Chairman of the audit committee

MCCG Intended Outcome 8.0
There is an effective and independent Audit Committee.
The board is able to objectively review the Audit Committee’s findings and recommendations. The company’s financial statement is a reliable source of information.

MCCG Practice 8.1
The Chairman of the Audit Committee is not the Chairman of the board.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why
The case for change

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

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

Recognising the need for objectivity amongst audit committee members, regulators have placed a heightened focus on the composition of this committee with an emphasis on its chairman, as shown below:

Paragraph 15.09(1)(a) and (b) of Bursa Securities Listing Requirements
A listed issuer must appoint an audit committee from amongst its directors which fulfils the following requirements:

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

Paragraph 15.10 of Bursa Securities Listing Requirements
The members of an audit committee must elect a chairman among themselves who is an independent director.

What could go wrong:
- Lack of objective review and scrutiny on the findings of the audit committee by the board.
- Deliberations and decision-making of the audit committee is dominated by a single individual.
- Omission of key discussion matters from the agenda of the audit committee.
- Lack of oversight on the effectiveness of the audit committee by the board.
In order to form a quorum in respect of a meeting of an audit committee, the majority of members present must be independent directors.

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

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

Point for reflection

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

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

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

Investors’ perspectives

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

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

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

---

1 Corporate governance and proxy voting guidelines 2015, Blackrock
In structuring its audit committee, the board should ensure that the chairman of the audit committee is distinct from the chairman of the board. In addition, as stated in paragraph 15.10 of Bursa Securities Listing Requirements, the chairman of the audit committee must be an independent director.

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

What are the key responsibilities of an audit committee chairman?

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

<table>
<thead>
<tr>
<th>Planning and conducting meetings</th>
<th>Overseeing reporting to the board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Role of the audit committee chairman</td>
<td></td>
</tr>
<tr>
<td>Encouraging open discussion during meetings</td>
<td>Maintaining active ongoing dialogue with management and both internal and external auditors</td>
</tr>
</tbody>
</table>

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

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

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

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

Can the chairman of the audit committee chair another board committee within the same company?

There are no restrictions for the chairman of the audit committee to chair another board committee within the same company as possibilities of conflicts of interest are minimal under normal circumstances.
In some instances, companies may find it value-adding for the chairman of the audit committee to chair another board committee, given the synergies that are involved between these two committees (e.g. audit committee and risk management committee or in the case of some financial institutions, audit committee and financing committee).

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

**Regional/international perspectives**

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

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>The board of a listed entity should have an audit committee which is chaired by an independent director, who is not the chair of the board [Recommendation 4.1(a)(2)].</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>The board should establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors. In smaller companies², the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman (Provision C.3.1).</td>
</tr>
</tbody>
</table>

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