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CORPORATE GOVERNANCE

AUDIT COMMITTEE'S VITAL ROLE

THE Securities Commission's (SC) Audit Oversight Board (AOB), in a press release on April 8, reminded audit committees (ACs) of public-listed companies (PLCs) of the importance of driving audit quality improvements by engaging their auditors to promote an effective audit process.

The AOB stated that this was in line with the SC's efforts to improve corporate governance and increase investors' confidence in the quality and reliability of audited financial statements.

It was also part of the AOB's capacity building initiatives for the accounting and auditing industry.

Going through the Listing Requirements (LR), it immediately falls into place why so much emphasis is placed on the AC and why so much more is expected of it.

External audit

Under the LR, it is the AC that deals exclusively with the external auditors, the audit plan, the auditor's evaluation of the system of internal controls and the audit report.

The AC must consider any letter of resignation from the external auditors of the PLC and whether there is reason to believe that the PLC's external auditor is not suitable for re-appointment and recommend the nomination of another external auditor.

The AOB highlighted the need for the AC to consider information in the annual transparency report (ATR) prepared by audit firms when evaluating the appointment and reappointment of external auditors.

(There are criteria as to which audit firms are obliged to prepare the ATR). The ATR provides information on legal and gover-

nance structures of the audit firms, measures taken to uphold audit quality and manage risks, and measurements of audit quality indicators.

Yes, the AC gets a chance to audit the external auditor as to its suitability and independence — a role reversal of sorts which an AC may silently relish.

The LR further beefs up the functions of the AC by requiring the quarterly results and year-end financial statements to be considered and recommended to the board.

And we do know that most of the time, PLCs get into all kinds of trouble because of their financial statements. A check-and-balance role played by the AC and the board — a majority independent flavoured recommendation to be considered by the full diversified board.

Internal audit

The LR goes on to state that the internal audit function reports formally to the AC. With the internal auditor, the AC must consider the adequacy of the scope, competency and resources of the internal audit function and that it has the necessary authority to carry out its work.

And when it comes to executing the work, the AC must consider the internal audit plan, processes and the results of the internal audit assessments.

The AC must also consider whether appropriate action is taken on the internal auditor's recommendations.

Incidentally, the AC has the power to hire, fire and remunerate internal auditors.

By now, it will become clear that the AC is indeed a powerful sub-committee of the board dealing with and having direct access to both sets of auditors.

RPT, conflict of interest and management integrity

The rules of the LR further seal the importance of the AC by dictating that any related party transaction and conflict of interest that may arise within the PLC or group, including any transaction, procedure or course of conduct that raises questions of management integrity, be first perused by the AC.

And in all instances, the AC must form the first view before recommending that view to the board. There are three important areas to be considered here. The first two important areas are those which traditionally have been shown to destroy shareholder value: related party transactions and conflict of interest situations.

The third part relates to the powerful catch-all clause that the AC must look at anything that raises questions of management integrity.

Empowering the AC

Having placed such demanding functions on the AC, it is only fitting that the rules of the LR empower the AC accordingly, and the LR does so overwhelmingly.

Under the rights of the audit committee, the PLC must ensure that wherever necessary and reasonable for the performance of its duties, an AC 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 per-

taining to the PLC;

(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.

Equipping the AC with such substantial powers simply means that so much more will be expected of it.

In fact, some AC members have expressed unease with so much power thrust upon them.

The AC as a whistleblower

Embedded in the rules of the LR is an oft-unappreciated exacting rule. It states that where an AC is of the view that a matter reported by it to the board of directors of a PLC has not been satisfactorily resolved resulting in a breach of the LR, the AC must promptly report such matter to the exchange.

Here the AC is obliged to be a whistleblower under the rules of the LR. Again, a role reversal of sorts where a creature created by the board turns on the creator, not necessarily by choice, but by the demands of a rule.

It is timely that the AOB highlighted the pivotal and important role played by ACs in corporate governance. AC members must be acutely aware of what the LR requires of them.

The writer is chief executive officer of Minority Shareholders Watch Group

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