Many SGX-listed firms not getting Internal Audit right

IA needs to be in place, on an ongoing basis, and is effective, adequately resourced and independent of the activities it audits, as required by SGX's new rule, by MAK YUEEN TEEH, ZHU ZINAN and CHEW YI HONG

O n August 6, 2018, a revised Code of Corpor- ate Governance for Singapore (the new Code), promulgated by the Corporate Governance Authority of Singapore (MAS) and certain corporate governance practices were made mandatory for all listed companies through changes to the listing rules of the Singapore Exchange (SGX). Starting from January 1, 2019, the SGX Rulebook for both Mainboard and Catalist companies require an independent internal audit function (IA) as part of the corporate governance system. An adequately resourced IA function which is functionally independent of management can provide appropriate assurance and can serve as an independent check on the efficacy of the broader system. A well-run IA function can add value to the company by providing objective advice, helping the board to identify potential risks, and enhancing the quality of management and board discussions. An IA function is critical to a company’s ability to effectively manage risk, improve its processes, identify opportunities for operational improvements and enhance its reputation.

IA TRENDS AND IMPACT

A study of SGX-listed companies by Mak Yuen Teeh, Zhu Zinan and Low Chin Yang found that between 2011 and 2014, the percentage of companies that disclosed that they have an IA function increased and averaged about 92 per cent over the years. Between 2011 and 2014, 36.1 per cent of companies that disclosed having an IA function had it in house, while those having an outsourced IA function had it from a provider of independent audit firms, with the smaller firms having IA functions from independent audit firms. The study also showed that the quality of the assurance provided by the IA function was perceived to be more effective than that provided by external auditors.

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Another company – as 5-chp – also did not have an IA and said that it would “have one not later than 31 December 2019”, even though the SGX rules say it by January 2019.

One Singapore company said in its FY2015 and FY2016 ARs that it would look to engage an IA, as said in the FY2017 AR, said that it had yet to appoint an IA but would do so for FY2018. In the FY2018 AR, it said that management is in the process of setting up an in-house internal audit department as of the date of this report. Its FY2019 AR and AGM have now been delayed – like 1IA.

A Singapore real estate and property developer which has expanded into Cambodia combined its disclosures for the “Audit Committee”, “Internal Audit” and “Risk and Management and Internal Controls” sections of its corporate governance report, and listed 13 functions of the AC that task very much like “cut and paste”, including responsibilities relating to the AC’s oversight of IA. However, there was no specific disclosure as to whether there was an IA function, whether it was in house or outsourced, or whether it met applicable international auditing standards.

Speaking of “cut and paste” – or stuck in time – another company disclosed in its 2015 and 2017 ARs that the AC had reviewed the IG plan – for FY2015.

One 5-chp said that it recognised the responsibilities of the Board to maintain an IA function and that the AC has the responsibility to oversee the IA – but did not act- ually say whether there was one. Some companies disclosed that IA was outsourced with no disclosing whether it was outsourced to. One Singapore company said that it outsources its IA to “external professional firms”. However, not only did it not disclose the identity of the outsourced IA, but it also neglected to include the impression that different firms may be used. Frequent changes in the outsourced IA service provider are likely to compromise the effectiveness of the IA.

IA PERSONNEL WITH CONFLICTING ROLES

One company which describes itself as a “leading supplier” of equipment and supplies to the printing circuit board (PCB) industry in Asia and which also provides other services to the PCB industry said this under its disclosure of IA: “The current size of operations of the Group does not warrant the establishment of a dedicated IA function. As the Group has substantial operations overseas, and in particular China, the AC has instructed the CFO to review certain critical areas such as the Group’s China and other overseas subsidiaries and enhance the internal controls if necessary.”

It went on to say: “The AC has considered and determined that the CFO is competent and is capable to carry out the review of the activities. The findings and recommendations arising from these reviews and testing were discussed with Management and presen- ted to the AC and the Board.”

Another company said it has an in-house 5-chp team which “comprises personnel of the Company’s HR & Ad- min team” and that “the role of IA is such that an arrangement would ensure that that internal audit function would have appropriate standing within the company.”

One mining 5-chp said it did not engage any in-ternal auditors for the most recent financial year and that “the Group does not operate an internal audit function to review the internal controls, risk management and compliance systems...” It said that it will outsource IA functions to an external audit firm “as and when needed.”

In a letter to the exchange dated by the first au- thor, it was mentioned that BDO Rafflins was providing IA services in January 2019 and also in February 2008, while its then partner, Lee Jou Hat, was chairing the company’s AC. Since the AC is supposed to oversee IA, there was clearly a self-review of the IA.

Hyflux subsequently moved its IA function in-house. However, during the period from May 2013 to December 2015 when its non-executive director, Kim Kwek was designated to executive director, he had responsibilities for Corporate Finance, Information Technology, IA and Corporate Marketing functions. This may raise doubts about the independence of the IA function during that period, given that he was over- seeing various support functions that IA would be expected to review as part of its work. Even if he did not carry out any reviews, the IA functions would be rotated on a relatively short period of time. A LinkedIn search indicates that a Head of IA was appointed in May 2015.

Another company with significant operations in Malaysia engaged the advisory services of a Big Four ac- counting firm, in May 2015. However, it also disclosed that the BDO program was developed with assist- ance of the IA, an obvious conflict of interest in view of the inter- dependence of the IA involvement in the ERM initiat- ives.

The self review threat was even more evident for an- other 5-chp based on its disclosures. It said that it had engaged a consulting firm “specialising in supporting the IA function” which meets the standards set by internationally recognised professional bodies including the Standards for the Professional Practice of Internal Auditing set by the Institute of Internal Auditors. The engage- ment of such an auditor would compromise the independence of the IA.

One company which engaged a risk management advisory firm was found to be underwriting its IA. It also disclosed that the ERM program was developed with assist- ance of the IA, a situation that raises obvious dilem- mas and the potential for IA involvement in the ERM initiat- ives.

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