

PART A: AUDIT COMMITTEES..... 1

PART I..... 1

INTRODUCTION..... 1

PART II..... 1

IMPLEMENTATION..... 1

PART III..... 2

ORGANISATION OF AUDIT COMMITTEE..... 2

1. Establishment..... 2

2. Composition..... 2

3. Independence of AC Members..... 2

4. Qualification, Experience, Knowledge and Skills 4

5. Authority 4

6. Meetings..... 5

7. Duties and Responsibilities..... 5

8. Reporting to the Bank 12

PART A: AUDIT COMMITTEES

PART I

INTRODUCTION

1. An Audit Committee (AC) plays a vital role in assisting the Board of Directors of an insurer (the board) in the discharge of its responsibilities. In particular, the AC plays an important role in ensuring the integrity and transparency of the financial reporting process.
2. These Guidelines represent the minimum expectations of Bank Negara Malaysia (the Bank) with regard to the establishment and scope of work of audit committees and internal audit departments, and lay down minimum internal audit standards for insurance companies.

PART II

IMPLEMENTATION

1. For implementation purposes, insurers are required to:
 - (i) amend the terms of reference of the AC to reflect the requirements of the revised Guidelines by **31 March 2005**;
 - (ii) comply with the requirements relating to the minimum composition of independent directors as defined in the revised Guidelines by **31 December 2005**; and
 - (iii) have any **existing arrangement** involving the outsourcing of non-audit services to the external auditor reviewed and endorsed by the AC at the earliest opportunity but not later than **31 March 2005** in accordance with paragraph 7.2.2.3 of the revised Guidelines.
2. Other requirements of the revised Guidelines are applicable with **immediate effect**.

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 2/12
------------------	--	--	-----------

PART III

ORGANISATION OF AUDIT COMMITTEE

1. Establishment

- 1.1 The board is required by resolution to form a committee of directors to perform the role of AC. An insurer that is part of a group shall have its own AC that is separate from that of the group.
- 1.2 The board should establish written terms of reference for the AC that should provide a clear understanding of the AC's role. The terms of reference should be made available to board members, management and internal auditors and should include the matters outlined in the following paragraphs.

2. Composition

- 2.1 The AC should consist of a minimum of three members appointed from the board of the insurer.
- 2.2 The members of the AC should be appointed by the board of the insurer, after taking into consideration the recommendations of the nominating committee. In determining the appropriate size and composition of the AC, the board should in particular, take into consideration the necessary mix of skills and experience required for the AC to effectively discharge its responsibilities.
- 2.3 If for any reason the number of AC members at any point in time is reduced to below three, notification should be provided to the Bank within two weeks. The notification should be addressed to Pengarah, Jabatan Penyeliaan Insurans dan Takaful (JP3). The board should fill the vacancy/vacancies arising within three months.
- 2.4 Notification should also be provided to JP3 where any director ceases to be a member of the AC within two weeks of the cessation. Such notifications should include reasons for the cessation.

3. Independence of AC Members

- 3.1 No AC member should be employed in an executive position in the insurer or its related corporations¹, or otherwise have a relationship which in the opinion

¹ As defined under section 6 of the Companies Act 1965

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 3/12
------------------	--	--	-----------

of the board will interfere with the exercise of independent judgment in carrying out the functions of the AC. In addition, members of the AC should not be directly responsible for, or part of any committee involved in, the management functions of the insurer.

3.2 As best practice, the Bank encourages all AC members to be independent. Where this cannot be achieved, the majority of the AC members, including the Chairman, should be independent.

3.3 An independent director should not: -

- (a) hold more than 5% equity interest directly or indirectly in the insurer or in its related corporations;
- (b) be employed in an executive position in the insurer or its related corporations at least two years prior to his appointment date;
- (c) have an immediate family member who is, or has been in the past two years, employed by the insurer or any of its related corporations as a key senior officer. For this purpose, an 'immediate family member' refers to the spouse, parent, brother, sister, child (including adopted or step child) and the spouse of such brother, sister or child, of the director;
- (d) be engaged, or have been engaged in the past two years, as a professional adviser by the insurer or any related corporations of the insurer, either personally or through a firm or company in which he is a partner, director or major shareholder; and
- (e) be engaged, or have been engaged in the past two years, in any transaction (irrespective of whether it is a **for-profit transaction or not**) of a value exceeding RM1 million with the insurer, whether with other persons or through a firm or company in which he is a partner, director or major shareholder. However, "transactions" as stated above excludes transactions entered into:
 - for personal use of the said director; or
 - for personal investment of the said director except for the purpose of carrying on a trade or business;

provided that such transactions are on normal commercial terms.

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 4/12
------------------	--	--	-----------

4. Qualification, Experience, Knowledge and Skills

- 4.1 Candidates for the AC should have sound judgment, objectivity, an independent attitude, management experience and adequate knowledge of the industry. They should be committed to the task and demonstrate a keen perception of the internal control environment within the insurer and an ability to make probing inquiries.
- 4.2 Collectively, the AC should have a wide range of necessary skills to undertake its duties and responsibilities. Ideally, all AC members should be able to understand the financial reporting process and be financially literate. At a minimum, at least one member of the AC should be familiar with accounting, auditing practices and financial reporting requirements. Preferably, this individual should be a member of a recognised professional accounting body.
- 4.3 In addition, in view of the important role of the committee in ensuring that there are adequate checks and balances within the operations of an insurer, all AC members, either individually or collectively, are also expected to be familiar with areas included in the scope of internal insurance audits, including risk management, underwriting, investment and claims management.

5. Authority

- 5.1 The AC should have the authority to investigate any matter within its terms of reference and should have unlimited access to all information and documents relevant to its activities, to the internal and external auditors, and to employees and agents of the insurer.
- 5.2 The AC should be kept regularly updated on audit matters and be notified immediately of any fraud and significant irregularities or internal control deficiencies discovered by management or the internal audit department. Fraud and irregularities discovered by management should be referred to the internal audit department for investigation.
- 5.3 The AC should have access to copies of audit reports (including interim financial audits) on a timely basis and should be kept regularly informed of corrective actions arising from internal and external audit findings.

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 5/12
------------------	---	---	-----------

5.4 The AC should have adequate resources to perform its duties and discharge its responsibilities and should be authorised to obtain independent professional advice as considered necessary.

6. Meetings

6.1 The AC should hold regular meetings in order to effectively fulfil its duties.

6.2 In addition, the Chairman of the AC should call a meeting of the AC if requested to do so by any AC member, the management or the internal or external auditors.

6.3 The quorum for AC meetings should be at least two thirds of the members with independent directors forming the majority.

6.4 While the AC may invite any person to be in attendance to assist it in its deliberations (e.g. relevant officers concerned in the management of the insurer, the external auditor and the internal auditor), the AC should ensure that the committee meets exclusively when necessary.

6.5 The company secretary should act as secretary of the AC and should be responsible for drawing up the agenda with the concurrence of the Chairman and circulating it, supported by explanatory documentation, to AC members within a reasonable time frame prior to each meeting.

6.6 The secretary should also be responsible for keeping the minutes of meetings of the AC, their timely circulation to AC members and other members of the board, and following up on outstanding matters in relation to the meetings.

6.7 The Chairman of the AC should provide written reports to the board on the deliberations of the AC on a regular basis. In addition, the Chairman should also present a summary of all significant matters (highlighting the risks and implications) and resolutions made by the AC at board meetings.

7. Duties and Responsibilities

The AC's duties and responsibilities in relation to the internal audit and external audit functions should include the following:

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 6/12
------------------	--	--	-----------

7.1 Internal Audit

7.1.1 Governance

7.1.1.1 The AC should:

- (a) ensure that the internal audit department is distinct and has the appropriate status within the overall organisational structure for the internal auditors to effectively accomplish their audit objectives.
- (b) ensure the effective organisation of the internal audit function, with due regard to the professionalism, capacity and competence of the internal audit personnel (also see paragraph 7.1.2);
- (c) review and approve the audit plan, audit charter and budget required under part B of the Guidelines;
- (d) ensure that reporting relationships of the internal audit staff do not impede the exercise of independent judgement by the internal auditors. In particular, internal audit reports should not be subject to the clearance of the chief executive officer or any executive director.

7.1.1.2 The AC should also review the scope of internal audit procedures, in particular:

- (a) any restrictions placed on access by the internal auditors to any of the insurer's records, assets, personnel or processes which are relevant to the conduct of audits;
- (b) appropriateness of the risk assessment methodology employed pursuant to Part B of the Guidelines to determine the frequency and scope of audits, having regard to the nature, size and complexity of the insurer's operations;
- (c) compliance with internal auditing standards; and
- (d) coordination between internal and external auditors.

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 7/12
------------------	--	--	-----------

7.1.1.3 AC members should ensure that they are adequately informed of, and understand, the risks and implications of internal audit findings and recommendations. The AC should pay particular attention to internal audit assessments of:

- compliance with company policies, relevant laws and regulatory requirements;
- effectiveness of internal controls in critical areas of operations (e.g. accounting, underwriting, claims, investment, derivatives and information technology management); and
- management's responsiveness to, and corrective actions taken in respect of, internal audit findings and recommendations.

7.1.1.4 the AC should ensure that all findings and recommendations are resolved effectively and in a timely manner.

7.1.1.5 The AC should note any significant disagreements between the internal auditor and management irrespective of whether they have been resolved in order to identify any impact that this may have on the audit process or findings.

7.1.2 Resources and staffing

7.1.2.1 The AC should ensure on an ongoing basis that the internal audit department has adequate and competent resources, given the size and complexity of the insurer's operations. In this respect, the AC should:

- (a) approve the appointment, remuneration, performance evaluation, removal and redeployment of the Chief Internal Auditor (CIA) and senior officers of the internal audit function; and

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 8/12
------------------	--	--	-----------

(b) be informed of any resignation of the internal audit staff and reasons therefore, and provide resigning staff with an opportunity to submit reasons for their resignations.

7.1.2.2 The AC should ensure that internal audit staff receives necessary training to perform audit work. In this respect, there should be a programme of continuing education and training to enable the internal auditors to keep abreast of business trends and latest developments at both the institution and industry levels, as well as to enhance technical skills required to effectively support the audit function.

7.2 External Auditor

7.2.1 Appointment of external auditor

7.2.1.1 The AC is responsible for the appointment of the external auditor, having particular regard to the external auditor's objectivity, performance and independence.

7.2.1.2 The AC should:

- (a) review and assess various relationships between the external auditor and the insurer or any other entity that may impair or appear to impair the external auditors' judgement or independence in respect of the insurer. This may include affiliations resulting from the insurer's employment of former employees of the external auditor in senior positions within the insurer;
- (b) review and assess fees paid to the external auditor, considering:
 - the economic importance of the insurer (in terms of total fees paid) to the external auditor;
 - fees paid for non-audit services as a proportion of total fees;

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 9/12
------------------	--	--	-----------

- whether an effective, comprehensive and complete audit could be reasonably conducted for the audit fee paid.

The fees paid should not impair or appear to impair the external auditor's judgement or independence in respect to the insurer; and

- (c) investigate reasons for any request made by management to dismiss the external auditor, or any resignation by the external auditor. The results of the investigation should be disclosed to the full board together with the AC's recommendations on proposed actions to be taken. The decisions of the board in relation to the recommendations made by the AC should be documented in the board minutes, with a copy of the relevant minutes extended to Pengarah, Jabatan Penyeliaan Insurans dan Takaful within two weeks of the board's decision.

7.2.2 Provision of non-audit services by the external auditor

- 7.2.2.1 Any provision of non-audit services by the insurer's external auditor should be approved by the AC before the commencement of the service, or whenever there is a significant change in the level of services provided.
- 7.2.2.2 In considering the provision of non-audit services by the external auditor, the AC should have regard to restrictions on outsourcing to external auditors set out in BNM/RH/GL/003-4: Guidelines on Outsourcing for Insurers.
- 7.2.2.3 The AC's decisions with respect to the provision of non-audit services should be documented in a statement which outlines whether or not it believes the level of provision of non-audit services by the external auditor is compatible with maintaining auditor independence (together with supporting reasons).

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 10/12
------------------	--	--	------------

7.2.3 Audit plan, findings and recommendations

7.2.3.1 The AC should review with the external auditors, the:

- (a) audit plan prior to the commencement of the annual audit;
- (b) financial statements (before the audited financial statements are presented to the board), including:-
 - whether the auditors' report contained any qualifications which must be properly discussed and acted upon to remove the cause of the auditors' concerns;
 - significant changes and adjustments in the presentation of financial statements;
 - major changes in accounting policies and principles;
 - alternative accounting treatments discussed with management and the ramifications of the alternatives;
 - compliance with relevant laws and accounting standards;
 - material fluctuations in the statements;
 - significant variations in audit scope;
 - significant commitments or contingent liabilities; and
 - the validity of going concern assumptions.
- (c) audit reports, including obligatory reports to the Bank on matters covered under Section 82 of the Insurance Act (Act);
- (d) any significant disagreements between the external auditor and management irrespective of whether they have been resolved; and
- (e) any other findings, issues or reservations faced by the external auditor arising from interim and financial audits.

7.2.3.2 The AC should review and monitor management's responsiveness to, and action taken on, external audit findings and recommendations. In this regard, the AC should ensure that all findings and recommendations are resolved effectively and in a timely manner.

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 11/12
------------------	--	--	------------

7.2.3.3 In order to allow external auditors to express concerns, problems and reservations arising from financial audits effectively, the AC should meet at least annually with the external auditor without the presence of management.

7.3 Other responsibilities

7.3.1 The AC should also:

- (a) review:
 - the Chairman's statement, interim financial reports and preliminary announcements;
 - corporate governance disclosures made in the Directors' Report pursuant to the requirement in BNM/RH/GL/003-2: Prudential Framework of Corporate Governance for Insurers and be satisfied that any departure from the Framework principles and the circumstances justifying such departure are sufficiently explained;
 - all representation letters signed by management, and be satisfied that the information provided is complete and appropriate;
- (b) review any related-party transactions and conflicts of interest situations that may arise within the insurer including any transaction, procedure or conduct that raises questions of management integrity;
- (c) ensure that the insurer complies with section 95 of the Act which requires an insurer to publish its accounts within fourteen days of the laying of its accounts at its annual general meeting;
- (d) ensure that the insurer's accounts are prepared in a timely and accurate manner for regulatory, management and general reporting purposes, with regular reviews carried out on the adequacy of provisions made; and
- (e) ensure that supervisory issues raised by the Bank are resolved in a timely manner.

BNM/RH/GL/003-22	Prudential Financial Policy Department	GUIDELINES FOR AUDIT COMMITTEES AND INTERNAL AUDIT DEPARTMENT (PART A)	Page 12/12
-------------------------	---	---	-----------------------

7.3.2 The AC shall also be responsible for any other functions as may be determined by the board and reflected in its terms of reference.

8. Reporting to the Bank

8.1 The AC shall submit to the Bank, a summary of material concerns/weaknesses in the internal control environment of the insurer noted during the year and the corresponding measures taken to address these weaknesses. This should be submitted together with the annual report on the AC and its activities which is submitted to the Bank pursuant to principle 18 of BNM/RH/GL/003-2.