IIA Malaysia e-techline
February 2021 Issue 1/21

GOVERNANCE

5 STEPS FOR RELIABLE ESG REPORTING AMID GROWING DEMAND (BY GEORGE SPENCER - AICPA)

Financial reporting is getting a green makeover. The global trend to incorporate ESG (environmental, social, and governance) data in mainstream financial reports is accelerating.

"Companies that haven't begun thinking about sustainability reporting and how ESG topics will impact them should start doing so, regardless of their size," said Corinne Dougherty, CPA, a partner at KPMG who serves on the AICPA Sustainability Assurance and Advisory Task Force.

Many major companies issue sustainability reports, but these are separate from their financial reports, making it difficult to see connections between financial and sustainability performance.

The IFRS Foundation Trustees also are considering creating a board to create a set of sustainability accounting standards that could be applied worldwide in a uniform fashion. These developments are likely to create additional opportunities for CPAs to provide assurance on the ESG information reported by companies.

With this issue taking center stage, the AICPA has identified five steps accounting professionals can take to create reliable data to increase stakeholder trust. The AICPA recommends organisations take these measures for enhanced ESG reporting and assurance:

1) **Blend the management of ESG risks into the company's overall risk management.** Each company should define its ESG policy in a way that relates to its own business, values, and how it speaks to stakeholders. The strategy should identify and prioritise the particular key ESG areas that contribute the most to its business.

2) **Set key performance metrics.** Leaders must ask how a company can improve its impact related to ESG and where it adds the most value in areas that are most important to stakeholders and most relevant to the company's sustainability reporting.

3) **Implement effective internal control over the ESG data collection, processing, and reporting process.** Appropriate processes, systems, and internal controls must be created to help ensure this information is accurate, reliable, and timely. The systems must also produce consistent results that are comparable over time.

4) **Create board oversight of critical ESG issues.** The board has an important role to play in setting the tone and seeing that company ESG efforts are appropriately prioritised. Further, just as boards play a role in providing independent oversight and establishing and maintaining effective governance over financial reporting, boards should play a similar role in sustainability reporting.

5) **Hire a CPA firm to conduct a readiness assessment.** This will help prepare for an assurance engagement regarding ESG data. Having a CPA firm conduct an audit will also give stakeholders and investors' confidence about the reliability of the ESG data being reported and improve a company's ESG ratings. If a company wants to get started with ESG reporting but does not know how to, a CPA firm can advise them on how to get started on their reporting journey.

What Internal Auditors should do?

Standard 2110 Governance of the IPPF specifically identifies the internal audit activity's responsibility for assessing and making appropriate recommendations to improve the organisation's governance process.

Internal auditors can act in several different capacities to achieve this, i.e. advising the identified five steps by the AICPA which the Chief Financial Officer can take to create reliable data to increase stakeholder trust of the organisation.

Reference:

https://www.journalofaccountancy.com/news/2021/feb/reliable-esg-reporting-amid-growing-demand.html

CORPORATE GOVERNANCE TRENDS TO WATCH IN 2021 (BURSA MALAYSIA BERHAD)

The COVID-19 has compelled boards to grapple with the question of how to enhance resilience of their respective companies in a highly uncertain, volatile and interconnected risk environment. Risk oversight is a primary board responsibility and boards must continue to play a critical role in developing and improving practices to establish a well-defined and effective oversight function. This includes clearly defining which risks the full board should discuss regularly versus those can be delegated to a board committee, continually assessing the existing risk management framework to account for emerging risks, as well as disclosing the processes established for overseeing risk.

During the worst of the pandemic in 2020, companies had to put in place new procedures to conduct virtual AGMs – a necessity is likely to stay. The Minority Shareholders Watch Group (MSWG) has already called listed companies "to appoint independent moderators at virtual general meetings to improve and enhance the transparency of the Q&A session".

Entering 2021, boards should continue to provide oversight and pay attention to data governance as a top issue, as companies increasingly rely on data analytics to optimise business operations. Companies should expect increased scrutiny of data privacy and security practices from customers, regulators and shareholders.

The trust deficit between business and society has been widening for some time, and the pandemic has only reinforced the view that corporate purpose needs to be aligned with society's needs. Thus, the fiduciary duties of directors will continue to expand and evolve to emphasise accountability to wider stakeholders, not just shareholders.

Climate governance has become critical, as climate change poses very real risks to the business, particularly in Asia-Pacific in the absence of adaption and mitigation. Referencing guidance from the Task Force on Climate-related Financial Disclosures (TCFD), investors, lenders and regulators are increasingly asking their companies and their boards to not only understand and quantify the risks posed by climate change, but also develop strategies to ensure resilience and to report on this.

What Internal Auditors should do?

As part of adhering to *Standard 2110 Governance* of the International Professional Practices Framework (IPPF), the Chief Audit Executive (CAE) should assess whether the current internal audit plan encompasses the organisation's governance processes and addresses their associated risks, inclusive of data governance and climate governance. The CAE may engage board members and others in key governance roles to gain a clearer understanding of the organsation-specific processes and assurance activities governing these two areas. If your organisation is regulated, the CAE may want to review any governance concerns identified by regulators. The discussion with the board and senior management will ensure agreement and alignment of expectations about what constitutes governance, so an appropriate internal audit plan and approach can be executed.

Reference*:*

https://bursasustain.bursamalaysia.com/droplet-details/corporate-governance/corporate-governance-trends-to-watch-in-2021

LISTED CORPORATIONS IGNORE GOOD GOVERNANCE TO THEIR DETRIMENT (BY WALTER SANDOSAM – THE STAR)

According to Bursa Malaysia Listing Rules, an independent non-executive director is defined as a director who is independent of management and free from any business or other relationship that could interfere with the exercise of independent judgement or the ability to act in the best interests of a listed issuer.

Being independent of management, serving in the best interest of the listed issuer is of paramount importance. This includes, among others, an attestation to the veracity of published financials and oversight of non-financial issues relating to the environment, governance and corporate social responsibility.

They are not acting in the "best interests" of the corporation they serve if they are silent about non-adherence to regulations and/or questionable management practices. It is not uncommon to hear of cutting corners to report higher profits. If this means compromising on ethical issues, independent directors are expected to speak up. This notwithstanding that they may be beholden to the corporation's owners for being selected as an independent director, not to mention the emoluments package that goes with the position.

Best practices recommend that independent directors should at least constitute a majority in the audit committee of the board, if not wholly. It is also incumbent on the committee to have an effective internal audit function that reports directly to it. The internal audit function would be the conduit to ensure that corners have not been cut, be it in financial reporting or other operational efficiencies, which could include staff welfare, among others. Hence the criticality and importance of the function.

Independent directors cannot feign ignorance of the company's operational aspects as that is what they are there for in the first place – to sound alarm bells when necessary.

There are two critical assessments that need to be conducted to offer comfort.

It is critical that independent parties are engaged to conduct board effectiveness evaluations. Professional interest groups like the Institute of Corporate Directors Malaysia and accounting firms provide this service. The entire board is evaluated on eight to 10 parameters, which include board leadership, board composition, board dynamics and board management relationships, among others. It includes the examination of the supporting board sub-committees.

As for the audit committee of the board, periodic quality assurance reviews are a must to attest to the quality of the internal audit function, which by default is the committee's "eyes and ears", charged with highlighting issues of importance.

… 3

The responsibility to ensure that directors are up to the mark falls on investors, professional groupings and entities like the Minority Shareholders Watchdog Group. These must play an active role in promoting good governance within the broader spectrum of social issues.

Given the rising levels of shareholder activism and the rapidly changing economic environment due to the Covid-19 pandemic, listed corporations ignore good governance to their detriment.

What Internal Auditors should do?

Standard 2110 Governance of the IPPF specifically identifies the internal audit activity's responsibility for assessing and making appropriate recommendations to improve the organisation's governance processes. Internal auditors can act in several different capacities to achieve this e.g. advising the two critical assessments and their respective processes involved to be conducted to offer comfort to the board, benefits to the board and organisation when these assessments are undertaken as well as the potential implications if the assessments are not undertaken.

Reference*:*

https://www.thestar.com.my/opinion/letters/2021/01/12/listed-corporations-ignore-good-governance-to-their-detriment

GOVERNANCE MUST BE SUBSTANCE OVER FORM (BY PANKAJ C. KUMAR – THE STAR)

According to the Securities Commission's (SC) website, MCCG 2017, which was introduced in April 2017, comprise 34 standard practices to support three key main principles, which are board's leadership and effectiveness; effective audit, risk management, and internal controls; and corporate reporting and relationship with stakeholders.

In addition, the MCCG 2017 has laid out two additional practices meant for large corporations and four step-up practices to encourage companies to adopt even higher governance standards. Last year, the MCCG 2017 got a little boost from the SC with the introduction of "Conduct of Directors of Listed Issuers and Their Subsidiaries". With the exception of Chapter 5 on Group Governance, which was effective from Jan 1 this year, the rest of the guidelines were already effective since July 30 last year.

In essence, under the guidelines, a director must exercise his/her powers for a proper purpose and in good faith in the best interest of the company. A director, who is appointed by virtue of his/her position as a representative of a shareholder, must act in the best interest of the company in which he/she sits as a board member and not his/her nominator.

While we continue to see corporates improving their governance score by a higher level of adoption of these practices, there are instances where companies continue to find reasons as to why they are not meeting the expected practices. Key lapses we see is in the area of independence of directors, both in terms of tenure and numbers as a percentage of the total number of directors. Lapses are also seen in a number of women directors on the board of companies while in terms of disclosure of remuneration, some companies are still shying away from disclosing salaries of their top five personnel of their senior management.

The MCCG 2017 also encourages Integrated Reporting (IR), which we are seeing increasingly being adopted by almost all listed companies, in depth and in breadth. Investors who read these annual reports are given clear messages that are being communicated by these listed companies, which is generally always on a positive note, with far reaching claims of what a corporate has done over the past financial year.

In today's business world, where corporates are also trying to score on Environment, Social and Governance (ESG) angle, we also see how companies provide meaningful and detail disclosures on their ESG practices in order to gain traction amount investors who are increasingly demanding greater governance and transparency. In addition, as corporates move with times and new standard practices introduce, some are also beginning to disclose issues related to climate change and what they are doing to help global warming.

While all the IR, ESG and climate change reporting is good and we definitely welcome the openness that a corporate is trying very hard to communicate, how far are some of the claims that corporates make in their respective annual reports are truthfully reported?

While we have MCCG 2017, Bursa Malaysia's Listing Requirements, Bank Negara Malaysia and SC's various guidelines as well as the host of legislations governing our corporates, what is more important is the substance of governance must take precedence over form.

It is not just a mere reporting function for a corporate in its annual report to disclose its best practices via the IR framework but for corporates to walk the talk. Perhaps, we need to ensure that IR is substantiated by some form of an audit of a company's best practices claims in its annual report and not mere hearsay.

What Internal Auditors should do?

Standard 2110 Governance of the IPPF specifically identifies the internal audit activity's responsibility for assessing and making appropriate recommendations to improve the orgnaisation's governance processes. Internal auditors are in the position to assess and validate the accuracy, completeness and timeliness of reporting disclosures in the areas of IR, ESG, Climate Change, both of SC's guidelines and Bursa's Listing requirement.

Reference*:*

https://www.thestar.com.my/business/business-news/2021/02/06/governance-must-be-substance-over-form

INTERNAL AUDIT

HOW DO YOU ANSWER, "WHAT DO INTERNAL AUDITORS DO?" (BY RICHARD CHAMBERS – IIA INC)

Internal auditing has got to be the coolest profession in the world! Said Tom Peters in his presentation at an IIA International Conference a few years ago. Delivering the perfect elevator pitch does not happen by accident, or we would all be doing it. But embracing a few proven techniques can rapidly improve your ability to make a strong first impression about yourself and your profession. There are eight tips for delivering a strong, crisp elevator pitch on what internal auditors do.

1) **Grab their attention with the first sentence.** First impressions are important, and the easiest way to keep your elevator pitch from sounding canned is to start out with an opener that is so interesting

your audience starts asking questions.

2) **Short and simple is better than impressive and complicated.** The lesson here is to make the complex simple, not to baffle your audience. So, leave the audit jargon back in the internal audit department.

3) **Put it on paper**. Write down everything you would like to say, then edit it down to the essentials. Read it out loud to yourself and adjust the words until it flows smoothly. Then commit it to memory.

4) **It cannot sound rehearsed.** Although you absolutely should memorise key points. You need to be able to make on-the-spot adjustments to fit each specific situation. Without careful preparation, this might be more difficult than you would think.

5) **It is not all about you**. Whether your elevator pitch is about internal auditing or your favourite hobby, it should be tailored to the audience's needs, not yours.

6) **One is good, two are better.** After you have perfected your succinct elevator pitch, it cannot hurt to have a longer version ready, or to be prepared to give more information about anything you already mentioned.

7) **Enthusiasm is infectious**. It also can be difficult to garner support for internal auditing or confidence in your abilities if you do not display these qualities yourself.

8) **Be ready to keep the conversation going**. Try to end your elevator pitch with an invitation to give your audience more information. You might learn you have something in common, or that they are part of an organisation that could benefit from a strong and effective internal audit function.

Richard Chambers had eventually shared the "Internal auditors' creed" in a 2019 blog post "Internal Auditors: What Is It You Do?" and elaborated on the six points that he made in the LinkedIn post as follows:

1) **I am an internal auditor!** This first line should be self-explanatory. Few professions offer opportunities to contribute to the success of our organisations as what internal auditing does.

2) **I serve my organisation to protect and enhance its value.** Internal auditor here to serve my organisation to protect and enhance its value**.**

3) **I Model integrity, objectivity, confidentiality, and competency every day.** This is what we stand for as a profession, and it is something every practitioner should exhibit with every engagement and every interaction.

4) **I improve risk management, internal controls, and governance in my organisation.** This is at the heart of the Definition of Internal Auditing, articulated in the IPPF. We do this by improving risk management, internal controls, and governance**.**

5) **I follow The IIA's International Standards when providing assurance and advice**. I also urge internal auditors who have earned IIA certifications to proudly speak out. One should not be shy about proclaiming, "I am certified by The IIA to demonstrate the proficiency I have for carrying out my responsibilities as a professional internal auditor.

6) **I am respected and admired because I am an agent of change!** Every internal auditor may not be respected and admired as a change agent, but that should be their aspiration.

What Internal Auditors should do?

The Internal auditors should improve the ability to make a strong impression about the profession from others so that the profession will be respected, admired and trusted.

Reference:

https://iaonline.theiia.org/blogs/chambers/2021/Pages/How-Do-You-Answer-What-Do-Internal-Auditors-Do.aspx

FRAUD

PROCUREMENT FRAUD: 12 COMMON PITFALLS (BY SYLVIA LIM – IIA INC)

Twelve common pitfalls can increase the risk of fraud in the procurement process.

1) **Weak Control Environment.** Procurement policies and procedures that lack comprehensive review, approval and monitoring of scenarios will increase the risk of procurement fraud.

2) **Incompetent Purchase Budget Review or Approval**. Reviewers and approvers may not have been equipped with relevant antifraud skills to ask the right questions before requested items are approved in the purchase budget.

3) **Inadequate Purchase Request Scrutiny.** In the absence of proper security, staff members might be able to request and make excessive or unnecessary purchases.

4) **Inadequate Review of Purchase Specifications.** Purchase specifications can be customised to favour certain vendors and cause unnecessary financial losses to the organisation.

5) **Ineffective Quote Reviews.** Without an effective assessment of quotes or bids before contract award, intentional favouritism of a particular vendor might not be easily detected.

6) **Insufficient Background Checks.** Without an effective background check on new vendors, it could lead to approve of vendors without requiring them to provide appropriate documentation.

7) **Ineffective Conflict of Interest Declaration Procedures.** Without well-designed procedures, employees may perceive the declaration as routine and fail to recognise its importance.

8) **Ineffective Inspection of Goods and Services Received.** If goods and services are delivered to the organisation without being checked and acknowledged by independent, competent parties, intentional underdelivery, damaged goods, or inferior goods could go undetected.

9) **Ineffective Project Monitoring.** Without robust controls in place to monitor ongoing projects, it may not detect warning signs of fraud such as excessive change orders and cost mischarging.

10) **Ineffective Three-Way Matching.** Those responsible for reviewing invoices submitted for payment may lack the expertise to recognise potentially fraudulent items such as personal purchases, inflated invoices and fictitious purchases.

11) **Absence of Robust Procurement Analytics.** When irregularities occur more frequently, with lower dollar amounts that seem insignificant in isolation, they might easily go unnoticed without more sophisticated analytics.

12) **Inadequate Criteria for Evaluating Vendors.** Once a vendor is hired, the organisation may neglect to monitor its performance on an ongoing basis.

What Internal Auditors should do?

Standard 2120.A2 Risk Management of the IPPF specifically identifies the internal audit activity must evaluate the potential for the occurrence of fraud and how the organisation manages fraud risk. With awareness of the potential pitfalls, it aids internal audit in identifying potential fraud risks in procurement process and provide advice on improvement control procedures.

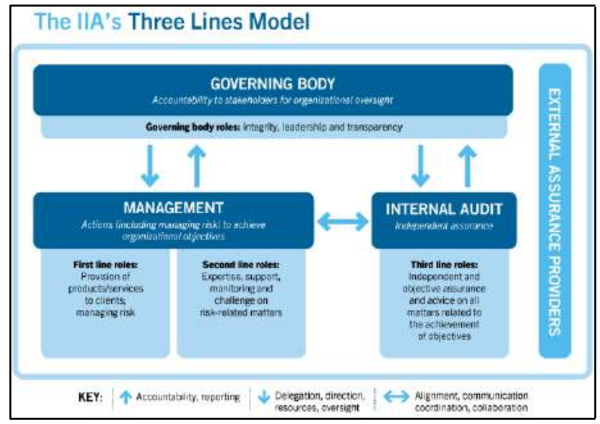
Reference*:*

https://iaonline.theiia.org/2021/Pages/Procurement-Fraud-12-Common-Pitfalls.aspx

GLOBAL PERSPECTIVE AND INSIGHTS

THE THREE LINES MODEL – AN IMPORTANT TOOL FOR THE SUCCESS FOR EVERY ORGANISATION (IIA INC)

The **Three Lines Model** helps organisations identify structures, design processes and assign responsibilities that best assist the achievement of objectves and facilitate strong governance and risk management. It makes the case for the three essential players in audit. At the same time, it clarifies the main essential elements governance requires at its most basic: accountability, actions and assurance and advice.



What is New?

The model encourages a principles-based approach to match the needs and circumstances of an organisation. Clearly, all organisations are different and there can be no one-size-fits-all approach. This led to the model's explicitly defined six principles on which it is based.

On top of that, there is a change in the use of language, eliminating the use of "lines" and instilling the idea of "roles." Defining the key roles and describing the relationships among those core roles in the new Model confirms coordination and alignment are essential to ensure organisational coherence and avoid silos.

The new model amplifies the critical need for assurance on the adequacy and effectiveness of risk responses, including controls, as a fundamental component of governance. This is achieved through the competent application of systematic and disciplined processes, expertise and insight by internal audit.

The Six (6) Principles:

1) Governance
2) Governing Body Roles

3) Management and First and Second Line Roles
4) Third Line Roles
5) Third Line Independence
6) Creating and Protecting Value

Applying the Model

The Model accommodates the existence in organisations of varying structures. Organisations can structure however they like depending on goals, resources, regulation culture, etc. First and second line roles remain within the responsibility of management. Whereas, the internal audit is dependent of the responsibilities of management.

What Internal Auditors should do?

It helps internal auditors to have a better understanding of their roles and subsequently to be able to demonstrate appropriate flexibility and scalability to widen the applicability of internal audit activity within the organisation.

Reference*:*

https://global.theiia.org/knowledge/Public%20Documents/GPAI-Three-Lines-Model-An-Important-Tool-for-the-Success-of-Every-Organization.pdf

PRACTCE GUIDE – NEW!

AUDITING MARKET RISK IN FINANCIAL INSTITUTIONS (IIA INC)

Market risk has always been considered a key risk for financial services organisations. Regulators and supervisors have increasingly focused on this risk, emphasising the necessity of having accurate models that can measure the capital impact of market activities on the financial viability of an institution.

These requirements and supervisors' expanded expectations are giving internal audit a more relevant and active role in the assessment of market risk. In addition, an organisation's board of directors has direct responsibility for the market risk oversight and governance, so internal audit should give independent assurance per the elements laid out in The IIA's International Professional Practices Framework, 2017 edition.

This guidance serves as a resource for internal auditors in the banking, insurance and asset management industries as well as any companies and organisations that have financial investments and deal with market risk. It will equip internal auditors with the tools to audit those investments, make judgments about organisational levels of risk exposure and communicate with stakeholders.

In addition, this guidance explores the background of market risk, offering definitions and scenarios with the intention of informing and educating internal auditors who may be newer to the financial services industry or who lack a deep background in finance. The second half of the guide offers assistance in auditing market risk.

What Internal Auditors should do?

Internal auditors from financial institutions may refer to this practice guide as guidance in order to have a better understanding of what is market risk and the know-how to conduct an audit on market risk.

Reference*:*

https://global.theiia.org/standards-guidance/Member%20Documents/PG-Auditing-Market-Risk-in-Financial-Institutions.pdf

If you missed out the previous issues of e-techline, you may visit our website at https://iiam.com.my/technical-qa-services/e-techline/.