Introduction

Background

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

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

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

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

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

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

Establishment and terms of reference

Given the importance of an audit committee to the governance structure of a company, the establishment of this committee is mandated for listed issuers through paragraph 15.09 of Bursa Securities Listing Requirements. The need for a charter or written terms of reference and minimum functions of the audit committee (covered in Section II of this Introduction is set out in paragraphs 15.11 and 15.12 of Bursa Securities Listing Requirements. Similar provisions are also encapsulated for financial institutions in Standard 12.1 and Appendix I of Bank Negara Malaysia’s Policy Document on Corporate Governance.

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

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

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

Composition and membership

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

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<th>Size</th>
<th>Independence</th>
<th>Skills and qualities</th>
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<td>The size of the audit committee will vary depending on the needs of the company, the board and the extent of responsibilities delegated. Paragraph 15.09(1)(a) of Bursa Securities Listing Requirements mandates that the audit committee must be composed of not fewer than 3 members.</td>
<td>As stated in paragraph 15.09(1)(b) of Bursa Securities Listing Requirements, all the audit committee members must be non-executive directors, with a majority of them being independent directors. Paragraph 15.10 of Bursa Securities Listing Requirements prescribes that the chairman of the audit committee must be an independent director. Considerations on independence are covered in detail in the write-ups to Practice 8.1 and Step Up 8.4.</td>
<td>An appropriate level of expertise, experience and commitment amongst members is essential to the fulfilment of the committee’s mandate. At least one member of the audit committee must fulfil the financial expertise requisite of paragraph 15.09(1)(c) of Bursa Securities Listing Requirements. Considerations on financial literacy and other pertinent qualities are covered in detail in the write-up to Practice 8.5.</td>
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Meetings

It is for the audit committee chairman, in consultation with the company secretary, to decide on the frequency and timing of the audit committee’s meetings. There should be as many meetings as the audit committee’s roles and responsibilities require. It is recommended that there should be at least five meetings during the year, held to coincide with the key dates within the financial reporting (quarterly results and annual reporting) and audit cycle. The audit committee should meet prior to the release of the company’s quarterly results and annual reports to discuss on the proposed disclosures.

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

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

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

**Participants**

The chief executive officer, head of internal audit, external auditor or any other members of the management team and external experts may be invited to attend the meetings when the agenda calls for their insights.

**Paragraph 15.13 of Bursa Securities Listing Requirements** stipulates that a listed issuer must ensure that other directors and employees attend any particular audit committee meeting only at the audit committee’s invitation, specific to the relevant meeting.

**Quorum**

In order to form a quorum in respect of an audit committee meeting, the majority of members present must be independent directors (paragraph 15.18 of Bursa Securities Listing Requirements).

**Agenda**

A comprehensive agenda helps committee members stay focused on their objective.

Where necessary, the agenda should include input from the chief executive officer, finance director, the internal and/or external auditors.

The audit committee chairman is accountable for the agenda and should not delegate it to management.

**Timing**

Sufficient interval should be allowed between audit committee meetings and board meetings to allow any work arising from the audit committee meeting to be carried out and reported to the board as appropriate.
Rights and resources

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

**Rights of the audit committee**

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

(a) have authority to investigate any matter within its terms of reference;

(b) have the resources which are required to perform its duties;

(c) have full and unrestricted access to any information pertaining to the listed issuer;

(d) have direct communication channels with the external auditors and person(s) carrying out the internal audit function or activity;

(e) be able to obtain independent professional or other advice; and

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

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

**Performance evaluation**

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

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

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

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

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

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

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

**Section II**

Roles and responsibilities of the audit committee

Understanding of roles and responsibilities

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

1. Oversees financial reporting
2. Reviews conflict of interest situations and related party transactions
3. Assesses the internal control environment
4. Evaluates the internal audit process
5. Evaluates the external audit process
In addition to the aforementioned responsibility areas, audit committees of financial institutions are also required to review the accuracy and adequacy of the chairman’s statement in the directors’ report, corporate governance disclosures, interim financial reports and preliminary announcements in relation to the preparation of financial statements\(^1\).

**Oversight of financial reporting**

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

(i) changes in or implementation of major accounting policy changes;

(ii) significant matters highlighted including financial reporting issues, significant judgments made by management, significant and unusual events or transactions, and how these matters are addressed; and

(iii) compliance with accounting standards and other legal requirements.

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

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

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

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\(^1\) Paragraph 10, Appendix 1 of Bank Negara Malaysia’s Policy Document on Corporate Governance
In general, the audit committee should focus on the following when reviewing financial statements of the company:

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

Appendix I of this Pull-out sets out a list of indicators that the audit committees should be aware of in relation to financial reporting and a sample questionnaire that can be customised to seek management’s representation on a range of financial reporting matters.

Review of conflict of interest situations and related party transactions

The audit committee is tasked under paragraph 15.12(1)(h) of Bursa Securities Listing Requirements to review and report to the board on any related party transactions (including recurrent related party transactions) and conflict of interest situations that may arise within the listed issuer or group. This includes any transaction, procedure or course of conduct that raises questions of management’s integrity. The audit committee should therefore ensure that the transactions carried out are amongst others, in the best interest of the listed issuer as well as not detrimental to the minority shareholders².

Conflicts of interest situations generally refer to circumstances where a person with a vested interest in the company is in a position or has the opportunity to influence the company’s business or other decisions in ways that could lead to personal gain or advantage of any kind (“interested parties”).

Examples of situations that are likely to give rise to conflicts of interest amongst others include the following:

- where the interested party(ies) have an interest in a business that competes or is likely to compete, either directly or indirectly, with the business of the company or its subsidiaries (collectively “the group”);

² Refer to paragraph 3(a), Appendix 10C of Bursa Securities Listing Requirements
- where the interested party(ies) conduct or have an interest in business transactions involving goods or services, either directly or indirectly, with the group;
- where the interested party(ies) provide or receive financial assistance from the group; and
- where the interested party(ies) lease property to or from the group.

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

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

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

Companies should also be cognisant of **Section 228 of Companies Act 2016** which prescribes the obligations of a company (i.e. to obtain prior shareholder approval at a general meeting) in respect of transactions involving a director or substantial shareholder of the company or its holding company, or its subsidiary, or a person connected with a director or substantial shareholder.

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

4 **Paragraph 10.02(I)(ii) of Bursa Securities Listing Requirements**.

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

6 A substantial shareholder is a person who has not less than 5% of the voting shares in the company.
Taking into account the aforementioned enumerations, it is therefore incumbent on companies, particularly listed issuers through the audit committee, to determine how to address conflict of interest situations and monitor compliance with related party transaction policy and/or mandate, including transactions or situations that warrant timely internal and regulatory disclosures and appropriate review and reporting.

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

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

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

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

- Are the terms of the transaction (including the price) fair, reasonable and on normal commercial terms?
- What impact will the transactions have on the financial statements?
- Are there business reasons or economic substance for the company to enter into the transaction with the related party and not a third party?

Examples of matters to be tabled to the audit committee on related party transactions are outlined in Appendix III of this Pull-out.

In addition, it is important for the audit committee to look into transactions that do not neatly fall within the definition of a related party transaction as stated in Chapter 10 of Bursa Securities Listing Requirements but may still involve a certain level of conflict of interest due to the close proximity (e.g. relationship) of the counterparties with individuals (such as employees) within the listed issuer who are involved in the transactions.

In certain instances, the audit committee may also be faced with the possibility of undisclosed conflict of interest situations or related party transactions. Hence, it is important for the audit committee to ensure that the comprehensive framework mentioned above is able to identify questionable transactions or potential conflict of interest situations or related party transactions. For this purpose, the audit committee should request management to provide the following information:

- background information on the company’s trading partner and transacting parties;
- information on the trading partners’ directors and substantial shareholders;
- identity of related parties;
- information about the key business partners, major customers, major suppliers and parties to key contracts; and
- salient terms or arrangements of the transactions.
Assessment of internal control environment

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

- **Control environment**: This sets the tone and culture of the company. It is the foundation of all aspects of internal controls, providing discipline and structure. It includes the integrity, ethical values and competency of the personnel.

- **Risk assessment**: Identifies and analyses relevant risks that prevent the company from achieving its objectives and forms the basis for determining how those risks should be managed.

- **Control activities**: These are the policies and procedures that help ensure the necessary actions are taken to address risks impeding the achievement of the company’s objectives, and maintaining these risks within an acceptable risk appetite.

- **Information and communication**: Identifies, captures and communicates information in a form and timeframe that enables personnel to carry out their responsibilities.

- **Monitoring activities**: Assesses the performance of the control system on a continuing basis.

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

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

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

Considerations on risk management and internal control system are covered in detail in the write-up to Practices 9.1 and 9.2. Discussion on the establishment of a risk management committee is provided in write-up to Step Up 9.3.
Evaluation on internal audit

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

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

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

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

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

Evaluation on external audit

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

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

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

- Adequacy of the experience and resources of the accounting firm
- Persons assigned to the audit
- Accounting firm’s audit engagements
- Size and complexity of the listed issuer’s group being audited
- Number and experience of supervisory and professional staff assigned to the particular audit
In the event of removal or resignation of the external auditors, it is imperative for the audit committee to look into the reasons thereof, especially when the impending removal or resignation arises from an inability to resolve contentious matters that affect financial reporting.

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

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

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

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

- discuss with the external auditor before the audit commences, the nature and scope of the audit, including the terms as detailed in the external auditor’s engagement letter. This will clarify the responsibilities of the company and the external auditor and other logistical matters; and

- study and evaluate the audit plan, especially the approach to be deployed by the external auditor.

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

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

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

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

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

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

Section III Communication on audit, risk management and control

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

**Paragraph 15.15(3) of Bursa Securities Listing Requirements**

**Audit committee report**

The audit committee report must include the following:

(a) the composition of the audit committee, including the name, designation (indicating the chairman) and directorship of the members (indicating whether the directors are independent or otherwise);

(b) [deleted]

(c) the number of audit committee meetings held during the financial year and details of attendance of each audit committee member;

(d) a summary of the work of the audit committee in the discharge of its functions and duties for that financial year of the listed issuer and how it has met its responsibilities; and

(e) a summary of the work of the internal audit function.

Note: As stated in Paragraph 2, Appendix 4 of Bank Negara Malaysia’s Policy Document on Corporate Governance, financial institutions are required to disclose the attendance of each director at board and board committee meetings during the financial year and discuss the roles and responsibilities of the board and the board committees.
The audit committee report should describe relevant significant issues in a concise and understandable form, tailored to the specific circumstances of the listed issuer. Merely disclosing the audit committee’s terms of reference or charter without describing how the committee actually carried out its roles and responsibilities during the financial year would not be particularly useful for stakeholders.

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

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

In addition to the audit committee report, paragraph 15.26(b) of Bursa Securities Listing Requirements requires the board of the listed issuer to provide a statement about the state of risk management and internal control of the listed issuer as a group. The statement should contain sufficient and meaningful information needed by stakeholders to make an informed assessment of the main features and adequacy of the listed issuer’s risk management and internal control system. Further, paragraph 15.23 of Bursa Securities Listing Requirements provides for the external auditors to review the statement made by the board of directors of a listed issuer, with regard to the state of risk management and internal control of the listed issuer and report the results thereof to the board of directors of the listed issuer.

It is also important to note that the chairman of the audit committee should be present at the annual general meeting to answer questions on the audit committee’s activities and on matters that are within the scope of the audit committee’s responsibilities.