Speech delivered by Mr David Gerald, as Guest-of-Honour, at IIA Annual Conference 2013, @ Sands Expo & Convention centre, Marina Bay Sands, Jasmine Ballroom

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Distinguished auditors, Ladies & gentlemen

1. The recent global financial crisis exposed a number of governance weaknesses, that resulted in firms' failure to understand the risks they were taking. In the wake of the crisis, numerous reports painted a fairly bleak picture of risk governance frameworks at financial institutions, which consists of the three key functions: the board, the firm-wide risk management function, and the independent assessment of risk governance.

2. If we allow the risk management and internal controls to fail in the listed companies, we allow the wrong doers of at-risk companies to plunder the hard earned life savings of the ordinary citizens. Even as the company's business is in the process of collapsing, the board and the Audit Committee are not kept in the know or even wilfully deceived by the wrong doers. Singapore too has had its fair share of corporate scandals and our citizens have been victimised. China Aviation Oil, Citiraya, Sino Environment and Ferro China are but some of the local corporate scandals. In the face of miscreant management or directors, the ordinary citizens are helpless; they cannot stop the wrong doing or seek recourse. There is no scandal insurance, unfortunately.

3. Since the financial crisis, many jurisdictions have made regulatory changes to enhance supervisory oversight of risk management and internal controls. In Singapore too the regulators have risen to the challenge by enhancing the rules that govern the responsibilities of risk management. SGX Listing Rule 1207 (10) and Principle 11 of the revised Singapore Corporate Governance Code issued in May 2012 have created a greater awareness for the responsibilities of Directors and the senior management.

4. With these new rules, the Board's responsibility over risk management has become more explicit now. The amendments to the listing rules now require the Board to provide an opinion on the adequacy of internal controls, addressing financial, operational and compliance risks of their companies. The Board can no longer make a cursory comment on the internal controls for the business operations as a whole without specifying the assessment basis, or the key weakness areas.

5. Principle 11 of the Code goes further and states that "The Board is responsible for the governance of risk. The Board should ensure that Management maintains a sound system of risk management and internal controls to safeguard shareholders' interests and the company's assets, and should determine the nature and extent of the significant risks which the Board is willing to take in achieving its strategic objectives." What this means is, in the event of a scandal, neither the senior management nor the board can claim ignorance and throw the blame onto other parties. They in fact face serious penalties including imprisonment for serious offences. So it is in their best interest to absolutely ensure that scandals do not occur during their watch, Can they do it their own? Are they willing to take the risk of going it alone? Who then will be the white knight for them? **The internal audit function is now emerging s an important safeguard for the Board, Senior Management and the investors.**

6. The role of an internal auditor is now becoming more important with the recent implementation of the SGX Listing Rule 1207 (10). In providing this opinion, the Board and the Audit Committee are required to demonstrate that they have rigorously assessed the internal controls in relation to all three areas of risks, namely financial, operational and compliance. Due to this, management, line departments and external auditors are involved in providing Board assurance on adequacy of controls and thus complying with the listing requirement.

7. Whilst most corporate leaders are honourable and can be trusted, there will always be a few who, due to greed or selfish ambitions, cause losses to investors. Investors, therefore, need someone within the Organisation to be their eyes and ears. They need the comfort of knowing that a professionally-trained person is in the Organisation full-time to point out any wrongdoing or give early warning signal to the CEO and/or the Chairman of Audit Committee like the dogs that sniff out drugs at the airports.

8. Most companies that believe in good corporate governance have full-time internal audit function. Indeed the Singapore Code of Corporate Governance, Principle 13, calls for a company to establish an effective internal audit function that is adequately resourced and independent of the activities that it audits. However, it does not prescribe for a full-time internal auditor.

9. Whilst we see the CEO, the CFO, the Directors but the shareholders never get to meet or see the internal auditor, who is the conscience of the Organisation. Given his importance, should he not have a seat at the table? Why is he hidden unlike the external auditors?

10. Between the line departments and internal audit, which function is apt to provide independent and objective views to management and the Board, and has the skill-set and competencies to provide the assurance that the Listing Rule calls for? Naturally, Internal Auditors should be foremost in the Board's and management's mind. Is this the case? Stakeholders and shareholders may not be fully aware that management and Boards could or would rely on Internal Auditors in addition to the External Auditors and line departments

to play a crucial role in protecting the organisation's interest leading to maximisation of share value as well as supporting creation of value. The **Internal Auditor's value** is his independence and objectivity in providing assurance to stakeholders that an independent party is guarding their interest in their investments.

11. Given the complex business environment and stakeholders' expectations these days, would it not be prudent to have an additional layer of check and balance within the organisation? Especially when the public funds are solicited, should it not be the concern of the organisation as a whole, that strict internal oversight would provide the advantage that is currently missing in many listed companies. Right now slightly over half of the listed companies (51%) have IA functions that are in-house according to the SAC and KPMG internal audit survey 2013; I strongly believe that every listed company should have, at least 1 full-time internal auditor who would report directly to the Audit Committee Chairman. The internal auditor, with his independence, will be in a position to help secure shareholder investments and hopefully give the senior management and the board members peace of mind.

12. I am not alone in this call. Recently, a panel discussion on the internal audit function reported in The Business Times, August 1st, 2013 highlighting the call by a former Chief Financial Officer, with 15 years of experience, and currently a Board Director, saying: "The internal audit function has become tremendously important… because business nowadays is so complex. A good board will require an internal auditor, whatever the circumstances… I sit on boards, and I always rely on the internal auditor. I hear what they tell (and) I use that to corroborate and check against what the management tells me."

13. With the growing demands made on directors and senior management, it is only natural that they would be looking for assurance within the Organisation. They will turn more to the internal auditor, especially for compliance with the aforesaid new listing rule. This rule is an important development and it underpins the importance of the role of internal audit function. We need to break barriers and build bridges to move forward. It is our hope that listed companies will move towards establishing full-time internal audit function.

14. Whilst larger companies have the resources and the means to establish an in-house internal audit department, a significant number of companies outsource this function. Whilst I am not advocating that external auditors cannot effectively function as internal auditors, it must be accepted that there is an advantage in having full-time internal auditor to provide eyes and ears for the comfort of all stakeholders. <u>It is, therefore, our position that all listed companies should be required to have mandatory internal audit function. In the interest of our citizens, there must be the political will to make this a reality.</u> Should this happen, we believe more investments will flow into our companies and consequently, benefitting our capital markets. This will assist Singapore in its aspiration to be a leading financial hub.

15. An internal audit function is currently not required by law in most parts of the world. Many companies do not appoint a full-time internal auditor because, of the ignorance of the significance of having one or of the cost of doing so. That is a mistake because whilst

appointing a full-time internal auditor can be costly, scandals are even more costly. Companies spend millions of dollars in professional fees after a scandal in putting things right with their reputation damaged.

16. Frederick D. Lipman and L. Keith Lipman on ‘Corporate Governance, Best Practices’ suggest perhaps management should look at internal audit as a substitute for scandal insurance. “If scandal insurance were available (which it is not), many companies would purchase it if the premium cost were reasonable. Internal audit cost should be viewed as a form of insurance. In fact, effective internal auditing, both operational and strategic, can save the company enormous amount of money in uncovering duplication, waste, errors and wrongdoing in the company.”

17. Another area where the role of internal audit is crucial is the area of compliance. Non-compliance with law can lead to serious consequences for the senior management and directors.

18. Are we asking too much from the internal auditor? In the recent SAC and KPMG internal audit survey 2013, 62% of senior managers indicated that the internal audit budget is currently smaller than the external audit budget despite both having the same role, scope and responsibilities. For the internal auditor to succeed as the third line of defence and go beyond being a mere rubber stamp, to genuinely add value to stakeholders, listed companies must furnish them with adequate resources; or else they are set up for failure. At the minimum, every listed company should have at least one full-time internal auditor and should be provided with sufficient resources to carry out his terms of reference.

19. In view of the above, shareholders will be further assured if the Board of listed companies could report in their annual reports that they have, in fact, integrated the independent report on the adequacy of internal controls addressing operations, compliance and financials by the internal auditor in its corporate governance section of their report.

20. Some of the listed organisations that have full-time internal audit function have done well in corporate governance. And companies who won the Corporate Governance Awards and the internal Audit Excellence Awards are testimony to these! We know there are costs of setting up IA units but from their roles, we know companies will benefit from it.

21. However, the fact that a company has full-time internal audit may not necessarily mean that there will never be a lapse in governance. A fine example is the WorldCom debacle, where, the senior management, including the CFO and the CEO were able to side step the internal audit department causing tremendous losses to shareholders. They were able to do this because the internal audit department was required to report to senior management and not to the Audit Committee and also because their scope was limited to non-financial audits. What then must happen to avoid that situation?

22. The internal auditor must be fully independent, objective and report directly to the Audit Committee Chairman. He or she must not be interfered with by management as occurred in WorldCom. The internal auditor must be brave and be prepared to blow the whistle, like, Cynthia Cooper in WorldCom. Cynthia Cooper defied management in favour of personal integrity to report WorldCom management's misdeeds to the police. In other words, she did not compromise her good conscience or integrity for career gains. I believe every internal auditor should embody the values of Cynthia Cooper and all stakeholders, will have peace of mind. Enlightened CEOs would see such internal auditors as their eyes and ears, and as an advantage to his own position in the company. After all, when a scandal occurs, the CEO is usually the first in the firing line.

23. On our part, SIAS is committed to increasing the understanding of the role of internal audit among investors. We have put up on our website the "Questions for Shareholders to ask at AGMs" regarding the Internal Audit Function. The questions are drawn from relevant guidelines from the Singapore Code of Corporate Governance and the Guidebook on Audit Committees in Singapore.

24. In addition, together with IIA and SMU, we confer the Internal Audit Excellence Award to company and the individual with the best internal audit practices and qualities. We aim to raise the level of professionalism and encourage companies to have in place effective internal audit functions.

25. In conclusion, I would like to reiterate that a full-time internal audit function be made compulsory in listed companies. After all, you go to your family physician who knows you best before seeking consultation from an external specialist.

26. Thank you and have a good Conference.