the internal auditors** on the extent of resources required to address the company's risk areas

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

- 1.2.17 The AC should review the adequacy of the budget, ensuring that there are no budgetary limitations that would constrain the ability of the IA function to carry out its work.
- 1.2.18 To ensure that the outsourced IA service provider obtains information for its work and has access to key executives and managers, the AC should assign an IA coordinator to liaise with the service provider on administrative matters.
- 1.2.19 The IA coordinator assigned should have sufficient authority to provide the IA function with the appropriate support to execute its audits effectively.

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

### Scope of IA Activities

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

- 1.2.20 The AC can authorise the internal auditors, through the IA charter, to undertake additional specified services that the AC has concluded would not represent a conflict of interest and would not detract from its obligations to the Committee. A sample IA charter is set out in **Appendix D2**.
- 1.2.21 Consulting services typically provided by internal auditors take the form of informal and formal advice, analysis and assessments. By providing consulting services, the internal auditors can deepen their knowledge and understanding of the company's business processes and issues without necessarily impairing their objectivity.
- 1.2.22 To ascertain if the proposed consulting services could potentially impair the auditor's objectivity, the AC should consider whether the internal auditor has taken over Management decision-making functions. Where there is a decision to adopt or implement recommendations made by Management arising from the consulting services, the objectivity of the IA should not normally be threatened<sup>8</sup>.

### IA Plan

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

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#### FAQ 14

##### **Q: How could the AC assess whether the coverage of the IA plan is adequate?**

A: In assessing the adequacy of the coverage, the AC could consider whether these factors have been addressed:

- **A robust audit risk assessment process is in place** to identify key risk areas
- **Key risk areas are included** in the audit plan
- **IT risks have been addressed** in the audit plan
- **There is regular and adequate audit coverage** over the following:
  - High risk activities particularly in cases where IA resource shortage impacts on the ability to complete the annual audit plan
  - Significant operations which may include:
    - Overseas operations taking into consideration the local state of corporate governance practices and standards, quality of local management expertise and stability of local political and regulatory environment
    - Operations with significant volume of transactions or activities
    - Operations that have material contributions to the listed entity's consolidated accounts
    - Operations in highly regulated environments or industries
- **Where there are areas that the internal auditors may not have the expertise to audit effectively** or do not have access to information or management (e.g. Information Technology and foreign operations), such audits are outsourced to relevant specialists
- **The disposal of prior year findings has been reviewed**

- 1.2.24 Where the company has other internal compliance functions (such as legal, ethics, health and safety, security, risk management) the AC could enquire on the working relationship between the IA function and these other functions in facilitating the monitoring and reporting of material risk and control issues to the AC.
- 1.2.25 To assess the effectiveness of the working relationship between the IA function and the internal compliance functions, the AC could ask the Head of IA to present the findings from their review of the work of the compliance functions and confirm if these activities have taken place:
- **Minutes of meetings of the compliance functions have been shared** with the IA function
  - **The IA function has reviewed the sufficiency of the procedures** carried out by the compliance functions
  - **Reports issued by the compliance functions have been circulated** to the IA function for review
- 1.2.26 Given that there may be areas of overlap between the work of the internal auditor and the external auditor, the AC should review the extent of reliance placed by the external auditor on the internal auditor's work. The AC should request that the auditors work with each other to minimise duplication of efforts where possible. Where there is limited or no reliance, the AC should enquire the reasons from the auditors.

- 1.2.27 To ensure that significant joint venture operations can be covered by the IA plan, the AC could encourage Management to include a right-to-audit clause in joint venture agreements or at the minimum, the right to receive audit reports from the joint venture partner(s).
- 1.2.28 For offshore subsidiaries and associated companies incorporated in countries where statutory audits are not required, the AC should consider the need to conduct an audit of those operations, taking into consideration the materiality of their contribution to the listed entity's financial statements and the extent to which the transactions in these entities have physically taken place in these countries where the controls for those economic activities are limited.

### Reporting

- 1.2.29 The internal auditors should generally provide the following to the AC on a regular basis<sup>9</sup>:
- **Independent (to the extent possible), objective assurance** and consulting activities relating to the effectiveness of the organisation's risk management, controls and governance processes
  - **Gathering of information** and arranging discussions with subject matter experts, to address the AC's questions and information needs relating to risk management, controls and governance processes
  - **Confirmation of the adequacy of the audit staff** and budget requirements, as well as the scope and result of IA activities
  - **Information on the coordination and oversight of other control and monitoring functions** (such as legal, security, health, safety and quality assurance)
  - **Information on emerging trends and successful practices** in IA
- 1.2.30 The internal auditors should also update these matters at each AC meeting:
- **Status of the audits** in the annual IA plan
  - **Key findings arising** from completed audits
  - **Implementation status** of outstanding Management action plans (if any)

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### **FAQ 15**

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

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

### Assessing the performance of the IA Function

### **FAQ 16**

**Q: How should the AC assess the efficiency and effectiveness of the IA function?**

A: The AC should assess the effectiveness of the IA function against agreed performance criteria (see **Appendix D3**) including:

- **The overall comprehensiveness of the IA plan** and its relationship to the strategic objectives of the company
- **Delivery of timely IA services** in accordance with the plan
- **The quality of reporting and communications**
- **The competence of IA staff**
- **The adequacy of resources and appropriateness of the resource mix** to achieve the agreed mandate and audit plan
- **The value of the IA function** – whether the IA function adds value to the organisation and if so, in what ways does it best add value
- **Where appropriate, the extent to which the IA function is facilitating process improvements** and a culture of continuous improvement
- **A re-assessment of whether the alternative of outsourcing the IA function** would result in a better realisation of objectives

The AC could consider seeking comments from the external auditors on the quality and effectiveness of the IA function and compare the respective findings from both teams on common areas of work, as a means of gauging the quality of the IA work.

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

- 1.2.32 To obtain assurance that the IA activity is in conformity with the international standards for IA, the AC could consider engaging a qualified independent reviewer to carry out an assessment of the IA process against the standards prescribed by the Institute of Internal Auditors (IIA) Standards and the Code of Ethics.
- 1.2.33 The IIA recommends that such an assessment to be conducted at least once every five years. Results of the assessment should be communicated to the AC and the Board. For outsourced IA functions, the AC should obtain confirmation from the service provider that their work conforms to the IIA Standards and the Code of Ethics.
- 1.2.34 **Appendix D4** provides a sample assessment checklist for the AC to evaluate the performance of the IA function.

#### Managing disagreements between IA function and Management

##### **FAQ 17**

**Q: Management and the internal auditors disagree on the proposed recommendation to address a control gap. What could the AC do?**

A: The AC could consider these courses of action:

- **Seek to have a full understanding** of the issue and the areas of disagreement, by having a discussion with all parties concerned and thereafter concluding its fact-finding by taking an independent position and communicating its decision to all parties concerned
- **Obtain an opinion from an external adviser** with the relevant expertise (e.g. the external auditors)

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

### Private Session with Auditors

#### **Case Study 11**

**This case study illustrates how an AC could handle feedback from the internal auditors regarding weaknesses in internal controls:**

In a private discussion session with the AC, the internal auditor shared his preliminary observation that certain controls are unacceptably weak as a result of decisions made by Management to improve operational efficiency and that these control weaknesses may have an adverse material impact on the quality of financial reporting information.

**Q: How could the AC handle the feedback?**

Given that the internal auditor has yet to confirm his observation, the AC could consider waiting for the results of his investigation before taking up the matter with Management. The AC should require the investigation to be completed with urgency.

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

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## SECTION IV: FINANCIAL REPORTING



### 1.1 Regulatory Requirements and Guidelines:

- 1.1.1 **CA Section 201(1A):** Generally, the profit and loss account shall comply with the requirements of the Accounting Standards, and give a true and fair view of the profit and loss of the company for the period of accounting as shown in the accounting and other records of the company.
- 1.1.2 **CA Section 201B(5)(a)(vi):** The functions of an AC shall be to review the balance-sheet and profit and loss account of the company and, if it is a holding company, the consolidated balance-sheet and profit and loss account, submitted to it by the company or the holding company, and thereafter to submit them to the Directors of the company or the holding company.
- 1.1.3 **The Code Guideline 11.4(b):** The duties of the AC should include reviewing the significant financial reporting issues and judgements so as to ensure the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance.

## 1.2 Best Practices:

### Competence of the Finance Team

- 1.2.1 The company's CFO and finance team are critical in supporting good internal controls, effective audits and high quality financial reporting and disclosure. The AC should be satisfied that the CFO has adequate staff resources with the appropriate experience and expertise, and that the CFO is able to perform his duties. In satisfying itself, the AC should have regard to the number and experience of supporting staff, the size and complexity of the group and the frequency of cross-border dealings.
- 1.2.2 The AC may consider participating in the appointment of the CFO by reviewing Management's recommendation of candidates and their qualifications and experience and finally concurring with Management's recommendation on the choice of candidate.

#### FAQ 18

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

A: The AC could:

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

### Overseeing the Integrity of Financial Statements

- 1.2.3 While Management is primarily responsible for the preparation of complete, accurate and reliable financial statements and also formal announcements relating to the company's financial performance, it is the AC's duty to oversee the integrity of the financial statements and other related disclosures.
- 1.2.4 Strong and candid relationships with Management and the external auditor are crucial – the AC should engage both parties in frank and timely discussions. It is important for the AC to demonstrate an appropriate level of scepticism and ask probing questions to ascertain whether the full year and quarterly financial statements are complete and consistent with operational and other information known to the AC.
- 1.2.5 During the AC's review of the full year and quarterly financial statements, its discussions with Management and/or the external auditors should address the numerous qualitative factors that can affect financial statements, including these factors:

### **1.2.5.1 Accounting Policies**

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

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

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

### Case Study 12

**This case study illustrates a situation of a “voluntary” change in an accounting treatment:**

Term fees were recognised progressively by a teaching establishment as revenue over the period of the course. Just before the second quarter results announcement, Management of the company changed its revenue recognition policy to account for revenue upon registration, at which time the non-refundable fees for the term would be payable in full. At the AC meeting to consider the draft announcement, the AC noted that the change in accounting treatment had a material impact on the financial performance for the quarter. Management briefed the AC on the change in the accounting treatment, and explained that the new accounting treatment was more reflective of the economics of its business since the fees were received in full at the start of each term and were not refundable; furthermore, there were no marginal costs relating to the earning of such revenue.

**Q: What are the matters that the AC should take into account in considering the proposed change in accounting treatment?**

The AC could ask Management for an analysis of the old and new accounting treatments against the relevant accounting standard, and the basis of their conclusion that the new accounting treatment was more in line with the accounting standard.

The AC should ask Management for the reasons for the change in the accounting treatment. Factors that the AC could weigh up in considering the change include the quality of the accounting analysis and resultant conclusions, the motivation of Management in making the change, the timing of the change, and the manner of presentation.

The AC could also consider the extent of disclosures in the financial statements, the view of the external auditors on the merits of the change in accounting treatment and the possibility of obtaining a formal opinion from them or other advisers.

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

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

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

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

- Apply the criteria towards determining the materiality of errors and mis-statement

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

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

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

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

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

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

## **FAQ 19**

**Q: What are some examples of questions that the AC could ask Management?**

A: (a) **Uncollectible accounts receivable:**

- What is the bad debts amount this period? How does it compare to the last period?
- How is the allowance for doubtful accounts determined?
- Has there been a change in the methodology or assumptions used in determining the allowance? If so, why?
- How is its adequacy evaluated?

(b) **Slow-moving or obsolete inventory:**

- What steps are taken to identify slow-moving or obsolete inventory which requires provision?
- How is provision for such inventory determined and evaluated for adequacy?
- Are there any significant write-downs? If so, why? How do these write-downs compare to the last period?

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

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

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

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

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

- **Monitor movements in provisions established in prior periods**

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

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

- Where special purpose financing structures or unusual transactions which affect ownership rights (such as leveraged recapitalisations, joint ventures and preferred stock of subsidiaries) exist, the AC should consider these factors:
  - Impact of the special structures on risks and rewards of the entity, timing and amounts of reported income and cash flow
  - Impact of the structures on transparency and how well the enterprise's economic position is understood as compared to its financial statements
  - Comparative structures used in practice
- Where there are significant period-to-period changes in the accounts (such as significant increases in volume immediately before the period-end close, significant changes between the final quarter's results, the trend over the first three quarters or the recording of one-off transactions), the AC should consider:
  - Reasons for the major variations and/or the purpose behind the significant transactions
  - Economic substance of the transactions
  - Impact of the transactions on the financial statements

### Case Studies 13

**These case studies illustrate the use of special structures:**

- A) A controlling shareholder and certain key executives induce a company to fraudulently exclude from its annual and quarterly consolidated financial statements over \$2.3 billion in bank debts by deliberately shifting those liabilities into the books of the company's off-balance sheet, unconsolidated affiliates.

This precipitated a series of misrepresentations about these liabilities, including the creation of: (1) sham transactions backed by fictitious documents to give the false appearance that the company had actually repaid debts when, in truth, it had simply shifted them to unconsolidated entities and (2) misleading financial statements by giving the false impression through the use of footnotes that stated liabilities listed in the company's financials included all outstanding bank debts.

- B) The CFO of a company led a team to create off-books offshore entities (used for planning and avoidance of taxes, raising profitability of a business) to hide losses that the company was taking, and made the company appear more profitable than it actually was.

The Company funded some of its investments by entering into arrangements with outside third parties. These joint investments typically were structured as separate, special purpose entities (SPEs) to which the company and other investors contributed assets or other consideration.

Under the accounting rules applicable at the time, an SPE could receive off-balance-sheet treatment if the third-party investment was genuinely at risk, among other things. If the third party was not truly independent, or its investment was not truly at risk, consolidation of the SPE into the company's balance sheet would be required. Some of the SPEs were not eligible for off-balance-sheet treatment because the supposedly independent third party investors were controlled by the CFO and others. Also the third party 'investment' was not at risk, since the company, the CFO, or others provided the funds to be invested or guaranteed the investment against risk of loss. Thus, these SPEs should have been consolidated into the company's balance sheet.

#### **1.2.5.5 Related Party Transactions**

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

The discussion could address:

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

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

#### **Case Study 14**

**This case study illustrates an instance where the company engages in frequent and significant transactions with related parties:**

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

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

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

#### **1.2.5.6 Audit adjustments**

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

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

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

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

### Case Study 15

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

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

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

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

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

Points for consideration:

- The AC should ask Management if the information in the financial statements clearly and fully reflects the on-going operations of the business. Does it cause any distortion of the actual results?
- If the AC identifies a material item that Management has not proposed to disclose, it should question Management's reasons for non-disclosure
- Where the company discloses earnings guidance, forward-looking information and other financial information, the AC should carefully assess whether the company is in a credible position to provide such information, taking into consideration these factors:
  - Quality of systems and reliability of data underlying the financial information
  - Underlying business assumptions and the likelihood of such assumptions occurring
  - Management's history in meeting past earnings targets
  - Analysts' expectations of the company

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

#### **1.2.5.8 Reviewing group financial statements**

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

- **Were the accounting policies consistently adopted** by all companies in the group?
- **What were the significant judgements and estimates involved** in the subsidiaries' financial statements and how do they affect consolidated financial statements

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

#### **1.2.5.9 Other Matters**

Other matters for consideration may include these factors:

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

Discussions of the AC with Management may include:

- Factors taken into consideration when valuing tangible and intangible assets. Such factors may include: rights, privileges or conditions that are attached to the ownership interest, remaining economic life / legal life, earnings capacity, nature and history, economic outlook of relevant economies and the condition and outlook of the specific industry
- The company's bases for determining useful lives assigned to tangible and intangible assets and salvage values (discussion should include the type and quality of evidence supportive of such bases/factors)
- Carrying value of other assets and liabilities, including an explanation of how factors affecting carrying values were selected and how alternative selections would have affected the financial condition and earnings of the enterprise

- ***Disagreements between Management and auditors***

### Case Study 16

This case study illustrates the measures an AC can take when the external auditors disagree with Management on financial reporting issues:

The external auditors disagreed with Management on the interpretation of FRS 36 Impairment of Assets and how Management performed the impairment assessment on the company's fixed assets. In addition, Management had also refused to provide certain information requested by the external auditors as it felt that such information is neither relevant nor necessary in performing the impairment assessment.

#### Q: What should the AC do?

The AC should note the disagreements between Management and the external auditors and seek to resolve the conflict in a timely manner. Where appropriate, the AC should engage the auditors and Management in discussion and consider the following:

- Understand the transaction, issues, concerns and accounting implications (including alternative and preferred accounting treatments)
- Determine whether to consult additional resources, e.g. seek a second opinion from another audit firm if the disagreement concerns accounting standards and their application

#### • **Fraud and Illegal Acts**

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

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

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

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

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

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

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

*For more comprehensive guidance on fraud, please refer to the section on Internal Controls and Whistleblowing.*

### Case Study 17

#### This case study illustrates measures an AC could adopt to review unusual transactions:

A company has been reporting strong growth in a new line of business, with a Fortune 500 company taking up almost all of the company's capacity and generating a gross profit margin significantly above those recorded in other areas of the company's business. As a result of criminal investigations not originally involving the company but which had eventually extended to the company, it was discovered that the entire new line of business was a sham, with fictitious sales that never involved the Fortune 500 company. The sales were settled seemingly on time, using the company's own cash that had been diverted from the company through inflated prices for equipment purchases. These purchases had been routed through tax haven companies that were in fact related parties.

#### Q: What could the AC have done to review these sales transactions?

Where a new line of business is expected to become material to the company, the AC should seek a detailed understanding of the business and its expected impact on the financial results of the company. The original case-for-investment papers submitted to the Board should be reviewed, and compared to subsequently reported results, with explanations provided by Management.

Where the AC feels that there are certain aspects of the financial information relating to the new business that it cannot fully understand, it should engage in open discussions with the internal auditors and the external auditors to get other views. The AC could direct the auditors to pay particular attention to the areas in which the AC has concerns, and report on the procedures undertaken and the conclusions reached.

- ***Management representation letter***

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

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

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

### Other key financial information

- 1.2.6 Paragraph 1.2.5 above listed and discussed some of the factors which the AC should take into consideration in their discussions with Management when reviewing the company's financial statements.
- 1.2.7 Such discussions should take place every quarter.
- 1.2.8 In addition, if appropriate, the AC could also ask Management to provide a summary of key financial information on a monthly basis (rather than quarterly), so that the AC can be alerted to any potential financial problems within the company early on, and apply appropriate remedial actions to address the problems. Examples of key financial information include:
- Operating revenue composition and margins
  - Net profits before and after tax
  - Return on total assets
  - Earnings per share
  - Working capital ratios
  - Gearing ratios
  - Net tangible asset per share
  - Trade receivables and payable turnover
  - Free cashflows

### Factors Indicative of Weaknesses in Financial Reporting Process

- 1.2.9 In addition to having regular discussions with Management when reviewing the company's financial statements, the AC should also be alert to any weaknesses in the company's financial reporting process. Examples of 'red flags' which may indicate weaknesses include:
- **High turnover** of key accounting personnel
  - **Frequent significant changes in accounting practices and estimates** by Management that are not in line with industry norms
  - **Numerous late adjustments** raised by Management after accounts are closed
  - **Unexplained significant fluctuations** in account balances
  - **Material variances between physical and book value** inventories
  - **Material variances between confirmations** received and book values for assets and liabilities e.g. accounts receivable, bank balances and accounts payable
  - **Numerous audit adjustments** raised by the external auditors, especially when these adjustments relate to errors in the financial statements

- **Numerous Management letter points** pertaining to (a) errors and discrepancies noted in the company's accounting books and records and (b) lapses in internal accounting control process for example inadequate Management oversight
- **Frequent change of internal/external auditors and Independent Directors**

## SECTION V: EXTERNAL AUDIT



### 1.1 Regulatory Requirements and Guidelines:

1.1.1 **CA Section 201B (5):** The functions of an AC shall be:

- (a) to review
  - (i) with the auditor, the audit plan;
  - (ii) with the auditor, his evaluation of the system of internal accounting controls;
  - (iii) with the auditor, his audit report; and
  - (iv) the assistance given by the company's officers to the auditor
- (b) to nominate a person or persons as auditor, notwithstanding anything contained in the articles or under section 205, together with such other functions as may be agreed to by the AC and the Board of Directors.

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

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- 1.1.3 **CA Section 201B(7):** Upon the request of the auditor, the Chairman of the AC shall convene a meeting of the Committee to consider any matters the auditor believes should be brought to the attention of the Directors or shareholders.
- 1.1.4 **Listing Rule 716(1):** An issuer may appoint different auditors for its subsidiaries or significant associated companies provided that the issuer's board and AC are satisfied that the appointment would not compromise the standard and effectiveness of the audit of the issuer.
- 1.1.5 **Listing Rule 1207(6)(b):** The annual report must contain enough information for a proper understanding of the performance and financial conditions of the issuer and its principal subsidiaries, including at least confirmation by the AC that it has undertaken a review of all non-audit services provided by the auditors and they would not, in the AC's opinion, affect the independence of the auditors.
- 1.1.6 **The Code Guideline 11.4(a):** The duties of the AC should include reviewing the scope and results of the audit and its cost effectiveness, and the independence and objectivity of the external auditors. Where the auditors also supply a substantial volume of non-audit services to the company, the AC should keep the nature and extent of such services under review, seeking to balance the maintenance of objectivity and value for money.
- 1.1.7 **The Code Guideline 11.4(e):** The duties of the AC should include making recommendations to the Board on the appointment, reappointment and removal of the external auditor, and approving the remuneration and terms of engagement of the external auditor.
- 1.1.8 **The Code Guideline 11.5:** The AC should meet with the external auditors, and with the internal auditors, without the presence of the company's Management, at least annually.
- 1.1.9 **The Code Guideline 11.6:** The AC should review the independence of the external auditors annually.

## 1.2 Best Practices:

### Role of External Auditors

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

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

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

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

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

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

The primary objective of the external audit therefore is to add credibility to financial statements, rather than the detection of fraud and errors. To help prevent and detect fraud and errors, the entity and its Management team should practise good corporate governance.

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

### Audit Scope and Approach<sup>10,11</sup>

- 1.2.2 The AC should obtain a good understanding of the scope of the external auditor's work and the approach they will be adopting in performing the audit of the company's financial statements.
- 1.2.3 For a start, the AC should request from Management a copy of the external auditors' engagement letter and review this letter to have an overall understanding of the scope and extent of the external auditors' work. This will help the AC to understand the external audit coverage as well as ensure that all key financial statement risks are considered during the audit process.
- 1.2.4 Before the start of the audit, the AC should receive an audit plan from the auditors. This document should set out the audit scope and approach. However, to further enhance the AC's understanding of the external audit scope and approach, the AC should have a discussion with the external auditor and during that discussion, the AC may consider asking these questions:
  - **What are the objectives** of the external audit?
  - **What are the company's financial reporting requirements** and what is the expected time frame to comply with these requirements?
  - **How do the external auditors identify** the key financial statement risks that will affect the audit and the audit approach? How will the external auditors communicate these risks to the AC?
  - **Do the external auditors have a role** in detecting material errors, fraud and illegal acts? How will these be addressed in the audit?
  - **How do the external auditors evaluate** the effectiveness of the company's internal controls over the financial reporting functions?
  - **Are there any financial statement areas where the external auditor does not plan to rely on internal controls** and why not?
  - **How will the external auditors coordinate their work** with the internal auditors?
  - **How do company computer systems and applications affect the audit approach?** How will the external auditor audit these areas?
  - **How will recent changes in accounting policies or regulatory requirements impact** this year's financial statements?

<sup>10</sup> In developing guidance for the parts on "Audit Scope and Approach", "Private Session with External Auditors" and "Engagement of External Auditors" in Section V: "External Audit" of the guidebook, the ACGC has referred to Ernst & Young LLP, 2006, *Audit Committee Member Toolkit*, United States

<sup>11</sup> In developing guidance for the part on "Audit Scope and Approach" in Section V: "External Audit" of the guidebook, the ACGC has referred to Copyright 2005, *Audit Committee Effectiveness – What Works Best, 3<sup>rd</sup> edition*, by The Institute of Internal Auditors Research Foundation, 247 Maitland Avenue, Altamonte Springs, Florida 32701-4201 U.S.A. Reprinted with permission.

- **How do the external auditors obtain assurance** over areas that involve Management judgement and estimates?
- **How will the external auditors audit RPTs?**
- **How will any recent changes in the company – e.g. major acquisitions or disposals of investments, new product lines – affect the audit scope and approach?**
- **How will the external auditors follow up on the audit issues** highlighted in the previous period?
- In a group structure where the company has subsidiaries and associates, some questions that the AC may consider asking the external auditors include:
  - What subsidiaries will the external auditor audit? What will the external auditors do for those not audited?
  - What company locations will the external auditors visit this year and why? How do the external auditors determine which locations to visit?
  - What procedures will the external auditors perform for associates?
  - If other audit firms are involved, will the external auditors rely on their audit report without undertaking additional procedures? If not, what are the procedures the external auditors would undertake to be satisfied that the other auditor's work is acceptable and that they are independent?

#### **FAQ 20**

##### **Q: How should the AC respond to the external auditor's queries relating to fraud?**

A: When the external auditors make enquiries with the AC concerning fraud within the company, the AC may wish to consider the information provided by Management and have a discussion with Management, if necessary. The AC may also wish to refer to the fraud reporting process which has been put in place by Management.

In addition, during its discussion with the external auditors in this area, the AC could highlight to the external auditors any additional areas which may require particular audit emphasis. Such areas could be areas where, in the AC's opinion, the relevant internal controls are weak or lacking. The AC could refer to the work and results of the IA function and the Risk Management Committee of the company in order to identify such areas.

#### **Management Letter**

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

- **Focus on whether the auditor's Management letter highlights unusual weaknesses**, such as the collectibility of receivables, saleability of inventory, significant post-balance sheet date events, or susceptibility to fraud or illegal acts
- **Review and monitor** Management's response to the auditors' findings and recommendation
- **Review the weaknesses** highlighted and categorise each of the weaknesses into these broad categories:
  - Critical
  - Important
  - Good-to-know

For each category, the AC shall establish procedures for follow-up and set reasonable timelines for implementation of remedial action.

### **Cost-effectiveness**

- 1.2.6 Some questions the AC could consider in evaluating the cost effectiveness of the entity's audit function (internal and external audits) include:
- **What are the external auditors' fees** for the current year's audit? What caused the increase/decrease compared to the previous year?
  - **What are the IA costs** this year? What caused the increase/decrease compared to the previous year?
  - **Are the external audit fees reasonable** in light of the size and complexity of the entity's business during the year? How does the audit fee compare to peer companies within the industry?
  - **Are the external auditors able to rely on the work performed** by the internal auditors?
  - **Were the external auditors able to meet the company's reporting timetable?**
  - **What are the qualifications** of the engagement partner and the team members?
  - **What are the audit firm's plan and procedures** for partner rotation and to ensure a smooth transition to the new partner?

### **Private Session with External Auditors**

- 1.2.7 Guideline 11.5 of the Code recommends that the AC should meet with the external auditors without the presence of the company's Management, at least annually.

### Case study 18

**This case study illustrates the usefulness of the AC having a private session with the external auditors without the presence of Management:**

Company A has five Directors. The Managing Director holds significant shares in the company and his nephew is employed in the company as the CFO and put in charge of the company's finance team. The CFO is tasked with the responsibility to ensure that the company has a proper financial reporting process which includes the preparation and presentation of the company's financial statements. While his nephew is a Certified Public Accountant (CPA), members of the AC have some concerns over the CFO's competency given his young age and that he has no prior working experience in a similar industry. In addition, given his relationship with the Managing Director, they are also concerned about whether the CFO is able to discharge his responsibility objectively where the preparation of true and fair financial statements are concerned. Given that the AC has limited opportunities to work closely with the CFO and the finance team on a daily basis, how could the AC get any objective feedback on the CFO's performance?

The AC should consider meeting regularly in private with the external auditors to discuss issues such as auditor's performance, Management's performance, future agenda topics or how the AC might improve its own performance. In particular, when the AC meets independently with the external auditors, the AC will be able to obtain an objective and critical assessment of Management's performance in areas concerning the proper maintenance of accounting books and records and the preparation of true and fair financial statements.

- 1.2.8 The AC should also consider the following in their private meetings with the external auditors at the conclusion of the external audit process:

#### 1.2.8.1 *Exposure areas*

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

### **1.2.8.2 Findings and conclusions**

- **What are the external auditors' observations** on the quality of the company's internal control environment, including the 'tone-at-the-top'?
- **What are the external auditors' overall evaluation** of the degree of comparability between the presentation of the current period's financial statements and that of previous periods? Were there reclassifications of previous periods' reported amounts and why? Did the entity change its approach to its financial statements presentation?
- **In the external auditors' opinion, is Management aggressive** in:
  - Their selection of accounting policies for the company?
  - Making their accounting estimates and assumptions?
- **Were there any changes in accounting policies** that have a significant effect on the current period's financial statements? Do they agree with the changes?
- **Did the entity apply its accounting policies consistently** from previous periods? How did the entity's accounting policies compare with other companies in the same industry?
- **Were there any significant changes made to internal controls** during the current period over the entity's financial reporting process?
- **Did the external auditors note any unusual transactions?** Were the external auditors satisfied with the accounting treatment?
- **What were the audit findings in the high-risk areas?** Did the external auditors have any specific comments or recommendations in these areas?
- **Did the external auditors note any material weaknesses** or control deficiencies over the entity's financial reporting process? If yes, what was the effect on the financial statements?
- **Were there any financial reporting issues** the AC should be aware of
- **What type of audit opinion did the external auditors expect to issue** on the financial statements?
- **Did the external auditors become aware of any instances of known or suspected fraud committed by employees**, questionable payments or breaches of laws and regulations?

### **1.2.8.3 Co-operation from Management<sup>12</sup>**

- **Was Management co-operative during the course of the external audit?** Did the external auditors encounter any difficulties, including significant disagreements with Management, during the audit?
- **Were time pressures placed on the external auditor's work?** If so, how did this affect the audit procedures performed and the conclusion drawn by the external auditors?

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<sup>12</sup> Ernst & Young LLP, 2006, *Audit Committee Member Toolkit*, United States

- **Did Management attempt to influence the scope and extent of the auditors' work?**
- **Were any audit adjustments raised by the external auditors related to errors in the financial statements?** How did the external auditors resolve these audit adjustments with Management? Were they unnecessarily defensive?
- **Where the external auditors identified material weaknesses or control deficiencies over financial reporting,** did Management respond adequately to address the issues?

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

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

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

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

## Engagement of External Auditors

- 1.2.9 One of the duties of the AC is to make recommendations to the Board on the appointment and reappointment of external auditors. In addition, the AC should review the external auditors' fees and make appropriate recommendations to the Board for approval. In order to discharge its responsibilities, the AC should consider instituting a formal process for the engagement of the external auditors.
- 1.2.10 In formalising such a process, the AC may wish to consider these factors:
- **Identifying the necessary procedures** involved in the reappointment of external auditors on an annual basis and set out the timeframe for the performance of these procedures. These procedures typically include:
    - Scheduling meetings with respective parties, e.g. Management, Board and audit firms for the evaluation and selection of auditors
    - Arranging for the approval of the appointment at the company's annual general meeting, making any necessary SGX announcements and lodgement of statutory forms etc
  - **Setting out the criteria** to be used for the evaluation and selection of external auditors. These would include:
    - The company's specific needs (e.g. if the company is in a specialised industry such as banking and insurance, the external auditors selected should have relevant knowledge and expertise within the industry)
    - The audit requirements in other jurisdictions where the company has operations
    - Number of audit firms invited for evaluation
    - Acceptable fee levels
- 1.2.11 The evaluation and selection process should cover both the evaluation of external auditors for new appointments, as well as the evaluation of the incumbent external auditors with regards to re-appointment. During the evaluation process, some of the factors that the AC should consider may include the following:

### 1.2.11.1 Evaluation of External Auditors for New Appointments

- **Background of the audit firm**
  - **The audit firm's standard billing rates** for classes of professional personnel for each of the last three years
  - **The audit firm's commitment** towards ensuring staff continuity on the company's audit, including the audit firm's staff turnover experience in the last three years and also other quality control systems
  - **What are the assigned partner's and manager's other similarly-sized clients?**
  - **How and why the audit firm is different** from other firms being considered and why the firm selected as independent auditors is the best
  - **How much attention the audit firm would give** to the company

- **The audit firm's reputation** (including obtaining a copy of the firm's most recent peer review report, outcome of recent firm inspections or other regulatory oversight reviews, if available), a related letter of comments and the firm's response to the letter of comments
- **The audit firm's approach** to the resolution of technical disagreements (a) among engagement personnel and (b) between the firm and the client
- **The audit firm intends to comply with the requirement for audit partner rotation** every five years (this is especially relevant to those companies that operate in specialised industries)
- **The audit firm's representation and network** in other jurisdictions that the company/group has operations in
- **How the audit firm co-ordinates with its counterparts** in other jurisdictions for audits involving multiple jurisdictions
- **How and to what extent the audit firm can keep the AC and Management apprised** of changes in accounting standards

- ***Experience in Industry***

- The audit firm's experience in providing audit and tax services to companies in the same sector, as well as companies of a comparable size

- ***Relationship and Experience with Regulators***

- The audit firm's experience in providing audit services to listed companies in the past three years
- Any investigation by the regulatory authorities where either the audit firm or their clients were the target
- If there are any civil or criminal litigation matters involving the audit firm but not necessarily the client
- Any positions taken by the audit firm with respect to accounting and audit matters, with the SGX, ICPAS and/or others, that could be viewed as controversial and are related to the company's business

- ***Expected Approach to this Audit***

- Identify the partner, manager and accountant in-charge who will be assigned to the company's audit if the audit firm is appointed and provide their work experience in biographic material
- If there are any complaints against these people that have been levelled by ICPAS or other regulatory authority and the remedial actions that have been taken by the audit firm
- How the firm will approach the audit of the company, including the use of any associated or affiliate member firm personnel

- The audit firm's fee proposal for the 20XX audit, with whatever guarantees that may be given regarding fee increases in future years. Ensure that the fee as proposed is sufficient to cover the work that the firm expects to perform if appointed
- Understand how frequently and in what manner (e.g. meetings and/or reports) the audit firm will be communicating matters arising from the audit to the AC

## **FAQs 21**

**A)**

**Q: Company S is a subsidiary of Company P. Both companies are incorporated in Singapore and are listed on the SGX. Must Company S engage the same accounting firm as Company P?**

A: As Company S is itself listed on the SGX, it may appoint different auditors according to the SGX Listing Rule 716. In this case, the AC of Company S should carry out the evaluation and selection process as stated in paragraph 1.2.11.1 above.

**B)**

**Q: Is the AC of the listed parent company responsible for the effectiveness of the AC of the listed subsidiary? How should the AC of the listed parents discharge this oversight responsibility?**

A: Each listed company must have its own AC which discharges its responsibilities independently (i.e. independent of the AC of its listed parent or major shareholder). However, if the parent company or major shareholder is also listed, such parent company or major shareholder can discharge an oversight role through its nominees on the Board and the AC of the listed subsidiary or associated company.

The Board and the AC of the listed subsidiary works independently and has to discharge its fiduciary responsibilities. The AC of the listed subsidiary does not have a reporting responsibility to its parent company's AC. However, in areas of common interest, the Chairman of both the ACs may discuss matters of common interests such as the sharing of IA resources, etc.

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

The parent company's AC could also consider requesting the parent company's auditor to present key significant or critical issues noted by the subsidiary.

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

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C)

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

A: The SGX Listing Rules do not require that the same network of accounting firms be appointed. However, Rule 715(2) of the SGX Listing Manual requires that Company A must engage suitable auditors for its significant foreign-incorporated subsidiaries and associated companies. In evaluating and selecting an appropriate auditor for its subsidiary, the AC of Company A could consider the factors as stated in paragraph 1.2.11.1 above. In addition, the AC should also consult its auditors on additional factors they should consider in appointing the subsidiary's auditor. This is because Company A's auditors would need to rely on the audit work performed by the subsidiary's auditors in order to express an opinion on the consolidated financial statements comprising Company A and its subsidiary.

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

- These are some factors that the AC may consider before it recommends to the Board the re-appointment of existing auditors:
  - The engagement partner and team members' overall business acumen and knowledge and experience in the company's industry
  - The AC's ability to build a trusting relationship with the partner in charge and its level of comfort with periodic contact between meetings
  - The auditor's ability to clearly, candidly and effectively communicate issues and concerns to the Committee, both in private sessions and during meetings
  - The auditor's ability to work co-operatively with Management, including the CEO and non-financial management, while maintaining objectivity
  - The auditor's ability to meet deadlines in providing services and responding to issues in a timely manner

#### **Auditors' Independence**

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

Such a framework should include these policies and procedures:

- Obtaining an annual confirmation from the external auditors that they have maintained their independence with respect to the company in accordance with the Accountants (Public Accountants) Rules
- Pre-approve the types of services (audit and permissible non-audit services) that can be performed by the external auditors. For non-audit services, AC could consider setting a fee limit above which the AC should be consulted and separately approve such services on a case-by-case basis
- These types of services should not be performed by the auditors:
  - Services that would result in the auditors functioning in the role of Management
  - Services that would result in the auditors auditing their own work
  - Services that would result in the auditors serving in advocacy roles for the company

Examples of such services include, but are not limited to:

- Book-keeping services
- Financial information systems design and implementation
- Appraisal or valuation services
- Actuarial services
- IA outsourcing services where such IA services are related to the internal accounting controls, financial systems and financial statements of the company
- Management or human resources functions

#### FAQ 22

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

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

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

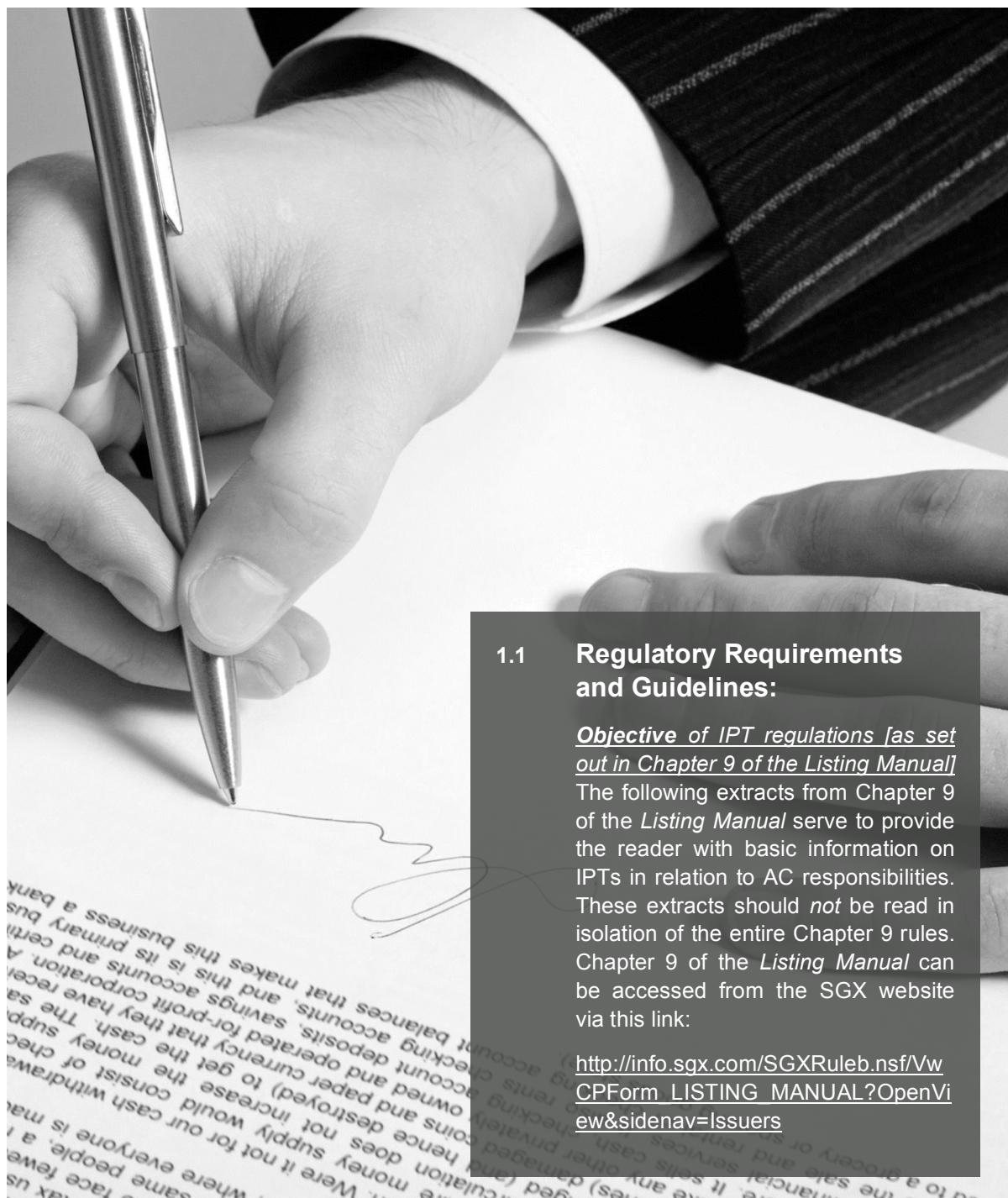
As for other services which are not prohibited, the AC should review the specific nature and scope of each type of tax work and ensure that the conduct of these services will not result in self-review or advocacy threats to the external audit.

- Review the non-audit services provided by the external auditors on an annual basis and the corresponding fees
- Where the fees paid to the external auditors for non-audit services in a financial year exceed 50% of the total amount of fees paid to the auditors in that financial year, the AC should conduct a review of all fees and expenses paid to the auditors and determine if the auditors' independence may be impaired

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# SECTION VI: OTHER DUTIES AND RESPONSIBILITIES

## A. INTERESTED PERSON TRANSACTIONS



### 1.1 Regulatory Requirements and Guidelines:

#### Objective of IPT regulations [as set out in Chapter 9 of the Listing Manual]

The following extracts from Chapter 9 of the *Listing Manual* serve to provide the reader with basic information on IPTs in relation to AC responsibilities. These extracts should *not* be read in isolation of the entire Chapter 9 rules. Chapter 9 of the *Listing Manual* can be accessed from the SGX website via this link:

[http://info.sgx.com/SGXRuleb.nsf/VwCPForm\\_LISTING MANUAL?OpenView&sidenav=Issuers](http://info.sgx.com/SGXRuleb.nsf/VwCPForm_LISTING MANUAL?OpenView&sidenav=Issuers)

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### General Requirements

#### 1.1.1 **Listing Rule 905:**

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

#### 1.1.2 **Listing Rule 906:**

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

### Sale of Property Units

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

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

1.1.4 **Listing Rule 916:** *These transactions are not required to comply with Rule 906:*

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

**Announcement Requirements**

1.1.5 **Listing Rule 917:** An announcement under Rule 905 must contain all of the following information:

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

**IPTs Under General Mandate**

1.1.6 **Listing Rule 920:**

- (1) An issuer may seek a general mandate from shareholders for recurrent transactions of a revenue or trading nature or those necessary for its day-to-day operations such as the purchase and sale of supplies and materials, but not in respect of the purchase or sale of assets, undertakings or businesses. A general mandate is subject to annual renewal.
- (b) A circular to shareholders seeking a general mandate must include:
  - (i) An opinion from the Audit Committee if it takes a different view to the independent financial adviser

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

#### Related Party Disclosures under FRS

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

##### **1.1.7 FRS 24 – Disclosure (Extracts):**

- 13. To enable users of financial statements to form a view about the effects of related party relationships on an entity, it is appropriate to disclose the related party relationship when control exists, irrespective of whether there have been transactions between the related parties.
- 17. If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to the requirements in paragraph 16 [of FRS 24] to disclose key Management personnel compensation. At a minimum, disclosures shall include:
  - (a) the amount of the transactions;
  - (b) the amount of outstanding balances and:
    - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
    - (ii) details of any guarantees given or received
  - (c) provisions for doubtful debts related to the amount of outstanding balances; and
  - (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

## 1.2 Best Practices:

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

- 1.2.1 When a company transacts with individuals who have significant influence over the decision-making process in the company (also defined by the Listing Rule as interested persons), there is a risk that the interests of the company or its shareholders may be compromised. The AC, with Independent Directors as the majority, is tasked to review such transactions (also defined by the Listing Rule as IPTs) and ensure that they are carried out on normal commercial terms and are not prejudicial to the interests of the company or its minority shareholders.

#### FAQ 23

##### Q: Are all IPTs also RPTs and all RPTs also IPTs?

A: Interested Person Transactions (IPTs) have a much narrower definition than Related Party Transactions (RPTs). An IPT may be simultaneously classified as an RPT. However, an RPT may not necessarily qualify as an IPT. Why? The definitions of an interested person and a related party illustrate this:

Interested persons, as defined in the Listing Manual, would encompass the Directors, the CEO, the controlling shareholder and their associates

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

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

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

Please refer to **Appendix E1** for a summary of differences between IPT and RPT.

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

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

### **Discharging oversight responsibility on IPT**

- 1.2.3 To enable the AC to properly discharge its oversight role over IPTs, Management must put in place a framework for the identification, valuation, approval and reporting of IPTs. The AC should satisfy itself that the framework will provide reasonable assurance that IPTs will be identified, evaluated, presented for review and approval and reported, where required. **Appendix E2** sets out an example statement of policy on IPTs.
- 1.2.4 The AC's role in relation to IPTs is distinct from the Board's. Whilst the Board considers and approves the commercial merits of IPTs, the AC's role is focused on the controls over the approval and pricing of IPTs to ensure that interested persons do not abuse their powers to gain unfair advantage to the detriment of the company and its minority shareholders. All Directors, and not just those on the AC, are responsible for ensuring that the company conducts its affairs in the best interest of the company and all shareholders.

### ***Identification of 'Interested Persons'***

- 1.2.5 To facilitate the identification of individuals who may have influence over decisions made by the company, the AC could request the Directors and the Chief Executive Officer (namely individuals identified as 'interested persons' in the Listing Rule) to submit regular disclosures on the directorships and shareholdings held by them and their associates and to sign a representation letter that the information submitted is complete, at least on an annual basis. In certain circumstances where it may be necessary to request similar disclosures from the controlling shareholder who is not a Director, officer or employee of the company, the availability of such information from the controlling shareholder may be subject to the willingness of the controlling shareholder to volunteer such information. **Appendix E3** sets out an example of such a disclosure form.

### Case Study 19

**This case study illustrates how an AC could act if it has concerns regarding a possible IPT:**

A listed property developer recently awarded a multi-million dollar waste management contract to a local contracting company. It was subsequently discovered that the contracting company was owned by a brother-in-law and a cousin of the listed developer's major shareholder, who is also the CEO of the listed company. The shareholder pointed out that neither the brother-in-law nor the cousin was considered as 'interested persons' under the Listing Rule and hence he saw no reason to disclose his relationship with them to the Board. He further clarified that he was not involved in the tender review or the selection process.

#### **Q: How should the AC respond?**

Under the Listing Rules, neither the brother-in-law nor the cousin are defined as 'interested persons' and the shareholder is correct in concluding that he is not required to disclose his relationships with these two parties. However, as transactions with such parties carry a risk of being prejudicial to the company or its minority shareholders, it is necessary that they be placed before the AC.

As mentioned in Listing Rule 902, the AC should have regard to commercial substance and not just form and technicality, in applying the Listing Rules on IPTs. As a result, notwithstanding the definition of interested persons, it is good practice for the controlling shareholder to discuss with the AC, transactions that could be construed as falling within the spirit of the IPT rules. Even if it does not fall within the definitions of an IPT, such a transaction might be an RPT requiring disclosure in financial statements.

The determination of whether such relationships are interested person relationships is not straightforward, and hence may require legal advice.

If the transaction is not considered to be an IPT but it has certain elements of an IPT that the AC sees a need to oversee, the AC would normally direct Management to put appropriate controls in place and report periodically to the AC.

- 1.2.6 The Listing Rules only identify certain specified relationships as interested persons. Examples of relationships that do not come within the definition of 'associate' in the Listing Rules, but that may potentially exert an influence over an interested person, are set out below:
- (a) Relatives who are not defined as members of the "immediate family" of a Director, Chief Executive Officer, or controlling shareholder
  - (b) Individuals who share a common home, habitat or residence and/or have a close relationship with or financial dependence on a Director, Chief Executive Officer, or controlling shareholder

- 1.2.7 Such relationships that potentially have the substance of interested person relationships are not easy to uncover, if there is an intention to conceal them from the AC. Certain entities with which the company has major transactions may potentially be interested persons which have not been identified. The AC should be aware of the possibility of such concealed interested person relationships. In normal circumstances, unless the AC has reason to believe that not all the IPTs are being identified, it does not implement additional procedures to uncover them.
- 1.2.8 Where the AC becomes aware of the other potentially close relationships with parties that are not interested persons, the AC should consider the need to make further enquiries on the influence that these parties might be able to exercise over the company, and consider the need for legal advice.
- 1.2.9 As to whether the relationship with any party does in fact exert any influence, real or perceived, over the outcome of executive decisions made by Directors and officers of the company, is a matter of judgement for the AC. In making its assessment, the AC should take account of all known circumstances. As the AC has to take account of the economic and commercial substance of the IPT, different conclusions may be arrived at in different situations for relationships that have the same legal form.

**FAQ 24**

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

A: Transactions with an interested person are viewed together with those entered into with associates of the interested person. Such transactions are aggregated as if these are all entered into with the same person, for the purpose of establishing the relative size and significance of the IPTs with the interested person. As this is an area that can be very complex and complicated, the AC should consider the need for professional advice where the groupings are not straightforward.

***Transaction Pricing***

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

### Case Study 20

**This case study illustrates how an AC could go about satisfying itself that the pricing of a transaction is appropriate:**

A listed company is proposing to buy several patents, from a research company owned by a Director, for S\$10 million. The company's Management has prepared case-for-investment papers showing that there is a sound business case for the purchase at the proposed price, with the return on investment exceeding the threshold rate used by the company. Management has also engaged an external specialist, who has issued a written report to say that the fair value of the patents on the royalty relief method is at least S\$10 million.

**Q: What could the AC do to determine if the transaction price is appropriate and not prejudicial to the interests of the company or its minority shareholders?**

The AC could ensure that the Board has considered the commercial merits of the proposed investment. It could discuss with Management the basis and assumptions behind Management's valuation of the patents and review the specialist report on the valuation, considering the independence and qualifications of the specialist. Based on those discussions and review, the AC could consider whether it needs to be directly involved in engaging an external specialist that has the independence and qualifications required by the AC to provide a second opinion.

- 1.2.11 Where the AC relies on an independent financial adviser (IFA), it should ensure that the work of the IFA is not unduly influenced by the IFA's contact and relationship with Management. As a minimum, the AC should ensure that it has available to it a list of candidates suitable for appointment and that it has the final say in the appointment decision.

### *Approval of IPTs*

#### Recurring Transactions - General Mandate

- 1.2.12 The company may seek a general mandate from shareholders for recurring IPTs of a revenue or trading nature or those necessary for its day-to-day operations such as the purchase and sale of supplies and materials, but not in respect of the purchase or sale of assets, undertakings or businesses.
- 1.2.13 Where frequent transactions are expected to be carried out pursuant to a general mandate, the AC could designate an Executive to review and approve the pricing of such transactions:
- The AC should empower this Executive to discharge its assigned duty independently of Management, so that he is not subject to undue influence from Management
  - The AC should establish a direct communication channel with the appointed Executive, including undocumented discussions and involvement in performance evaluations

### **FAQ 25**

**Q: A general mandate was obtained three years ago. To renew the mandate for another year, the AC has to issue a statement confirming that the methods or procedures set out in the shareholders' circular are sufficient to ensure that the transactions will be conducted on normal commercial terms and will not be prejudicial to the interests of the company and minority shareholders. What should the AC do prior to the release of this statement?**

A: In accordance with Listing Rule 920, the AC is required to confirm that the methods or procedures for determining the transaction prices have not changed or are sufficient to ensure that the transactions will be carried out on normal commercial terms and will not be prejudicial to the interests of the issuer and its minority shareholders.

To support the AC in making such confirmations, it could discuss with Management the methods or procedures currently in place and ascertain whether there have been problems in the application of the current procedures and whether there is room for improvement in the procedures. The AC should consider whether the internal auditor, the external auditor or an outside consultant should be tasked to review the relevance and adequacy of the methods and procedures.

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

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

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

### **Management Reporting on IPTs**

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

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

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

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

- A summary of IPTs
- Confirmation that mandated procedures have been followed
- Mandate on pricing criteria/guidelines every quarter
- Comparison of transacted prices with prices contracted with other non-related parties (if available), or with external market prices
- Declaration that prices for IPTs are reasonable and within market rates
- Gross margins on IPTs, where relevant

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

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

1.2.19 **Appendix E4** sets out the conditions that could indicate potential IPTs. **Appendix E5** sets out possible motivations for RPTs and **Appendix E6** sets out indicators of fraud in RPTs.

#### **Case Studies 21**

##### **A) This case study illustrates the measures an AC could take to be assured that potential RPTs and IPTs are identified:**

A listed manufacturer of electronic goods has been conducting a considerable proportion of its business with a group of companies, comprising Company X and Company Y whose parent company is incorporated in the British Virgin Islands (BVI parent company).

Company X is both a supplier and a customer. It sells raw materials to the listed company and purchases finished goods from the listed company. Management has explained that such transactions arise when Company X receives orders from its own customers that it cannot meet.

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Company Y is one of the listed company's major customers, contributing almost 20% of revenue. For this reason, Management of the listed company often grants preferential rates and generous payment terms to Company Y. The orders placed are large but irregular.

As the operations grew, the listed company has recently entered into a ten-year lease for premises and land with the BVI parent company, for its new plant expansion.

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

However the listed company does not consider Company X and Company Y to be related parties and no disclosures are made of transactions with these parties. As a result, shareholders are not aware of the nature of the links that the listed company's officers have with Company X and Company Y, nor the effect that transactions with these two companies have on the listed company's reported results.

Neither does the listed company disclose the BVI parent company as an 'interested person'. The lease transaction with the BVI company is not treated as an IPT. The listed company did not obtain shareholders' approval for the lease, nor was an opinion issued by the AC or an independent financial adviser on the transaction.

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

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

The AC should be alert to potential indicators of RPTs and IPTs. Where there are such indications (some of these examples being set out in **Appendix E4**), the AC should require Management to provide additional information on the transactions and the background of the trading partners to satisfy itself whether the transaction might be a RPT or an IPT where:

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

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**B) This case study illustrates some of the issues an AC should consider and the means to address them when assessing a transaction that may raise concerns regarding regulatory disclosures and IPTs:**

A listed offshore oil rig services firm is majority-owned by two Directors, who are the Chairman and the CEO. The Executive Chairman is the father of the CEO. The company has agreed to sell a business unit for S\$2 million to a company owned by the CEO's nephew. The consideration is to be satisfied by a loan extended by the vendor to the buyer to finance this sale. This transaction was not reported to the AC as an IPT. The AC chairman became aware of the connection with the CEO's nephew in a casual conversation prior to the completion of the sale.

When asked about the transaction, the CEO took the view that his nephew is not an 'interested person' under the Listing Rule and that the company's procedures relating to IPTs therefore did not apply. He also pointed out that this sale was being handled by the company's corporate strategy head and that he has had no direct involvement in the transaction.

**Q: What are the issues that the AC has to deal with?**

There are 3 issues that the AC faces above:

- Non-disclosure by an Executive Director and CEO of his relationship with a party entering into a transaction with the company
- The effect of the sale of the business unit on the interests of the company and its minority shareholders
- The basis of arriving at the sale price

**Q: How could the AC go about resolving the above issues?**

- The first issue the AC has to deal with is the failure of the CEO/Executive Director to disclose his relationship with the buyer of the business.

While a strict interpretation of the Listing Rules suggests that the AC does not need to review transactions with individuals that are not covered by the definition of 'interested parties', the AC should be alerted to transactions with persons outside of this definition that might in substance be an IPT. The AC could encourage the chairman and the CEO to discuss with the AC transactions with parties where they have a relationship that falls outside of the 'interested person' definition set out in the Listing Rules. In relation to the transaction with the CEO's nephew, the AC should seek full facts relating to the nature of the relationship between the CEO and his nephew and decide on what involvement that the AC would like in the approval of the transaction and its terms.

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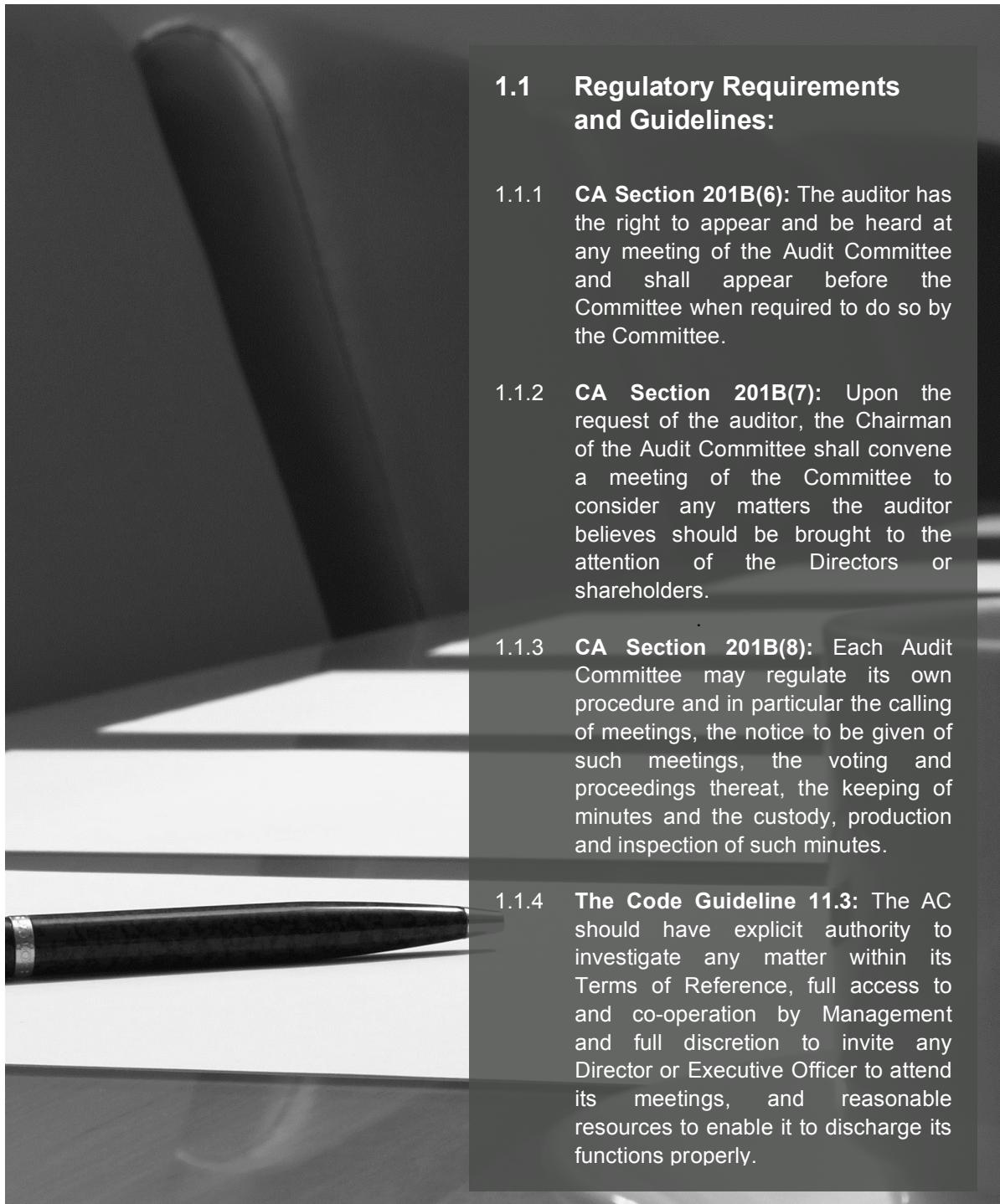
- The second issue relates to whether the sale of the business unit is in line with the company's objectives and in its best interests. This is a matter for the Board to decide. If this sale had been agreed without the Board's prior approval, the AC should consider whether the authorisation limits in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

**By virtue of the Listing Rules, the AC is charged with oversight responsibilities over IPTs.** Where a transaction is not strictly an IPT, as in this case, the AC could consider all surrounding circumstances to decide on the extent to which it feels a need for the transaction to be dealt with as if it is an IPT.

The AC could have an understanding with Management that sets out the types of relationships and transactions that it would want treated as if an interested person or an IPT that might extend beyond the Listing Rules' requirements. Had this been done earlier in this instance, this particular sale might have been required by the AC to be treated as if an IPT. Because the company has in this case already entered into legal obligations to sell the business unit without reserving the need to secure the approval of minority shareholders, the AC should wait for the decision of the Board (as set out above) as to whether the sale should proceed and together with legal advisers understand the legal complications involved, before deciding what further approval procedures on the sale price and the terms of sale (including the deferred payment terms) that the AC should oversee. The AC should consider the extent to which the value of the unit being sold is affected by the actions of the company prior to the sale (that could have been intended to depress the perceived value of the unit) or future intended actions of the company (that could increase the value of the unit) and consider the extent that the IA function or external advisers can help to establish whether the value of the unit being sold has been adversely affected by transactions that the AC is not aware of.

# SECTION VI: OTHER DUTIES AND RESPONSIBILITIES

## B. CONDUCT OF MEETINGS



## 1.2 Best Practices:

### Setting the Annual Workplan and Meeting Agenda

#### FAQ 26

**Q: How frequently should the AC meet to enable members to discharge their responsibilities adequately?**

**A:** The ACs of companies with quarterly reporting requirements should meet at least quarterly. In most other companies the AC also meets four times a year.

- 1.2.1 The AC should meet as frequently as required. At the start of each year, the AC should set out the annual workplan that lists the key activities that it needs to undertake during the year.
- 1.2.2 Based on the workplan, the AC Chairman, in consultation with the Company Secretary, should determine the frequency and timing of its meetings. The AC meetings should coincide with key dates within financial reporting and audit cycles. The number of meetings and their duration should vary depending on the scope and complexity of issues to be discussed.
- 1.2.3 There should be a sufficient time interval between the AC meeting and the Board meeting so as to allow any work arising from the AC meeting to be completed and reported to the Board as appropriate.
- 1.2.4 The AC should meet with the internal auditors and external auditors, without Management's presence, at least once a year, to communicate matters of concern.
- 1.2.5 The AC should undertake a full discussion on all issues, as may be required to enable all parties to seek clarification, ask questions and provide input.
- 1.2.6 The auditors should update the AC on the status of outstanding audit action plans and current year audit issues. Such discussions should be documented in the meeting minutes.
- 1.2.7 The AC meeting minutes should be given to the AC Chairman for approval before circulating to the AC members for comments, within a reasonable time period. Many companies have the policy of circulating the meeting minutes within 7 working days after the meeting.

### **FAQ 27**

**Q: Some AC meetings take two hours while others can take as long as half a day. How could the AC ensure that the meeting is conducted in an efficient and effective manner?**

A: In practice, most companies provide 2 to 4 hours for the AC to deal with standard agenda matters. Members should provide up to 4 hours to attend a routine AC meeting, so that there is sufficient time for members to participate and contribute to matters discussed.

To ensure that meetings are conducted efficiently and effectively, AC members should:

- Have a good understanding and appreciation of agenda matters to be discussed
- Receive information, documents or relevant meeting materials ahead of the meeting in order to have adequate time for review of the same (It is a good practice to agree that all meeting materials are received at least a pre-agreed number of days before the meeting)
- Devote time to review and read all meeting materials so as to be informed and apprised of matters to be discussed
- Come prepared for meetings so that discussions are meaningful and fruitful

The Chairman should stay focused and lead discussions on key areas.

Specifically for non-standard and non-routine agenda items, the AC should request that Management provide an executive summary to assist the AC to understand these items.

### **Case Study 22**

**This case study illustrates what an AC could do if it needs more time to consider a proposal tabled by Management without prior notice during a routine AC meeting:**

Towards the close of a routine AC meeting, the CEO tabled a proposal for the acquisition of a piece of development land from a related party, under 'Any Other Business'.

A short oral presentation on the value of the land and the purpose of the acquisition was made by the CEO, following which approval was sought for the acquisition to be recommended to the Board for consideration.

A proposed development plan was also tabled.

The meeting was scheduled to end in half an hour.

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### What could the AC do?

The meeting could be adjourned and re-convened at an appropriate time after members have received and reviewed all pertinent and relevant financial information on the proposed acquisition (e.g. valuation, funding, rate of return, cash flow projection and other information related to the interested person etc.). Members may submit their comments and input before the re-convened meeting to ensure effective and efficient conduct of the meeting.

Management must be reminded that oral presentations should be accompanied by handouts and significant and important matters should not be tabled under 'Any Other Business' but as separate agenda items.

- 1.2.8 Where there are key issues to be discussed, the AC should consider having ad-hoc meetings with Management to understand the issues before the AC meeting.
- 1.2.9 The AC Chairman should review the meeting agenda to ensure that critical issues are identified and prioritised so that these matters are tabled and addressed early in the agenda, in order to allow sufficient time for discussion.
- 1.2.10 It is the AC Chairman's responsibility to ensure that the re-convened meeting is scheduled on a date/time convenient to all members. Members should ensure attendance as far as possible. Members unable to attend should consider participating in the meeting via teleconference, video conference or any other form of audio or audio-visual instantaneous communication means.

### FAQ 28

#### **Q: What are some of the key financial information that the AC should request and receive from Management?**

A: Many companies provide the following information to the AC on a quarterly basis, and present them at each AC meeting. Such information includes reports on the performance and financial position of the company in respect of:

- Actual
- Last Year
- Budget/Forecast

with explanations for any material variances. Any unusual or non-recurring items should be identified and explained.

Materials to be provided before review of the performance of the company for each quarter should include:

- Comments from Management

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- Comments from auditors, if applicable (where an audit or a review has been undertaken)
- Financial review procedures undertaken by Management in the preparation of the financial statements (where no audit or review is performed by the auditors) to ensure its integrity and accuracy

The AC could require the CFO to provide frequent standing reports to identify and highlight areas of concern to the AC.

#### 1.2.11 The AC should require Management to :

- Confirm, at each meeting that no adverse or unusual events have taken place that would have an impact on the performance of the company
- Provide timely information on changes in business strategies and other relevant information

#### FAQ 29

A)

**Q: What could the AC do if Management reported that it has entered into transactions without obtaining the necessary prior approval from the AC and the Board?**

A: The AC could take these steps:

- **Seek professional assistance** of lawyers and auditors (in some situations, involving transactions that require disclosure or shareholder approval, consultation with the regulators might be appropriate)
- **Decide on an appropriate course of action** in consultation with the Board, having regard to advice received from the company's professional advisers and the regulators, including the need for an immediate announcement

B)

**Q: How could the AC Chairman and members resolve conflicts or disagreements within the Committee?**

A: All differing views should be considered in frank and open discussions within the Committee with the objective of addressing conflicts or disagreements.

The Chairman of the Board and/or the Board could be consulted.

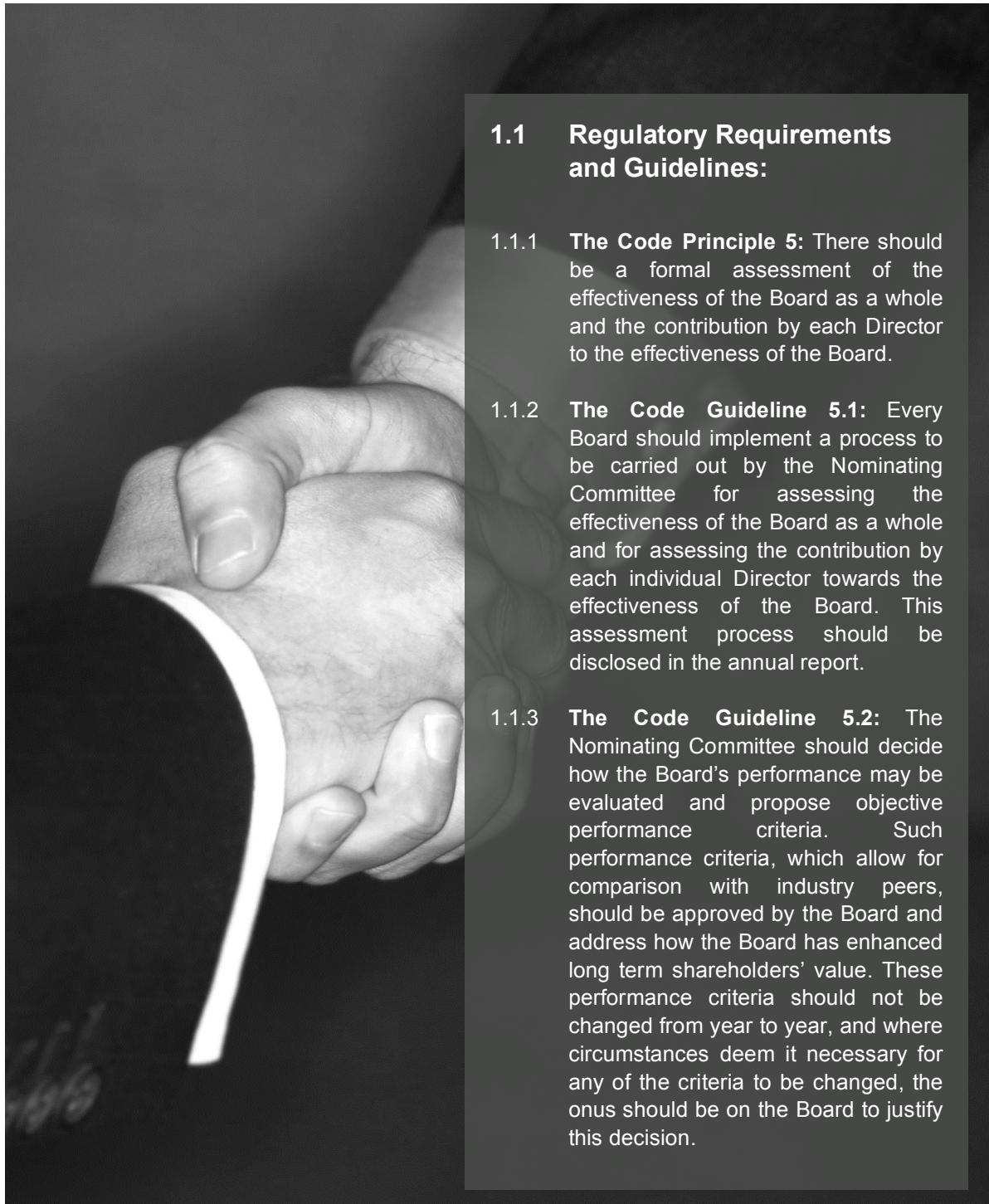
In some situations, it would be appropriate for unresolved issues to be brought to the attention of the regulators.

#### 1.2.12 Appendix F1 provides examples of good practices for an effective AC Chairman.

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# SECTION VI: OTHER DUTIES AND RESPONSIBILITIES

## C. PERFORMANCE ASSESSMENT



### 1.1 Regulatory Requirements and Guidelines:

- 1.1.1 **The Code Principle 5:** There should be a formal assessment of the effectiveness of the Board as a whole and the contribution by each Director to the effectiveness of the Board.
- 1.1.2 **The Code Guideline 5.1:** Every Board should implement a process to be carried out by the Nominating Committee for assessing the effectiveness of the Board as a whole and for assessing the contribution by each individual Director towards the effectiveness of the Board. This assessment process should be disclosed in the annual report.
- 1.1.3 **The Code Guideline 5.2:** The Nominating Committee should decide how the Board's performance may be evaluated and propose objective performance criteria. Such performance criteria, which allow for comparison with industry peers, should be approved by the Board and address how the Board has enhanced long term shareholders' value. These performance criteria should not be changed from year to year, and where circumstances deem it necessary for any of the criteria to be changed, the onus should be on the Board to justify this decision.

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- 1.1.4 **The Code Guideline 5.4:** Individual evaluation should aim to assess whether each Director continues to contribute effectively and demonstrate commitment to the role (including commitment of time for Board and Committee meetings, and any other duties). The Chairman should act on the results of the performance evaluation, and where appropriate, propose new members be appointed to the Board or seek the resignation of Directors, in consultation with the Nominating Committee.

## 1.2 Best Practices:

### Performance Assessment

#### FAQ 30

**Q: Should the AC conduct a performance evaluation of itself and individual members on the Committee?**

A: In most companies, the Board or the Nominating Committee conducts a formal review on the performance of the AC as a whole. If the AC Chairman or members of the AC have any feedback on their fellow Directors on the AC, they would normally give their comments to the Nominating Committee.

1.2.1 Together with the Nominating Committee, the AC could carry out a performance assessment exercise in these ways:

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

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

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

- Expertise
- Enquiring attitude, objectivity and independence
- Judgement
- Understanding of the company's business
- Commitment to the AC's duties and responsibilities
- Willingness to devote the time needed to prepare for and participate in the Committee's deliberations
- Timely responses
- Attendance and participation at meetings

1.2.3 On an annual basis, the Committee could review its performance against the Terms of Reference of the Committee, to ensure that the Committee has carried out its responsibilities. **Appendix G1** provides a sample checklist for self-assessment by the AC.

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

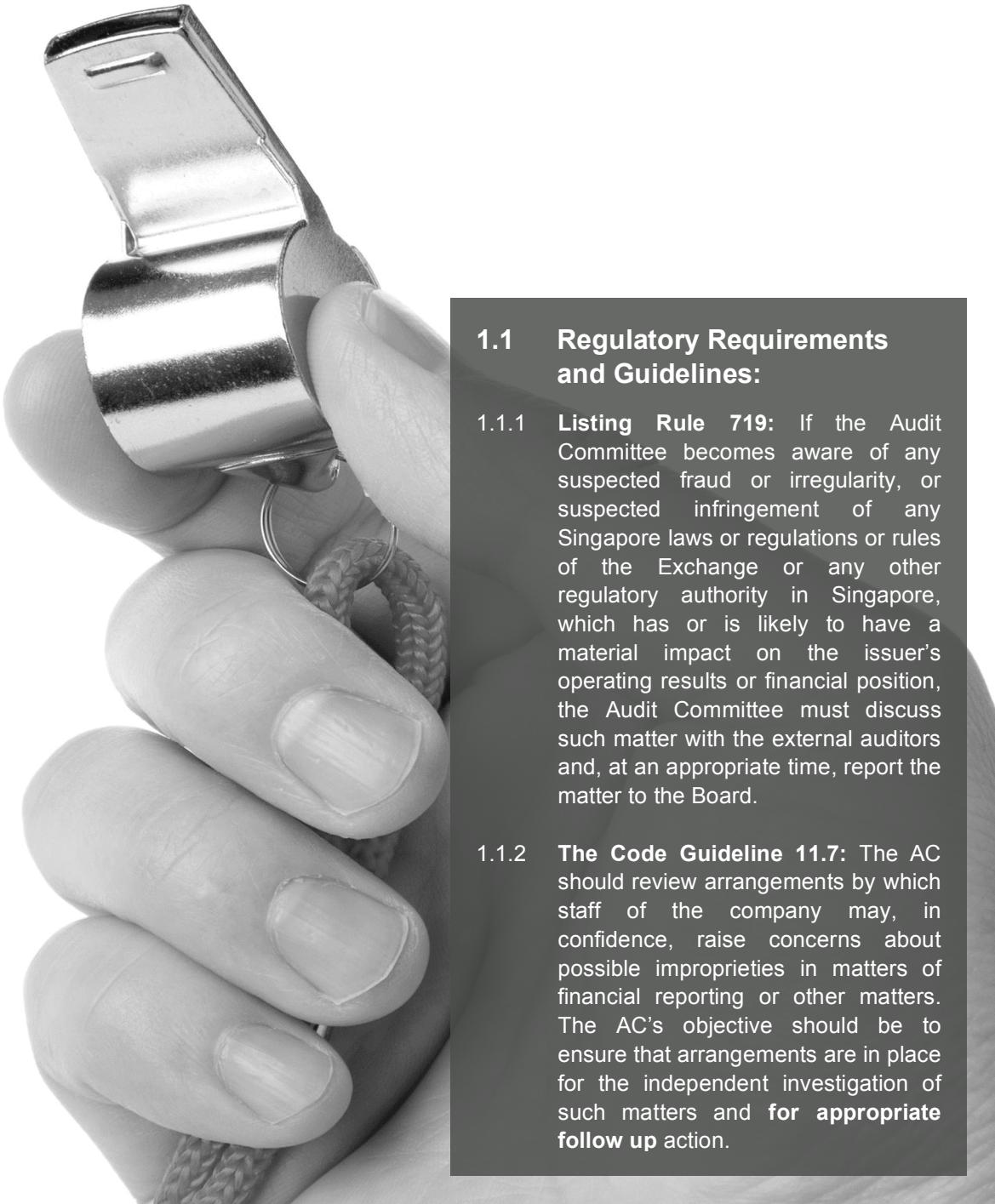
**FAQ 31**

**Q: What can the AC members do if the AC Chairman is not discharging his duties effectively?**

A: The AC members could provide feedback on the AC Chairman's performance to the Nominating Committee. If an annual performance evaluation is carried out, this feedback should be addressed during the evaluation.

# SECTION VI: OTHER DUTIES AND RESPONSIBILITIES

## D. WHISTLEBLOWING



### 1.1 Regulatory Requirements and Guidelines:

- 1.1.1 **Listing Rule 719:** If the Audit Committee becomes aware of any suspected fraud or irregularity, or suspected infringement of any Singapore laws or regulations or rules of the Exchange or any other regulatory authority in Singapore, which has or is likely to have a material impact on the issuer's operating results or financial position, the Audit Committee must discuss such matter with the external auditors and, at an appropriate time, report the matter to the Board.
- 1.1.2 **The Code Guideline 11.7:** The AC should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The AC's objective should be to ensure that arrangements are in place for the independent investigation of such matters and for appropriate follow up action.

## 1.2 Best Practices:

- 1.2.1 A whistleblowing policy is a formalised, secure and confidential procedure where employees or any individual can disclose any wrongdoings such as fraud, misconduct, breach of any health and safety law, or any other illegal act, either on the part of Management or by fellow employees. Elements of a good whistleblowing policy are set out in **Appendix H1** and a sample of a whistleblowing policy is provided in **Appendix H2**.
- 1.2.2 As recommended by the Code, the AC should seek to satisfy itself that there are proper arrangements in place for employees to raise concerns about possible improprieties in matters of financial reporting or other matters. The AC would need to ensure that there are appropriate arrangements for an independent investigation and follow up on the concerns raised.

### Scope of the whistleblowing policy

- 1.2.3 The scope of the whistleblowing policy should at minimum, address the regulatory obligations of the AC as set out in the Code guideline 11.7 and the Listing Rule 719. As such, the scope of the whistleblowing policy may be defined as follows:
  - **Unethical and improper practices** or alleged wrongful conduct in matters of financial reporting or other related matters
  - **Non-compliances** with regulatory requirements or corporate policies relating to financial reporting or related matters
  - **Questionable or suspicious practices** relating to accounting policies/ treatments or audit matters
  - **Any other acts that may have a material impact** on the company's operating results or financial position

### Recipient of whistleblowing reports

- 1.2.4 The recipient of the whistleblowing report should be independent and not subject to undue influence or pressure by Management. These personnel could be considered as appropriate independent recipients:
  - AC Chairman
  - External parties such as Company Secretary, legal adviser, outsourced IA firm
  - Head of IA department
  - Dedicated team or department that handles investigations of misconduct or any other matters and has a direct reporting line to Independent Directors
- 1.2.5 For companies where the controlling shareholder is also the CEO, the AC has to consider if an internal recipient is sufficient to deal with the complaint.

- 1.2.6 Recipients are required to submit all feedback received to the AC who will then decide on the actions required. The AC could include the review of whistleblowing reports in their routine meeting agenda.
- 1.2.7 Recipients of whistleblowing reports are responsible for ensuring that all feedback received are accounted for, appropriately secured (with restricted user access) and reported to the AC.
- 1.2.8 The AC may wish to set a timeframe for the timely resolution of matters arising from whistleblowing reports.

### **Protection for whistleblowers**

- 1.2.9 The recipient should also ensure the confidentiality of the whistleblower's identity at all times.
- 1.2.10 Where the identity of the whistleblower is known, steps should be taken to ensure that the staff is not subjected to reprisals.

### **Whistleblowing channels**

- 1.2.11 The AC should recommend that the whistleblowing policy provides options for the whistleblower to report via different channels such as electronic mailbox, facsimile and postal mail.

### **Communication of whistleblowing policy**

- 1.2.12 The whistleblowing policy should at minimum, be communicated to the staff of the company. Such communication should reach out to staff of all levels, new and existing staff, consultants, part-time and temporary staff and be written in an appropriate format and style that ensures that the intended audience can understand it.
- 1.2.13 The AC may consider having the whistleblowing policy accessible through the company's website or intranet, notice boards or internal electronic mail system.

### **Review of whistleblowing policy**

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

### FAQ 32

**Q: What are some of the factors that the AC could consider when reviewing a whistleblowing policy?**

A: The AC may want to consider these factors:

- **Does the policy set the right tone** to encourage users to blow the whistle?
- **Are there adequate procedures** to track the actions taken in relation to concerns raised and to ensure appropriate and timely follow-up action has been taken to investigate and, if necessary, resolve problems indicated by whistleblowing?
- **Have confidentiality issues been appropriately addressed** in the policy?
- **Are potential internal users of the whistleblowing policy identified and informed of the procedures?**
- **Does the policy specify protection** for the whistleblowers?
- **Are protocols established** for the timely distribution of each type of complaint to appropriate individuals within the company and to the AC and Board where appropriate?
- **Are complaints of any kind involving senior Management automatically and directly submitted** to the AC or other designated independent parties without filtering by Management or other personnel?
- **Are the internal auditors carrying out periodic review on the design and operating effectiveness** of the whistleblowing procedures?

### **Dealing with anonymous feedback**

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

### **Case Study 23**

**This case study illustrates how an AC could deal with an unsubstantiated complaint of a breach by the Chairman:**

The AC Chairman receives an anonymous letter that claims that the Chairman did not make the necessary regulatory disclosure relating to an investment by the company. The claim is supported with details which cannot be verified at this point.

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**Q: What could the AC do?**

The AC Chairman could convene a meeting with the AC members to review the contents of the letter. If the AC considers that there is a possibility of fraud, in accordance with the Listing Rule 719, the AC should discuss the facts of the case with the external auditors and seek legal advice. The AC Chairman could explain the regulatory requirements of the case to the Chairman and recommend for compliance.

If the AC does not consider that there is a likelihood of fraud, the AC should seek clarification from the Chairman and consider the need to escalate the issue to the Board for resolution. Where the AC is not satisfied with the Board's decision, the AC could seek advice from the external auditors and/ or the legal counsel.

*For more comprehensive guidance on fraud, please refer to the section on Internal Controls.*

**Handling whistleblowing reports**

**Case Study 24<sup>13</sup>**

**The following case study illustrates what an AC could do in response to allegations of fraudulent revenue recognition and bribery involving foreign government officials.**

Prior to the announcement of audited financial results and a secondary placement, the AC was confronted by a whistleblower's allegations of fraudulent revenue recognition and bribery of government officials by one of the group's foreign subsidiaries. In response to the allegations, the AC appointed the legal counsel working on the secondary placement to undertake an investigation.

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The appointed legal counsel found evidence of collusion and bribery involving management of the foreign subsidiary and government officials from a small sample of government projects. In the time available a limited review of other government contracts involving the particular foreign subsidiary was carried out. It did not yield evidence of further wrongdoing. It had the appearance of an isolated local incident involving only the management of the foreign subsidiary. A review of email traffic between the foreign subsidiary and head office aroused some suspicion by a member of the AC of an inappropriate tone at the top set by the group CFO on revenue recognition and an encouragement to bribe officials. Additionally, the same AC member also raised concerns over the financial incentives enjoyed by the group CFO in meeting financial targets. These concerns were dismissed by the other AC members as an insult to the integrity of the group CFO as the financial incentives were enjoyed by all senior management.

The group auditors accepted the report of the investigating legal counsel despite reservations from its own forensic team and evidence of revenue recognition problems raised by audit teams in other parts of the group. The group auditors issued an unqualified report on the financial statements which were included in the prospectus of the secondary offering.

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

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

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

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

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

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

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

# SECTION VI: OTHER DUTIES AND RESPONSIBILITIES

## E. TRAINING



### 1.1 Regulatory Requirements and Guidelines:

#### 1.1.1

**The Code Guideline 11.2:** The Board should ensure that the members of the AC are appropriately qualified to discharge their responsibilities. At least two members should have accounting or related financial management expertise or experience, as the Board interprets such qualification in its business judgement.

## 1.2 Best Practices:

### Training Requirements for AC members

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

#### FAQ 33

##### **Q: What are the training requirements for AC members?**

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

- 1.2.1 The AC Chairman should monitor the needs of the AC members and consider relevant courses for the members to attend. Such courses should provide the AC members with the necessary knowledge to discharge their oversight responsibilities effectively. The courses could cover these topics:
  - Updates on developments in accounting and reporting standards
  - Good practices in corporate governance
  - Risk and control issues relating to operations in specialised areas (e.g. Derivatives trading, treasury, policy underwriting)
- 1.2.2 Management should provide the AC with access to the company's training programmes, whether in-house or externally sourced.
- 1.2.3 At the point of its IPO launch, it is typical that the issue manager arranges training for the Directors to brief them on their responsibilities. The AC may explore the possibility of retaining the issue manager or any other training provider to continue this training role after the IPO.
- 1.2.4 The AC Chairman should ensure that the costs of courses and seminars attended by the AC members are borne by the company.

## Training Topics for AC members

### FAQ 34

#### **Q: What are the basic topics that all AC members should be familiar with?**

A: AC members should be familiar with:

- **Regulatory obligations and responsibilities** as a Director and an AC member
- **Company's business environment**, operations and the risks relating thereto
- **Key accounting and financial reporting concepts** and practices relevant for the industry

- 1.2.5 To the extent necessary, AC members should ensure that they have sufficient training on matters unique to the industry and business environment in which the company operates.
- 1.2.6 The expertise that collectively an AC should have would typically include knowledge of accounting standards, corporate governance, regulatory and compliance requirements and risk management.
- 1.2.7 AC members who do not have financial expertise or experience should attend general financial training and acquire an understanding of basic concepts in accounting principles and financial reporting.
- 1.2.8 Directors with no prior experience in serving on ACs of Singapore companies should familiarise themselves with the local business laws and regulations that are relevant to their duties as a Director and as an AC member.
- 1.2.9 The Company Secretary, external auditors and internal auditors should provide regular and timely updates to the AC on changes in the regulatory environment, accounting standards and industry best practices.

## Orientation for incoming AC members

- 1.2.10 The AC should work with Management and other compliance functions (e.g. IA, legal, risk management) on a formal process to brief new Committee members to ensure that they understand their responsibilities, the company's business and its operations, current issues, the audit process and the performance expectations of the Board. The briefing session should include:
  - An overview by Management and relevant compliance functions on the company's risk and compliance framework and any current audit and financial reporting issues
  - Meetings with Management and the internal auditor to discuss any unusual transactions or other matters that come under the purview of the Committee or that may concern the Committee
  - An introduction to and a meeting with the external auditor

1.2.11 The new AC members should be provided with:

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

1.2.12 **Appendix I1** sets out a list of topics that could be covered in the orientation programme for the AC members.

## APPENDIX A (AC COMPOSITION)

### Appendix A1: Sample confirmation of Director's independence form

(In completing this confirmation, a Director may wish to consider other factors that could affect his independence. These are discussed under "Independence and Objectivity", sections 1.2.1 and 1.2.2 of the "AC Composition" section.)

[COMPANY NAME]  
(Incorporated in [COUNTRY NAME])  
(Co. Reg. No: [CO NO])

#### CONFIRMATION OF INDEPENDENCE

I confirm the following:

1. That I \*am/am not an Executive Director of [COMPANY NAME] ("the Company") or any of its related companies and \*have/have not been employed by the Company or any of its related companies in the immediate past three financial years.
2. That I \*have/do not have an immediate family member (\*spouse/parent/brother/sister, son or adopted son or step-son or daughter or adopted daughter or step-daughter) who is, or has been in the immediate past three financial years, employed by the Company or any of its related companies as a senior executive officer whose remuneration is determined by the Company's Remuneration Committee.
3. That I, or an immediate family member (\*spouse/parent/brother/sister, son or adopted son or step-son or daughter or adopted daughter or step-daughter) \*have/have not accepted any compensation from the Company or any of its related companies other than fees for acting as a Director of the Company for the current or immediate past financial year.
4. That I, or an immediate family member (\*spouse/parent/brother/sister, son or adopted son or step-son or daughter or adopted daughter or step-daughter) \*am/am not \*a substantial shareholder of \*or a partner in (with 5% or more stake), \*or an executive officer of, or \*a Director of any for-profit business organisation to which the Company made, \*or from which the Company received, significant payments (aggregated over any financial year in excess of S\$200,000) in the current or immediate past financial year.
5. That I \*do/do not have a relationship with the Company, its related companies or its officers that could interfere or be reasonably perceived to interfere, with my exercise of independent business judgment with a view to the best interests of the Company and in carrying out my functions as an independent Director and as a member of any Board committee(s).

If any of the relationships stated above exist, please provide details:

.....  
.....  
.....

In view of the foregoing, I am to be considered \*independent/not independent of the Company's Management as contemplated by the Code of Corporate Governance.

.....  
Name:  
Date:

\* *Delete, where inapplicable.*

## **Appendix A2: Sample AC Terms of Reference<sup>14</sup>**

### **Membership**

The Board shall appoint an AC that has sufficient and relevant expertise to fulfill its role effectively.

The AC shall consist of not less than three members.

The AC shall be composed exclusively of Non-Executive Directors. At least, the majority of its members shall be independent. The Chairman of the Board should not chair the AC.

New AC members shall receive an induction covering the AC's Terms of Reference, and be provided with an overview of the company's internal control organisation and risk management systems.

### **Secretary**

The Secretary of the company shall be the Secretary of the Committee.

### **Attendance at meetings**

No one else other than AC members shall be entitled to attend AC meetings.

The Chairman of the Board, other Non-Executive Directors, the CEO, CFO, Head of IA, representatives of the external auditor(s), or other persons with relevant experience and expertise shall attend the meetings at the invitation of the Committee.

The AC shall meet the external auditor(s) and the Head of IA at least twice a year to discuss any issues arising from the audit process.

### **Frequency of meetings**

The AC shall meet at least four times a year (to coincide with key dates in the company's financial reporting cycle).

The external auditors and internal auditors may request a meeting whenever deemed necessary

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<sup>14</sup> Adapted from Audit Committee Institute, 2006, *A Practical Guide – Shaping the UK Audit Committee Agenda*, KPMG in the UK

## Authority

The AC is authorised by the Board to:

- **Annually review** its Terms of Reference and its own effectiveness and recommend any necessary changes to the Board
- **Assist the Board** in fulfilling its monitoring responsibilities by investigating any activity within its Terms of Reference
- **Seek any information** that it requires from any employee of the company within its Terms of Reference
- **Have direct and unrestricted access** to the representatives of the external auditor(s) and the Head of IA
- **Meet with any relevant person** of the company without the executive manager present
- **Obtain professional advice** at the company's expense whenever deemed necessary

## Duties

The duties of the Committee shall be fourfold:

### ***Overseeing financial reporting***

The Board shall appoint an AC that has sufficient and relevant expertise to fulfill its role effectively.

The AC shall:

- **Monitor the integrity** of the financial information provided by the company, in particular by reviewing the relevance and consistency of the accounting standards used by the company (i.e. entity level) and its group (i.e. consolidation level)
- **Assess, and challenge**, where necessary, the correctness, completeness, and consistency of financial information (including interim reports) before submittal to the Board for approval or made public

Particular attention should be paid to:

- **Critical accounting policies and practices**, and any changes in them
- **Decisions requiring a significant element of judgment**
- **The extent to which the financial statements are affected by any unusual transactions** in the year and how they are disclosed
- **Clarity of disclosures**
- **Significant adjustments** resulting from the audit
- **Going concern assumption**
- **Compliance with stock exchange** and other legal requirements
- **Significant financial reporting issues** with both executive management and the external auditor
- **Other topics** at the request of the Board

### ***Overseeing internal control (including risk management if delegated by the Board)***

- **Assess the effectiveness of the internal control** (including risk management) systems established by management to identify, assess, manage, and disclose financial and non-financial risks (including those relating to compliances with existing legislation and regulation) at least once a year [Note: The Board retains the responsibility for the review of the effectiveness of the system of internal control, and must form its own opinion despite aspects of the review being delegated to the AC.]
- **Where there is a Risk Committee, to coordinate** with the Risk Committee on its oversight on financial reporting matters
- **Review the statements included in the annual report** on the company's internal controls and risk management framework (if delegated by the Board)
- **Review Management's and the internal auditors' reports** on the effectiveness of the systems for internal control, financial reporting, and risk management
- **Review the company's procedures** for detecting fraud and whistleblowing, and ensure that arrangements are in place by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting, financial control, or any other matters

### ***Overseeing internal and external audit processes***

#### Internal audit

- **Monitor and assess** the role and effectiveness of the internal audit function in the overall context of the company's risk management system
- **Ensure that the internal audit function is adequately resourced** and skilled in line with the company's nature, size, and complexity
- **Ensure an adequate budget** is allocated to the internal audit function, assuring its proper functioning
- **Review the internal audit program** with regard to the complementary roles of the internal and external audit functions
- **Receive the internal audit reports** or a periodic summary thereof
- **Receive a report** on the results of the internal auditors' work on a periodic basis
- **Review and monitor management's responsiveness** to the internal auditor's findings and recommendations
- **Ensure that the Head of IA** has direct and unrestricted access to the Chairman of the Board and the AC
- **Participate in the selection** and approve the appointment or dismissal of the Head of IA
- **Assess the performance** and determine the remuneration of the head of internal audit, within company guidelines

#### External Audit

- **Oversee the company's relations** with the external auditor(s)
- **In connection with the terms of engagement to the external auditor(s), to make recommendations to the Board** on the selection, appointment, reappointment, and resignation of the external auditor(s) based upon a thorough assessment of the external auditor(s)' functioning. This proposal should be submitted to the general meeting of shareholders for approval

- **Review the external audit fees** and recommend it for approval by the Board
- **Monitor and assess** the external auditor(s)' independence. Steps to consider include:
  - **Seeking reassurance that the auditors and their staff** have no family, financial, employment, investment, or business relationship with the company and its group (other than in the normal course of business), based on a forwarded report by the external auditor(s)
  - **Seeking from the audit firm**, on an annual basis, information about policies and processes for maintaining independence and monitoring the external auditor(s)' compliance with relevant regulatory requirements (e.g. audit partner rotation requirements, level of fees the company pays in proportion to the overall income of the firm, etc.)
  - **Agreeing with the Board** and monitoring the company's policy for the employment of former employees of external auditor
- **Keep the nature and extent of non-audit services provided by the external auditor(s) under review** to ensure the external auditor's independence or objectivity is not impaired. In doing so, the AC will:
  - Set and apply a formal policy specifying the types of non-audit services: (a) from which the external auditors are excluded; (b) for which the external auditors can be engaged without referral to the AC; (c) for which a case-by-case decision is necessary by the AC
  - Consider whether the skills and experience of the audit firm make it a suitable supplier of the non-audit services
  - Ensure safeguards are in place to provide assurance that the external auditor's objectivity and independence is not impaired when performing non-audit services
  - Consider the nature of the non-audit service and the related fee levels (both individually and in aggregate) relative to the audit fee
- **To assess, at the end of the audit cycle**, the effectiveness of the audit process by:
  - Reviewing the external auditor's findings arising from the audit (including any issues that have subsequently been resolved), giving particular considerations to the key accounting and audit judgments (including why certain errors might remain unadjusted), the level of errors identified during the audit, and the obtained explanation from Management
  - Reviewing whether the auditor has met the agreed audit plan, and understanding the reasons for any changes, including changes in perceived audit risks, and the work undertaken by the external auditors to address those risks
  - Assessing the accuracy of the auditors in their handling of the key accounting and identified audit judgments, their responding to questions from the AC, and their commentary on the systems of internal control
  - Obtaining feedback about the conduct of the audit from the key people involved
- **Review the audit representation letters** before consideration by the Board, giving particular consideration to matters that relate to non-standard issues
- **Review the content of the external auditor's Management letter** in order to assess whether it is based on a good understanding of the company's business, and monitor the responsiveness of Management to the recommendations made (or the reasons why they have not been acted upon)
- **Ensure that the external auditors have direct and unrestricted access** to the Chairman of the AC and the Chairman of the Board

### ***Overseeing IPT***

- **Review IPTs** to consider whether they are on normal commercial terms and are not prejudicial to the interests of the company or its minority shareholders
- **Consider the need for a general mandate** for IPTs
- **Appoint an independent financial adviser** to advise on a general mandate
- **Where a general mandate is being renewed, consider whether the methods or procedures for determining the transaction prices** are sufficient to ensure that the transactions will be carried out on normal commercial terms and will not be prejudicial to the interests of the issuer and its minority shareholders
- **Direct Management to present** the rationale, cost-benefit analysis and other details relating to IPTs subject to a specific mandate
- **Consider the need for independent advisers** to advise on IPTs subject to specific mandates
- **Receive reports from Management and IA** on IPTs
- **Report to minority shareholders on its recommendations** on general and specific mandates

### **Reporting**

The AC shall report regularly to the Board on the exercise of its duties, identifying those matters which it considers require action or improvement, and making recommendations as to the step to be taken.

The AC shall, after each Committee meeting, send the Board a report on its findings and recommendations.

## APPENDIX B (INTERNAL CONTROLS)

### Appendix B1: Questions the AC might ask Management about internal control

Matters for Consideration Related to Internal Control<sup>15</sup>

Questions the AC may want to ask Management about internal control include:

#### *General*

- **Is the segregation of duties adequate?** (e.g. can one person both initiate and approve transactions?) If not, what steps are being taken to enhance segregation or mitigate the lack of segregation?
- **What are the company's anti-fraud programmes and controls?**
- **Does the company have a formal code of conduct?**
- **Are there adequate controls** over the approval and monitoring of special transactions? (e.g. related party transactions, securitisations using special purpose entities and other structured transactions)
- **How does the company use the Internet** for eCommerce and communications? Has Management assessed the adequacy of controls related to this technology, including the security, privacy, confidentiality and reliability of information and the systems supporting it?
- **Does the company have an appropriate business continuity plan** and has that plan been tested?
- **What longer-term improvements** in internal controls have been planned?

#### *Scope of Management's Assessment of Internal Control over Financial Reporting*

- **What, if any, is Management's project plan** to perform an assessment of internal control over financial reporting? What resources are committed to performing the assessment? Has Management discussed the project plan with the Board and obtained their approval?
- **How will Management determine the locations** to visit for the assessment? What type of 'coverage' (e.g. percentage of total assets, revenue, pre-tax income) will be obtained from the work performed to assess internal control?
- **Will any operations be excluded** from the evaluation?
- **Has Management established** a materiality threshold for determining the scope of its assessment of internal control over financial reporting?
- **What role will internal audit have** in Management's assessment of internal control over financial reporting?
- **What specialists will be involved** in evaluating controls over complex, judgemental and information-technology dependent processes?
- **Will identified control deficiencies and planned remedial actions be tracked**, evaluated and communicated to the AC?
- **How will Management's assessment consider and evaluate controls** over critical accounting estimates and judgemental areas?
- **How will information technology-dependent controls and information technology general controls be assessed** for effectiveness?

<sup>15</sup> In developing guidance for the appendix on "Matters for Consideration Related to Internal Control" of the guidebook, the ACGC has referred to Ernst & Young LLP, 2006, *Audit Committee Member Toolkit*, United States

- **If applicable, how will Management consider controls over accounting systems** that have been outsourced to a third-party service organisation?

Questions the AC may want to ask the internal auditors include:

*Scope of Audit of Internal Control over Financial Reporting*

- **Do you believe the company's project plan** and allocated resources are sufficient for purposes of Management's assessment of internal control over financial reporting this year?
- **Will internal audit be reviewing Management's assessment of internal control over financial reporting this year?**
- **How do you determine the locations to visit** for the review of internal control over financial reporting?
- **What type of 'coverage' (e.g. assets, revenue, pre-tax income) will be obtained** from the locations selected?
- **Will any operations be excluded** from the internal control assessment? If so, why?
- **How will control deficiencies and planned corrective actions be tracked**, evaluated and communicated to the AC?
- **How will information technology-dependent controls be assessed** for effectiveness?
- **What is the scope of information technology general controls** that will be included in your review of internal control over financial reporting?
- **How will your assessment consider and evaluate controls** over critical accounting estimates and judgemental areas?
- **What specialists will be involved in evaluating controls** over complex, judgemental and information-technology dependent processes?

Results of Internal Auditors' review of internal control over financial reporting

*General*

- **What control deficiencies** in the company's internal control over financial reporting were identified, and was the severity of each deficiency evaluated?
- **For identified control deficiencies that were determined to be material**, what are the underlying causes of the weaknesses (e.g. systemic or confined to a particular area)?
- **How did Management respond** to identified control deficiencies?
- **Did Management implement** new controls or strengthen existing procedures to correct control deficiencies before year-end?
- **Did Management exclude** any recently acquired business or other consolidated entities from their assessment of internal control over financial reporting?
- **How does Management intend to improve the process** for its assessment of the effectiveness of internal control over financial reporting in the future?
- **What are your observations** about the effectiveness of the company's control environment, including the 'tone at the top'?
- **Did you identify any control deficiencies** that could increase the risk of mis-statements due to fraud?
- **Did your review procedures uncover** any instances of employee fraud, questionable or illegal payments, or violations of laws or regulations?
- **What do you believe are the most important changes to internal control** the company needs to make in the future?

## Appendix B2: Information the AC might consider when assessing the internal control environment

### Consideration of Internal Control at the Entity Level<sup>16</sup>

When gaining an understanding of internal control at the entity level, it is helpful to consider information relating to each of the five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring.

The Audit Committee should appropriately consider if these factors are present, as these factors could relate to deficiencies in the company's internal control at the entity level.

#### Control Environment

##### *Integrity, Ethical Values and the Behaviour of Key Executives*

- **Lack of a written code of conduct**, or a code of conduct, or a code exists but is not communicated to all employees
- **A corporate culture that does not emphasise the importance of integrity** and ethical behaviour (e.g. violators are not immediately sanctioned)
- **Management does not lead by example**
- **Senior Management does not hold itself to the highest standards**
- **Management does not take appropriate action** in response to departures from approved policies and procedures or the code of conduct

##### *Management's Control Consciousness and Operating Style*

- **Management does not give appropriate attention** to internal control, including information technology controls
- **One or a few individuals dominate Management** without effective oversight by the Board or AC
- **Management has an aggressive tendency** with respect to selecting accounting principles and determining accounting estimates
- **Management does not consult** with the auditors on significant matters relating to internal control and accounting issues and/or there are frequent disputes with auditors

##### *Management's Commitment to Competence*

- **Accounting, finance and information technology personnel do not have the competence** and training needed to deal with the nature and complexity of the entity's business
- **Repeated errors are not addressed appropriately** by changes in personnel or systems
- **Management is not committed** to providing sufficient accounting and financial personnel to keep pace with the growth and/or complexity of the business and the demands of the stakeholders
- **Accounting and finance personnel do not have the required technical skills** to address new or pending accounting or statutory requirements

##### *Board and/or Audit Committee Participation in Governance and Oversight*

- **The Board does not have a charter** (or other written objectives) for the Audit Committee
- **There is no open line of communication** among the Board, Audit Committee and external and internal auditors, or the nature and frequency of communication is inappropriate given the size and complexity of the company
- **The members of the Audit Committee are not appropriately experienced or qualified**

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<sup>16</sup> Ernst & Young LLP, 2006, *Audit Committee Member Toolkit*, United States

- All members of the Board are not independent of Management
- The number and length of Board and Audit Committee meetings is not sufficient given the size and complexity of the company
- The Audit Committee (and/or Board) is not adequately involved in the financial reporting process
- The Audit Committee (and/or Board) does not give adequate consideration to monitoring business risks affecting the entity and Management's risk assessment processes (including the risks of fraud)
- High turnover of Board members

*Organisational Structure and Assignment of Authority and Responsibility*

- The assignment of responsibilities is not clear within the entity (including responsibilities specific to information systems processing and programme development)
- The structure for assigning ownership of data, including who is authorised to initiate and/or change transactions, is inadequate
- Policies and procedures for the authorisation of transactions have not been established at the appropriate level

*Human Resource Policies and Practices*

- The entity does not have adequate standards and procedures for hiring, training, motivating, evaluating, promoting, compensating, transferring, or terminating personnel (particularly those in accounting, finance and information systems)
- The entity does not have written job descriptions or reference manuals that inform personnel of their duties (or, in the absence of written documentation, adequate communication of job responsibilities and expectations)
- Policies and procedures are not clear, or they are not issued, updated, or revised in a timely manner
- The entity does not have adequate procedures for establishing and communicating policies and procedures to personnel at decentralised locations (including foreign operations)
- The Company does not have protection (e.g. insurance, bonding) for employees with access to cash, securities and other valuable assets

*Risk Assessment*

- A risk assessment process, including estimating the significance of risks, assessing the likelihood of their occurring and determining needed actions, has not been established
- The client's risk assessment process does not specifically include identifying and assessing the risks of fraud
- There are no mechanisms in place to anticipate, identify and react to changes that may have a dramatic and pervasive effect on the client (e.g. asset/liability Management committee in a financial institution, commodities trading risk management group in a manufacturing entity)
- There are no mechanisms in place to anticipate, identify and react to routine events or activities that affect achievement of entity or process/application-level objectives
- The accounting department does not have processes in place to identify significant changes in generally accepted accounting principles promulgated by relevant authoritative bodies
- Communication channels are not in place to notify the accounting department of changes in the client's business practices that may affect the method or the process of recording transactions
- The accounting department does not have processes in place to identify significant changes in the operating environment, including regulatory changes
- Entity-level objectives, including how they are supported by strategic plans and complemented on a process/application level, are not established and communicated

*Control Activities, Information and Communication*

- **Lack of adequate physical controls** (e.g. secured facilities, adequate safeguards over access to assets and data, authorisation for access to computer programmes and data files and periodic counting and comparison of physical assets with amounts shown on control records)
- **Lack of processes** for reviewing actual performance versus budgets, forecasts and prior period performance, or inadequate reporting of exceptions and variations from planned performance and appropriate responses to such exceptions and variations
- **Planning and reporting systems** (such as business planning budgeting, forecasting and profit planning and responsibility accounting) that do not adequately set forth Management's plans and the results of actual performance
- **Inadequate segregation of duties**
- **Inability to prepare accurate** and timely financial reports, including interim reports
- **Users are generally not satisfied** with information systems processing, including the reliability and availability of reports
- **Inappropriate level of coordination** between the accounting and information technology functions
- **Accounting and information technology departments are not properly staffed**, with experienced and/or capable personnel
- **There are no adequate policies and procedures** for developing and modifying accounting systems and controls, including changes to and use of computer programmes and/or data files
- **High turnover** of accounting and information technology personnel

*Monitoring*

- **Management does not respond** timely and appropriately to recommendations on internal control from the internal or external auditors
- **Monitoring procedures** are not performed in a timely fashion
- **A high level of customer complaints** and/or Management does not respond in a timely fashion and also appropriately to the cause of such complaints
- **For smaller entities, the owner/manager is not actively involved in the business**
- **The parent company does not adequately scrutinise** the activities of the various operating units (e.g. subsidiaries, divisions, plant locations)
- **If applicable, the oversight by legislative or regulatory bodies is not effective**
- **Internal audit is not adequately staffed and trained**, with appropriate specialised skills given the nature, size and complexity of the company and its operating environment
- **The internal audit department is not independent** (authority and reporting relationships) or does not have adequate access to the Audit Committee (or equivalent)
- **The scope of internal audit's activities is not appropriate** given the nature, size and complexity of the company and its operating environment
- **Internal audit does not devote sufficient time and attention** to evaluating the design and operation of internal control
- **Internal audit does not have the authority** to examine all aspects of the client's operations, including those overseen or controlled by senior Management
- **Internal audit does not adhere to professional standards**

### Appendix B3: Sample fraud policy

Example of a fraud policy<sup>17</sup>

#### Background

The corporate fraud policy is established to facilitate the development of controls that will aid in the detection and prevention of fraud against [name of entity]. It is the intent of [name of entity] to promote consistent organisational behaviour by providing guidelines and assigning responsibilities for the development of controls and conduct of investigations.

#### Scope of policy

This policy applies to any irregularities, or suspected irregularity, involving employees as well as shareholders, consultants, vendors, contractors, outside agencies doing business with employees of such agencies and/or any other parties with a business relationship with [name of entity], (also called the Company)

Any investigative activity required will be conducted without regard to the suspected wrongdoer's length of service, position/title, or relationship to the company.

#### Policy

Management is responsible for the detection and prevention of fraud, misappropriations and other irregularities. Fraud is defined as the intentional, false representation or concealment of a material fact for the purpose of inducing another to act upon it to his or her injury. Each member of the Management team will be familiar with the types of improprieties that might occur within his or her area of responsibility and be alert for any indication of irregularity.

Any irregularity that is detected or suspected must be reported immediately to the Director of [ ], who coordinates all investigations with the Legal Department and other affected areas, both internal and external.

#### Actions constituting fraud

The terms defalcation, misappropriation and other fiscal irregularities refer to, but are not limited to:

- Any dishonest or fraudulent act
- Misappropriation of funds, securities, supplies, or other assets
- Impropriety in the handling or reporting of money or financial transactions

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<sup>17</sup> Association of Certified Fraud Examiners, American Institute of Certified Public Accountants & The Institute of Internal Auditors, 2007, 'Appendix C: Sample Fraud Policy', *Managing the Business Risk of Fraud: A Practical Guide*, Florida

- Profiteering as a result of insider knowledge of the company activities
- Disclosing confidential and proprietary information to outside parties
- Disclosing to other persons securities activities engaged in or contemplated by the company
- Accepting or seeking anything of material value from contractors, vendors, or persons providing services/materials to the company. Exception: Gifts less than [ ] in value
- Destruction, removal, or inappropriate use of records, furniture, fixtures and equipment; and
- Any similar or related irregularity

### **Other irregularities**

Irregularities concerning an employee's moral, ethical, or behavioural conduct should be resolved by departmental Management and the Employee Relations Unit from Human Resources rather than the [ ] Unit.

If there is any question as to whether an action constitutes fraud, contact the Director of [ ] for guidance.

### **Investigation responsibilities**

The [ ] Unit has the primary responsibility for the investigation of all suspected fraudulent acts as defined in the policy. If the investigation substantiates that fraudulent activities have occurred, the [ ] Unit will issue reports to appropriate designated personnel and, if appropriate, to the Board through the Audit Committee.

Decisions to prosecute or refer the examination results to the appropriate law enforcement and/or regulatory agencies for independent investigation will be made in conjunction with legal counsel and senior Management, as will final decisions on disposition of the case.

### **Confidentiality**

The [ ] Unit treats all information received confidentially. Any employee who suspects dishonest or fraudulent activity will notify the [ ] Unit immediately and *should not attempt to personally conduct investigations or interviews/interrogations* related to any suspected fraudulent act (see Reporting procedures below).

Investigation results *will not be disclosed or discussed* with anyone other than those who have a legitimate need to know. This is important in order to avoid damaging the reputations of persons suspected but subsequently found innocent of wrongdoing conduct and to protect the company from potential civil liability.

### **Authorisation for investigating suspected fraud**

Members of the Investigation Unit will have:

- Free and unrestricted access to all Company records and premises, whether owned or rented
- The authority to examine, copy and/or remove all or any portion of the contents of files, desks, cabinets and other storage facilities on the premises without prior knowledge or consent of any individual who might use or have custody of any such items or facilities when it is within the scope of their investigation

### **Reporting procedures**

Great care must be taken in the investigation of suspected improprieties or irregularities so as to avoid mistaken accusations or alerting suspected individuals that an investigation is under way.

An employee who discovers or suspects fraudulent activity will *contact the [ ] Unit immediately*. The employee or other complainant may remain anonymous. All enquiries concerning the activity under investigation from the suspected individual, his or her attorney or representative, or any other enquirer should be directed to the Investigations Unit or the Legal Department. No information concerning the status of an investigation will be given out. The proper response to any enquiries is 'I am not at liberty to discuss this matter'. *Under no circumstances* should any reference be made to 'the allegation', 'the crime', 'the fraud', 'the forgery', 'the misappropriation', or any other specific reference.

The reporting individual should be informed of the following:

- Do not contact the suspected individual in an effort to determine facts or demand restitution
- Do not discuss the case, facts, suspicions, or allegations with *anyone* unless specifically asked to do so by the Legal Department or [ ] Unit

### **Termination**

If an investigation results in a recommendation to terminate an individual, the recommendation will be reviewed for approval by the designated representatives from Human Resources and the Legal Department and, if necessary, outside counsel, before any such action is taken. The [ ] Unit does not have the authority to terminate an employee. The decision to terminate an employee is made by the employee's Management. Should the [ ] Unit believe the Management decision is inappropriate for the facts presented, the facts will be presented to executive-level Management for a decision.

### **Administration**

The Director of [ ], is responsible for the administration, revision, interpretation and application of this policy. The policy will be reviewed annually and revised as needed.

## Appendix B4: Red Flags of Fraud<sup>18</sup>

### 1 Fraudulent Financial Reporting - Risk factors

#### 1.1 Management's characteristics and influence over the control environment

##### 1.1.1 Motivation to engage in fraudulent financial reporting

- A significant portion of Management's remuneration: bonuses, stock options or other incentives, depends on the achievement of aggressive financial targets
- Representations made by Management to analysts, creditors and other third parties regarding the achievement of financial targets which appear to be overly aggressive or unrealistic
- Inclination by Management to use inappropriate accounting practices to maintain or boost share prices and/or minimise tax liabilities

##### 1.1.2 Failure of Management to adhere to sound practices concerning internal controls and financial reporting processes

- Lack of clearly written policies relating to internal controls and financial reporting processes
- Absence of a written code of conduct and/or code of ethics
- Lack of communication on the entity's policies and codes
- Decision-making within Management is dominated by an individual or a group of individuals without compensating controls such as effective oversight by the Board or the Audit Committee
- Inadequate monitoring of significant controls
- Failure to correct known reportable conditions promptly
- Setting of overly aggressive financial targets and expectations for employees
- Disregard for the need to comply with regulatory requirements
- Employment of ineffective or inexperienced staff in accounting, IA and/or IT audit

##### 1.1.3 Non-financial Management excessively participates in, or is pre-occupied with the selection of accounting principles or the determination of significant estimates

##### 1.1.4 High turnover of senior Management and/or Board members

##### 1.1.5 Strained relationship between Management and the current or predecessor auditor

- Frequent disagreements with the current or predecessor auditor on accounting, audit or reporting matters

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<sup>18</sup> Extracted from Red Flags of Fraud, KPMG Forensic, Singapore

- Placing unreasonable demands on the auditor including unreasonable time constraints to complete the audit
  - Formal or informal restrictions placed on auditors limiting their access to information and/or their ability to communicate effectively with the Board or the Audit Committee
  - Domineering Management behaviour in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work and findings
- 1.1.6 Company and its senior Management have a known history of violating securities law

## **1.2 Economic and regulatory environment in which the entity operates**

- 1.2.1 New legislation and/or regulations in the following areas that may have an impact on the financial stability or profitability of the entity:
- Accounting
  - Statutory
  - Regulatory
- 1.2.2 High degree of competition or market saturation, accompanied by declining margins (Are the margins of the company declining?)
- 1.2.3 Company is highly vulnerable to rapidly changing technology or rapid product obsolescence (How does the company respond to those rapid industry changes?)
- 1.2.4 Have acquisitions been taking place in the last few years? If so:
- How many have taken place?
  - Over which period did they take place?
  - What kind of companies were acquired?
  - When?
- 1.2.5 Has the company been a subject of any restructuring exercise?

## **1.3 Operating characteristics and financial stability**

- 1.3.1 Inability of the company to generate positive cash flows despite reporting growth in earnings
- 1.3.2 Significant pressure to obtain additional capital necessary to stay competitive such as the need to raise funds to finance major research and development or capital expenditures

- 1.3.3 Aggressive estimates used in valuing company assets, liabilities, revenues or expenses. Examples: ultimate collectibility of receivables, timing of revenue recognition, realisability of financial instruments based on the highly subjective valuation of collateral, difficult-to-assess repayment sources, or significant deferral of costs etc.
- 1.3.4 Having significant related party transactions not in the ordinary course of business or not audited
- 1.3.5 Having significant transactions with parties of inadequate financial standing
- 1.3.6 Unusual or highly complex transactions, especially close to year-end, that pose difficult 'substance over form' questions
- 1.3.7 Significant bank accounts in a tax-haven jurisdiction for which there appears to be no clear business justification
- 1.3.8 Subsidiary or branch operations in a tax-haven jurisdiction for which there appears to be no clear business justification
- 1.3.9 Complex organisation structure, involving numerous or unusual legal entities, managerial lines of authority, or contractual arrangements without any apparent business purpose
- 1.3.10 Individual(s) of the organisation that control(s) the entity is/are difficult to be determined
- 1.3.11 Unusually rapid growth or profitability, especially compared with that of other companies in the same industry
- 1.3.12 Vulnerable to changes in interest rates
- 1.3.13 Unusually high dependence on debt or marginal ability to meet debt repayment requirements (Are there debt covenants which are difficult to maintain?)
- 1.3.14 Unrealistically aggressive sales or profitability incentive programmes
- 1.3.15 Threat of imminent bankruptcy, foreclosure or hostile take-over
- 1.3.16 Adverse consequences on significant pending transactions such as business combination or contract award, if poor financial results are reported
- 1.3.17 Poor or deteriorating financial position of the company while Management has personally guaranteed significant debts of the entity
- 1.3.18 Significant changes have taken place with regard to:
  - The organisation's operating environment
  - Staffing
  - IT
  - Products or activities

## Appendix B5: Fraud Warning Signals – Examples<sup>19</sup>

Financial Consideration
<ul style="list-style-type: none"><li>• <b>Exposure to interest</b> and currency fluctuations</li><li>• <b>Organisation's share price has fallen</b> sharply recently</li><li>• <b>Overly complex transactions</b> and organisational structures</li><li>• <b>Deterioration in the collection of debts</b> and/or quality of debtors</li><li>• <b>Increase in amounts owed</b> to creditors</li><li>• <b>Ongoing or prior investigation</b> by regulators</li><li>• <b>Inadequate information</b> regarding financial performance</li><li>• <b>Unusually rapid growth</b></li><li>• <b>Regular deferral</b> of capital expenditure</li><li>• <b>Unrealistic earning expectations</b> by the financial community</li><li>• <b>Explanation for variances</b> from budget considered to be inadequate</li><li>• <b>Excessive or inappropriate performance-based compensation</b></li><li>• <b>Gearing or liquidity forecast</b> to be a problem</li><li>• <b>Inadequate review and analysis of budgets</b> against actual performance</li><li>• <b>Recognising revenue</b> before sale is complete</li><li>• <b>Loan agreement covenants</b> not being complied with</li><li>• <b>Results appear unrealistically</b> high given industry and economic conditions</li><li>• <b>Key ratios deteriorating</b></li><li>• <b>Significant decline in turnover</b> and market share</li><li>• <b>Last minute transactions</b> that result in significant revenues</li><li>• <b>Slow-down in receipt of financial reports</b></li><li>• <b>Financial results consistently meet</b> or closely match budget/forecast</li><li>• <b>Unusual results or trends</b></li><li>• <b>Organisation incurs losses</b></li></ul>

<sup>19</sup> Audit Committee Institute, 2006, *A Practical Guide – Shaping the UK Audit Committee Agenda*, KPMG in the UK

## Board and Management

- **Chairman and CEO dominate meetings** and make decisions without first consulting the Board
- **Autocratic Management**
- **Inappropriate ‘tone at the top’**
- **Flow of information delayed**, especially concerning problem areas
- **Inexperienced Management**
- **Inadequate examination** of acquisitions and mergers
- **Insufficient questioning and enquiry** by Board members
- **Lack of harmony and respect** between Board members
- **Lack of understanding** about technology
- **Insufficient number of board committees**
- **CEO is a dominant entrepreneur**
- **Managerial and Board self-indulgence**
- **Lack of Management oversight**
- **Poor relationship** between Directors and senior Management
- **Reporting to the Board** only through the CEO
- **Board and Management focused on the past**
- **Resignation** of key Management
- **Failure to comply with code of ethics/conduct**

## Audit Considerations

- **Auditors report and Management letters show an increasing number of control problems** and areas of disagreement with Management
- **External auditors changed** due to accounting or financial reporting disagreements
- **Internal auditors performing under restrictions**
- **Organisation’s accounting principles and practices** are aggressive or vary from the industry norm
- **Untimely reporting and responses** to AC enquiries
- **AC not meeting with external and internal auditors without Management present**

## Other Warning Signals

- **Abnormally high levels** of related party transactions
- **Exposure to rapid technology changes**
- **Frequent customer complaints** about quality of goods and services provided
- **Increasing stock levels** compared to turnover
- **Major deterioration** in any of the organisation's key markets
- **No policy for managing** key intellectual capital assets
- **Insufficient controls** over disposal of pollutants
- **Performance of major outsourced providers** less than adequate
- **Insufficient review** of compliance with legislative requirements
- **Media commenting adversely** on the organisation's performance and products
- **Deteriorating morale**
- **Resistance to abandonment** of an unprofitable venture
- **Not fully understanding** overseas market places
- **Shortage of raw material or inventories**, resulting in the late delivery of orders and indicating a loss of supply markets or late payment of creditors
- **Significant drop in sales order activity**, especially forward sales
- **Significant staff turnover**
- **Significant strategic changes** in the organisation's operating environment
- **Trend of losses** appears continuing
- **Unexpected losses have occurred**
- **Major new projects 'out of control'** – behind time, significantly over budget, not delivering benefits
- **Deteriorating performance** on long term projects
- **Consideration of high risk strategies**
- **Deteriorating relationship** with the organisation's banker
- **Lack of or inadequate succession planning**
- **Bad news not floating to the top**

## APPENDIX C (RISK MANAGEMENT)

### Appendix C1: Possible types of risks faced by a company

(Note: These risks may be considered by the AC if they are relevant to the company. The list is not exhaustive.)

#### **Business and environmental risks**

- Business continuity/ pandemic
- Business market environment
- Liability lawsuits
- Political risk
- Regulatory/ legislative/ compliance
- Materials risk
- Supply chain
- Terrorism

#### **Financial risks**

- Capital availability
- Credit/ counterparty
- Financial market risk (including interest rates and liquidity)
- Complex instruments (such as market-price sensitive financial instruments, embedded financial derivatives and leveraged financial instruments)

#### **Management risks**

- Data security
- Employee health and safety
- Mergers and acquisitions/restructuring
- Outsourcing problems
- Reputation
- Information support systems
- Succession planning

**Appendix C2:** Identifying and assessing risk – sample questions<sup>20</sup>

Risk management framework	Evaluation of risk management framework
<b>Risk strategy:</b> the approach for associating and managing risks based on the organisation's strategies and objectives	<ul style="list-style-type: none"> <li>• <b>What are the risks</b> inherent to our business strategies and objectives?</li> <li>• <b>How is our risk strategy</b> linked to our business strategy?</li> <li>• <b>Is our risk management policy clearly articulated</b> and communicated to the organisation? If not, why not? If yes, how has this been achieved?</li> <li>• <b>Is our risk appetite (the amount of risk the organisation is willing to take) clear?</b> How is that linked to our objectives?</li> <li>• <b>How has the Board's perspective on risk permeated the organisation and culture?</b></li> </ul>
<b>Risk structure:</b> the approach for supporting and embedding risk strategy and accountability	<ul style="list-style-type: none"> <li>• <b>Is there a common risk management language/terminology</b> across the organisation? If not, why not?</li> <li>• <b>Is accountability of risk management transparent</b> at Management level? If not, why not? If yes, describe how this has been achieved</li> <li>• <b>Are risk management activities/responsibilities included in job descriptions?</b></li> <li>• <b>How do our performance management and incentive systems link to our risk Management practices?</b></li> </ul>
<b>Measuring and monitoring:</b> the establishment of KPIs and continuous measuring and improving of performance	<ul style="list-style-type: none"> <li>• <b>Are risk owners clearly identified?</b> If not, why not? If yes, how?</li> <li>• <b>Are there systems in place</b> for measuring and monitoring risk?</li> <li>• <b>How are risks, including suspected improprieties, escalated to the appropriate levels</b> within the organisation?</li> <li>• <b>How is the risk management framework</b> linked to the organisation's overall assurance framework?</li> </ul>

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<sup>20</sup> Audit Committee Institute, 2006, *Audit Committee Toolkit*, KPMG in the UK

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Risk management framework	Evaluation of risk management framework
<p><b>Portfolio:</b> the process for identifying, assessing and categorising risks across the organisation.</p>	<ul style="list-style-type: none"> <li>• Does a comprehensive risk profile exist for the organisation? If not, why not?</li> <li>• Does the risk profile evidence identification and evaluation of non-traditional risk exposures?</li> <li>• Are the interrelationships of risks clearly identified and understood?</li> </ul>
	<p><b>Operational Risk</b></p> <ul style="list-style-type: none"> <li>• What are the risks inherent in the processes chosen to implement the strategies?</li> <li>• How does the organisation identify, quantify and manage these risks given its appetite for risk?</li> <li>• How does the organisation adapt its activities as strategies and processes change?</li> </ul>
	<p><b>Reputation Risk</b></p> <ul style="list-style-type: none"> <li>• What are risks to brand and reputation inherent in the way the organisation executes its strategies?</li> </ul>
	<p><b>Regulatory or Contractual Risk</b></p> <ul style="list-style-type: none"> <li>• Which financial and non-financial risks are related to compliance with regulation or contractual arrangements?</li> </ul>
	<p><b>Financial Risk</b></p> <ul style="list-style-type: none"> <li>• Has operating processes put financial resources at undue risk?</li> <li>• Has the organisation incurred unreasonable liabilities to support operating processes?</li> <li>• Has the organisation succeeded in meeting measurable business objectives?</li> </ul>
	<p><b>Information Technology Risk</b></p> <ul style="list-style-type: none"> <li>• Is our data/information/knowledge reliable, relevant and timely?</li> <li>• Are our information systems reliable?</li> <li>• Do our security systems reflect our e-business strategy?</li> </ul>

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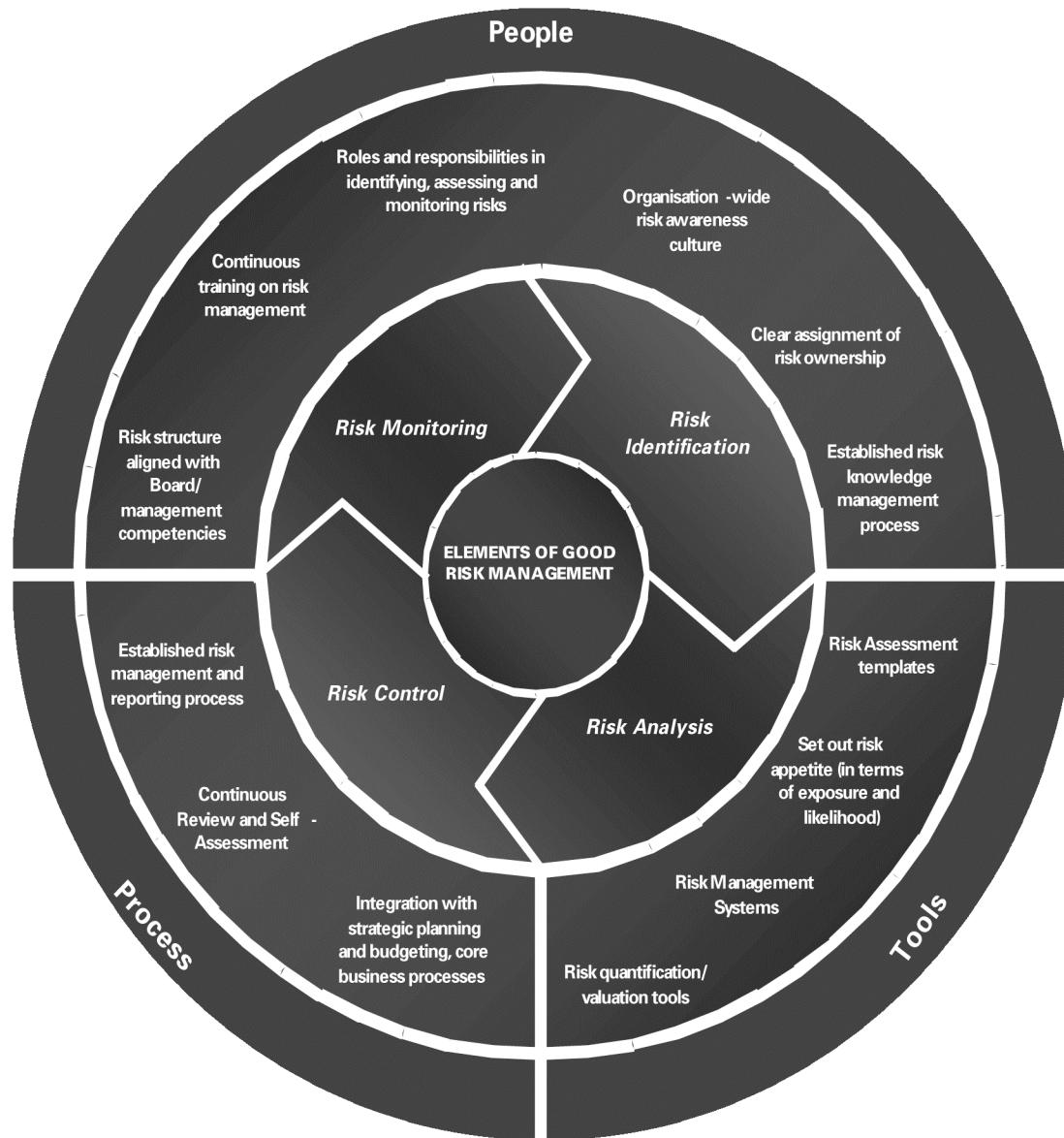
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Risk management framework	Evaluation of risk management framework
	<p><b>New Risks</b></p> <ul style="list-style-type: none"><li>• In a business environment that is constantly changing, are there processes in place to identify emerging risks? If not, why not? If yes, describe</li><li>• <b>What risks have yet to be developed?</b> These might include risks from new competitors or emerging business models, recession risks, relationship risks, outsourcing risks, political or criminal risks, financial risk disasters, such as rogue traders and other crisis and disaster risks.</li></ul>
<p><b>Optimisation:</b> balancing potential risks and opportunities based on the appetite to accept risk</p>	<ul style="list-style-type: none"><li>• <b>Does the risk approach include regular search</b> for new markets, partnering opportunities and other risk optimisation strategies? If not, why not? If yes, how is this achieved?</li><li>• <b>Is risk a priority consideration</b> whenever business processes are improved? If not, why not? If yes, describe how this is achieved</li></ul>

### Appendix C3: Elements of a good risk management framework<sup>21</sup>

A good risk management framework should address three key aspects – *People*, *Process* and *Tools* in the four key activities of risk management – *Risk Identification*, *Risk Analysis*, *Risk Control* and *Risk Monitoring*.

The elements of a good risk management framework are illustrated in the figure below:



<sup>21</sup> Adapted from KPMG in Singapore's Enterprise Risk Management Framework, 2007

## APPENDIX D (INTERNAL AUDIT)

**Appendix D1:** Benefits and drawbacks on various options for setting up of an Internal Audit Function<sup>22</sup>

	Outsourcing	In-house
Benefits	<ul style="list-style-type: none"> <li>• <b>Readily available resources</b> at any point in time</li> <li>• <b>Continuity can be maintained</b> with the vast resource pool of the outsourced service provider</li> <li>• <b>Cost can be managed</b> depending on the need for reviews</li> <li>• <b>Leverage the outsourced service provider's knowledge</b> - local, regional and global in any industry</li> <li>• <b>This would be more cost efficient</b> in terms of contracting a diverse, wide range of skill sets which may not be 100% utilised</li> <li>• <b>Ability to complete special projects</b> both locally and overseas. With international offices of the outsourced service provider, deployment of staff is easy, simple and quick</li> <li>• <b>The diverse skill sets</b> would mean that even for special projects, such as investigation, due diligence for business acquisitions or disposals can be conducted with the local knowledge available</li> <li>• <b>Fully independent</b></li> </ul>	<ul style="list-style-type: none"> <li>• <b>Cultivate a group of specialised IA professionals</b> within an organisation that have a unique perspective of the organisation's business and operates closely with the business to add value</li> <li>• <b>IA function becomes the core competency</b> of the organisation</li> <li>• <b>Full control of IA activities</b>, planning, scope etc.</li> <li>• <b>Readily deployable at any time</b></li> <li>• <b>Building of knowledge base</b> internally and familiarity with business operations over time</li> <li>• <b>Able to conduct other forms of review</b> such as investigation, due diligence for business acquisitions or disposals as and when required, having an in-depth knowledge of the business</li> </ul>

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<sup>22</sup> Courtesy of KPMG Internal Audit, Risk and Compliance Services, Singapore

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	Outsourcing	In-house
<b>Drawbacks</b>	<ul style="list-style-type: none"> <li>• <b>Utilisation in an effective and efficient manner</b></li> </ul>	<ul style="list-style-type: none"> <li>• <b>No full time Internal Auditors</b> to serve the needs of Management, the Board and AC members</li> <li>• <b>Not close to the ground</b> to be involved at the operational level</li> <li>• <b>May not be able to attend meetings</b> at last minute notice</li> <li>• <b>On-site presence</b> based on IA plan</li> <li>• <b>There might be a longer reaction time</b> to ad hoc assignments if not in accordance with IA plan</li> <li>• <b>Need to continually monitor service provider's performance</b></li> </ul>

## **Appendix D2: Sample Internal Audit Activity Charter<sup>23</sup>**

### **MISSION AND SCOPE OF WORK**

The mission of the internal audit department is to provide independent, objective assurance and consulting services designed to add value and improve the organisation's operations. It helps the organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

The scope of work of the internal audit department is to determine whether the organisation's network of risk management, control and governance processes, as designed and represented by Management, is adequate and functioning in a manner to ensure:

- **Risks are appropriately identified and managed**
- **Interaction with the various governance groups** occurs as needed
- **Significant financial, managerial and operating information** is accurate, reliable and timely
- **Employees' actions are in compliance** with policies, standards, procedures and applicable laws and regulations
- **Resources are acquired economically**, used efficiently and adequately protected
- **Programmes, plans and objectives** are achieved
- **Quality and continuous improvement** are fostered in the organisation's control process
- **Significant legislative or regulatory issues** impacting the organisation are recognised and addressed appropriately

Opportunities for improving Management control, profitability and the organisation's image may be identified during audits. They will be communicated to the appropriate level of Management.

### **ACCOUNTABILITY**

The Head of Internal Audit, in the discharge of his/her duties, shall be accountable to Management and the AC to:

- **Provide annually an assessment** on the adequacy and effectiveness of the organisation's processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work
- **Report significant issues** related to the processes for controlling the activities of the organisation and its affiliates, including potential improvements to those processes and provide information concerning such issues through resolution
- **Periodically provide information** on the status and results of the annual audit plan and the sufficiency of department resources
- **Coordinate with and provide oversight** of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit)

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## INDEPENDENCE

To provide for the independence of the internal audit department, its personnel report to the Head of Internal Audit, who reports functionally to the Audit Committee and administratively to the Chief Executive Officer in a manner outlined in the above section on Accountability. It will include as part of its reports to the Audit Committee a regular report on internal audit personnel.

## RESPONSIBILITY

The Head of Internal Audit and staff of the internal audit department have the responsibility to:

- **Develop a flexible annual audit plan** using an appropriate risk-based methodology, including any risks or control concerns identified by Management and submit that plan to the Audit Committee for review and approval as well as periodic updates
- **Implement the annual audit plan**, as approved, including as appropriate any special tasks or projects requested by Management and the Audit Committee
- **Maintain a professional audit staff** with sufficient knowledge, skills, experience and professional certifications to meet the requirements of this Charter
- **Evaluate and assess** significant merging/consolidating functions and new or changing services, processes, operations and control processes coincident with their development, implementation and/or expansion
- **Issue periodic reports** to the Audit Committee and Management summarising results of audit activities
- **Keep the Audit Committee informed** of emerging trends and successful practices in internal audit
- **Provide a list of significant measurement goals** and results to the Audit Committee
- **Assist in the investigation** of significant suspected fraudulent activities within the organisation and notify Management and the Audit Committee of the results
- **Consider the scope of work** of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organisation at a reasonable overall cost

## AUTHORITY

The Head of Internal Audit and staff of the internal audit department are authorised to:

- **Have unrestricted access** to all functions, records, property and personnel
- **Have full and free access** to the Audit Committee
- **Allocate resources**, set frequencies, select subjects, determine scopes of work and apply the techniques required to accomplish audit objectives
- **Obtain the necessary assistance** of personnel in units of the organisation where they perform audits, as well as other specialised services from within or outside the organisation

The Head of Internal Audit and staff of the internal audit department are not authorised to:

- **Perform any operational duties** for the organisation or its affiliates
- **Initiate or approve accounting transactions** external to the internal audit department
- **Direct the activities of any organisation employee** not employed by the internal audit department, except to the extent such employees have been appropriately assigned to audit teams or to otherwise assist the internal auditors

## **STANDARDS OF AUDIT PRACTICE**

The internal audit department will meet or exceed the Standards for the Professional Practice of Internal Audit of The Institute of Internal Auditors.

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Head of Internal Audit

---

Chief Executive Officer

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Audit Committee Chair

Dated \_\_\_\_\_

### Appendix D3: Internal Audit Activity Measurement Criteria<sup>24</sup>

#### Human Resources

- Average years of audit experience
- Hours of training per auditor
- Percent training plan achieved
- Percent staff certified
- Auditor Turnover
- Staff rotated to and from operations departments
- Staff satisfaction survey

#### Effectiveness

- Balanced Scorecard
- Number of major audit findings/recommendations
- Percent recommendations accepted
- Amount of audit savings
- Number of repeat findings
- Number of process improvements

#### Quality

- Number of Management requests
- Average response time for Management requests
- Level of customer satisfaction - per survey conducted
- Number of complaints about audits

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### Cost/ Productivity

- Number of auditors per 1,000 employees
- Number of auditors per million dollars of revenue/million dollars of assets.
- Staff utilisation - direct vs. indirect time
- Completed audits per auditor
- Completed vs. planned audits
- Actual hours vs. budgeted hours
- Cost savings as a percent of department budget

### Reporting

- Number of audit reports issued
- Elapsed time - opening conference to field completion
- Elapsed time - field completion to final report
- Number of 'unsatisfactory' audit opinions

#### **Appendix D4: Evaluating the effectiveness of the internal audit team**

Questions that the AC should ask itself in evaluating the effectiveness of the internal audit team and where the AC members should ask follow-up questions as appropriate<sup>25</sup>

Evaluation of Internal Audit Team	Yes	No	Not Sure	Comments
1. Does the department appear to be using its time and resources effectively and efficiently?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2. Is the department's size and structure adequate to meet its established objectives?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3. Is the experience level of the internal auditors adequate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4. Does the department appear to be objective? What procedures are performed to ensure objectivity?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
5. Is the technical knowledge of the department members sufficient to ensure that duties are performed appropriately?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
6. Does the department have an appropriate continuing education programme?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
7. Are there department members with sufficient information systems audit expertise to address the level of technology used by the organisation?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
8. Is the department's work planned appropriately?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
9. Does planning include written audit plans and programmes?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
10. What types of reports are issued by the internal audit department and to whom?				
Notes:				
11. Are the internal audit reports issued on a timely basis?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

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Evaluation of Internal Audit Team	Yes	No	Not Sure	Comments
12. Do the internal audit reports include sufficient detail for effective action by Management and/or the Audit Committee?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
13. Does Management respond in an appropriate and timely fashion to significant recommendations and comments made by internal auditors?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
14. Do internal audit procedures encompass operational as well as financial areas?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
15. Was the department's involvement in the annual audit effective?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
16. What could be done in the future to maximise the department's effectiveness and efficiency?				
Notes:				
17. To what extent is outsourcing used in the internal audit function, what areas are outsourced, and to whom are they outsourced?				
Notes:				
18. Does the internal audit team have a periodic "peer review" or an ongoing quality assurance programme and, if so, what were the results of the latest review?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
19. What criteria are used to establish and prioritise the annual and long-range internal audit plan?				
Notes:				
20. Is the department's work concentrated in areas of high risk, judgement and sensitivity?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
21. To what extent does the internal audit team keep itself informed and involved in professional activities?				
Notes:				
22. What are the internal auditor's views regarding controls, the risk of fraud and compliance matters?				
Notes:				

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Evaluation of Internal Audit Team	Yes	No	Not Sure	Comments
23. Has the charter of the internal audit department been evaluated to determine whether it is still appropriate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

## Appendix D5: Private Session with the Auditor<sup>26</sup>

This is a list of illustrative questions. It is not an exhaustive list but is intended to stimulate thought as to the type of issues that could be raised with the internal auditor. Typically, each private session should address a few matters which may vary from meeting to meeting, in addition to any matters of current concern.

### *Attitudes*

- **What is your assessment of the ‘tone from the top’?**
- **What is your assessment of Management’s attitude towards:**
  - disclosure controls and procedures
  - internal control systems and procedures?
- **Has Management adequately responded** to your prior recommendations?

### *Relationships*

- **Did you receive full cooperation during the audit** and did you get full, honest answers to all questions that were asked?
- **Was any information withheld from you?**
- **Was Management forthcoming, open and candid** in discussions with you?
- **How are your relationships with management personnel?** External auditors? CEO? CFO?

### *Other issues*

- **Did you receive everything** you requested on a timely basis?
- **Are there any issues** that you would like to highlight to the AC?

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<sup>26</sup> Adapted from Audit Committee Institute, 2006, *A Practical Guide – Shaping the UK Audit Committee agenda*, KPMG in the UK

## APPENDIX E (INTERESTED PERSON TRANSACTIONS)

### Appendix E1: Differences between IPT and RPT<sup>27</sup>

	Related party transactions (RPT)	Interested person transactions (IPTs)
Definition	<p><b>RPT includes transactions with key Management personnel. The related parties may not necessarily be a Director, Chief Executive Officer, or controlling shareholder of the issuer.</b></p> <p>The main intention is presumably to ensure that transactions with persons with responsibilities similar to those of Directors and the compensation paid to such person, do not escape disclosure simply because they are not Directors.</p>	<p><b>IPT includes transactions with a Director, Chief Executive Officer, or controlling shareholder of the issuer; or An associate of any such Director, Chief Executive Officer, or controlling shareholder.</b></p>
Governing Regulation	Singapore Financial Reporting Standards (FRS) 24.	Listing Manual Chapter 9.
Entities Applicable	All entities which adopt FRS24	Companies listed on Singapore Stock Exchange
Rationale for Disclosure	Enable <u>users of the financial statements</u> to form a view about the effects of related party relationships on an entity.	Guard against the risk that interested persons could influence the listed entity, its subsidiaries or associated companies, to enter into transactions with interested persons that may adversely affect <u>the interests of the issuer or its shareholders</u>

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<sup>27</sup> Courtesy of KPMG in Singapore

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	<b>Related party transactions (RPT)</b>	<b>Interested person transactions (IPTs)</b>
Transactions Covered	<p>FRS 24 requires entities to disclose these transactions:</p> <p>(a) Key Management personnel compensation includes:</p> <ul style="list-style-type: none"> <li>• Wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses and non-monetary benefits for current employees</li> <li>• Post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care</li> <li>• Long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within 12 months after the end of the period, profit sharing and deferred compensation</li> <li>• Termination benefits</li> <li>• Share-based payment</li> </ul> <p>(b) Other transactions</p> <p>FRS 24 requires that if there have been transactions between related parties, an entity shall disclose the nature of the related party relationships as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements.</p>	<p>Listing Rule 904 defines 'transactions' as:</p> <p>(a) provision or receipt of financial assistance;</p> <p>(b) acquisition, disposal or leasing of assets;</p> <p>(c) provision or receipt of services;</p> <p>(d) issuance or subscription of securities;</p> <p>(e) granting of or being granted options; and</p> <p>(f) establishment of joint ventures or joint investments whether or not in the ordinary course of business and whether or not entered into directly or indirectly (for example, through one or more interposed entities)</p> <p>An issuer must disclose the aggregate value of IPTs entered into during the financial year under review in its annual report. The name of the interested person and the corresponding aggregate value of the IPTs entered into with the same interested person must be disclosed.</p>

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	<b>Related party transactions (RPT)</b>	<b>Interested person transactions (IPTs)</b>
	<p>At minimum, the disclosure shall include:</p> <ul style="list-style-type: none"> <li>• The amount of the transactions</li> <li>• The amount of outstanding balances and: <ul style="list-style-type: none"> <li>- their terms and conditions, including whether they are secured and the nature of the consideration to be provided in settlement and</li> <li>- details of any guarantees given or received</li> </ul> </li> <li>• Provisions for doubtful debts related to the amount of outstanding balances</li> </ul> <p>The expense recognised during the period in respect of bad or doubtful debts due from related parties</p>	
Materiality for Disclosure	In determining whether RPT need to be disclosed in financial statements, the general concept of 'materiality' should be applied.	The Listing Manual only requires only transactions that are above S\$100,000 to be taken into consideration.

## Appendix E2: Sample IPT Policy<sup>28</sup>

### *Policy:*

It is the policy of the Board of Company A ('Company') that all Interested Transactions with an Interested Person, as those terms are defined in this statement of policy, will be at arm's length and on terms generally available to an unaffiliated third-party under the same or similar circumstances.

Except for the limited exceptions set forth in this Policy, transactions with interested persons that will exceed \$100,000 in any calendar year must receive the approval of the Board prior to the company entering into the 'interested transaction'.

### *Procedures:*

An interested person must promptly notify the Corporate Secretary of any material interest that the 'interested person' may have in a proposed 'interested transaction'. The Corporate Secretary will promptly notify the Chairman of the AC of such proposed 'interested transactions'. The Chairman of the AC will determine if approval of the 'interested transaction' under this policy is required.

If approval under this policy is required, the AC will review the material facts of the proposed 'interested transactions' and make a recommendation to the Board regarding whether to approve or disapprove entering into the 'interested transaction'. The AC and the Board will take into account whether the 'interested transaction' with an 'interested person' is on terms no less favourable than terms generally available to an unaffiliated third-party under the same or similar circumstances.

No Director will participate in any discussion or approval of an 'interested transaction' for which he or she is an 'interested person' or whose immediate family member is an 'interested person', except that the Director may provide information on the 'interested transaction' to the AC and the Board.

### *Definitions:*

#### Interested person

- (a) a Director, Chief Executive Officer, or controlling shareholder of the issuer; or
- (b) an associate of any such Director, Chief Executive Officer, or controlling shareholder

#### Interested person transaction

A transaction between an entity at risk and an interested person

#### Entity at risk

- (a) the issuer;
- (b) a subsidiary of the issuer that is not listed on the Exchange or an approved exchange; or
- (c) an associated company of the issuers that is not listed on the Exchange or an approved exchange, provided that the listed group, or the listed group and its interested person(s), has control over the associated company.

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<sup>28</sup> Courtesy of KPMG in Singapore

**Appendix E3: Sample Template on Disclosure of Director Interests**

**DECLARATION BY DIRECTORS AND CHIEF EXECUTIVE OFFICER**

<b>Name of Listed Company</b>	
<b>Name of Reporting Person</b>	

1. My direct interests, beneficial interests through immediate family members and other deemed interests in shares and debentures of the companies in which I have an interest, are as listed in Annex A.
2. Other than being a Director of the company, I am also currently serving as a member of the Board or Executive Officer of the corporations listed in Annex B.
3. I and members of my immediate family have interest (direct or indirect) amounting to <sup>29</sup>30% or more of the issued share capital of each of the corporations listed in Annex C.
4. I confirm that the disclosure made herein is complete.

Signed: \_\_\_\_\_

Date: \_\_\_\_\_

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<sup>29</sup> Based on the Listing Rule's definition of an 'associate'

**ANNEX A**

**DIRECTOR'S INTERESTS IN SHARES AND DEBENTURES  
(EXCLUDING OPTIONS IN SHARES AND WARRANTS)**

Particulars of direct interests and beneficial interests through my immediate family and other deemed interests in shares and debentures:

Name of Corporation	Class of Shares/ Debentures (par value of each share and whether fully paid or otherwise)	Number/ Amount (% of total)	Options in shares and warrants	Number
Interest registered in own name <sup>1</sup> :				
Interest of immediate family members <sup>2</sup> :				
Other deemed interest <sup>3</sup> :				

**Notes:**

- (1) (a) Companies Act Sections 201(6)(g) and 201(6A)(h) require Directors subsisting at the end of the financial year (according to the register kept by the company) to make the disclosure.  
(b) Companies Act Section 4 includes an alternate or substitute Director as a Director. However, SGX Listing Manual does not specifically include an alternate Director as a Director, nor does it state that his/her remuneration should be disclosed.
- (2) A Director's interests in shares and debentures include the beneficial interests of his immediate family (i.e. spouse and children under 21 years, including step-children and adopted children, provided none of them are Directors).
- (3) Section 7 of the Companies Act defines other deemed interests (for example, interests under trust and interests through associated persons or corporations).

**ANNEX B**

**LIST OF OTHER DIRECTORSHIPS**

Name of Corporation	Nature of Appointment

Note:

No disclosure of the Directorship on the Board of the company and its subsidiaries and associated companies is required.

**ANNEX C**

**LIST OF CORPORATIONS IN WHOSE ISSUED SHARE CAPITAL I AND MEMBERS OF MY IMMEDIATE FAMILY TOGETHER OWN AN INTEREST (DIRECT OR INDIRECT) OF <sup>30</sup>30% OR MORE**

Name of corporation	Interest held (% of issued shares)

<sup>30</sup> Based on the Listing Rule's definition of an 'associate'

#### Appendix E4: Examples of indicators of potential RPTs<sup>31</sup>

##### Understating Expenses

- **Agreements in which one party pays** expenses on behalf of another party  
*A related party may pay certain expenses on behalf of the company and then pass through the expenses back to the company. In this way, the company may understate its expenses by deferring such pass through and expense recognition in the books.*
- **Services or goods purchased** from a party at little or no cost to the entity

##### Inflating Revenue

- **Selling real estate/property/asset** at a price that varies significantly from its appraised value
- **Sales without substance**, including funding the other party to the transaction so that the sales price is fully remitted
- **Sales with a commitment** to repurchase that, if known, would preclude recognition of all or part of the revenue
- **Sales at below market rates** to an unnecessary ‘middle man’ related party, who in turn sells to the ultimate customer at a higher price with the related party (and ultimately its principals) retaining the difference
- **Circular arrangements** whereby the arrangements between related parties have concurrent obligations to buy and sell and where the purchase transaction is essentially funded by the sale transaction
- **Repetitive quarter or year end transactions** with the same party

##### Inflating/Deflating Assets

- **Exchanging property for similar property** in a non-monetary transaction
- **Purchases of assets** at prices in excess or below fair market value
- **Advancing the company funds** that are subsequently transferred to a debtor and used to repay what would otherwise be an uncollectible loan or receivable
- **Loans advanced ostensibly** for a valid business purpose and later written off as uncollectible

##### Transactions Against Company's Interests

- **Borrowing or lending on an interest-free basis** or at an interest rate that is significantly above or below prevailing market rates
- **Making unsecured loans** with no scheduled repayment terms
- **Accruing interest at above market rates** on loans
- **Loans to parties** that do not possess the ability to repay
- **Payment for services rendered** or not even rendered, at inflated prices
- **Engage in business deals** that are not at market value

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**Appendix E5:** Examples of motivations for RPT<sup>32</sup>

- **Lack of sufficient working capital or credit** to continue the business
- **An urgent desire for a continued favourable earnings** record in the hope of supporting the price of the company's stock
- **Trying to justify an overly optimistic earnings forecast**
- **Dependence on a single or relatively few products**, customers, or transactions for the continuing success of the venture
- **A declining industry** characterised by a large number of business failures
- **Excess capacity**
- **Significant litigation**, especially litigation between stockholders and Management
- **Significant obsolescence dangers** because the company is in a high-technology industry

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**Appendix E6:** Examples of indicators of fraud in RPT<sup>33</sup>

- **Significant related party transactions** not in the ordinary course of business or with related entities not audited or audited by another firm
- **Significant, unusual, or highly complex transactions**, especially those close to year-end, that pose difficult ‘substance over form’ questions
- **Highly complex business practices** that enhance the ability of Management to mask the economic substance of a business transaction
- **Significant bank accounts or subsidiary or branch operations** in tax-haven jurisdictions for which there appears to be no clear business justification
- **Overly complex organisational structure** involving numerous or unusual legal entities, managerial lines of authority, or contractual arrangements without apparent business purpose
- **Difficulty in determining the organisation** or individual(s) that control(s) an off-balance sheet entity

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## APPENDIX F (CONDUCT OF MEETINGS)

### Appendix F1: Examples of good practices for an effective AC Chairman<sup>34</sup>

- **Lead from the front**, decide what your AC is going to achieve, plan a schedule and push it through vigorously, keeping up with the momentum. A useful AC will be pro-active, not merely a critical audience
- **Get the timetable for meetings right** to ensure that the AC considers matters in good time for recommendations to be effective and influential
- **Use the agenda both to control meetings** (ensure the right topics are covered in the right order) and to ensure that members are prepared for the meetings
- **Know the strengths and weaknesses** of the other AC members well enough to encourage and guide them effectively
- **Plan to rectify** if you do not have the right mix of knowledge and experience amongst the AC members to give the support you need
- **Ensure that the AC's decision and concerns are reported to the Board** regularly and effectively, orally as well as by circulation of the minutes
- **Ensure that the Finance Director recognises the need to brief you** in good time on critical reporting issues, particularly any proposals to change accounting policies and why
- **Know or learn enough about the audit** and how it is organized to be able to probe the external auditors and not to be confused by their expertise
- **Ensure that the external auditors recognise that they must keep you informed** of all relevant technical developments which will affect either the financial statements or the audit
- **Expect useful, informative, timely and relevant reports** to Management from auditors. Act promptly and vigorously on their contents
- **Be alert to indications of the external auditors' unease**, and be responsive to requests to consult with the auditors alone, outside the framework of AC meetings
- **Use the mandatory requirements of financial reporting as a lever** to increase the importance the company attaches to financial communication and to financial controls
- **Review regularly the company's approach to internal controls** and the professionalism of those employed to install and/or monitor them
- **Push for prompt and regular reports** from the internal audit department, focusing on identified risk areas. Regard inadequate or dilatory reporting as a danger signal which should trigger further pressure and also be drawn to the attention of the Board
- **Understand the company's approach** to obtaining and maintaining efficient and appropriate computer systems and ensuring their security. Ensure that periodic external professional reassurance is obtained about the continuing effectiveness of the systems
- **Ensure that the AC has the flexibility** to be able to respond quickly to the unexpected, and does not become entrenched in a routine. Late decisions to change financial reports may demand fast and relatively informal AC input if the AC is to avoid being by-passed

<sup>34</sup> Deloitte Touche Tohmatsu, 2003, 'Appendix 9: Tips and Hints for the AC Chairperson', *Audit Committees: A Better Practice Guide*, Sydney

## APPENDIX G (PERFORMANCE ASSESSMENT)

### Appendix G1: Sample AC self-assessment checklist

Example of a checklist for self-assessment of the effectiveness of the Audit Committee<sup>35</sup>

<b>Yes/ No/ NA</b>	<b>Comment</b>	<b>Criteria</b>
<b>Terms of Reference</b>		
Have the AC's terms of reference been approved by the Board?		
Do the terms of reference (AC charter) include:		
<ul style="list-style-type: none"> <li>• Monitoring the integrity of the financial statements</li> </ul>		
<ul style="list-style-type: none"> <li>• Reviewing the company's internal financial control system</li> </ul>		
<ul style="list-style-type: none"> <li>• Reviewing the company's risk management systems unless addressed by another board sub-committee or by the Board itself</li> </ul>		
<ul style="list-style-type: none"> <li>• Monitoring and reviewing the effectiveness of the company's IA function</li> </ul>		
<ul style="list-style-type: none"> <li>• Recommending to the Board the appointment of the external auditor and approving their remuneration and terms of engagement following appointment by the shareholders at the AGM</li> </ul>		
<ul style="list-style-type: none"> <li>• Monitoring the effectiveness of the external auditor's performance and their independence and objectivity</li> </ul>		
<b>Membership and appointments</b>		
Does the AC consist of independent Non-Executive Directors?		
Is the Chairman of the Board excluded from AC membership?		
Are AC members appointed by the Board on the recommendation of the Nominating Committee (where there is one) in consultation with the Audit Committee Chairman?		

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<sup>35</sup> Adapted from Audit Committee Institute, 2006, *A Practical Guide – Shaping the UK Audit Committee Agenda*, KPMG in the UK

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<b>Yes/ No/ NA</b>	<b>Comment</b>	<b>Criteria</b>
<b>Meetings</b>		
Does the AC meet regularly? (at least four times a year coinciding with key dates in the financial reporting and audit cycle)		
Are AC meetings well attended?		
Do AC meetings allow sufficient time for discussion and questions?		
Are meeting agendas and related background information circulated in a timely manner to enable full and proper consideration to be given to issues?		
Does the AC invite non-members to attend meetings (Only the AC members should be entitled to attend AC meetings)?		
Are arrangements in place for the AC to meet with external and internal auditors during the year without the presence of Management?		
Does the AC Chairman, and to a lesser extent the other members, keep in touch on a continuing basis with the key people involved in the company's governance eg. the Chairman of the Board, the Chief Executive, the Finance Director, the external auditor and the Head of IA?		
<b>Training and resources</b>		
Does the AC have sufficient skills, experience, time and resources to undertake its duties?		
Do at least two AC members have accounting or related financial management expertise or experience?		
Is an induction programme provided for new AC members?		
Do AC members receive relevant training in financial reporting and related topics on an ongoing and timely basis?		
Do AC members have the opportunity to attend formal courses and conferences, internal company talks and seminars, and briefings by external advisers such as the company's auditors and lawyers?		

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<b>Yes/ No/ NA</b>	<b>Comment</b>	<b>Criteria</b>
		Are funds available to enable the AC to take independent legal, accounting or other advice when it reasonably believes it necessary to do so?
<b>Financial Reporting</b>		
		Does the AC review the significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements, interim reports, preliminary announcements and related formal statements?
		Where an accounting treatment is open to a different approach, does the AC consider whether the company has adopted appropriate accounting policies and, where necessary, made appropriate estimates and judgements?
		Does the AC review the clarity and completeness of disclosures in the financial statements, interim reports, preliminary announcements and related formal statements and press releases?
		Where, following its review, the AC is not satisfied with any aspect of the proposed financial reporting, does it report such views to the Board and seek changes?
<b>Internal financial controls and risk managements systems</b>		
		Does the AC assist in the Board's assessment of the scope and effectiveness of the systems established by Management to identify, assess, manage and monitor financial and non-financial risks?
		In carrying out such an assessment, does the AC receive and review reports from Management on the effectiveness of the systems they have established and the results of any testing carried out by internal and external auditors?
		Does the AC review and approve the statements included in the annual report in relation to the process for managing risk and the Board's review of the adequacy of that process?
<b>Internal audit process</b>		
		Where no internal audit function exists, does the AC annually consider whether there is a need for one and make a recommendation to the Board?

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<b>Yes/ No/ NA</b>	<b>Comment</b>	<b>Criteria</b>
		Does the AC participate in the review and approval process of the appointment or termination of the Head of IA?
		Does the AC review and assess the independence and objectivity of the internal audit function such that the internal auditor has direct access to the Chairman of the Board and to the AC and is accountable to the AC?
		Does the AC review and approve the IA charter?
		Does the AC ensure that the IA function has the necessary resources and access to information to enable it to fulfil its mandate?
		Does the AC review and assess the annual IA work plan?
		Does the AC receive a report on the results of the internal auditors' work on a periodic basis, and monitor Management's responsiveness to the internal auditor's findings and recommendations?
		Does the AC meet with the Head of IA at least once a year without the presence of Management?
		Does the AC monitor and assess the role and effectiveness of the internal audit function in the overall context of the company's risk management system?
		Does the AC make appropriate enquiries about the coordination and cooperation between internal and external audit?
		Does the AC assess if the IA function follows the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors?
<b>External audit process</b>		
		Does the AC make recommendations to the Board (and hence to shareholders) on the appointment, reappointment and removal of the external auditors?
		Does the AC annually assess the qualification, skills and resources, effectiveness and independence of the external auditors?
		Does the AC develop and recommend to the Board the company's policy in relation to the provision of non-audit services by the auditor and keep the nature and extent of non-audit services provided by the auditors under review?

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<b>Yes/ No/ NA</b>	<b>Comment</b>	<b>Criteria</b>
		Does the AC satisfy itself that the level of fee payable in respect of the audit services provided is appropriate and that an effective audit can be conducted for such a fee?
		At the start of each annual audit cycle, does the AC consider whether the auditor's overall work plan, including planned levels of materiality, and proposed resources to execute the audit plan appear consistent with the scope of the audit engagement, having regard also to the seniority, expertise and experience of the audit team?
		Does the AC discuss with the external auditor major issues that arose during the course of the audit, review key accounting and audit judgements, review levels of errors identified during the audit, obtaining explanations as to why certain errors might remain unadjusted?
		Does the AC review the audit representation letters before signature by Management?
		At least annually, does the AC meet with the lead audit partner, and other members of the audit team as necessary, without the presence of Management, to discuss issues arising from the audit, and any other matters that the auditor might wish to raise with the AC and visa versa?
		As part of the ongoing monitoring process, does the AC review the Management letter (or equivalent) and monitor Management's responsiveness to the external auditor's findings and recommendations?
		Does the AC assess the effectiveness of the audit process at the end of the annual audit cycle?
		<b>Whistleblowing</b>
		Does the AC review the arrangements by which staff may raise concerns in confidence about possible improprieties in matters of financial reporting, financial control or related matters?
		<b>Relationship with the Board</b>
		Does the AC report to the full Board after each meeting?
		Where there is disagreement between the AC and the Board, is adequate time set aside for discussion of the issue with a view to resolving the disagreement?

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Yes/ No/ NA	Comment	Criteria
		<b>Communications with shareholders</b>
		Does the AC ensure that a report on its role and responsibilities, and the actions taken to discharge those responsibilities is included in the annual report and accounts?
		If the Board did not accept the AC's recommendation regarding the appointment, reappointment or removal of the auditors, did the AC ensure the annual report and accounts included a statement explaining its recommendation and the reasons why the Board took a different stance?
		Does the chairman of the AC attend the AGM and, where necessary, answer questions on matters within the scope of the AC's responsibilities?

### **Recommendations for Improvement**

How can the AC improve its performance?

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## APPENDIX H (WHISTLEBLOWING)

### Appendix H1: Elements of a good whistleblowing policy<sup>36</sup>

#### Good Policy

It is recommended a whistle blowing policy should make these points clear:

- **The organisation takes malpractice seriously**, giving examples of the types of concerns to be raised, so distinguishing a whistleblowing concern from a grievance
- **Staff have the option to raise concerns** outside of line Management
- **Staff are enabled to access confidential advice** from an independent body
- **The organisation will, when requested, respect the confidentiality of a member of staff** raising a concern
- **When and how concerns may be properly raised** outside the organisation (e.g. with a regulator)
- **It is a disciplinary matter** both to victimise a bona fide whistle-blower and for someone to maliciously make a false allegation

#### Good Practice

However good the written policy is, how it works in practice is critical. Good practice should:

- **Ensure staff are aware** of and trust the whistleblowing avenues
- **Make provision for realistic advice** about what the whistleblowing process means for openness, confidentiality and anonymity
- **Continually review** how the procedures work in practice
- **Regularly communicate** to staff about the avenues open to them

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<sup>36</sup> Adapted from Public Concern At Work, *Best Practice Guide*, <http://www.pcaaw.co.uk/>

## Good Audit

It is recommended that these questions be included when the whistleblowing policy is reviewed:

- **Are there issues or incidents** which have otherwise come to the Board's attention which they would have expected to have been raised earlier under the company's whistleblowing procedures?
- **Are there adequate procedures** to track the actions taken in relation to concerns made and to ensure appropriate follow-up action has been taken to investigate and if necessary, resolve problems indicated by whistleblowing?
- **Have confidentiality issues** been handled effectively?
- **Is there evidence of timely and constructive feedback?**
- **Have any events come to the AC's or the Board's attention** that might indicate a staff member has not been fairly treated as a result of their raising concerns?
- **Is there a review of staff awareness of the procedures needed?**

## Appendix H2: Example of a whistleblowing policy

### WHISTLEBLOWING POLICY

#### 1. INTRODUCTION

- 1.1 XXX Limited and its subsidiaries ('the Group') are committed to a high standard of compliance with accounting, financial reporting, internal controls, corporate governance and auditing requirements and any legislation relating thereto. In line with this commitment, the Whistleblowing Policy ('Policy') aims to provide an avenue for employees and external parties to raise concerns and offer reassurance that they will be protected from reprisals or victimisation for whistleblowing in good faith.
- 1.2 The Policy is intended to conform to the guidance set out in the Code of Corporate Governance which encourages employees to raise concerns, in confidence, about possible irregularities.

#### 2. WHO IS COVERED BY THIS POLICY

- 2.1 This Policy applies to all employees of the Group.

#### 3. OBJECTIVES OF THIS POLICY

- 3.1 Deter wrongdoing and to promote standards of good corporate practices
- 3.2 Provision of proper avenues for employees to raise concerns about actual or suspected improprieties in matters of financial reporting or other matters and receive feedback on any action taken.
- 3.3 Give employees the assurance that they will be protected from reprisals or victimisation for whistleblowing in good faith.

#### 4. REPORTABLE INCIDENTS

- 4.1 Some examples of concerns covered by this Policy include (this list is not exhaustive):
  - Concerns about the Group's accounting, internal controls or auditing matters
  - Breach of or failure to implement or comply with the Group's policies or code of conduct
  - Impropriety, corruption, acts of fraud, theft and/misuse of the Group's properties, assets or resources
  - Conduct which is an offence or breach of law

- Abuse of power or authority
- Serious conflict of interest without disclosure
- Intentional provision of incorrect information to public bodies
- Any other serious improper matters which may cause financial or non-financial loss to the Group, or damage to the Group's reputation
- Fraud against investors, or the making of fraudulent statements to the Singapore Exchange Securities Trading Limited, members of the investing public and regulatory authorities
- Acts to mislead, deceive, manipulate, coerce or fraudulently influence any internal or external accountant or auditor in connection with the preparation, examination, audit or review of any financial statements or records of the Group
- Concealing information about any malpractice or misconduct

4.2 The above list is intended to give an indication of the kind of conduct which might be considered as "wrong-doing". In cases of doubt, the whistleblower should seek to speak to his or her immediate superior or follow the procedure for reporting under this Policy

## **5. PROTECTION AGAINST REPRISALS**

- 5.1 If an employee raises a genuine concern under this Policy, he or she will not be at risk of losing his or her job or suffering from retribution or harassment as a result. Provided that the employee is acting in good faith, it does not matter if he or she is mistaken.
- 5.2 However, the Group does not condone frivolous, mischievous or malicious allegations. Employee(s) making such allegations will face disciplinary action in accordance with the Group's Disciplinary Procedures.

## **6. CONFIDENTIALITY**

- 6.1 The Group encourages the whistleblower to identify himself/herself when raising a concern or providing information. All concerns will be treated with strict confidentiality.
- 6.2 Exceptional circumstances under which information provided by the whistleblower could or would not be treated with strictest confidentiality include:
- Where the Group is under a legal obligation to disclose information provided
  - Where the information is already in the public domain

- Where the information is given on a strictly confidential basis to legal or auditing professionals for the purpose of obtaining professional advice
  - Where the information is given to the Police or other authorities for criminal investigation
- 6.3 In the event we are faced with a circumstance not covered by the above, and where the whistleblower's identity is to be revealed, we will endeavour to discuss this with the whistleblower first.

## **7 CONCERNS AND INFORMATION PROVIDED ANONYMOUSLY**

- 7.1 Concerns expressed anonymously are much less persuasive and may hinder investigation work as it is more difficult to look into the matter or to protect the whistleblower's position. Accordingly, the Group will consider anonymous reports, but concerns expressed or information provided anonymously will be investigated on the basis of their merits.

## **8 HOW TO RAISE A CONCERN OR PROVIDE INFORMATION**

### **Who to Report To**

- 8.1 Report to his/her immediate supervisor.
- 8.2 If the concern involves his/her immediate supervisor, manager or Head of Department, or for any reason he/she would prefer them not to be told, he/she may report to the following designated officer [ ].
- 8.3 If none of the channels above are suitable, the whistleblower can address his/her concerns to the Audit Committee Chairman.
- 8.4 Concerns or information are preferably raised or provided in writing (letter or e-mail). Ideally, the Group recommends the whistleblower to be detailed in setting out the background and history of events and the reasons for the concern.
- 8.5 If the whistleblower is not comfortable about writing in, he or she can telephone or meet the appropriate officer in confidence at a time and location to be determined together.

## **9 IMPORTANT POINTS TO NOTE WHEN RAISING A CONCERN OR PROVIDING INFORMATION**

- 9.1 The earlier the concern is raised the easier it is for the Group to take action.
- 9.2 The Group expects the whistleblower to provide his/her concern in good faith and to show to the appropriate officer that there are sufficient grounds for his/her concern.
- 9.3 The Group also recognises that the whistleblower may wish to seek advice and be represented by his/her trade union officer.

## 10 HOW THE GROUP WILL RESPOND

- 10.1 The Group assures you that any concern raised or information provided will be investigated, but consideration will be given to these factors:
  - Severity of the issue raised
  - Credibility of the concern or information
  - Likelihood of confirming the concern or information from attributable sources
- 10.2 Depending on the nature of the concern raised or information provided, the investigation may be conducted involving one or more of these persons or entities:
  - The Audit Committee
  - The External or Internal Auditor
  - Forensic Professionals
  - The Police or Commercial Affairs Department
- 10.3 The amount of contact between the whistleblower and the person(s) investigating the concern raised and information provided will be determined by the nature and clarity of the matter reported. Further information provided may be sought from the whistleblower during the course of the investigation.
- 10.4 The investigating officer(s) will communicate the findings of the investigation(s) to the Audit Committee for their necessary action.

## APPENDIX I (TRAINING)

### Appendix I1: Effective orientation programme topics<sup>37</sup>

#### Topics for Orientation Programmes

##### Financial Reporting and Control Reporting

- **Standard financial reports:** what information flows through to financial reports, what key line items represent and how to read reports and recognise issues
- **Critical accounting policies:** What they are, why they were selected, the level of estimation involved in their determination and their impact on financial reports
- **Key reporting risks:** Where vulnerabilities are in the financial reporting process
- **Internal Control over financial reporting:** The control environment, security and integrity of information systems, how Management addresses key risks, monitors control effectiveness, public reports on internal control and status of control deficiencies
- **Earning trends:** Financial position and prospects of the company, as well as the achievability of forecasts and expectation of analysts

##### Other responsibilities

- **Statutory and regulatory requirements:** Identify the nature of externally imposed requirements and descriptions and background of current issues, including requirements placed on the AC itself, as well as the company
- **Compliance:** Elements of the compliance programme and AC's oversight role
- **Whistleblower programme:** Procedures for handling complaints about accounting, internal control, or audit matters, including confidential, anonymous submissions and reporting to the AC
- **Code of conduct:** Its provisions, how it is disseminated throughout the company and how it is enforced
- **Legal issues:** Any legal matters the company is involved in that could have financial implications

##### Audit Committee Processes

- **The Committee's charter:** Outlining key responsibilities and authority
- **Meeting schedule and agendas:** Meeting frequency, length and typical topics
- **Support and resources:** Who supports the AC and the adequacy of those resources
- **AC assessment:** Self-assessment and charter review processes
- **AC Chairman:** Role, special activities, reporting to full Committee and to the Board

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### Key relationships

- **Management:** Identify key finance and business unit Management, backgrounds, experience
- **Internal audit:** Responsibilities, capabilities, the reporting relationship with the Committee, nature of audit plans, reports
- **External auditors:** Relationship with the Committee, audit scope, reports
- **Others:** Identify other key personnel reporting periodically to the Committee (e.g. chief compliance officer, chief risk officer, ethics officer, legal counsel), credentials