

Guidebook for Audit Committees in Singapore: An Essential Tool for Audit Committees

Irving Low

Partner, Head of Risk Consulting
KPMG Advisory LLP

Audit Committee Seminar 2015:

Jointly organised by:



CONTEXT FOR CHANGE SINGAPORE AC CONTEXT

GUIDEBOOK FOR AUDIT COMMITTEES IN SINGAPORE

2008



2014



SINGAPORE COMPANIES ACT



Singapore
Companies
Act (1967)

Singapore listed
companies required
to have AC (1987)

Singapore
Companies Act
(2004)

*Singapore
Companies Act
Reform*

SGX LISTING MANUAL



Singapore
Exchange
established (1999)

Revised SGX
Listing Rules
2011

SINGAPORE CODE OF CORPORATE GOVERNANCE



Singapore Code
of Corporate
Governance (2001)

Revised Singapore
Code of Corporate
Governance (2005)

Revised Singapore
Code of Corporate
Governance (2012)

CONTEXT FOR CHANGE

KEY DRIVERS OF CHANGE

	CG Code 2005	SGX 1207 (10)	CG Code 2012
Risk Management			
Adequacy	✓	-	✓
Effectiveness	-	-	✓
Internal Controls			
Adequacy	✓	✓	✓
Effectiveness	-	-	✓

LR1207 (10): “**Opinion of the board with the concurrence of the audit committee on the adequacy of the internal controls**, addressing financial, operational and compliance risks.”

P11.3: “**The Board should comment on the adequacy and effectiveness of the internal controls**, including financial, operational, compliance and information technology controls, and **risk management systems**, in the company’s Annual Report.”

CONTEXT FOR CHANGE POST-ADOPTION OF REVISED CG CODE

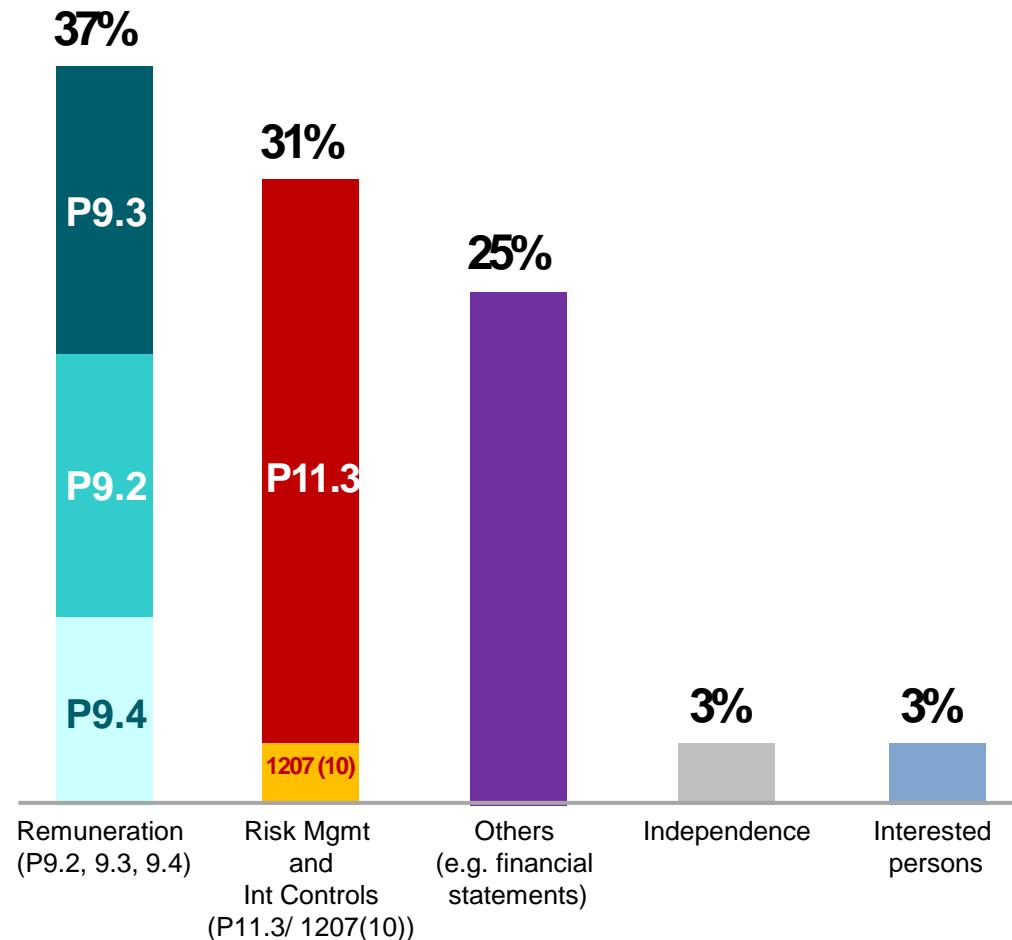
New disclosure requirements causing the biggest challenge

37% Remuneration

31% Risk management and internal controls

25% Financial statements related

Types of SGX queries (by number and percentage)



Source: KPMG Risk Consulting analysis 2014 SGX queries issued between 1-30 April 2014

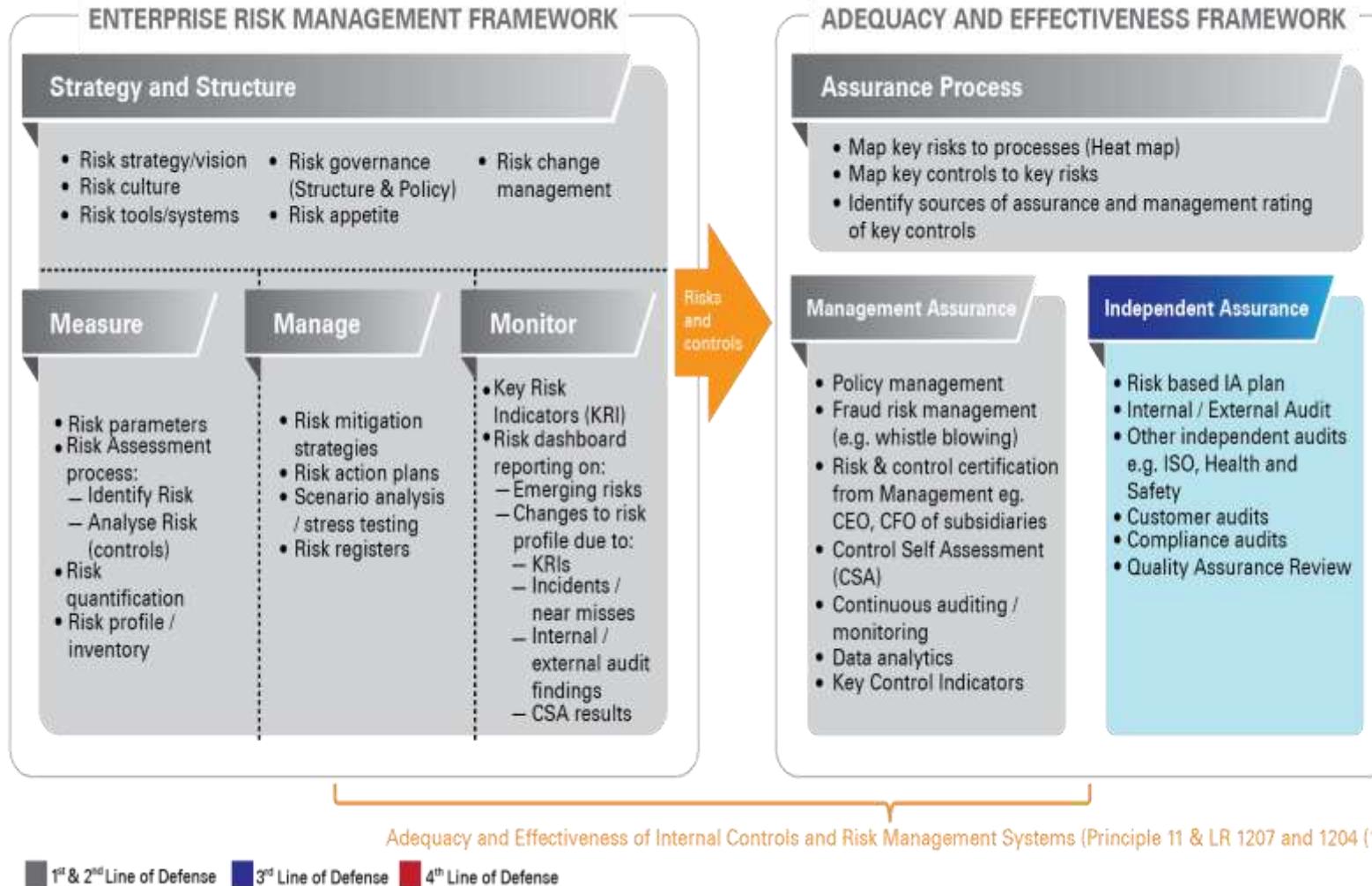
CONTEXT FOR CHANGE

WHICH SECTIONS HAVE CHANGED?

2008 Guidebook for ACs	2014 Guidebook for ACs	Level of change
AC Composition	Section 1: AC Composition	MODERATE
Section VI: Other Duties and Responsibilities <ul style="list-style-type: none">A.Interested Person TransactionB.Conduct of MeetingsC.Performance AssessmentD.Whistle-blowingE.Training	Section 2: AC Agenda	MODERATE
Section I: Internal Controls Section II: Risk Management	Section 3: Risk Management & Internal Controls	SIGNIFICANT
Section III: Internal Audit	Section 4: Internal Audit	MINIMAL
Section IV: Financial Reporting	Section 5: Financial Reporting	MINIMAL
Section V: External Audit	Section 6: External Audit	MINIMAL

RISK MANAGEMENT AND INTERNAL CONTROLS BOARD ASSURANCE FRAMEWORK

Board Assurance Framework



Risks and controls

ADEQUACY AND EFFECTIVENESS FRAMEWORK

Assurance Process

- Map key risks to processes (Heat map)
- Map key controls to key risks
- Identify sources of assurance and management rating of key controls

Management Assurance

- Policy management
- Fraud risk management (e.g. whistle blowing)
- Risk & control certification from Management e.g. CEO, CFO of subsidiaries
- Control Self Assessment (CSA)
- Continuous auditing / monitoring
- Data analytics
- Key Control Indicators

Independent Assurance

- Risk based IA plan
- Internal / External Audit
- Other independent audits e.g. ISO, Health and Safety
- Customer audits
- Compliance audits
- Quality Assurance Review

Adequacy and Effectiveness of Internal Controls and Risk Management Systems (Principle 11 & LR 1207 and 1204 (10))

■ 1st & 2nd Line of Defense

■ 3rd Line of Defense

■ 4th Line of Defense

RISK MANAGEMENT AND INTERNAL CONTROLS DISCLOSING A CLEAN OPINION

Clean opinion

The Board, with the concurrence of the Audit Committee, are of the opinion that the Group's internal controls addressing financial, operational, compliance **and** information technology risks, and **risk management systems** were adequate and effective *as at [date]*.

Source: Guidebook for Audit Committees in Singapore (Second Edition) , Appendix C5 "Disclosure requirements"

56% of companies issued a 'combined' opinion

Source: KPMG Risk Consulting analysis 2014 SGX queries issued between 1-30 April 2014

Adverse opinion

The Board, with the concurrence of the Audit Committee, are of the opinion that the Group's internal controls, addressing financial, operational, compliance and information technology controls, and risk management systems were **not adequate and effective as at [date]**.

The following **material deficiency(ies)** were identified:

1) *[Details of material deficiency to be provided]*

The following **actions** have been identified to address the material deficiencies:

1) *[Details of actions to address material deficiencies to be provided]*

Source: Guidebook for Audit Committees in Singapore (Second Edition) , Appendix C5 "Disclosure requirements"

Only **1%** of companies disclosed a 'negative opinion'
(i.e. ineffective controls)

Source: ISCA-KPMG "Towards better risk governance" 2013

RISK MANAGEMENT AND INTERNAL CONTROLS

WHAT DOES THIS MEAN FOR THE AC?

-  Higher level of AC engagement required to clarify the *mechanisms* in place to check adequacy and effectiveness
-  Increased training and awareness required for ACs in key areas such as evaluating control deficiencies and impact on disclosures
-  Heightened need for ACs to be demanding root cause analysis of findings/observations
-  Greater AC scrutiny of assurance providers in terms of scope and coverage (frequency of reviews)

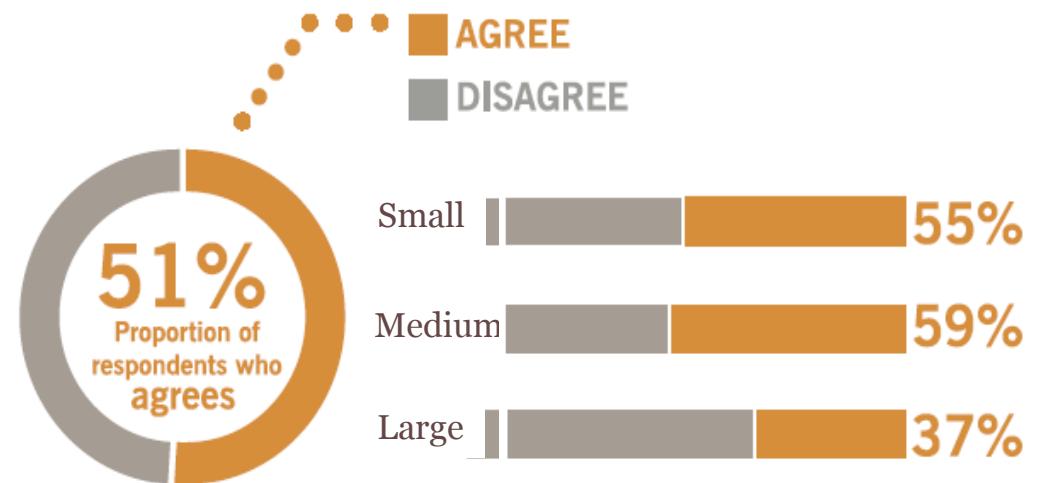
FINANCIAL REPORTING INTEGRITY OF FINANCIAL REPORTING

Financial reporting complexity remains top challenge. Key factors:

48% FRS change too often/ too complex

45% Recruitment/ retention of talents

37% Financial information for external reporting not aligned with that for internal use

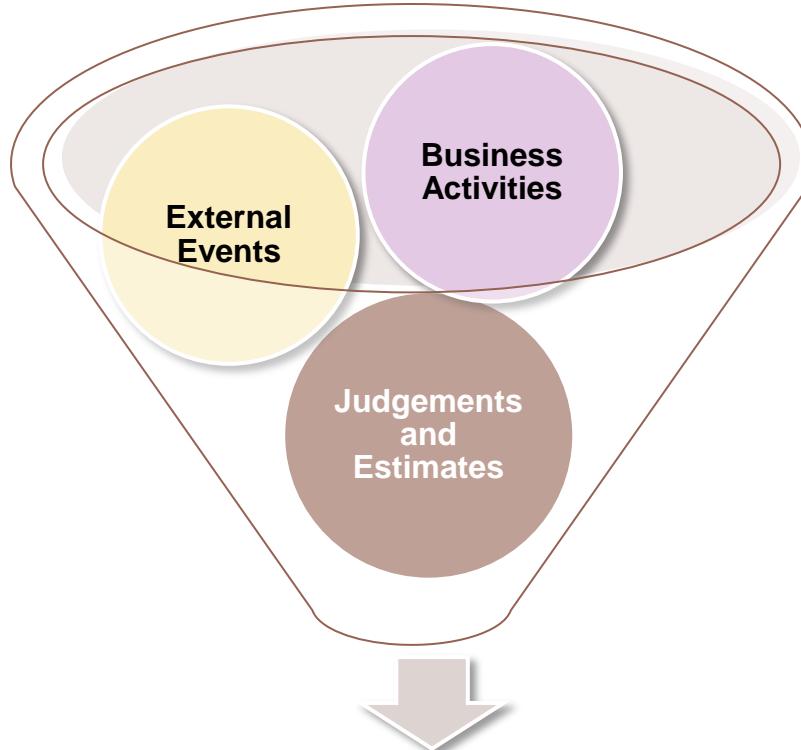


51% believe that the directors/ management engage experts (i.e. auditors) to prepare the financial statements

Source: ACRA-ACCA study 'Strengthening the value chain' 2013

Source: ACRA-ACCA study 'Strengthening the value chain' 2013

FINANCIAL REPORTING KEY DRIVERS OF FINANCIAL STATEMENTS



FINANCIAL STATEMENTS

Business Activities

- Activities that occurred throughout the year as a result of management's decisions (e.g. mergers, acquisitions, divestments, major contracts, etc)

External Events

- Events that are beyond the control of management, external to the company, that impact the company (e.g. natural disasters, prices fluctuations etc)

Judgements and Estimates

- Management's assumption, plan, outlook as well as external assumptions such as market expectations, that can have an impact on the company's financial position

FINANCIAL REPORTING EXTERNAL EVENTS

Singapore Swap Offer



oil



USD/SGD



EUR/SGD Exchange



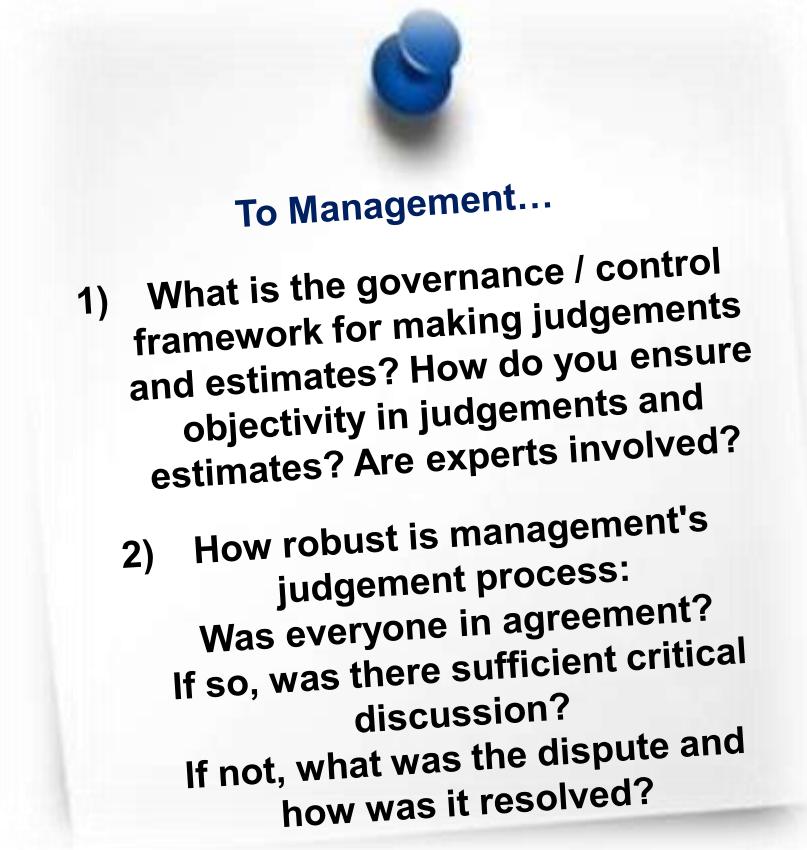
To Management...

- 1) How are we managing these uncertainties/risks?
 - 2) Where do I see the impact of these uncertainties reflected in our financial statements?

List of Areas

- Current versus non current classifications
- Gross versus net presentation
- Valuation – fair value hierarchy level 3
- Deferred tax
- Provisions
- Goodwill
- Impairment of assets (PPE, intangibles, etc)
- Where there is an accounting policy choice (e.g. PPE: revaluation model or cost model)
- ...

To Management...

- 
- 1) What is the governance / control framework for making judgements and estimates? How do you ensure objectivity in judgements and estimates? Are experts involved?
 - 2) How robust is management's judgement process:
Was everyone in agreement?
If so, was there sufficient critical discussion?
If not, what was the dispute and how was it resolved?

FINANCIAL REPORTING FINANCIAL JUDGEMENTS AND ESTIMATES

82% of total assets on balance sheets involve judgement.

A **1%** fluctuation in the total asset value can result in as much as a **38%** change in net profit of a given year.

KPMG's Financial Reporting Assessment Toolkit (FRAT) - extract

Top 10 Questions on Fair Values and Estimates	Y/N
Performance and Reliance 1. Are the use of fair values and estimates extensive in our financial statements?	
2. Are they aligned with our objectives and the economic environment?	
Governance and Compliance 3. Do we have adequate controls over the fair valuation and estimation process?	
4. Has the auditor sufficiently reviewed our fair values and estimates?	
Fair Valuation and Estimation Methodology 5. Are we comfortable with the models, inputs and assumptions?	
6. Have we considered alternative results?	
7. With the recent and upcoming changes in accounting requirements that may have an impact on fair values and estimates, have we assessed the potential impact on us?	
Business Impact 8. What risks do we face and how sensitive are we to these risks?	
Systems and Process 9. Are our systems and process adequate in supporting the sophistication and complexities of our fair valuation and estimation process?	
People 10. Are we up-to-date on the rapid changes in requirements?	

Source: KPMG 'Hard facts about accurate estimates' 2013

Source: Guidebook for Audit Committees in Singapore (Second Edition), Appendix E1 "Assessing fair values and estimates in financial reports" (Extract of KPMG's FRAT)

FINANCIAL REPORTING RISK AREA – REVENUE RECOGNITION

“It was like riding a tiger, not knowing how to get off without being eaten.”

- Chairman Ramalinga Raju, in his letter to the Board



The BBC News website features a prominent blue pushpin icon in the top right corner. The main headline reads "India Satyam fraud office probe". The story discusses the Indian government's investigation into the scandal at Satyam Computers, mentioning the resignation of chairman Ramalinga Raju and the appointment of Prem Chand Gupta to lead the probe. A photograph shows a close-up of a hand resting on a keyboard.

BBC NEWS

News Front Page

Watch ONE-MINUTE WORLD NEWS

Page last updated at 21:38 GMT, Tuesday, 13 January 2009

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India Satyam fraud office probe

The Indian government has said that the scandal involving Satyam Computers will be investigated by a federal office dealing with serious corporate fraud.

The company's chairman, Ramalinga Raju, resigned last week after admitting to years of accounting malpractices.

The Minister for Company Affairs, Prem Chand Gupta, said the investigation would examine the case in detail and submit its report within three months.

Satyam is the fourth biggest software firm in India

To Management...

- 1) What are the controls surrounding revenue recognition?
- 2) What are the key reasons for the increase/decrease in sales, cash and accounts receivable this year?

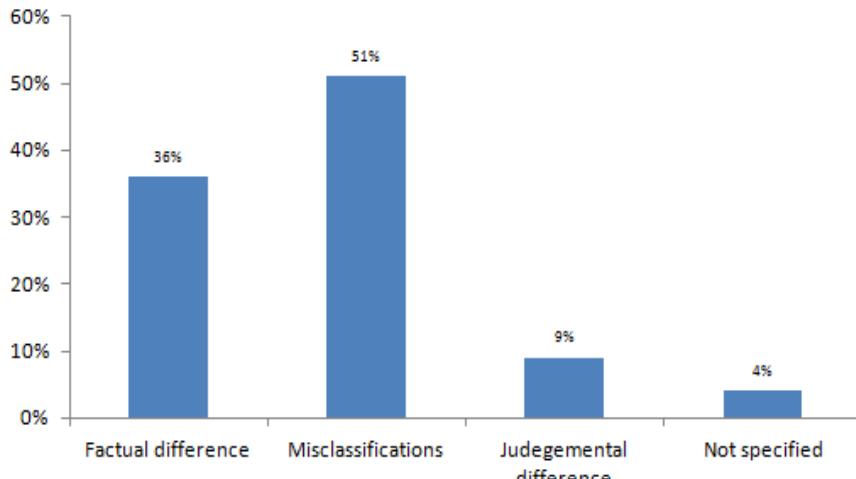
EXTERNAL AUDIT YOU NEED TO DRIVE VALUE FROM EA

"A good financial reporting process supported by an experienced and adequately staffed finance function is probably one where an external auditor would not find any material misstatements"

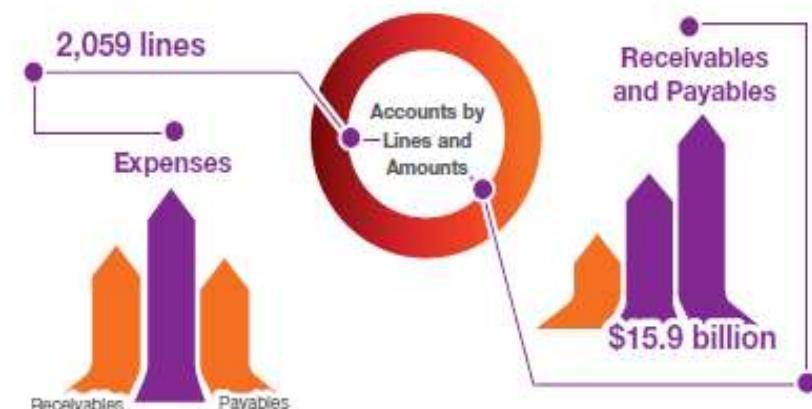


- Mr. Ong Pang Thye
Head Of Audit, KPMG

Proposed adjustments (\$33.9 billion):



Most frequently adjusted accounts:



Adjusting factual difference and misclassification made up \$29.3 billion or 87% of total proposed adjustments

Expenses were the most frequently adjusted accounts by line; Receivables and Payables the most by amount

EXTERNAL AUDIT

WHAT THE AC SHOULD DO?

Actions by AC	Key considerations
<input type="checkbox"/> Monitor external audit (EA) independence, quality and competencies	<ul style="list-style-type: none">• EA independence declarations• Pre-approvals for services/non-audit fees• Appendix F2 checklist for evaluating EA
<input type="checkbox"/> Clarify EAs role and responsibilities	<ul style="list-style-type: none">• Manage expectation gaps re: EA role• Review EAs' engagement letter
<input type="checkbox"/> Challenge EAs scope, coverage, observations and root causes regarding financial reporting integrity	<ul style="list-style-type: none">• Review audit plan – materiality, risks, scope, processes, reliance on other assurance providers, extent of IT audit etc
<input type="checkbox"/> Monitor implementation of remedial actions identified, particularly focusing on critical and material deficiencies	<ul style="list-style-type: none">• Document deficiencies in Management letter• Establish procedures for follow up/action timeframes
<input type="checkbox"/> Meet with EA without the Management, at least once annually	<ul style="list-style-type: none">• Appendix F1 provides possible questions the AC could raise during the private session
<input type="checkbox"/> Re-appointment and resignation of external auditors	<ul style="list-style-type: none">• Investigate issues relating to EAs resignation• Ensure effective transition from incumbent EA to incoming• Ensure that Management report the resignation to SGX

EXTERNAL AUDIT THE FUTURE OF EXTERNAL AUDIT?

“

If audits did not already exist, we would certainly need to invent them. Management, shareholders, banks and capital market participants would want them. But would we invent the audit product in its current form? I doubt it. ... The output would change, and as a result so would the process. ”

Tham Sai Choy, Chairman, KPMG in ASPAC Region Managing Partner, KPMG in Singapore

“

I think we already do more than give a pass/fail. If you look at the views and insights we provide to audit committees about internal controls, risks and IT systems, we're doing more. We also indicate where we think they're on the aggressive side or conservative side in their accounting. But we don't say any of that to the readers of our reports, who are principally the shareholders. So I don't think we lack the sophistication to do more and we can comment on our findings and views during the audit. I think the challenge for us will be to make sure we say things that add value, rather than falling back to boiler-plate language. ”

Mark Vaessen Global Head of IFRS, KPMG International

Appendix F1:

Possible Qs for the private session with the EA 139

- Did you recommend any changes to the financial statements or press releases that were not made? If so, what were the areas and nature of the suggested changes?
- What areas of our financial reporting do you believe could be challenged or scrutinized by regulators?
- What do you believe is the quality of our reported earnings for the current period?
- What is your perception of the tone at the top and at the middle Management levels?

Appendix F2: Sample checklist for evaluation of EA 140

- **Tone at the top**
- **Association with the right clients**
- **Clear standards and robust audit tools**
- **Recruitment, development and assignment of appropriately qualified personnel**
- **Commitment to technical excellence and quality service delivery**
- **Performance of effective and efficient audits**
- **Commitment to continuous improvement**

Appendix F2:

Sample checklist for evaluation of EA 140

- Do the key personnel in the EA team have relevant experience, industry focus and sufficient time to commit to the EA?
- Does the partner who is leading the audit demonstrate timely support and oversight?
- Do your auditors keep you informed of the outcome of any regulatory review of the audit engagement including any significant inspection findings as reported by the regulator and the description of actions taken by the firm in response to the findings?
- Are there cases where the reports issued by the audit firm in prior years have been restated/qualified subsequently?
- Is there an established protocol in the audit firm for your auditors to escalate complex issues and differences of opinions, to appropriate specialists or experts, for resolution in a timely manner?

KEY TAKE-AWAYS

HOW THIS GUIDEBOOK WILL HELP ACs



CLARIFY

What are the roles and responsibilities? Who does what ?



COMFORT

What is the risk appetite/tolerance – how much to do?



CHECK

How to determine Adequacy and Effectiveness of Risk Management and Internal Controls



CONFIRM

Use of the right tools or mechanisms – EA/IA/CSA, etc

CONTACT DETAILS



Irving Low

Partner,
Head of Risk Consulting
KPMG Advisory LLP
Tel: +65 6411 8888
Email: irvinglow@kpmg.com.sg

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