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" CORPORATE GOVERNANCE ISSUES AND ENFORCEMENT ACTIVITIES OF THE MALAYSIAN CORPORATE REGULATORS."

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Abstract.

This article discusses recent enforcement activities of the corporate regulators regarding corporate governance issues focussing on firstly, non-compliance with the Malaysian Code on Corporate Governance and its usefulness to shareholders' activism. The Malaysian Code on Corporate Governance was introduced in 1999 and since then listed companies are required to state how they have complied with the principles on corporate governance stated in the Code and explain deviation from the best practices laid down in the Code. The "comply or explain' approach of the Code gives discretion to the listed companies to decide on the appropriate corporate governance mechanism. The Code's enforceability depends on a large extent to the enforcement actions taken by the regulatory authorities whilst shareholders' activism on this point is still minimal. The article also considers the legal implication of breach of the Listing requirements in general and the Code in particular for directors. The second area of discussion relates to the audit committee and recent auditing scandals involving several listed companies.

CORPORATE GOVERNANCE ISSUES AND ENFORCEMENT ACTIVITIES OF THE MALAYSIAN CORPORATE REGULATORS.

Introduction

The Malaysian Code on Corporate Governance was introduced in 1999 and since then listed companies are required to state how they have complied with the principles on corporate governance stated in the Code and explain deviation from the best practices laid down in the Code. The "comply or explain" approach of the Code gives a lot of discretion to the listed companies to decide on the appropriate corporate governance mechanism.

The Malaysian Code on Corporate Governance was introduced as a result of the recommendations of the High Level Finance Committee on Corporate Governance in 1999. The Malaysian Code on Corporate Governance does not form part of the Listing Requirements. Nonetheless, Chapter 15 of the Listing Requirements of Bursa Securities requires that *all listed companies* must disclose in their annual reports a narrative statement of how they have applied the principles in part I of the Code which contains 13 principles on corporate governance and to what extent they have complied with the best practices in part II of the code. They are also required to explain reasons for any deviation from the best practices in Part II of the Code and to explain alternative mechanisms if they decide not to comply with the best practices.

The Code's enforceability depends on a large extent to the enforcement actions taken by the regulatory authorities. Companies listed on the stock exchange comply with the Listing Requirements based on the contractual agreement that in return for the privileges of using the facilities of the Stock Exchange, they will abide by the terms of the Listing requirements. However, statutory recognition has been given to the Listing Requirements

by section 11 of the Securities Industry Act 1983. [1] Section 11 of the SIA 1983 imposes on certain persons to personally comply with the Listing Requirements or to ensure that a listed company comply with the Listing Requirements.[2] The section gives statutory backing to the enforcement activities of Bursa Securities as the section authorizes the stock exchange to

> "…(a) direct the person in default to comply with, observe, enforce or give effect to such rules or listing requirements (b) impose a penalty the quantum of which shall be in proportion to the severity or gravity of the failure to comply with, observe, enforce or give effect to such rules or listing requirements but such penalty shall not exceed one million ringgit, or (c) reprimand the person in default".

Enforcing the disclosure obligation in relation to the Code's content.

Where the Code on corporate governance is concerned, non-compliance with the code *per se* is not a breach of the Listing requirement. Despite section 11 of the SIA 1983, the Listing Requirements does not make it mandatory for a company to adopt the Code's content. Rather, companies are given discretion whether or not to adopt the Code but explanation for deviation must be given. A breach of the Listing requirement occurs only when the company *failed* to disclose how they have applied the principles on corporate governance and/or failed to provide reasons for non-compliance with the Code. It is also a breach of the disclosure obligation if the company makes a misleading or false disclosure regarding the process and structure that they have adopted. This view was reflected in a recent enforcement activity involving a listed company.

Astral Asia Berhad and the case of the non-existent board meetings.

On 7 June 2006, the Bursa Securities announces a public reprimand of the directors of Astral Asia Berhad in relation to certain information in the company's Annual Report which were misleading. The misleading information was in relation to the number of

[1] See section 11 of the Securities Industry Act 1983. See also AN Mohd-Sulaiman "Enforcement Issues & the Recognition of the Kuala Lumpur Stock Exchange's Regulatory Instruments" [2001] 2 MLJ i-xii for a discussion on the persons who are deemed to be under an obligation to comply with , observe , enforce or give effect to the rules and listing requirements of the stock exchange.
[2] See section 11 of the Securities Industry Act 1983.

board of directors meetings and audit committee meetings which were held for the financial year ending 31 December 2004.

The company had published its Annual Report for the financial year ending 31 December 2004 and as required by the Chapter 15 of the Listing Requirements of Bursa Securities discloses its corporate governance practice based on the Code on Corporate Governance. Part I of the Malaysian Code on Corporate Governance contains the principles of Corporate Governance and Principle AI states that:

> " every listed company should be headed by an effective board which should lead and control the company."

In Part II of the Code, as part of best practice to ensure that there is an effective board, under Best Practice AA III, it is stated that:

> " the board should meet regularly, with due notice of issues to be discussed and should record its conclusions in discharging its duties and responsibilities. The board should disclose the number of board meetings held a year and the details of attendance of each individual director in respect of meetings held"

The company stated in its Annual report that there were 6 board meetings and 6 Audit committee meetings held during that period. Nonetheless, it was found out that Astral actually held only 1 board meeting. No audit committee meetings were ever held.

Bursa Securities then issued a public reprimand against the company and imposed a fine on the directors of the company. The basis for the enforcement actions is the fact that the directors had permitted, either knowingly or where they had reasonable means of obtaining such knowledge, the company to breach the Listing Requirements in relation to the disclosure of information in the Annual Report 2004 relating to the number of board meetings and audit committee meetings held. The public reprimand were also imposed on the directors who were the members of the audit committee for causing the company to breach the Listing Requirements by not ensuring that the company's audit committee discharge its functions as stated in the Annual Report 2004.[3]

[3] http://www.bursamalaysia.com dated 7 June 2006 viewed on 19 Sept 2006.

What was worrying about Astral's case is that there was clearly misleading information provided by the company to the shareholders and the investors. Despite the board having a good board composition in terms of a mix of executive and independent non-executive directors, [4] the independent non-executive directors were clearly ineffective thus highlighting the fact that ensuring 'independence' of directors is a continuous process and a director's categorization as "independent" does not ensure that there is actual independence.[5] The 2004 Annual Report did not only state that there were 6 audit committee meetings held but also stated that all the audit committee members had recorded full attendance at the audit committee meetings when in actual fact there was no audit committee meetings held. This fact was particularly worrying in view of several corporate collapses worldwide arising out of malfunctioning internal audit functions. In addition, the scarcity of the board meeting brings up the question whether there has been proper exercise of the duty of care, skill and diligence that directors need to demonstrate.[6]

What this case demonstrates is that corporate governance may not be able to address fully any deliberate and intentional dereliction of responsibilities. In such instances, the punitive element of the law should be fully utilised. Whilst the enforcement action taken by Bursa Securities conforms to the investor protection purpose of public regulation, there are views that the enforcement activities of the regulatory authorities in general are

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[4] The composition of the board were as follows:
- (a) Tan Sri Dato' Hj Hussein b Ahmad;
- (b) Dato Lim Kang Poh;
- (c) Tuan Haji Md Adanan Abdul Manap (INED);
- (d) Dato Md Adnan Sulaiman;
- (e) Dato Amilhamzah Ahmad (INED)
- (f) Tan Eng Chong (INED) and
- (g) Nik Jailani Nik Jid (resigned on 1 January 2005.

[5] *The Duke Group Ltd (in Liq.) v Pilmer & ors* (1998) 16 ACLC 567.

[6] *Daniels v Anderson* ; *Daniels (formerly practicing as Deloitte Haskin & Sells) v AWA Ltd; Daniels v Anderson; Hooke v Daniels* (1995) 13 ACLC 614.; (1995) 16 ACSR 607; *Re Barings PLC (No 5)* [2000] 1 BCLC 523; *Lim Weng Kee v PP*[2002] 4 SLR 327; see also AN Mohd-Sulaiman & W J Wan Jusoh "Duty of Care, Skill and Diligence: A Survey on Non-executive Directors in Public Listed Companies in Malaysia." (2005) Vol 1 No 2 *The Corporate Governance Law Review* 305.

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ineffective since fines or reprimands imposed are usually made against the company instead of against persons who are responsible for managing the company and causing the company to breach the Listing Requirements.[7] One enforcement power that is available but has not been effectively utilised by the regulatory authorities in Malaysia is the disqualification provisions in the Companies Act 1965 as well as the Securities Industry Act 1983. Where there has been a breach of the Listing Requirements by the directors, and an application is made by the Securities Commission, The Stock Exchange or a recognized clearing house to the court, the court may make an order for him to be removed from office or be barred from being involved in the management of other public companies.[8] Under section 99C(3) of the SIA 1983, the Securities Commission may also apply to disqualify a Chief executive officer or a director of a listed company for unfitness of conduct where the person has, amongst others, had action taken against him under section 11 of the SIA. The section applies to, amongst others, a director of a body corporate who has been admitted to the official list of a stock exchange and has not been removed from the official list and has failed to comply with, observe, enforce or give effect to the rules and listing requirements of a stock exchange. From a comparative

[7] The statistic stated below shows that there were sanctions imposed on directors of companies and that directors have been implicated in a company's failure to comply with the Listing Requirements.

	2003		2005	
	Private /public reprimand	Public reprimand and fine	Private/public reprimand	Public reprimand and fine
Failure to comply with Corporate Governance –Ch 15 of the LR	--- *2 investigations were initiated during the FY end 31 Dec 2003 but no sanction imposed	---	1 (private reprimand)	---
Breach by Directors for causing, aiding or abetting or permitting a breach of the LR by Listed Issuer-Para 16.1 of the LR	---	---	1 (public reprimand) *3 companies were issued warning/reminder letters	12 (Total fine RM3,4000,000.)

Source: KLSE Annual Report 2003; Annual report of Bursa Securities Malaysia Berhad 2005.

[8] Section 100 of the Securities Industries Act 1983.

perspective, UK and Australia have consistently utilized the directors' disqualification provision in the corporate and securities regulation. However, these disqualification actions, in UK for example, have been mostly utilized for 'failed companies and with the protection of the public from persons who have abused the privilege of trading with limited liability'.[9]

Shareholders activism, judicial oversight and market forces.

Shareholders activism in relation to compliance with the Code may be evident from several aspects.

One aspect is the existence of shareholders suit relating to non-compliance with the Code on Corporate Governance. At common law, members at general meeting may decide whether or not to sue the directors where there is breach of directors' duties. Shareholders may also bring a derivative action on behalf of the company[10] or a personal action under the existing oppression provisions[11]. The court has took cognizance of the existence of a code of conduct or a code of best practice which the company adopts in deciding whether the director has breached his statutory and/or common law duties.[12] In *NRMA v Geeson*[13] the Court was asked to grant an injunction to restrain the director from disclosing confidential information relating to the conduct of a board meeting and all relevant documents in relation to the agenda of the meting. In its decision, the court had to decide whether the information were confidential information and if so whether an injunction should be granted if the disclosure of the information would result in a breach of confidence or a breach of fiduciary duty to act n the best interest of the company. The

[9] Eilis Ferran "The Role of the Shareholder in Internal Corporate Governance: Shareholder Information, Communication and Decision-Making" 416-454, at 429 in G Ferrarini, K J Hopt, J Winter *et all, Reforming Company and Takeover Law in Europe* (2004) Oxford University Press, Oxford.

[10] *Foss v. Harbottle* (1843) 2 Hare 461; 67 ER 189; *Abdul Rahim b Aki v krubong Industrial Park (Melaka) Sdn Bhd* [1995] 3 MLJ 417.

[11] Sec 181 of the Malaysian Companies Act 1965.

[12] See also *Llyod Cheyham &Co Ltd v Littlejohn& Co* [1987] BCLC 303, at 313; Re Chez Nico (Restaurants) Ltd [1992] BCLC 192. In *ASIC v Southcorp*[2003] 203 ALR 627; 2003 FCA 1369 the company's voluntary adoption of a new disclosure policy recommended by its corporate governance committee was a contributory factor in the determination of the appropriate penalty for a contravention of the continuous disclosure provisions under the Corporations Act.

[13] [2001] 40 ACSR 1.

court also stated that sections 182 and 183 of the Corporations Act may be relevant provided that the disclosure of the information was an improper use of the directors' position. It was held that the existence of a code of conduct which was followed by the director concerned indicated that there was no breach of fiduciary duty nor was there any improper use of the director's position under section 182 and 183 of the Corporations Act.

There is nonetheless, a dearth of cases/ no cases directly dealing with the question whether directors' failure to ensure compliance with the Listing Requirements entitles the company to sue the directors for breach of duty of care, skill and diligence. However if a breach of duty of care, skill and diligence is based on whether other directors in the same situation would have observed the Listing Requirements and Code, the directors in default and who have been implicated in the non-compliance by a punitive sanction form the regulatory authorities should be asked to compensate the company for causing loss to the company.

There is also uncertainty whether it is possible for the shareholders to bring an action under oppression if the company failed to comply with the Listing Requirements or the code on corporate governance. In *Re Aster (BSR) plc*[14], the minority shareholders filed a petition under section 459 of the UK Companies Act 1985 to obtain an order for the majority shareholders to buy out all the minority shareholding that the majority did not already own. They relied on the majority shareholders' announcement that it will attempt to cease future dividend payments, replacement of three directors of the company and the company's, the City Code on Takeovers and the Cadbury Report as giving rise to unfairly prejudicial conduct. The minority shareholders alternatively argue that there was a breach of their legitimate expectation arising out of the majority shareholders' announcement after it had obtained 51% shareholding in the company that this will not have any impact on the company's strategy or board composition. Subsequent to this announcement, the majority shareholder made an offer to buy out the remaining shares of the company but this was not supported by the board. The majority shareholder then

[14] [1999] BCC 556.

successfully removed three directors form the board and replaced them with its nominees. The specific Listing Rules that was raised for deliberation in this case relates to the company's responsibility to ensure that a listed company is free to carry on its business independently of any controlling shareholders. The court stated that non-compliance with the Stock Exchange rules, the City Code on Take Over or the Cadbury Report *has not of itself caused prejudice*[15] to the shareholders. This was because, as far as the Listing Rules was concerned, there was no allegation that the company has not traded independently of the majority shareholders. In relation to the Cadbury report, the argument was that the company did not ensure that its board composition complies with the Cadbury Report's recommendation relating to independent directors.[16] The court held that the directors were independent from management and that there was no support for the allegation that the audit committee comprising non-executive directors may not function properly in future. The court also stated that

> " so far as corporate governance is concerned, members of the public buying shares in a listed company may well expect that all relevant rules and codes of best practice will be complied with in relation to the company. But that expectation cannot…give rise to an equitable constraint on the exercise of the legal rights conferred by the company's constitution (of which the Listing Rules, the City Code and the Cadbury Report form no part) so as to found a petition under section 459."[17]

In contrast, there is a decision of the Enterprise Chamber Court of Appeals in Amsterdam where minority shareholders of Versatel Telecom International N.V. were successful in requiring the company to comply with the Dutch Corporate Governance Code in relation

[15] Emphasis added by author.

[16] Ibid. The relevant provisions of the Cadbury Report which were cited by the court were as follows:

> "2.2 the majority [of non-executive directors] should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment , apart from their fees and shareholding.
>
> 4.12 An essential quality which non-executive directors should bring to the board is independence of judgment. We recommend that the majority of non-executives on a board should be independent of the company. This means that apart form their directors' fees and shareholdings they should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment."

[17] [1999] BCC 59

to transactions and circumstances which falls within the Code's purview. The case arose out of the acquisition by a company, Tele2 AB of 83% shares in Versatel. Tele2 AB wanted to bring the company private and thus needs to acquire the remaining shares of the company. However, a compulsory acquisition of minority shareholders interest was only possible if Tele2 AB held 92% shares. Versatel attempted to appoint directors nominated by the majority shareholders to enable a merger between the majority shareholder (Tele 2 AB), Versatel and Tele2's subsidiary and at the same time to replace certain corporate governance rules in relation to directors' conflict of interest. The Dutch Corporate Governance Code adopted by the company contained two important principles relevant to the case. Firstly, the rule that prohibits the supervisory directors from voting on any matters in which they have a conflict of interest and secondly, the requirement that all members of the supervisory board must be independent. The Court of Appeals took cognizance of the fact that the 2004 Annual Report clearly indicates that the company adopts the Dutch Corporate Governance Code and in the 2005 AGM did not inform the shareholders of any deviation form the Code. Thus the Court held that the company could not replace the corporate governance rules and that the minority shareholders were entitled to expect that the company fully complies with the code.[18]

The decision of the Amsterdam Court of Appeal in Versatel's case and UK court in *Re Aster (BSR) plc* are not based on the same grounds but essentially relates to the same issue i.e., what would be shareholders' remedy where there is non-compliance with the Stock Exchange Listing Rules or a Code on corporate governance. In Versatal, once a company has adopted a code on Corporate Governance, it continues to apply unless the company has stated otherwise. An important similarity between Versatel and Astral Asia Berhad is the fact that Astral did not state in its Annual Report that it deviated from best practice in relation to the board meetings and had also disclosed the number of board meetings and audit committee meetings held during that period. Although the minority shareholders in *Re Aster (BSR) plc* failed in their action, this was because there was no evidence of the fact that the company has traded not independently of the majority shareholders or that the audit committee comprising non-executive directors will not

[18] http://www.gtlaw.com/pub/alerts/2006/0104.pdf viewed on 16 August 2006. Also viewed on www.pwc.com/Extweb/pwcpublications.nsf/docid/F9E4739AF3950C86802571D8004AED2.

function properly in future. Nonetheless, the oppression provision has often relied on proof of dishonesty or illegality of conduct [19] where mere mismanagement or disagreement as to management policy often does not give rise to oppression[20] although there are cases stating that what is required is lack of probity or good faith[21] and that mismanagement amounting to complete disregard of commercial interests of company is actionable as oppressive conduct.[22] It may be argued that the persistent failure of a listed company to comply with the Listing Requirement which resulted in fines being imposed on the company is oppressive conduct as the company's affairs are being conducted in disregard of members' interest. This cannot be construed as mere mismanagement as a company is required to comply with rules and regulations.[23]

A second aspect of shareholders activism is the existence of shareholders proposal to require compliance or to prevent non-compliance with the Code on Corporate Governance. The "comply or explain" approach adopted by the Stock Exchange in relation to the Malaysian Code on Corporate Governance requires the Board to decide on the appropriate corporate governance mechanism that should be put in place (whether or not the mechanism is in line with the recommendations in the Code on Corporate Governance) and in theory allows shareholders to question the company's corporate governance mechanism through the discussion of the Annual Report at the annual general meeting. In contrast, some the Corporate Governance Code in certain jurisdictions require a company to declare once a year that the recommendations of the Code have been and are being complied with or indicate which of the Code's recommendations are not being complied with and this has been relied by shareholders to require company's compliance to a provision in the Code.[24]

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[19] See Latimer Holdings Ltd v v SEA Holdings New Zealand Ltd. (2004) 9 NZCLC 263,694 (CA) Re macro (Ipswich) Ltd [1994] 2 BCLC 354.

[20] Re Kong Thai Sawmills (Miri) Sdn Bhd [1978] 2 MLJ 227 (Privy Council Appeal from Malaysia), approving RE Five Minutes Car Wash Service Ltd [1966] 1 All ER .

[21]See Abdul Rahim b Aki v Krubong Industrial Park (melaka) Sdn Bhd [1995] 3 MLJ 417, where fraud in the context of the derivative action is not confined to actual fraud but covers lack of probity.

[22] Ng Chee Keong v Ng Teong Kiat Highlands Plantation Ltd [1980] 1 MLJ 45; Jenkins v Enterprise Gold Mines NL (1991) 6 ACSR 539.

[23] A business judgment defence would not be applicable as the business judgment does not apply when there is deliberate disregard of law and rules.

[24] German Corporate Governance Code.

Whilst the enforcement action taken by Bursa Securities in Astral is well within its authority as recognized under section 11 of the SIA 1983, the section gives locus standi only to the stock exchange or a recognized clearing house. There has been no report in Malaysia of shareholders' activism in relation to request by shareholders for a company to adopt certain best practices on Corporate Governance.

Do the shareholders have such authority? The board of directors and the general meeting of shareholders are the two organs of a company, both having authority to bind the company in relation to matters within its authority. The starting point is to ascertain what are matters within each organs' authority. Where the company legislation clearly stipulates the authority of the respective organs, there would not be any difficulty or dispute. However, where there is lacunae, then the company's internal governance rules will have to be relied on to provide the solution to the division of authority.[25] Most company's articles of association in Malaysia contains Art 73 which states that directors have the authority to manage the business of the company and may exercise such powers of the company that are not required by the Act or the Articles and Memorandum to be exercised by the company in general meeting. Article 73 has the same effect of section 198A of the Corporations Act in Australia in that the management of a company vests in the board of directors. Unless the company legislation specifies certain transactions as requiring shareholders approval, business decisions are to be made by directors. This legalistic approach on shareholders' involvement in company's decision-making reflects the dilemma faced by lawmakers to balance the entrepreneurial nature of business and the

[25] See *Baldev Singh v Mahima Singh* [1974] 2 MLJ 206, affirmed by the federal Court [1975] 1 MLJ 173, see also *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 and *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame* [1906] 2 Ch 34 cited in *Dato Mak Kok & Anor. V See Keng Leong & 9 Ors*, Hing Court Kuala Lumpur[Civil Suit No. D4-22-186-88] 30 May 1989.
See the Civil Law Act 1956 which lays down the hierarchy of legal instruments and case law in Malaysia as the sources of law. Sec 5 of the Civil Law Act 1956 states that

> " In all questions which arise or have to be decided in the states of West Malaysia other than Malacca and Penang, with respect to the law of partnerships, corporations, bans and banking, the law to be administered shall be the same as would be administered in England in the like case at the date of the coming into force of this ordinance, if such question or issue had arisen or had to be decided in England, unless in any case other provision is or shall be made by any written law".

See also *Credit Development Pte Ltd.v. IMO Pte Ltd.* [1993] 2 SLR 370.

right of residual owner of the company's assets to determine the direction to be taken by the company.

Whilst the 'jurisdictional conflict' between the board and the general meeting is a valid and important legal issue, it may be moot where the adoption of the Malaysian Code on Corporate Governance is concerned due to the existence of Chapter 15 of the Listing Requirements, in which case companies would have adopted the Code on corporate governance 'voluntarily' without shareholders having to pass a resolution requesting the company to do so. There is also no requirement for shareholders' approval to be obtained for any changes in corporate governance practice from one year to another.

Nonetheless, shareholders have attempted to use their statutory right to requisition or convene meetings to require the company to embark on certain course of conduct which traditionally comes within the category of 'business decision', with mixed results. The success of these shareholders' proposals rely on the strength of a business case for such proposals.[26] In most cases, it is the institutional shareholders who have been successful in promoting and proposing corporate governance changes and social responsibilities.[27]

A third aspect of shareholders activism lies in the capital market's reaction to instances of non-compliance. The survey conducted by McKinsey & Company in 2000 on Investor Opinion Survey on Corporate Governance found that investors would pay substantially more for the shares of a well-governed company than for the shares of a company with similar financial performance but poorer governance practices. In Malaysia, a 2002 survey showed that institutional investors are willing to pay a premium of at least 10% for companies with excellent Corporate Governance practices.[28]

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[26] See P Redmond, *Company and Securities law, Commentary and Materials (*3rd ed., 2000) LBC Information Services, at 328-333 citing North Ltd and Westfarmers Ltd; See also P Darvas, 'Section 249D and the "Activist" Shareholder: Court Jester of Conscience of the Corporation?' (2002)Vol 20 C&SLJ .

[27] Social Investment Forum *Mutual Funds, Proxy Voting and Fiduciary responsibility: How Do Funds rate in Voting Their Proxies and Disclosure Policies? April 2005*, citing institutional shareholders proposal on social issues in companies such as Coca Cola Co, Pfizer Inc, Colgate- Palmolive Co and Yum!Brands Inc. amongst others.

[28] *Corporate Governance- A Malaysian Survey of Public Listed Companies , Independent Non-executive Directors and Institutional Groups* (2002) by Kuala Lumpur Stock Exchange and PriceWaterhouseCoopers

There have been several research linking compliance with the Code on Corporate Governance with firm performance.[29] The share performance of the company is a proxy for the actualization of the institutional investors' view that they are willing to pay a premium for companies with good corporate governance practice.

Auditing and the case of the misleading accounts.

The mandatory audit requirement in the Companies Act 1965[30] is supported by additional rules for listed companies to be found in the Listing Requirements of Bursa Securities in relation to the internal audit requirement.[31] The relevant Listing Requirements on audit committee that relates to the composition and membership of the audit committee are as follows:

- The audit committee members are to be appointed from existing board members and no alternate directors can be appointed as a member of the audit committee.
- The majority of the audit committee must be independent non-executive directors with at least a member being an accountant.
- The minimum number of members in the audit committee is three.
- The audit committee must be chaired by an independent director.

[29] Access to SSRN Electronic library database using the search term "corporate governance and firm performance" showed a result of 60 matches. Some of the research on this area are as follows:
Weir, Charlie, Laing, David and McKnight, Phillip J., "An Empirical Analysis of the Impact of Corporate Governance Mechanisms on the Performance of UK Firms" , available at SSRN: http://ssrn.com/abstract=286440 or DOI: 10.2139/ssrn.286440; Bauer, Rob, Guenster, Nadja and Otten, Roger, "Empirical Evidence on Corporate Governance in Europe. The Effect on Stock Returns, Firm Value and Performance" (October 23, 2003). EFMA 2004 Basel Meetings Paper., available at SSRN: http://ssrn.com/abstract=444543 or DOI: 10.2139/ssrn.444543; Hutchinson, Marion R., "An Analysis of the Association Between Firms' Investment Opportunities, Board Composition, and Firm Performance" , available at SSRN: http://ssrn.com/abstract=295483 or DOI: 10.2139/ssrn.295483

[30] Sec

[31] Whilst the rotation of audit partner is not regulated by statute or by the Listing Requirements, mandatory rotation of audit partner is required by the Bye-laws of the professional bodies, of which an auditor must be a member. A person may be appointed as an auditor if he is
(a) registered with the Malaysian Institute of Accountants under the Accountants Act 1967 and;
(b)approved as a company auditor under the Companies Act 1965 by the Minister of Finance.

Nonetheless, the audit committee's procedure is left to the internal governance rules of the company where the audit committee is given the authority to decide on its own procedure in the conduct of its meetings.

The Listing Requirement also specifies the functions of the audit committee to include amongst others, :

- Preparation of audit committee report at the end of the financial year;
- A duty to report to the Bursa Securities on matters on which the committee had reported to the board but in the view of the audit committee was not satisfactorily addressed by the board and resulting in a breach of the Listing requirement.
- Review with the external auditors, the audit plan, the external auditors' evaluation of the system of internal control and the audit report of the external auditors

In Astral Asia Berhad's case, the fact that there was no audit committee held pointed to non-compliance with the company's obligation to ensure that the audit committee performs its functions. This was a direct breach of the Listing Requirement. Although the Code on Corporate Governance contain best practices recommendation in relation to the audit committee, the listing requirement requires each listed company to establish an audit committee.[32] Thus, listed companies cannot deviate from the best practices and choose not to establish an audit committee or adopt an alternative mechanism. Whilst Astral is an extreme case where no audit committee meeting was ever held, there have been several enforcement activities taken against listed companies in relation to accounts. The table below shows cases where the companies have been reprimanded in relation to a breach of the Listing Requirements, most notably in relation to financial accounts.

	2003		2005	
Failure to furnish annual audited accounts on time	4 (public reprimand) *1 company was warning	16 (Total fine RM 405,500)		20 (Total fine RM1,679,000)

[32] The exact mechanisms may differ from one company to another for example by outsourcing to co-sourcing the internal audit function.

	i.e., caution & impress			
Failure to furnish annual accounts/reports on time	4 (public reprimand)	4 (total fine RM 68,750)	1	12 (Total fine RM 1,618,750)

Source: KLSE Annual Report 2003; Annual report of Bursa Securities Malaysia Berhad 2005.

The company's failure to furnish the audited accounts on time has serious repercussions as far as investors' (existing and prospective shareholders) protection is concerned. Where shareholders rights are concerned, *Chiew Size Sun v Cast Iron Products Sdn Bhd.*[33] showed how poor financial reporting enabled the controllers of the company to enter into transactions that were not in the best interests of the company. The allegation in that case was that there was oppression and mismanagement of company's affairs and that the delay in tabling the unaudited accounts was also due to no proper accounting records kept by the company. The 1981 accounts was submitted in 1986 to shareholders and this was unaudited. The 1981 audited accounts was submitted in 1987 and the reason was attributed to computer failure. The 1981 audited accounts was only submitted after the petitioner sent a letter demanding to see the accounts. It was alleged that the delay was to enable a cover up of some directors' misappropriation of company's assets and unauthorized disposal of company's assets. Dividends was also not declared since the directors stated that there was no available profits. However shareholders argued that the absence of dividends to shareholders was unjustified when the company had available profits which was carried forward for several years. There was also tax mismanagement due to the delay in the preparation of inadequate accounts which resulted in the company having to pay additional assessment rates and tax penalty. The court held that there was oppression and the order for a company auditor to examine the records and prepare reports for shareholder was granted. The court allowed the application that an approved company auditor (other than the present auditor) be appointed to examine the accounts and records of the company from incorporation and to prepare proper accounts and a report for shareholders for the purpose of valuation of company's assets. The costs for the

[33] [1994] 1 CLJ 157.

examination and preparation of the company's accounts and records were to be borne by the company. Once this has been done the directors of the company were to purchase the shares of the petitioners in equal proportion.

Apart from delay in submitting the audited accounts, between 2004-2005, there were several case involving restatement of accounts by several listed companies. On 19 April 2005, Bursa Securities publicly reprimanded and imposed fine on Goh Ban Huat in relation to inaccuracies in its unaudited 4th quarterly results for the financial year ending 31 Dec 2004. This reprimand arose out of the company's announcement in February 2005 of its unaudited accounts of the company for the financial year ending 31 Dec 2004 where it was stated that the company had made a net profit of RM100.06 million. Not surprisingly, the company's share price increased tremendously after the announcement of the net profit. On 7 March 2005, the company announced that it became aware that it had made a mistake in relation to the accounting principles adopted in reporting its intra-group sales and purchase of assets and immediately the trading of the shares were suspended. Immediately after, on the 8th March 2005 the company announced that instead of making a profit, the company had actually made a net loss of RM 20.84 million. On 17 May 2005, the Securities Commission publicly reprimanded Goh Ban Huat and its board of directors and imposed a fine of RM50, 000 each against the managing director and one of the executive directors. Whilst it is usual that there may be discrepancies between the figures in the unaudited accounts and the audited accounts of a company, the variation in Goh Ban Huat's case is between the company making a profit of Rm100m to incurring a loss of nearly RM21m. It is also worth noting that there were inaccuracies and discrepancies between the unaudited and audited figures for the previous financial year ended 2002 and 2003.

Whilst Goh Ban Huat's misstatement was quite serious as it affected the share prices[34], there were several other listed companies which had been requested to reissue their accounts. On 24 June 2005, Bursa Securities issued a public reprimand to Oilcorp

[34] The share price rose dramatically 61% to RM1.32 from 82 sen on Feb 28, 2005. When the shares were suspended on & March 2005, a total of 1.16 million shares had changed hands.

Berhad for failure to ensure that the annual audited accounts for the financial year ended 31 December 2003 was factual, clear, unambiguous, accurate and succinct to enable investors to make informed investment decisions. The company's audited results was RM3.333 million lower than the unaudited results which was stated as RM15.333 million.[35] The Securities Commission had also taken action against Oilcorp Berhad on 24 March 2005 by requesting that the company reissue its accounts.[36] Another company, Aktif Lifestyle Corporation Berhad was publicly reprimanded on 4 May 2005 and requested to reissue its accounts so as to ensure that the company's consolidated financial statements comply with approved accounting standards.[37]

On 7 August 2006, Bursa Malaysia publicly reprimands Comsa Farms Berhad (COMSA) and its directors for inaccuracies of its 4th quarterly report for the financial year end 31 March 2005 which was released to the public.[38] This followed from the company's failure to submit its annual audited accounts for the financial year ended 31 March 2005 for which the company had also been given a public reprimand and fine on 2 November 2005. According to the Listing rules, the audited accounts for the financial year ended 31 March 2005 must be submitted to Bursa Securities on or by 30 October 2005 and the company was informed that if it failed to do so the company's shares will be suspended from trading. The Company had applied to Bursa Securities for extension of time of 2 months until 30 September 2005 to furnish the 2005 annual audited accounts but Bursa Securities rejected the application on 12 August 2005. On the 10th October 2005, an announcement was made through the Bursa that the existing auditor has indicted their intention to resign and the change of auditor was effected through the extraordinary general meeting on 26 October 2005. On 21 November 2005, the new auditors were requested by the Securities Commission to undertake verification exercise in relation to

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[35] http://www.bursamalaysia.com, Company announcement reference No 00-050429-C1AB0, dated 29 April 2005.

[36] See section 454- 462 of the UK Companies Act 2006 where the Secretary of State or person authorized by him may apply to court to order the directors of the company to prepare revised accounts or a revised report.

[37] http://www.sc.com.my dated 4 may 2005 viewed on 16 Sept 2006.

[38] http://www.bursamalaysia.com dated 7 August 2006 viewed on 19 September 2006. on 7 June 2005, Comsa announced its 4th quarterly report for the financial year end 31 March 2005.

the draft audited accounts of the company for the financial year ended 31 March 2005. The audited accounts showed discrepancies between the unaudited account and the audited account which were submitted only on 17 November 2006. The audited accounts reported a loss of RM196 million compared to the profit of RM12.6 million in the unaudited accounts. One of the reason for the deviation between the results as shown in the unaudited and audited accounts was because of overstatement of sales. [39]

The concern about the revision of the accounts is valid as earnings restatement is sometimes a 'proxy for fraud.[40] Although the restatement is not necessarily fraudulent, there are empirical research showing the possibility of insiders trading during the misstated periods to benefit form the inflated earnings or not selling hoping that the information will not be revealed and the company's share price continue on the uprise. [41] Whilst there are cases of genuine mistake, Securities Commission had also reported that it has encountered several cases where the profits were significantly overstated due to the creation of fictitious sales and debtors, the use of fictitious invoices and diversion of company's funds to related parties.[42] One regulatory response to irregularities in the audited accounts is the categorization of companies into a PN4 category.[43] One of the criteria for being categorized as a PN 4 company is when the auditors of the company have expressed adverse or disclaimer opinion in respect of the listed issuer's going concern in its latest audited accounts.[44] These companies faced the risk of being de-listed

[39] http://www.bursamalaysia.com dated 5 April 2006 viewed on 19 September 2006, general announcement reference No CC-060405-69720.

[40] John J Coffee, Jr., "Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms" 455-505 at 463 in G Ferrarini, K J Hopt, J Winter *et all, Reforming Company and Takeover Law in Europe* (2004) Oxford University Press, Oxford.

[41] See Li, Oliver Zhen and Zhang, Yuan, "Financial Restatement Announcements and Insider Trading" (October 2006, available at SSRN: http://ssrn.com/abstract=929539; Scott L. Summers, John T. Sweeney, "Fraudulently Misstated Financial Statements and Insider Trading: An Empirical Analysis " *The Accounting Review*, Vol. 73, No. 1 (Jan., 1998), pp. 131-146; Mark S. Beasley, " An Empirical Analysis of the Relation between the Board of Director Composition and Financial Statement Fraud " *The Accounting Review*, Vol. 71, No. 4 (Oct., 1996), pp. 443-465.

[42] Securities Commission, *Annual report 2005*, at 259-260.

[43] The nomenclature PN 4 is derived form the Practice Note no 4/2001 issued by the Securities Commission. Although he Practice Note 4/2001 has been repealed effective 3 January 2005, existing PN 4 companies must still comply with the Listing requirement, para 8.14 and under the Practice Note 4/2001, until they no longer trigger the reason for the companies being categorized as such.

[44] The other criteria are:

(a) the company ahs incurred a deficit in its adjusted shareholders' equity on a consolidated basis;

if they failed to regularise their financial situation. in most cases, these companies would attempt to restructure. [45] There are also statutory provision under the SIA 1983 that imposes liability on issuers who releases reports that contain false or misleading information.[46] However, no legal proceedings has been brought to court utilizing these sections where the report relates to the misstatement in the accounts in the case study stated above.[47]

(b) receivers and managers have been appointed over the property of the company or over the property o the company's major subsidiary/associate companies and the property must account for at least 70% of the total assets employed of the listed issuer on a consolidated basis; or

(c) special administrators have been appointed over the company or its major subsidiaries or major associated companies of the listed issuer pursuant to the provision of Pengurusan Danaharta Nasional Berhad 1998.

[45] The Securities Commission had also insisted on these PN4 companies to be made subject to an 'investigative audit' as part of the condition for the approval of the restructuring proposal. The investigative audit is to be conducted by an audit firm to enable the company to ascertain the reasons for the business loss, to take the necessary steps to recover the losses and report to the regulatory authorities any breach of law, rules, guidelines and/or memorandum and articles of association. See "Spotlight on PN 4 Companies" in The Star (Bizweek) Saturday, 8 May 2004, at 10-11. The reports on some companies showed that irregularities in relation to payments made without sufficient supporting document, unsubstantiated sales and overpayment in relation to purchase of assets.

[46] See sec 86 of the Securities Industry Act 1983

"Subject to section 87B, a person shall not make a statement, or disseminate information, that is false or misleading in a material particular and is likely to induce the sale or purchase of securities by other persons or is likely to have the effect of raising, lowering, maintaining or stabilising the market price of securities if, when he makes the statement or disseminates the information–

(a) he does not care whether the statement or information is true or false; or

(b*)* he knows or ought reasonably to have known that the statement or information is false or misleading in a material particular.

See also Securities Industry (Compliance with Approved Accounting Standards) Regulations 1999.

[47] "SC appeals on High Court decision on Pasaraya Hiong Kong former managing director" 7 December 2006, available at http://www.sc.com.my. The Securities Commission (SC) has brought an action against Yap Kim Seng the former managing director of Pasaraya Hiong Kong Sdn Bhd (PHK). Yap Kim Seng was charged, together with Yap Kim Fatt, the executive director of PHK, on 25 April 2005 with submitting false information on the revenue of PHK for the year ended 31 March 2003. This information was submitted in connection with Ocean Capital Berhad's proposed corporate restructuring exercise which included the proposed acquisition of PHK. The charge against Yap Kim Fatt was withdrawn upon the guilty plea by Yap Kim Seng.Yap Kim Seng had admitted that, PHK's Financial Statements for the year ended 31 March 2003 contained fictitious sales totaling RM7,786,665, which had the effect of increasing PHK's profit before tax to RM13,073,565. The Sessions Court had imposed a sentence of two years imprisonment on Yap Kim Seng on 16 January 2006, after he pleaded guilty to a charge of submitting false information to the SC in connection with the corporate restructuring exercise of Ocean Capital Berhad. However, he appealed and the High Court allowed the appeal by substituted the custodial sentence with a RM500,000 fine. The SC has recommended to the Attorney General's Chambers to file an appeal against the 6 December 2006 High Court decision. See also Securities Commission, *Annual Report 2005* at 2-63 where Wira Tjakrawinata was imprisoned for one year and fined RM500,000 causing the issuance of a prospectus which contained false information. The fact that an imprisonment sentence was meted out despite Wira's plea of guilt is an indication by the court of the seriousness of securities law transgressions.

Whilst a fine or reprimand against the directors personally is appropriate, some companies also have to bear the brunt of directors' mismanagement by being issued a public reprimand by Bursa Securities, as noted above. On this point the UK Companies Act 2006 provides that a director is liable to compensate the company for any loss suffered by the company as a result of any untrue or misleading statement in the directors' report, the directors' remuneration report, and a summary financial statement so far as it is derived from either of those reports or the omission from the report of anything required to be included in the report.[48] Whilst the directors have the power to voluntarily revise defective accounts and reports i.e the company's annual accounts, the directors' remuneration report or the directors' report, or a summary financial statement of the company, the Secretary of State or person authorized by him may apply to court to order the directors of the company to prepare revised accounts or a revised report. The court may order the directors who were party to the approval of the defective accounts or report to bear the cost the costs of the application and any reasonable expenses incurred by the company in connection with or in consequence of the preparation of revised accounts or a revised report. [49]

Conclusion

The Malaysian Code on Corporate Governance has been in force since 1999 but has not been 'enforced' until recently. The enforcement activity by Bursa Securities in relation to the Code on Corporate Governance (as depicted in Astral Asia Berhad's case) should be construed by listed companies as a warning not to take the "comply or explain" approach lightly. However, such enforcement activity may be rarely undertaken, not because of the

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[48] Section 454- 462 of the UK Companies Act 2006; see also section 463 of the UK Companies Act 2006.

[49] See section 456 (5) of the UK Companies Act 2006.

> (5) For this purpose every director of the company at the time of the approval of the accounts or report shall be taken to have been a party to the approval unless he shows that he took all reasonable steps to prevent that approval.
>
> (6) Where the court makes an order under subsection (5) it shall have regard to whether the directors party to the approval of the defective accounts or report knew or ought to have known that the accounts or report did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation), and it may exclude one or more directors from the order or order the payment of different amounts by different directors.

lack of willpower on the part of Bursa Securities, but because Bursa Securities has to rely on information concerning the internal management of a company before action may be taken. Whilst the protection for whistle-blowers is already found in the Securities Industry Act[50], the success of this protection for increasing enforcement activities depends to a large extent on societal norms. Where private enforcement is concerned, it is possible for the company to sue the directors provided that the court accepts that persistent failure to comply with the Listing Requirements amount to a breach of duty of care, skill and diligence or alternatively to rely on the oppression remedy. The article also depicts recent misstatement of financial statement involving several listed companies. Whilst there may be genuine cases, there were also situations where the profits were significantly overstated. In such cases, the role of public regulation is to punish repeat offenders and to protect future investors by disqualifying the errant directors from managing other listed companies.

[50] Section 99E of the SIA 1983.