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INTERNAL AUDIT

Strengthening internal audit's role

There is a growing debate on the need to make internal audit compulsory for listed companies, reports LYNETTE KHOO

WHENEVER fraud, accounting irregularities and other corporate governance lapses occur, the spotlight is invariably cast on the quality of internal controls in the companies in question.

While it is a widely held view that the role of internal audit needs to be strengthened, what remains debatable is whether the internal audit function should be made compulsory under Singapore listing rules.

Ng Siew Quan, risk & control solutions partner at PwC Singapore, notes that given the diversity and complexity of businesses today, having an internal audit function is an essential practice rather than a best practice.

But there is unlikely to be improvement in the internal audit function just by making it mandatory as 'there will always be the issue of form over substance', he adds.

Irving Low, partner, head of governance, risk and compliance at KPMG in Singapore, notes that there should definitely be a strong call for listed companies to have internal auditors.

But unlike some other capital markets, the composition of companies on the Singapore Exchange (SGX) consists of some very small companies and may not justify the need for internal audit to be made compulsory.

'The need to have one should be determined by the audit committee which is responsible for the oversight internal controls of an organisation,' Mr Low says.

Enhancing the IA role

Currently, the requirement for listed companies to have internal audit functions is articulated in the Code of Corporate Governance best practices.

Recent proposed changes to the Code are seen to be strengthening the case for an independent internal audit function.

The Corporate Governance Council proposed that the board of a company be explicitly responsible for overseeing the risks undertaken by the company and reviewing the adequacy and effectiveness of its risk management and internal control systems.

It also proposed that the board of a company should comment in the company's annual report on whether it has received assurance from the CEO and CFO that the financial records have been properly maintained and that they give a true and fair view of the company's operations and finances.

'To provide assurance on any system requires a structured and systematic approach to review and the application of due care and diligence by skilled practitioners,' says Protiviti's managing director for internal audit solutions, Philip Moulton.

'Therefore, it is difficult to visualise how such assurances could be provided in the absence of a properly resourced and independent internal audit function.'

Lobbyists of investor rights, however, have argued that the Code, which operates on a 'comply or explain' approach lacks teeth, and prefer a tougher stance in making internal auditing a regulatory requirement.

The Securities Investors Association (Singapore) (SIAS) has proposed to SGX to make it compulsory for all listed companies here to appoint internal auditors.

Qualification

Uantchern Loh, president of the Institute of Internal Auditors (IIA), feels that enhancing the role of internal audit goes beyond making the role a regulatory requirement.

'For instance in Malaysia, even though the listing rules require internal audit functions to be mandatory, everybody knows that it's a joke because many listed companies will just pay RM10,000 (S\$4,082) or RM20,000 outsourcing to some small companies that are not even qualified to do internal audit,' he says.

Instead of making internal audit compulsory, it is more important to certify and train internal auditors first, he says.

IIA is thus pushing for mandatory certification for internal auditors serving listed companies. It is working with the Pro-Tem Singapore Accountancy Council, which is tasked to implement recommendations of the Committee to Develop the Accountancy Sector (CDAS), to roll out a Singapore qualification by the end of 2012.

Among the proposals issued by CDAS last April was the suggestion to develop specialisation pathways such as internal audit, risk management, and business valuation.

The Singapore-styled qualification that IIA is coming up with will complement the Certified Internal Auditor designation, currently the only globally accepted certification for internal auditors.

In addition, IIA is pushing for more disclosures on the scope of internal audit work undertaken annually and how much money is spent on it. It is also seeking to introduce guidelines on internal auditing.

The practice of internal auditing is currently guided by the International Professional Practices Framework (IPPF). The IPPF, which is issued by the IIA and adopted by the Code of Corporate Governance, provides authoritative guidance on internal auditing standards, practices and ethics.

'We are coming up with guidelines on the minimum standards and minimum amount of work that should be done and we hope this will be incorporated in the Code of Corporate Governance,' Mr Loh says.

Since there is currently no mandatory requirement for internal audit, the scope of work, standard and responsibilities of the internal audit function, the quality of the internal audit staff or the outsourced provider, and the extent of the audit committee's supervision vary from company to company depending on their budget.

Mr Moulton observes that a majority of listed companies in Singapore already have internal audit functions, be it in-house or out-sourced.

Independence

But the reporting line of these internal audit functions is critical. The appropriate functional reporting line is the audit committee chairman. At the same time, internal auditors have an administrative reporting line to either the CEO or the CFO.

Singapore Telecommunications, for instance, explains that its internal audit function is independent of management and reports to the chairman of the audit committee.

'The role of internal audit is to provide assurance to the board of directors that management has exercised adequate and effective risk management activities through the audit work that internal audit performs,' says a SingTel spokesman.

As for Keppel Corporation, its internal audit findings and recommendations are sent to the audit

committee and significant findings are discussed at quarterly meetings.

The audit committee reviews the effectiveness of actions taken by management on the recommendations made by the internal auditors and the adequacy of the internal audit function and its resources each year.

'The training costs and programmes attended by the internal auditors are also reviewed to ensure the staff continue to update their technical knowledge and audit skills,' says Tan Eng Hwa, general manager of group internal audit.

At Boustead Singapore, there is an in-house internal audit department that undertakes a risk-based approach in its audit of operational and financial processes. The approach and methodology are developed based on the internationally accepted COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework.

Given increased demands on audit committees to enhance their oversight on internal controls and enterprise risk management, 'an effective internal audit function is therefore now emerging as a critical need - not something which is easily shrugged off as an additional burden', says Mr Moulton.

Educating investors

Another key aspect of strengthening the role of internal audit is in educating shareholders and investors on their role in ensuring that internal audit is effectively functioning and not just a checkbox-ticking exercise.

Shareholders and investors need to be educated on the role that internal auditors play so that they are able to demand better internal audit functions in the company, Mr Loh says.

On that note, IIA is working with SIAS to conduct more education programmes such as roadshows to help investors understand the value of internal audit and enable them to ask tough questions on internal audit at annual general meetings.

Mr Moulton notes that shareholders should quiz directors on whether enterprise risk assessment and the internal audit function cover the key risks, entities and locations at reasonable frequency.

'They should also ask how the internal audit function is resourced,' he adds. 'It is doubtful that an effective internal audit function can be staffed by finance team members who act as 'internal auditors' on a part-time basis.'

Shareholders should also find out what the reporting line is for the internal audit function. If internal auditors report to an executive director, 'it is doubtful that they have sufficient independence to conduct work without fear or favour', Mr Moulton says.

To ensure the independence of internal auditors is observed in substance, the audit committee should be the one making the decision on the hiring, firing and performance evaluation, Mr Low adds. The audit committee should also have authority to determine the budget for internal audit.

'Surprisingly, there is a large group of shareholders and investors who may not fully appreciate the mandates of both the audit committee and internal audit,' Mr Low says.

'By equipping themselves with the basic knowledge of what the mandates are, they can ask the right questions.'



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