SINGAPORE INSTITUTE OF DIRECTORS

STATEMENT OF GOOD PRACTICE

THE ROLE OF THE AUDIT COMMITTEE

This Statement has been superseded by the Audit Committee Guide.

Background

The corporate governance committee which was a ministerially appointed committee to review the development and promotion of best practices in corporate governance especially among public listed companies in Singapore issued the Code of Corporate Governance (The Code) in April 2001.

The Audit Committee

Under the Code, there are three working committees of the Board namely the Nominating Committee, the Remuneration Committee and the Audit Committee. The Audit Committee is the most important of the 3 working committees in that its role in Board oversight is the last line of defence for a company to prevent fraud and manage risks. To function properly, certain conditions need to be fulfilled. Its members need to be circumspect and painstaking in enquiries and review. The committee should operate under a charter or terms of reference which needs board approval at least once a year to remain relevant. Its Chairman performs a pivotal role in ensuring the support and confidence of management in undertaking its duties. The committee should comprise at least three directors, all non-executive, the majority of whom including the Chairman should be independent. At least two members should have an accounting or related financial management expertise or experience. The committee will have authority to investigate any matter within its terms of reference or charter, full access to and cooperation by management and full discretion to invite any director or executive officer to attend its meetings. In addition it will be afforded reasonable resources to discharge its functions properly.

Specific duties of audit committee

The role of the audit committee is spelt out clearly in the Code which requires the committee to understand the internal control process within a company and to review its effectiveness at least once a year. To do that, it needs to examine the system and interact closely with the internal auditor and the external auditor respectively to ensure that all material weaknesses in the system are addressed. The internal control system is the bedrock or cornerstone of any risk management system that is implemented in a company. Without updating the internal controls regularly or at a minimum annually, companies run the risk of getting into grave difficulty statutorily and organisationally.
Apart from attending the audit committee meetings to review the quarterly financial statements before they are announced to SGX, an audit committee member should at a minimum be concerned with the following duties:

- review and update the audit committee’s term of reference regularly;

- obtain updates from management on the key enterprise wide risk and processes to manage risks;

- clearly define the committee’s oversight responsibility ;

- interact closely with stakeholders such as management, external and internal auditors respectively;

- obtain confirmation from external and internal auditors that all material weaknesses have been addressed and get their assessment of the efficacy of the system;

- be knowledgeable about developments in the company’s internal control structure and get a report from management on the overall effectiveness of internal controls at least once a year;

- examine interim financial reports for board approval and obtain a negative assurance of these from the external auditors. Review annual accounts for board endorsement;

- get a thorough briefing on developments in accounting and auditing and understand changes in legislation, standards and rules. Ensure the Code is clearly applied;

- examine and confirm immateriality to the accounts of certain unadjusted audit differences aggregated by the external auditor at end of year; and

- confirm the external auditor’s independence and recommend their appointment or reappointment at end of year.

Review of Internal control

The annual review of internal control should focus on key controls applied to critical accounting policies and the preparation of financial statements. In particular the audit committee will need to look out for control deficiencies in the system which could for example include the ability of senior management to circumvent internal controls over financial reporting; ineffective controls over accounting for certain complex transactions; and ineffective balance sheet reconciliation processes.

Risk Management

The audit committee is also required to consider and review risk management within a company. In doing so, it needs to ensure that management is familiar with risk management as a concept and the process of managing them. At a minimum there will be (a) a library of risks which the company will maintain and update regularly taking account of changing business and environmental circumstances; and (b) a risk management framework for dealing with risks which must be updated regularly in the light of current business performance and future developments. Management then has to demonstrate to the audit committee that it actively manages the risk process across the entire business spectrum. Risk management thus concerns managing all risks be they commercial, compliance or governance in nature. The audit committee not only ensures there is an efficient risk management system but it needs to understand and review the framework and the risks dealt with periodically. In other words, there must be close interaction between governance and the management and assessment of commercial and organizational risks.

Other general duties of an audit committee

Audit committee members should have a general understanding of their duties under the Companies Act, the Securities and Futures Act and the Listing Rules of the SGX –ST. At a minimum they must realise their duty under the Companies Act to discharge their duty of good faith, reasonable diligence and not to make improper use of information acquired by virtue of their position. Apart from specific disclosure requirements which companies need to comply with such as changes in interests in a company there are a host of continuous disclosure rules under the SFA which give teeth to the SGX in applying its rules. For example, a company listed on the SGX must not intentionally, recklessly or negligently fail to notify the SGX of information on specified events or matters as they occur or arise so long as they are required to be disclosed under the Listing Manual for purposes of making information available to the market. Other specific disclosure requirements under the SFA which the audit committee should know about and conscientiously seek to ensure compliance with concern the rules on insider trading and the principles applied by the SGX in determining interested person transactions and the materiality 'thresholds for announcement and shareholders' approval. As a matter of principle and good governance, the audit committee needs to look at these rules at every meeting and ensure the company's compliance with them.

Lastly, the audit committee must review periodically and at least once a year a register of interested person transactions to ensure that all transactions which fall under this definition are dealt with as required by the SGX rules and that all thresholds for disclosure of these transactions are strictly observed.

Conclusion

These are just some of the many issues which audit committees will have to grapple with if they are to ensure that they apply the minimum standard of care, skill and diligence in conducting their duties as directors of companies in Singapore. Others which audit committees should be concerned with are the latest developments in thinking with regard to business ethics, corporate responsibility and business continuity planning especially in a large group.
