CHAPTER 3 THE ROLES AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS IN MALAYSIA

This chapter will study the corporate governance in Malaysian’s context and discuss the powers, roles and responsibilities of directors under the Companies Act 1965. In the later part of this chapter, it touches on the role of Malaysian Institute of Corporate Governance (MICG) in formulating a “Code of Best Practices” for the local corporations.

3.1 Corporate Governance Structure: The Malaysian Context

Malaysia’s structure of corporate governance mirrors the combination of Model II and Model III discussed in Chapter Two. The Malaysian government has a strong influence on the economy sectors.

There is a total of 630 companies listed on the Kuala Lumpur Stock Exchange (KLSE) main board and 311 on the second board. Some of these companies were formerly state-owned bodies but were recently privatized, however the government still holding substantial equities in these companies. Majority of these corporations evolved from sole proprietor or family owned businesses to incorporated companies. Some are joint ventures between locals and foreign
investors that went public. However most of these companies are still very much controlled by majority shareholders (either individual or family controlled) who are closely involved in the daily management of the corporations. As a result, the governance issues to be addressed must extend to related party or intra-company deals that may be prejudicial to minority shareholders’ interests.

A study was conducted by Lim (1981) on local corporate ownership and control in the years of 1970s revealed that share ownership was highly concentrated in the hands of a few institutions in accurate and that there was in fact a growth of such concentration in the 1990s. (Koh, 1994b)

Mansur Md. Isa (1993) also pointed out the similar scenario in his article that "Over the years, it seems that the ownership concentration has increased. This is evident from the findings of a KLSE Survey.....which shows about 5% of the shareholders in Malaysia as at the end of 1987 were institutions, owning above 80% of the shares. The remaining 95% were individuals, holding about 20% of the shares.”

3.2 Legislative Framework

The initiatives for better corporate governance have so far been largely government-led. Corporate law in Malaysia is primarily governed by the provisions of the Companies Act 1965 that was based on the UK Companies
Act 1948 and the Australian Uniform Companies Act 1961. Companies Regulation 1966 and Malaysian Code on Takeovers and Mergers 1987 are two major subsidiary legislation that have been passed under the Companies Act in area of corporate governance. The regulatory authority of the act is the Registrar of Companies, under the Ministry of Domestic Trade. This Act governs various aspects of directorship, including directors relationships with their corporations.

This legislation is later supplemented by the Securities Industry Act 1983, Securities Commission Act 1993, both under the Ministry of Finance and the Guidelines on the Regulation of Acquisition of Assets, Mergers and Takeovers (FIC Guidelines), under the Ministry of International Trade & Industry. These legislative provisions co-exist with the rules of common law and equity emanating from judicial decisions from our own Malaysian Courts and also Singapore, Australia, Canada, New Zealand and the United Kingdom. (Koh, 1994c)

There has been a continuous effort to strengthen the framework for investor protection from time to time. e.g., a new law on insider trading has been approved by Parliament in 1998 which prohibits all persons in possession of inside information from acquiring or disposing of affected securities, procuring an acquisition or disposal of affected securities, or communicating the inside
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information for self interest. Under the new law, insiders are no longer confined to persons who have a fiduciary duty to the company, but would include all persons who have in their possession information that is not generally available.

Recently, the Second Finance Minister Datuk Mustapha Mohamed has made an announcement that a new ruling limiting to five the number of directorships a person can hold in companies listed on the KLSE to be enforced, as measure undertaken to improve corporate administration, strengthen growth and enhance confidence in the securities market. Relevant regulations, including the listing requirements of the KLSE, would be amended by the Securities Commission to accommodate this new ruling (Star, 2/1/99)

3.21 Powers and Position of the Directors

Since a company has no physical existence, its daily activities are carried out by a small group of persons who have been entrusted with the power and authority to act on behalf of company, such persons are called ‘directors’. The expression ‘director’ includes “any person occupying the position of director of a corporation by whatever name called and includes a person in accordance with whose directions or instructions the directors of a corporation are accustomed to act and an alternate or substitute director” - Section 4(1) Companies Act 1965.
the ordinary resolution of members. If the directors act in contravention of the Articles of the company, the shareholders may ratify their actions by an ordinary resolution.

Directors are not servants of the company. They are described as agents or trustees to a company. Under the Companies Act, a director shall act honestly at all times, and use reasonable diligence in the discharge of the duties of his/her office accordingly in the interest of the company as a whole. They have the authority to apply the company's asset for the purposes specified in the Memorandum or Article of Association.

The Articles of the company empower the board to appoint persons to be the servants/agents of the company with authority to exercise any of the directors' powers for such period as the board may think fit. In fact, most of the companies in Malaysia are run by a Managing Director (Chief Executive Officer), rather than by the board. Table A of the Articles also outlines permission given to directors to delegate any of their powers to a committee consisting of one or more of the directors (the management structure with executive powers who led by the Managing Director). However, such delegation may be revoked by the board at any time.
3.22 Role & Duties of Directors

The Board of Directors is empowered to act on behalf of a company. It plays a major role in safeguarding the interest of corporation and its shareholders. The companies Act regulates directors by (a) prohibiting certain persons from managing (Section 130), (b) disqualifying a person from being a director if he is or has been a director of a company which has at any time gone into liquidation and was insolvent at that time (Section 130A), (c) providing for disclosure of interests, whether directly or indirectly in a contract or proposed contract or holds any office or possesses any property which might be in conflict with his duties as a director. (Section 131)

Directors have 6 most common types of duties under the Companies Act 1965, i.e.

(1) **Fiduciary duties**

Directors occupy a fiduciary position in the company; that is, a relationship of trust with the company. Since the company places its trust in the directors, they must use their best exertions and utmost good faith towards the company in their dealings with it or on its behalf. The extent of the director's duties has been classified by the provision of the Companies Act and the case laws. Their duties include:

(a) To act, 'bona fide', and for the benefit of the company as a whole. 'Benefit for the company' could mean the directors must have regard for the
interest of the members, employees and consumers of the products of the company as well as the community as a whole (including the interests of creditors).

(b) To use their powers, bona fide, for the purposes which they were conferred. The directors who dishonestly use their powers for a 'non-bona fide' purpose, for e.g., to obtain personal profits for themselves at the expense of shareholders without informing them, commit a breach of such entrusted duty as mentioned in (a) above.

(2) **A responsibility to avoid a 'conflict of duty' and personal interest**

A director must not allow his own personal interests to conflict with his duty as a director. There are two common aspects of this duty:-

(a) Company contracts or other transactions in which a director has an interest. The general rule of law is that a director cannot put himself in a position where his personal interest can conflict with his business interest.

- if a director has such an interest in the company’s contract thus contravening this rule, the contract thus approved can become void later decides so.

- if the contract, however, cannot be avoided that bind the company against an innocent third party who is unaware of the director’s interest, the company may claim any damages suffered from the director concerned.
(b) Other secret profits. If a director makes any secret profit, he must account for that profit to the company. Such profit, however, may be kept by the director if he obtains the approval of the members in a general meeting either before or after it has been made.

(3) **A duty to have regard for the interests of the company's employees and members in general**

The duty of directors is owed to the company and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.

(4) **A duty of care, skill and diligence**

There is no uniform standard of care, skill and diligence; however, a director is expected to exercise a certain degree of competence. If he fails to reach the expected standard, he is liable to answer to the company for the negligence. The duty of care and skill expected of each director is dependent on his position in the company. For example:

(a) **Executive Directors**

The degree of care and skill of such directors is expected to be much higher. He is expected to use reasonable skill in the performance of the duties of his office.

(b) **Non-executive directors**

If a non-executive director possesses certain relevant qualifications or
experience, he is expected to exercise reasonable skill and care in the performance of this duty. If a non-executive director does not have the relevant qualification or experience, he/she must do his/her best and use his/her own knowledge and experience to act with reasonable care.

(5) **A statutory duty to make disclosure under Section 134 & 135** Director has a general duty to notify his company within 14 days of the following:

- shares in the company or in related corporation being shares in which the director has an interest and the nature and extent of that interest;
- debentures of or participatory interest made available by company or a related corporation being debentures or participatory interests in which the director has an interest and the nature and the extent of that interest;
- right or options of the director in respect of the acquisition or disposal of shares in, debentures of or participatory interest made available by the company or a related corporation,
- contracts to which the director is a party or under which he is entitled to be a benefit, and
- reaching the age of 70 if he is a director of a public company or its subsidiary company.

Failure to make any such notification will render the directors liable to a fine of RM15,000 or imprisonment for 3 years.
(6) **A duty to keep accounts**

Directors are accounted to run funds which owned by the shareholders, therefore they should keep the shareholders on how the funds are being allocated or expensed for the shareholders' interests.

(a) Every director of the company must ensure that his company keeps proper books of accounts with respect:

- all transactions of goods (i.e. sales and purchases) by the company;
- all receipts and expenditure (i.e. cash received and cash paid) by the company;
- a statement of the annual stocktaking;
- the assets and liabilities of the company.

(b) The books of accounts must give a true and fair view of the state of the company's affairs. The books of accounts must be kept at the registered office of the company, or at such other place as the directors think convenience, and must at all times, be opened to inspections by the directors.

If any director of the company fails to take all reasonable steps to secure compliance by the company with the foregoing requirements, he is liable, upon conviction, to imprisonment for a term of six months or RM5,000 fine or both (S167)
The directors of every company must lay before the company at its AGM an audited profit and loss account as well as the balance sheet for that particular financial year (or not more than 15 months after each proceeding account). It is compulsory for a company to attach a report by its directors to every balance sheet laid before any AGM. The report should contain information relating to (a) the directors' names in office at the time of report, (b) the company's principal activities and any significant change of such activities during that financial year, (c) the company's net profit or loss for that financial year after making provision for taxation, (d) the amount and particulars of any material transfers to, or from reserve funds or other provision, (e) capital issues, and (f) any other requirements as prescribed under the Companies Act S169.

3.23 Liabilities of Directors and Insider Trading

Since directors occupy fiduciary positions, they may be, therefore, prone to a breach of duty and breach of trust or negligence. Some of the most important liabilities of directors are summarized as following:

(1) Directors are liable to penalties if they fail to carry out their duties required under the Companies Act such as failure to keep proper books of accounts, register of members, failure to file annual return and other statutory returns.
(2) Directors may be guilty of misfeasance if they misapply the company's property of funds such as taking bribe, committing a breach of the company's Articles which can result in losses of company.

(3) Directors may be liable to penalties if they fail to obtain their respective qualification shares, or cease to hold such qualification shares as required by the Articles of the company.

(4) Directors are jointly and severally liable if they are jointly implicated in a breach of trust, whether the breach results in gain to them or not.

(5) Directors are prohibited of abuse of information, such as providing any specific confidential information to their related parties that may affect the value of the company's securities, more commonly referred to 'insider trading' (regulated under Section 132B, C.D.E.F & G of Company Act and Section 89 of Securities Industry Act)

The whole Board of Directors (regardless whether a director is in the executive or non-executive capacity) is ultimately responsible for ensuring an effective system of internal control is in place and for limiting and detecting fraud.
3.24 Statutory Registers

Every company must keep at its registered office, a register of directors containing the names, addresses, business occupation and particulars of any other directorships of public companies or their subsidiaries held by each director. The register must be opened to inspection by any member of the company without charge, and any other persons (non-members) at a charge not exceeding two dollars. A copy of the return in the prescribed form must be sent to the ROC within one month after the incorporation of the company, or in the case of changes (S.141, Companies Act). A company must keep a register showing the number or amount of shares /debentures held by each director of the company or in its related corporations, rights or options of the director to acquire or dispose of shares/ debentures in the company or its related corporation, and benefits obtained from any contract executed by director of company. Details to be included in the register must be recorded within three days of transaction (S.134, Companies Act)

3.25 Company Meetings

Every public company having a share capital must within a period of between one month and three months from the date it commences business, hold a general meeting of the members of the company. This is known as the ‘statutory meeting’. A statutory report concerning the shares allotment and shares paid-up shall be produced and filed with ROC.
Every company is required to hold its Annual General Meeting (AGM) once in every calendar year. The Companies Act stipulates that there should be no interval longer than 15 months between any two AGMs. A company that fails to hold its AGM or fails to hold the AGM within the prescribed period allowed by the Act, will render itself and its directors liable for a fine. The AGM must be called by giving 21 days’ notice in writing to all its members. Article 46 of Table A provides that ordinary business transacted at an AGM may include: declaring a dividend; considering the accounts, balance sheets, and the reports of the directors and auditors; the election of directors in place of those retiring; the appointment and fixing the remuneration of the auditors and any other special matters.

Article 79 of Table A of the Article of Association allots the provision for Board of Directors’ Meeting, it indicates the directors may meet together for the dispatch of business, adjourn, and otherwise regulate their meetings as the think fit. A director may at any time and the secretary shall on the requisition of a director summon a meeting of the directors. It does not specify the duration required for service of such notices for the meetings. However a quorum at any board of directors’ meeting has to be fixed by the directors themselves and decision of the directors’ meetings to be determined by a majority of votes. The Chairman may use his/her second or casting vote in cases of any
impasse. Minutes of all proceedings at the meeting must be taken and to be entered into the company’s minute book within 14 days of such meeting. The minutes must be signed by the Chairman of meeting.

Extraordinary General Meeting (EGM) and Class of Shareholders’ Meeting may be called directors on request of members according to the proceeding for resolving issues or passing of a special resolution.

Keeping of minutes of all general meetings, directors’ meetings and managers’ meeting (if any) are required by the Act. Such minutes, signed by the Chairman, will become evidence of proceeding and will remain valid until any contrary is proved. Failure to comply with the foregoing rules will render the company and its director liable, upon conviction, to a penalty (s.156, Companies Act). The company must also make available copies of such minutes to members upon request in writing within 14 days. Failure or refusal to provide such copies to members at their request, the company and every director will be liable (s.157 Companies Act).

3.26 Audit Committee

The audit committee has been mandated to all the Kuala Lumpur Stock Exchange (KLSE) listed companies since 1 August 1993 (KLSE Listing Requirements, Section 15A and Section 344A). The committee members are
nominated from the company's board members. This committee is used as a tool by the Board of Directors to monitor the conduct of management team in the governance of corporation. The Audit Committee shall consist of not less than three (3) members with a majority of whom shall be Non-Executive Directors.

The KLSE was among the very few stock exchanges that mandated audit committees to all companies listed on the exchange. The concept of audit committees in the Malaysian financial reporting environment is very recent, which traced back to the time following the financial fiasco of the Bumiputra Finance Berhad (BMF) in the early 1980's. This committee is perceived to be useful to ensure that the financial statements published by a firm reflect a 'true' and 'fair' view of the financial position of the company. (Shamsul Nahar Abdullah & Abdul Latif Shaikh Mohd Al-Munsi, 1997)

Some of the primary responsibilities of the committee are:

(a) to review the financial condition of the company, its internal controls and audit programme, the performance and findings of the internal auditor and to recommend action to be taken thereon by management;

(b) to review with auditors the scope of their audit and audit reports, including their findings and any action to be taken.
(c) to select independent auditors for appointment by the Board of Directors each year.

(d) to ensure the prompt publication of the annual accounts of the company. The board has a duty to ensure that accounts are timely and accurate, with frequent reviews of the adequacy of provision against contingencies.

Some of the functions of the committee shall include the following:-

(a) to review with the auditors
   (I) their audit plan, their evaluation of the system of internal accounting controls and their audit reports;
   (II) the assistance given by the company's officers to them,

(b) to review the scope and results of the internal audit procedures, findings in the internal audit reports and management's corrective action taken.

(c) to review the accounts of the company and the consolidated accounts of the group and thereafter to submit them to the Board of Directors of the company.
3.3 Code of Best Practice: Malaysian Institute of Corporate Governance

The Malaysian Institute of Corporate Governance (MICG) was set up in March 1998, aims to spearhead private efforts to improve corporate governance standards among companies. It is an industry-led initiative that groups together five industry groups and professional bodies in the country i.e. the Federation of Public Listed Companies (FPLC), the Malaysian Institute of Accountant (MIA), the Malaysian Association of Certified Public Accountants (MACPA), the Malaysian Association of the Institute of Chartered Secretaries and Administrators (MAICSA), and the Malaysian Institute of Directors (MID). Among MICG’s objectives are:

- To represent the opinions of members on issues related to management of Malaysian corporations so as to enhance long-term value for shareholders and the companies’ financial viability;
- To enhance accountability of management to stakeholders, including employees, customers, suppliers and the environment in which the corporation operates;
- To promote awareness of corporate governance; and
- To strengthen compliance by corporations to laws and regulations and to enhance self-regulating practices.

One focus of MICG is the role of directors in improving corporate governance. It is concerned the ignorance among directors of their duties and
responsibilities, and the failure of directors to play their proper roles. As such, it intends to set up programs to train and enhance quality of local directors, and hope to develop a pool of competent non-executive directors.

MICG stressed the need for a Code initiate by the private sector to establish standards of corporate governance at the firm’s level, which include issues such as the composition of the board, procedures for recruiting new directors, remuneration to directors, the use of board committees, their mandates and activities. Presently there are at least seven corporate governance codes in force around the world, including the UK, Canada, United States, Australia, South Africa, France and Hong Kong. All addresses the basic governance issues of board effectiveness and accountability.

A step is being made in the direction of a “Code of Best Practice” for local corporations. In April 1998, a high level finance ministry-led committee chaired by the Secretary General of the Ministry of Finance was set up to bring about awareness of corporate governance among regulators and people involved in the financial management of the country. This committee is also looking into the promulgation if an appropriate “Code of Best Practice”. MICG is given the task to study and formulate the Code and standards for Malaysia. The role of the Code is to guide boards by clarifying their responsibilities and providing prescriptions to strengthen the control exercised boards over their companies.
A draft of Malaysian's "Code of Best Practice" has duly completed and was submitted to the Ministry of Finance for comment and endorsement in June 1998. Currently the report is disseminated by the Ministry to other relevant bodies for study, comments and inputs before final endorsement.

MICG believes in self-regulation enduring. However, it recognized that there are certain aspects where statutory regulation is necessary, while certain aspects where self-regulation complemented by market disciplinary are more appropriate. For example, the responsibilities of companies and directors need to be defined by law, but the detail in implementation, process of carrying out the responsibilities is harder to capture in legal terms.

MICG highlighted that merely introduced the "Code" of corporate governance is insufficient to remedy the situation. It depends on the degree of compliance of the Code. It quoted, in Britain, companies which do not comply with their code on corporate governance would be queried by the London Stock Exchange as to why they did not comply. MICG hopes that the KLSE would do the same with the Malaysian's own "Code of Best Practice" and standards of corporate governance when it is fully implemented then.