

the consent of all shareholders. This is primarily because the auditor's role in the company is an empirical factor in monitoring the cash and fund flow of the company.

- 10.040 The auditor is also entitled to be heard on any part of the meeting that concerns him in his capacity as auditor at any general meeting that he attends. This entitlement to be heard covers every meeting the auditor attends even if he retires at that meeting, or a resolution for his removal is passed at that meeting.⁵⁰

C. INTERNAL AUDIT

1. Overview

- 10.041 The general rule is that the management, which usually comprises the executive officers of the company and the company secretary, are responsible for devising and maintaining a system of internal control to not just keep possible fraud at abeyance, but also to simply ensure accuracy and consistency in general work undertaken. To aid it in this task, an internal audit function is normally established in large organisations. Such an internal audit function is unlikely to be found in the smaller companies, including family run businesses, although it is good practice to establish an internal audit function to undertake regular monitoring of key controls and procedures. Internal audit should be an integral part of a company's system of internal control which helps to ensure its effectiveness. Personnel of any internal audit or control system must be of the highest level of integrity, to say the least.
- 10.042 The primary role of an internal audit function, also known as internal auditors, is to review the adequacy of risk management systems and internal controls of a corporate organisation. The benefits of such an internal audit function cannot be understated. It is not unusual to have breaks in the system, which can give rise to cases of misappropriation and criminal breach of trust. One such example is the prominent case involving an employee of the Singapore Airlines Ltd, who had over a period of 13 years amassed for himself nearly S\$35m through misappropriation.⁵¹ The point to note is that even the largest companies with many layers of checks and balances can have problems. No organisation and no internal audit system can be infallible. Having said this, however, the internal audit

50 Companies Act (Cap 50, 2006 Rev Ed) s 207(8).

51 The employee, Teo Cheng Kiat, was in year 2000 convicted and sentenced to 24 year's jail.

function can drastically reduce the incidents of misfeasance occurring.

An internal audit function which comprises of competent personnel who have a good understanding of the company structure and business, and the possible market and other risks involved can assist in the following ways: **10.043**

- (a) provide an objective opinion to management and the audit committee on the adequacy and effectiveness of the company's internal control systems;
- (b) provide assurance on compliance with corporate policies, legislation and regulations;
- (c) identify and alert management and the audit committee, and as the case may necessitate, the board of directors, about critical issues that ought to be addressed to prevent fraud or other failure from occurring, as well as any breaches; and
- (d) increase the deterrent effect in countering fraud, corruption and other illegal acts in the company through suitable checks and balances, including frequent reviews, and meetings with the various groups in the company.

The Audit Committee Guidebook provides advice for the implementation of the internal audit function. The internal audit function can be in-house, outsourced to a reputable accounting/auditing firm or performed by a major shareholder, holding company, parent company or controlling enterprise with internal audit staff. The Code of Corporate Governance states that the internal auditor should meet or exceed the standards set by nationally or internationally recognised professional bodies including the Standards for the Professional Practice of Internal Auditing set by the Institute of Internal Auditors. **10.044**

The Guidebook suggests that the day-to-day operations of the internal audit function should include the following: **10.045**

- (a) budgeting and management accounting;
- (b) human resource administration, including personnel evaluations and compensation;
- (c) internal communication and information flow; and
- (d) administration of the organisation's internal policies and procedures.

An effective internal audit function will cater to a proper management of strategies, employees, customers and other third parties, information flow, technology processes, quality control and project management. It should also go further and cater to a corporate wide risk management process, which seeks to identify and arrest potential risks that could thwart the corporate objectives. **10.046**

- 10.047 It is recommended that the internal auditors' primary line of reporting should be to the chairman of the audit committee, although they may also report functionally and administratively to the chief executive officer. The internal auditor should also be an appointee of some seniority in the organisation, to enable him as and when necessary to take management to task about breaks and/or inconsistencies in the system. Further, the internal auditor should also be appointed as a member of the audit committee, whether or not the internal auditor is a director. Having unrestricted access and regular meetings with the audit committee, and, if possible, being a member thereof, both ensures and enhances the independence of the internal audit function.

2. Internal controls

- 10.048 An internal audit function should also be part of the bigger internal control mechanisms of a company. Internal controls, broadly defined by the Committee of Sponsoring Organisations of the Treadway Commission ("COSO"),⁵² is a process effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
- (a) effectiveness and efficiency of operations;
 - (b) reliability of financial reporting; and
 - (c) compliance with applicable laws and regulations.

Objectives of a system of internal controls are to, amongst others, enable the following:

- The examination of transactions to ensure that they are in accordance with management's general and specific authorisation.
- The prompt recording of all transactions in the correct amount in quantity and value, where appropriate in the relevant accounts and within the accounting period in which the transaction has been executed so as to permit preparation of financial information within the framework of a recognised accounting policy. In this regard, there must be put in place a proper recording system with trained personnel

52 The Treadway Commission on fraudulent financial reporting was a private sector initiative jointly sponsored by several US organisations, including the American Institute of Certified Public Accountants. The COSO document, 'Internal Control – Integrated Framework', was prepared in response to the recommendations of the Treadway Commission in its report issued in 1987. The COSO framework provides guidance on internal control and establishes benchmarks that could be used for evaluating internal controls.

- ensuring that all transactions and events are monitored.
- The segregation of duties and responsibilities between various personnel.
 - A system of independent checks on performance and verification systems must also be conducted.
 - The permission to assess the assets and records in accordance with management's authorisation.
 - The ascertainment of the recorded particulars of assets by comparing and verifying with the existing assets and new assets where appropriate at reasonable intervals, and the taking of timely and appropriate action with regard to any discrepancies found during internal audit procedures.

Table 1 – Objectives of Internal Control System Broadly Stated

Section 199(2A) of the Companies Act⁵³ requires every Singapore-incorporated public company to devise and maintain a system of internal controls sufficient to provide reasonable assurance that: **10.049**

- (a) assets are safeguarded against loss from unauthorised use or disposition; and
- (b) transactions are properly authorised and that they are recorded as necessary to permit the preparation of true and fair profit and loss accounts and balance sheets and to maintain accountability of assets.

It follows from section 199(2A) of the Companies Act⁵⁴ that the primary purpose of internal control systems is to, as far as practicable, ensure an orderly and efficient conduct of the company's business. **10.050**

The Institute of Chartered Accountants of England and Wales has put out a guidance note entitled "Internal Control – Guidance for Directors on the Combined Code" ("Guidance on Internal Control").⁵⁵ The objective of this Guidance on Internal Control is as follows: **10.051**

- (a) to reflect sound business practice whereby internal control is embedded in the business processes by which a company pursues its objectives;
- (b) to remain relevant over time in the continually evolving business environment; and
- (c) to enable each company to apply it in a manner which takes account of its particular circumstances.

53 Cap 50, 2006 Rev Ed.

54 Cap 50, 2006 Rev Ed.

55 The Internal Control guidance is dated September 1999.

- 10.052** In establishing internal control mechanisms, a company will have regard to its size, its organisation and ownership characteristics, the nature of its business activities, the diversity and complexity of its operations; the methodologies it uses to process data and the regulatory environment. It must also ensure at the very least that there is a clear segregation of front and back office functions. The purpose of the back office is to act as a check to all front office activities to minimise fraud occurrences. The back office is also frequently responsible for providing regular reporting to the management and to the audit committee. It must also be borne in mind that at any given time, a company's objectives and strategies are evolving. This means that the risks it faces also change from time to time. Hence, any system of internal control must be reviewed at regular intervals in conjunction with the changing face of the risks that the company faces. This is not to say that the internal control measures can be modified to suit the whims and fancies of management. It should be provided that such changes can only be modified through appropriate mechanisms, which should also involve the audit committee. On this, the directors should, at least annually, conduct a review of the effectiveness of the company's system of internal controls and report to the shareholders that they have done so. The review should cover all controls including, where appropriate, financial, operational and compliance controls.
- 10.053** The review should also cover the adequacy of risk management activities. It is also a requirement, under the Companies Act,⁵⁶ that the audit committee is required to review with the external auditors their evaluation of the internal accounting control system, and to review the scope and results of internal audit procedures.
- 10.054** Any internal control system implemented can only function effectively if there is top management support, including the board as a whole. Additionally, the board and senior management must also take on a supervisory role to ensure that there is sufficient understanding of all activities to prevent, not just fraudulent but also unconscious mistakes.⁵⁷

Guidance to the board and senior management on what they should be looking out for when conducting the internal audit:

- (1) Is there a strong ethical environment and culture?
- Do board members and senior executives offset standards of high

⁵⁶ Cap 50, 2006 Rev Ed.

⁵⁷ This presupposes sufficient skill and knowledge on the part of senior management; elements which were clearly lacking in the Barings Inc debacle. See *Re Barings plc (No 5)* [2000] 1 BCLC 523, and L Chew "Not Just One Man – Barings" (IFCI Risk Institute) <<http://risk.institute.ch/137550.htm>> (accessed 30 October 2009).

	<p>integrity and lead by example?</p> <ul style="list-style-type: none">• Are performance and incentive targets realistic or is the pressure for short-term results excessive?• Are balance scorecard approaches to performance appraisals undertaken?• Is there regular training and top-down communication to ensure that standards of integrity that have been set are communicated to all employees?• Are there open communication channels throughout the organisation?• Is there zero tolerance for fraudulent financial reporting at any level?
(2)	<p>How does the organisation identify and manage risks?</p> <ul style="list-style-type: none">• Is there a risk management process and is it effective?• Is risk management seen as part of the internal control systems?• Is risk managed throughout the organisation?• Are major risks candidly discussed with the board and all key personnel as may be necessary?• Is there good communication and reporting throughout the organisation?• Are controls seen as enhancing the achievement of objectives?• Are quality people hired promptly and trained adequately?• Are problem areas fixed quickly and completely?
(3)	<p>Is there strong monitoring?</p> <ul style="list-style-type: none">• Is the board independent, informed, and inquisitive?• Does internal audit have the support of senior management and the audit committee?• Do the internal and external auditors have and use open lines of communication and private access to all senior executives and the audit committee?• Are line managers monitoring the control process?

Table 2 – Guidance to Conducting the Internal Audit

It is important to recognise that internal control structures and frameworks on their own cannot ensure success. A number of other external factors, including unfortunate decisions, insufficiently skilled personnel, dishonest management, and environmental factors, can counter the effects of any system that is put in place.

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