

4.0 Overview of Malaysian Code on Corporate Governance and RLR

4.1 The Malaysian Code on Corporate Governance

The Code sets out a set of principles and best practices aimed towards enhancing the standards of Corporate Governance. It could be said that the Code of practice is designed to instil greater confidence among potential investors in Malaysian companies. Potential investors can then be assured that their investments will be managed ethically with a high level of accountability and transparency as spelt out in the corporate governance framework. As there is a changing capital market environment and when new investors are setting higher standards, there is a need to continually improve the corporate governance framework.

The MCCG is based on the parameters laid down by the Cadbury Committee (1992) as follows:-

- A board of Directors should include a significant number of competent and experienced (non-executive) directors who are independent of management and free from any business or other relationship that could significantly influence their judgement.
- A board should appoint three committees, one each on management compensation, appointments or nominations, and audit, to assist the Board as a whole in governing the company. The compensation Committee would deal essentially with fixing remuneration including bonuses of the chief executive and other executive directors (and senior managers if appropriate). The Nominations Committee's role would be to ensure that executive and non-executive directors are appointed through a proper process that helps in bringing to the board the necessary calibre and freshness of thought without compromising continuity and experience. The Audit Committee, comprising wholly of independent (non-executive) directors, meeting with auditors without management being present, will have the key responsibility of

reviewing interim and annual financial statements before submission to the full Board, ensuring adequate resources for the internal audit function and its coordination with external statutory auditors, and appointing external statutory auditors, assessing and fixing their fees, and discussing their audit results.

- The Board report should include an evaluation of internal control and assessment of the going-concern status of the company, with the statutory auditors reporting on the Board's report.
- Institutional investors should use their power and influence to help correct problems that arise rather than respond by selling their holdings.

The broad structure of the Code is outlined below:

Part 1 sets out **13 broad principles** of Corporate Governance comprises 4 key areas:

- Board of Directors;
- Directors' remuneration;
- Shareholders; and
- Accountability and audit.

Companies are required to apply these principles flexibly and with common sense in accordance with its individual circumstances. The details of **13 principal statements** are highlighted in Section 6.1.

Part 2 details **33 best practices** for companies in 3 key areas:

- The Board of Directors;
- Accountability and audit; and
- Relationship with shareholders.

The best practices as a whole is identified a set of guidelines on practices intended to assist companies in designing the approach to CG. The details of 33 best practices are highlighted in Section 5.3.

Part 3 is addressed to investors; and auditors. These are purely voluntary and serve the function of enhancing the role of external auditors and other corporate participants.

Part 4 provides explanatory notes to Part 1 to 3. It also sets out best practices in addition to the 33 best practices in Part 2. Companies do not have to explain circumstances justifying departure from these best practices.

4.2 KLSE RLR on CG

The RLR were introduced in January 2001. Chapter 15 of the RLR sets out the key CG requirements for PLCs. Amongst the new requirements, the most significant is the Corporate Governance disclosure requirements in the annual reports of PLCs.

Under paragraphs 15.26 and 15.27 of the RLR, the Board of a PLC is required to make the following statements in their annual reports:

- Principles statement - a narrative statement on how the PLC has applied the Principles set out in Part 1 of the Code (paragraph 15.26(a)).
- Compliance statement – a statement on the extent of compliance with the best practices in Corporate Governance as set out in Part 2 of the Code, the statement shall specifically identify and give reasons for any areas of non-compliance; and where applicable state the alternative practices adopted (Paragraph 15.26(b)).
- Directors' Responsibility Statement – a statement explaining the Board's responsibility for preparing the annual audited accounts (paragraph 15.27(a)).
- Statement on Internal Control – a statement about the state of internal control of the PLC (paragraph 15.27(b)).

The principles and best practices set out in Parts 1 and 2 of the Code are directed mainly to Boards of PLCs with the objective of increasing their efficiency and accountability. The principles and practices are generic in

nature and applicable to all entities, which have an interest in enhancing their level of CG practices.

4.3 CG Issues

The governance disclosures under the RLR represent a major shift in the public reporting process by Malaysian PLCs. It requires that Boards to decide on the steps necessary to develop their Corporate Governance practices so as to be on par with heightened industry norms. Failure of Boards to self-regulate will result in the role being filled by regulators through an even more rigid and prescriptive approach to disclosure.

Such a degree of latitude may be admirable, but it relies on companies to exercise their judgement in a responsible way rather than pay only lip service to the requirements should not be taken as an excuse to disclose as little as possible. The success of the Code will depend, in part, on the quality of governance disclosures – companies should aim to produce statements which are informative with due regard to a company's circumstances.

4.3.1 Director's Duties and Liabilities

Today, an invitation to become a director of a company is seen as a questionable task. In accepting this position, a director automatically assumes onerous duties, responsibilities and personal liabilities.

Now, with the changing CG structure, Board members have to accept the simple fact that the "buck stops with them". The Board is fully responsible to the Company, its members or shareholders, its people, lenders, creditors and other stakeholders.

4.3.2 Independent Directors

One of the more imperative issues in the area of CG is likely to be the need for independent directors. The Code prescribes that at least one third of the board should comprise independent non-executive directors.

The RLR defines an “independent director” is a person who is “independent of Management and free from any business or other relationship which could interfere with the exercise of their independent judgement or the ability to act in the best interests of a listed issuer”.

The RLR also sets out the criteria which excludes a person from being an independent director, including a person who:

- Has been an officer (except as an independent director) within the last 2 years of the PLC or any related corporation;
- Is a major shareholder of the PLC or any related corporation;
- Is a relative of any executive director, officer or major shareholder of the PLC or any related corporation. Relative covers the spouse, parent, brother, sister, child (including adopted or step child) and the spouse of such brother, sister or child;
- Is acting as a nominee or representative of any executive director or major shareholder of the PLC or any related corporation;
- Has within the last 2 years engaged in any transaction with the PLC or any related corporation, whether by himself or with other persons or through a firm or company of which he is a partner, director or major shareholder, as the case may be, the value of which exceed RM250,000.

Though it is for the Board to determine which directors they consider to be “independent”, it does not follow that shareholders should necessarily accept the Board’s view.

Shareholders can draw their own conclusions as to the independence, or of the non-executive directors. This may influence the voting decisions of the shareholders. Thus, when using the word “independent”, for the purpose of developing and reporting on Corporate Governance, the directors should clearly define their interpretation of the item.

4.3.3 Board Committees

The process of directing and controlling an organisation has become more challenging over time as a result of an increase in legislative and reporting requirements i.e. the Code and RLR. Thus, many Boards have established committees (as indicated in the Code) to assist them in performing and discharging their duties and responsibilities. However, the creation of Board committees does not reduce the Directors' overall responsibilities.

Audit Committee

In recognising the importance of the committee as an internal control mechanism, the role, rights, composition and functions of audit committees in the accountability and audit processes are prescribed in the Code and RLR.

The RLR requires that the audit committee should include at least one member who is a member of the Malaysian Institute of Accountants, or at least one who had either passed the examinations specified in Part 1 of the 1st schedule of the Accountants Act 1967, or is a member of one of the associations of accountants specified in Part II of the 1st Schedule of the Accountants Act 1967. Using the above criteria of appointment to the audit committee, companies may have to re-address its committee composition to satisfy the RLR.

Now under paragraph 15.16 of the RLR, Board of Directors is required to ensure that audit committee report is prepared at the end of each financial year. The report should highlight the functions and major work performed by the audit committee, including a review of the internal audit function. The details of audit committee functions are as follows:-

- To consider the appointment of the external auditor, the audit fee and any questions of resignation or dismissal;
- To discuss with the external auditor before the audit commences, the nature and scope of the audit, and ensure coordination where more than one audit firm is involved;

- To review the quarterly and year-end financial statements of the company;
- To discuss problems and reservations arising from the interim and final audits, and any matter the auditor may wish to discuss (in the absence of management where necessary);
- To review the external auditor's management letter and management's response;
- To consider any related party transactions that may arise within the company or group;
- To consider the major findings of internal investigations and management's response;
- To ensure the adequacy of internal audit function;
- Approve any appointment or termination of senior staff members of the internal audit function;
- Inform itself of resignations of internal audit staff members and provide the resigning staff member an opportunity to submit his reasons for resigning; and
- To consider other topics as defined by the Board.

Paragraph 15.17 of the RLR now requires the audit committee to promptly report to the KLSE matters which have not been satisfactorily resolved by the board, resulting in a breach of the listing requirements.

Nomination Committee

The Code requires the Board to establish a nomination committee; which comprises all non-executive directors, a majority of whom are independent. The roles of the committee should include:

- Recommending candidates to the Board for directorships;
- Consider candidates proposed by the Chief Executive for directorships and in so far that it is practical to do so, nomination by any senior executive, director or shareholder;
- Recommend directors to fill in the seats on Board committees to the Board; and

- Assessing the effectiveness of the Board as a whole, the Board committees and also the contribution of each individual director through an evaluation process.

The nomination committee members are required to exercise their roles in a responsible way rather than paying only lip service to the Code's prescriptions. It must be clearly understood that an effective nomination committee ensures that the Board has an appropriate balance of expertise and ability among non-executive directors. The Board as a whole is ultimately responsible for the recommendations put forth by the nomination committee.

Remuneration Committee

The Code requires the Board to establish a remuneration committee, which comprises wholly or mainly of non-executive directors, to recommend to the Board the remuneration of the executive directors. Non-executive directors' remuneration is a matter for the full Board.

The challenge for the remuneration committee is to develop a policy on the remuneration of executive directors and propose balanced packages to these directors i.e. packages which attract, retain and motivate executive directors of the quality required, yet avoiding paying more than is necessary for this purpose. The key to this is to provide packages that:

- Link rewards to both individual and company performance; and
- Align the interest of shareholders and directors in promoting the company's progress.

Thus, performance related elements of remuneration should play a crucial role within the remuneration policy.

4.3.4 The Role of Shareholders

Shareholders play an important role in the process of Corporate Governance and this has to be recognised when reporting on Corporate Governance practices. The shareholders' primary role in governance is to approve the

appointment of the Directors. In addition, shareholders can satisfy themselves that an appropriate governance structure is in place by asking relevant questions at the Annual General Meeting.

4.3.5 Internal Control Framework

The Code requires the Board to maintain a sound system of internal control to safeguard shareholders' interest and Company's assets. Internal control is wide as it encompasses the entire operation of an entity i.e. both financial and non-financial matter such as efficiency, value for money, legal and regulatory compliance issues. The requirement in relation to internal control reporting is that the directors are required to report on the "state of internal control" in the PLC.

4.4 Enforceability and Sanctions

The underlying principle in the enforceability of the Code is that compliance with the prescriptions in the Code is voluntary, but compliance with the disclosure provisions under the RLR is mandatory. Failure by a PLC to make the disclosure required under paragraphs 15.26 and 15.27 of the RLR as well as making false or misleading disclosure, are considered as non-compliance.

Non-compliance with the RLR in turn may result in the following:

- KLSE may issue a public/private reprimand, suspend trading in securities, de-list the company or issue other penalties/conditions as the KLSE deems appropriate. Under the RLR, actions may be directed to the PLCs, directors and officers of the PLCs as well as advisers (defined as *"any other person who, acting in the capacity of an adviser, presents, submits or discloses an application, a circular or any other document to the exchange on behalf of an applicant or a listed issuer"*).
- Under section 11 of the Securities Industry Act 1983, KLSE may fine (not more than RM1 million), reprimand or issue directive to PLCs which fails to comply with the Listing Requirements.
- Under section 122B of the Securities Industry Act 1983, *"A person who will intent to deceive, makes or furnishes and who with intent to deceive,*

makes or furnishes and who knowingly authorises or permits the making or furnishing of any false or misleading statement or report to the stock exchange relating to the affairs of a listed corporation commits an offence and is liable on conviction to a fine up to RM 3 million or imprisonment for a term not exceeding 10 years or both.