

Corporate Governance Q & A—Audit committee

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***In case of any discrepancy between the Chinese version and the English one, the Chinese version shall prevail.**

1. Which companies are required under the Securities and Exchange Act to establish an audit committee ? What are the related buffer mechanisms? What are the procedures for amending the articles of incorporation?

A:

1. Article 14-4 of the Securities and Exchange Act specifically provides that a public company shall establish either an audit committee or a supervisor. The Competent Authority may, however, in view of the company's scale, type of operations, or other essential considerations, order it to establish an audit committee in lieu of a supervisor.
2. The FSC applies a gradual approach towards implementing the aforesaid regulations under which qualifying companies are required to establish an audit committee. Pursuant to FSC Order No. 1020004592 published on February 20, 2013, financial holding companies, banks, bills finance companies, insurance companies and the integrated securities firms of the subsidiary of a financial holding company or an exchange/OTC-exchange listed company and non-financial institutions listed on the stock exchange or OTC exchange with paid-up capital in excess of NT\$ 50 billion, shall establish an audit committee. However, a financial institution that is a 100%-owned subsidiary of a financial holding company has the discretion to establish either an audit committee or institute a supervisor in accordance with regulatory requirements. For companies where the term of the current directors and supervisors expires in 2013, application of the new requirements may be postponed until after expiration of the terms of directors and supervisors elected in 2013.
3. Paragraph 2, Article 14-4 of the Securities and Exchange Act stipulates that an audit committee shall be composed of the entire number of independent directors, and shall not be fewer

than three persons in number. The articles of incorporation shall provide that the election of independent directors be conducted by way of a candidate nomination system. A company required by law to establish an audit committee shall amend its articles of incorporation as follows:

- (1) Where the company has a sufficient number of independent directors pursuant to the aforesaid regulations, the only requirement is to remove the clauses of its articles of incorporation that relate to supervisors. Where the supervisor has yet to complete his or her term of office, the articles of incorporation may be amended at a shareholders' meeting to specifically set out the date on which an audit committee will come into operation. Refer to Question 9 of the "Corporate Governance Q & A- Independent Directors" for an example. The company may also refer to Ministry of Economic Affairs order No. 09502320300 published on June 21, 2006 to determine whether it may amend its articles of incorporation in the shareholders' meeting and is exempt from appointing a supervisor and establishes an audit committee in the same meeting. The aforesaid letter provides that a public company may, in the shareholder meeting when all directors and supervisors are re-elected and when an audit committee is established, amend or remove clauses in its articles of incorporation that are applicable to supervisors. The company may then, in accordance with the amended articles of incorporation, be exempt from the requirement of electing a supervisor. The company shall, however, specifically set out regulations governing the operation of its audit committee in its articles of incorporation.
- (2) If a company does not have a sufficient number of independent directors according to the aforesaid regulation, it shall convene a special shareholders' meeting one year prior to expiration of the term of office of the current directors and supervisors, or prior to the annual general shareholders' meeting, to amend its articles of incorporation, remove the

clauses applicable to supervisors and ensure that the qualification of independent directors and the method of nomination are in compliance with the provisions of the Securities and Exchange Act. The company shall elect independent directors and establish an audit meeting in the next shareholders' meeting and the company may specify the date on which the audit committee will come into operation in its articles of incorporation at the time of amendment.

2. Shall the conduct of an audit committee voluntarily set up by a public company be bound by the provisions of the Securities and Exchange Act and the related laws and regulations governing an audit committee?

A: A public company voluntarily setting up an audit committee shall do so in accordance with the provisions of the Securities and Exchange Act and its related law, "Regulations Governing the Exercise of Powers by Audit Committees of Public Companies".

3. Can a company amend its articles of incorporation to exempt it from appointing a supervisor in the same shareholders' meeting as when an audit committee was established?

A: Pursuant to Ministry of Economic Affairs order No. 09502320300 published on June 21, 2006, effective from January 1, 2007, public companies may, in the shareholder meeting when all directors and supervisors are re-elected and when an audit committee is established, amend or remove clauses in its articles of incorporation that are applicable to supervisors. The company may then, in accordance with the amended articles of incorporation, be exempt from the requirement of electing a supervisor. The company shall, however, specifically set out regulations governing the operation of its audit committee in its articles of incorporation.

4. Shall a company's articles of incorporations include

provisions regulating the audit committee?

A: Paragraph 1, Article 14-4 of the Securities and Exchange Act specifically sets out that “A company that has issued stock in accordance with this Act shall establish either an audit committee or a supervisor”. As such, a company that establishes an audit committee in accordance with the provisions of the Securities and Exchange Act shall remove the provisions governing supervisors in its articles of incorporation. The company has the discretion to decide whether its articles of incorporation will include provisions regulating the audit committee.

5. **Article 14-4 of the Securities and Exchange Act specifically sets out that an audit committee shall be composed of the entire number of independent directors, and shall not be fewer than three persons in number. Does this mean that all members of an audit committee must be independent directors or may a person other than an independent director of the company be a member?**

A: Paragraph 2, Article 14-4 of the Securities and Exchange Act stipulates that an audit committee shall be composed of the entire number of independent directors, and shall not be fewer than three persons in number. For example: if a company has five independent directors, its audit committee shall be composed of all five independent directors.

6. **Paragraph 2, Article 14-4 of the Securities and Exchange Act provides that at least one member of the audit committee shall possess accounting or financial expertise. How is this defined or what are the criteria to qualify for this position?**

A:

1. Paragraph 2, Article 14-4 of the Securities and Exchange Act prescribes that at least one member of the audit committee shall possess accounting or financial expertise to ensure

effective operation of the audit committee. For flexibility considerations, the qualification of such person is not expressly defined in the Securities and Exchange Act.

2. A person is deemed to possess the required accounting or financial expertise if he or she meets the qualification requirement of an independent director as set out in the “Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies” as well as one of the following criteria. But companies may also put in place higher standards according to actual requirements:
 - (1) Persons with experience in the capacity of a finance manager, accounting manager, chief accountant and internal audit manager in a public company.
 - (2) Persons with experience in directly supervising the persons described in (1) above.
 - (3) An accredited CPA/securities investment analyst or persons who have successfully completed the national financial/accounting examinations and obtained certification with at least two years of experience in accounting, auditing, taxation, finance or internal audit.
 - (4) Persons who have completed a minimum of 12 credit hours of accounting, finance, auditing or taxation courses at a domestic or foreign graduate studies institute recognized by the Ministry of Education, and possess at least three years’ experience in accounting, auditing, taxation, finance or internal audit.
 - (5) Persons who have completed a minimum of 12 credit hours of accounting, finance, auditing or taxation courses at a domestic or foreign vocation school or an equivalent educational institution recognized by the Ministry of Education, and possess at least five years’ experience in accounting, auditing, taxation, finance or internal audit.
7. **Are there any regulations in place to govern the selection of the members of an audit committee?**

A: Paragraph 2, Article 14-4 of the Securities and Exchange Act stipulates that an audit committee shall be composed of the entire number of independent directors and Article 5 of the “Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies” prescribes that independent and non-independent directors of a public company shall be elected at the same time, but in separately calculated numbers. As such, the election of members of the audit committee shall be subject to the same regulations governing the election of independent directors.

8. Does an audit committee become officially operational upon election of independent directors and abolishment of the supervisor system in the shareholders’ meeting?

A: Pursuant to Article 3 of the “Regulations Governing the Exercise of Powers by Audit Committees of Public Companies”, a public company that sets up an audit committee in accordance with the Securities and Exchange Act shall put in place an Audit Committee Charter that is to be adopted by resolution of the board of directors. The first part of paragraph 1, Article 14-4 of the Securities and Exchange Act stipulates that a company that has issued stock in accordance with the Securities and Exchange Act shall establish either an audit committee or a supervisor. As such, the supervisor system may be abolished upon establishment of an audit committee.

9. Where a company has four independent directors among whom three are members of the audit committee, shall the company convene a special shareholders meeting to hold a by-election of independent directors when all three have been dismissed?

A:

1. Paragraph 2, Article 14-4 of the Securities and Exchange Act prescribes that an audit committee shall be composed of the

entire number of independent directors and shall be at least three in number. Therefore, an audit committee shall not comprise of members of non-independent directors. For example, the company has four independent directors, its audit committee shall be composed of all four independent directors of the company.

2. Members of the audit committee are independent directors of the company. The by-election of independent directors dismissed under specific circumstances shall be handled in accordance with the provisions of paragraph 5, Article 14-2 of the Securities and Exchange Act. As such, in an event where all independent directors have been dismissed for specific reasons, a company shall convene a special shareholder's meeting for by-election of independent directors within 60 (sixty) days of the actual occurrence of the event.

10. How shall an audit committee operate if the company has less than three independent directors?

A:

1. Members of the audit committee are independent directors of the company. The by-election of independent directors dismissed under specific circumstances shall be handled in accordance with the provisions of paragraph 5, Article 14-2 of the Securities and Exchange Act.
2. To avoid impact on the company's operations and to ensure smooth operation of the company's financial and business operations, Article 8 of the "Regulations Governing the Exercise of Powers by Audit Committees of Public Companies" specifically sets out that "If for a legitimate reason it is impossible to hold an audit committee meeting, matters on the meeting agenda shall be adopted with the consent of two-thirds or more of the entire board of directors. Notwithstanding the foregoing, with respect to the matters in Article 14-5, paragraph 1, subparagraph 10, of the Act, a

written opinion shall be obtained from each independent director member indicating approval or disapproval”.

11. Shall specific regulations be put in place to govern the conduct of an audit committee?

A:

“Regulations Governing the Exercise of Powers by Audit Committees of Public Companies” specifically sets out the regulations governing the exercises of powers by the audit committee, conduct of audit committee meetings (the number of times an audit committee meeting has been held, method of calling a meeting, and provision of essential information by related personnel), proxy for attending a meeting and the method of resolution.

12. How shall a public company handle any matter not been subject to the consent of its audit committee or matters to which its audit committee has expressed opposing views?

A:

1. Paragraph 1, Article 14-5 of the Securities and Exchange Act specifically sets out matters that shall be subject to the consent of one-half or more of all audit committee members (including assessment of the effectiveness of the internal control system), while with the exception of subparagraph 10, paragraph 1 of Article 14-5 concerning annual and interim financial reports, any matter under a subparagraph of the preceding paragraph that has not been approved with the consent of one-half or more of all audit committee members may be undertaken upon the consent of two-thirds or more of all directors.
2. Subparagraph 10, paragraph 1, Article 14-5 of the Securities and Exchange Act stipulates the adoption of a company’s financial reports by its supervisors. If a company has established an audit committee in place of the supervisor system, the reports shall irrespectively be approved with the consent of one-half of the audit committee members.

13. Are matters which shall be subject to the consent of one-half or more of all audit committee members pursuant to Article 14-5 of the Securities and Exchange Act required to be submitted for a resolution in an audit committee meeting?

A: An audit committee operates under a joint resolution method whereby all proposals shall be subject to the resolution of all committee members at an audit committee meeting, and paragraph 5, Article 14-4 of the Securities and Exchange Act specifically provides that regulations governing exercise of powers by the audit committee and its independent director members and matters related thereto shall be prescribed by the Competent Authority. As such, the conduct of audit committee meetings shall be governed by the provisions of the “Regulations Governing the Exercise of Powers by Audit Committees of Public Companies”.

14. Article 14-5 of the Securities and Exchange Act provides that assessment of the effectiveness of the internal control system shall be subject to the consent of one-half or more of all audit committee members. What does assessment of the effectiveness of the internal control system refer to?

A: The “Statement of Internal Controls System” filed by a public company with the Competent Authority in accordance with Paragraph 3, Article 14-1 of the Securities and Exchange Act refers to a report on the overall effectiveness of a company’s internal controls system issued by the company’s board of directors and the President stating the internal control deficiencies and abnormal items, the status of improvement and other source information based on self-assessments conducted by the company’s various departments and subsidiary companies and reports of internal audit departments. The process undertaken by a company to assess the overall effectiveness of its internal controls system described in the preceding paragraph refers to the “assessment of the

effectiveness of the internal control system” as described in Article 14-5 of the Securities and Exchange Act.

15. Where a company has established an audit committee, can the application form for its newly issued shares be effected and affixed with the seal of the audit committee thereon in place of the supervisor’s seal?

A: Where a company has established an audit committee and that the issuance and offering of marketable securities have been subject to the approval of its audit committee, Article 14-4 of the Securities and Exchange Act and Article 5 of the “Regulations Governing the Exercise of Powers by Audit Committees of Public Companies” provide that power conferred to be exercised by supervisors may also be exercised by the convenor of the audit committee. Where the proposal has not been subject to the consent of the audit committee but instead, was adopted with the consent of two-thirds or more of the entire board of directors, the convenor of the audit committee is not required to affix his or her seal on the space provided for the supervisor’s seal. However, an explanatory note explaining the aforesaid situation shall be included with the minutes of the audit committee meeting attached thereto.

16. Are a company’s forms and statements reviewed in accordance with Article 14-5 of the Securities and Exchange Act examined by the audit committee and adopted by the board of directors required to be audited by a supervisor prior to submission to the shareholders’ meeting for a resolution?

A: Pursuant to paragraph 3, Article 14-4 of the Securities and Exchange Act, the provisions regarding supervisors in the Company Act shall apply mutatis mutandis to the audit committee of a company. Article 14-5 of the Securities and Exchange Act prescribes that the annual financial reports shall be subject to the consent of the audit committee. As such, a public company shall submit its annual financial reports to the

audit committee. Where the financial reports have already been subject to the consent of the audit committee prior to being submitted to the board of directors for adoption, the financial reports need not be audited by the audit committee after being adopted by the board. Non-financial reports and forms shall be submitted to the audit committee for an audit prior to being submitted to the shareholders' meeting for adoption in accordance with the provisions of Articles 219, 228 and 229 of the Company Act.

17. The hiring or dismissal of an attesting CPA, or the compensation given thereto, shall be approved by the board of directors and the audit committee in accordance with Article 14-3 and Article 14-5 of the Securities and Exchange Act. How is “the attesting CPA” defined? Can the aforesaid matters be adopted with an interim approval and be submitted in a subsequent meeting for ratification?

A: The term “the attesting CPA” described in Article 14-3 and Article 14-5 of the Securities and Exchange Act shall refer to a certified public accountant engaged by the company to audit and attest to the financial reports as described in Articles 36 and 37 of the Securities and Exchange Act. In order to enhance the functions and ensure effective operation of the board of directors and the audit committee, Articles 14-3 and 14-5 of the Securities and Exchange Act specifically set out that matters with material impact on a company's financial status and business shall be submitted to the board of directors for a resolution or be subject to the consent of at least one-half of the members of an audit committee and be submitted to the board of directors for approval if an audit committee has been put in place. As such, matters prescribed in the aforesaid Articles may not be adopted with an interim approval and be submitted in a subsequent meeting for ratification.

18. For a company that has established an audit committee in accordance with the Securities and Exchange Act, is the

audit committee's prior consent to the ex-rights date required prior to the date being set by the board of directors?

A: Subparagraph 7, paragraph 1, Article 14-5 of the Securities and Exchange Act stipulates that the offering, issuance, or private placement of any equity-type securities by a public company that has established an audit committee shall be subject to the consent of one-half or more of all audit committee members and be submitted to the board of directors for a resolution. As such, the offering, issuance, or private placement of any equity-type securities by a public company shall be subject to the consent of its audit committee prior to being proposed to the board of directors or shareholders for a resolution. The company has the discretion to decide whether the finer details regarding the implementation of the aforesaid processes (such as the adoption of the ex-rights date by the board of directors) shall be subject to the consent of its audit committee according to actual circumstances.

19. Shall the proceedings of audit committee meetings be recorded on audio or video tapes?

A: The Securities and Exchange Act and the "Regulations Governing the Exercise of Powers by Audit Committees of Public Companies" do not specifically enforce as to whether the proceedings of an audit committee meeting shall be recorded on audio or video tapes. The company may determine if it is required according to actual circumstances.

20. Among the matters that shall be recorded in the minutes of an audit committee meeting, how is "session of meeting" determined?

A: Pursuant to Article 14-4 and Article 183 of the Securities and Exchange Act, a company may establish an audit committee in place of a supervisor. Subparagraph 1, paragraph 1, Article 10 of the "Regulations Governing the Exercise of Powers by

Audit Committees of Public Companies”, states that “Discussions at an audit committee meeting shall be included in the meeting minutes, which shall faithfully record the following: 1. Session, time, and place of meeting....” In relation to session of meeting, the meeting minutes shall faithfully record the date of establishment of the company’s audit committee and the session of the convened meeting.

21. Article 14-4 of the Securities and Exchange Act provides that the audit committee shall be composed of the entire number of independent directors and a company with an established audit committee shall not appoint a supervisor concurrently. As such, an independent director who serves concurrently as a member of the audit committee carries a dual role. How shall the remuneration to directors and supervisors be distributed? Are independent directors then entitled to double the remuneration as a result of their dual roles?

A:

1. Article 14-4 of the Securities and Exchange Act prescribes that a public company shall establish either an audit committee or a supervisor. As such, the allocation of remuneration to supervisors or remuneration to supervisors does not constitute an issue for a company with an established audit committee.
2. Members of an audit committee are independent directors. Refer to Q36 of Corporate Governance Q & A for Independent Directors for handling of remuneration to independent directors.