Corporate Governance: Moving from Aspiration to Actualisation

Corporate Governance Guide

Executive Summary

3rd Edition
www.bursamalaysia.com
This Corporate Governance Guide (“Guide”) is issued by Bursa Malaysia Berhad for
users to gain an understanding and appreciation on the application of corporate
governance practices especially in relation to those set out in the Malaysian Code on
Corporate Governance.

This Guide is provided for reference purposes only and is not exhaustive in its
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is the boards’ and company officers’ responsibility to obtain independent, professional
advice regarding any specific set of facts or issues before using or relying on it.

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Corporate Governance Guide: Moving from Aspiration to Actualisation

Corporate governance defines a company’s commitment to values and ethical business conduct. Good corporate governance serves to enhance the effective deployment of capital and ultimately contributes towards growth and positive sustainable performance. Poor governance, on the other hand, detracts the company from fulfilling its potential as well as its ability to attract capital investment with severe ramifications on trust and confidence in the company and capital market as a whole.

In this regard, a strong understanding on the principles of good governance and responsible conduct is needed before it can be successfully embedded within a company’s culture and DNA. This will support the company in achieving its goals whilst safeguarding stakeholders’ interests.

I hope this Corporate Governance Guide (“Guide”) will serve as a frame of reference as well as guidance that will foster greater appreciation and promote constructive actions within the realm of corporate governance. This Guide is intended to support board members and management in raising the bar on corporate governance standards as well as getting key parties involved in corporate governance to play their part.

In addition, this Guide reinforces the Exchange’s commitment to inculcate better corporate governance practices amongst listed corporations, aligning their governance practices with stakeholders’ expectations and thereby promoting investor confidence. In developing this Guide, the views of all stakeholders were sought to ensure all needs were considered. We would like to thank all our stakeholders for providing invaluable input and feedback to this Guide.

The architecture of a robust corporate governance framework will only be sustainable if it is supported by a culture that promotes ethical conduct, transparency and sustainable value creation. Hence, good corporate governance must be a mindset, and not an afterthought. Let us therefore work together to actualise our aspirations and chart the contours of change that will lead to a capital market that is distinguished by the quality of its corporate governance practices.

Tan Sri Amirsham A Aziz
Chairman
Bursa Malaysia Berhad
Bursa Malaysia would like to acknowledge the invaluable input and expertise towards the development of this Guide, in particular to Ms. Kasturi Nathan and Mr. Krishman Vargas of KPMG Management & Risk Consulting Sdn. Bhd.

We would also like to accord a very special word of thanks to the Securities Commission Malaysia, Bank Negara Malaysia, Companies Commission of Malaysia, Malaysian Institute of Accountants (MIA), Malaysian Institute of Certified Public Accountants (MICPA), Institutional Investor Council Malaysia (IIC), Minority Shareholder Watchdog Group (MSWG), Malaysian Institute of Chartered Secretaries and Administrators (MAICSA), Malaysian Directors Academy (MINDA), Malaysian Institute of Corporate Governance (MICG), directors and company secretaries of listed issuers as well as participants of the focus group sessions and public consultation for their contribution in the development of this Guide.
Executive Summary

Preamble

The actualisation of corporate governance aspirations largely hinges on the collective effort of all stakeholders who stand to gain from higher standards of corporate governance. The wider stakeholder participation will go a long way in ensuring that those helming the companies continuously direct their efforts towards the best interest of the companies and stakeholders.

In this regard, it is imperative for all players in the corporate ecosystem to recognise that the growth of the capital market can only be sustainable if it is underpinned by a proper system that promotes and incentivises accountability, transparency as well as integrity and ethics. Such a system reinforces market integrity and confidence. In fact, the value of good corporate governance is well-codified by an ever-growing body of research. For example, a review by Credit Lyonnais Securities Asia and the Asian Corporate Governance Association across 12 Asia Pacific countries including Malaysia in the year 2016 revealed that companies with stronger corporate governance deliver superior fundamental outcomes (e.g. higher earnings quality risk scores and higher balance sheet quality risk scores)\(^1\).

Premised on the proposition of good corporate governance, in Malaysia, a range of reform measures has been put in place over the years to strengthen the corporate governance ecosystem as a whole. The introduction of the new **Companies Act 2016**, the release of the **Malaysian Code on Corporate Governance** in April 2017 ("MCCG") as well as the enhancements to the corporate governance disclosure framework under Bursa Malaysia Securities Berhad Listing Requirements ("Bursa Securities Listing Requirements")\(^2\) subsequent to the release of the MCCG amongst others, serve as a testimony to these efforts. These reform measures have been designed to promote more meaningful application of good governance practices and more transparent disclosures that can be relied upon by stakeholders to have effective engagements with the company.

In tandem with these developments, this **Corporate Governance Guide** ("Guide") by Bursa Malaysia Berhad ("Bursa") seeks to enrich the application and actualisation of corporate governance practices by providing practical guidance to listed issuers. It is also hoped that the Guide will cultivate listed issuers’ appreciation on the drivers of sound corporate governance. Over the years, the Guide has served as an organic document – a publication that has adapted to the issues in the Malaysian market with the ultimate objective of bringing about a deep comprehension on corporate governance matters. This latest iteration of the Guide is part of the evolution with extensive analysis and articulation of the corporate governance tapestry including the regulations and best practices that form the domestic corporate governance architecture.

As a prelude to the Guide, this Executive Summary serves to provide an overview that articulates the context of the Guide. This Executive Summary is set out over two sections. **Section I** provides an overview on the content of the Guide. **Section II** serves to shed light on the corporate governance disclosure regime in Malaysia.

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1. *Corporate Governance Watch* 2016, Credit Lyonnais Securities Asia & Asian Corporate Governance Association ("ACGA")
2. Bursa Securities Listing Requirements collectively refer to the Main Market Listing Requirements and the ACE Market Listing Requirements. Where reference is made to a particular paragraph or Practice Note of the Main Market Listing Requirements, the corresponding Rule or Guidance Note of the ACE Market Listing Requirements also applies accordingly.
About the Guide

Understanding the Guide

In recognising the need for a contemporaneous guide that can provide companies, particularly listed issuers with insights and practical resources to raise their corporate governance standards, Bursa revamped its 2nd Edition Guide which culminated in this Guide.

This latest incarnation of the Guide which supersedes its earlier editions takes on a new approach to promote greater internalisation of corporate governance culture. This Guide has been developed to reflect the new modes of thinking as well as the “CARE” (i.e. C – Comprehend; A – Apply and Re – Report) concept that underpins the MCCG.

The CARE concept urges companies to give effect to the spirit behind the practices whilst appreciating the significance of the principles in supporting long-term value creation. The salient features of the MCCG are summarised below:

Equipped with 3 Principles, 32 Practices and 4 Step Ups, the MCCG calls upon companies to view corporate governance disclosures as an opportunity to demonstrate to stakeholders that they have a holistic and an effective corporate governance system which governs their processes, people and practices in their achievement of corporate excellence.
Taking into account these developments, this Guide has been designed to instil a greater appreciation and promote constructive actions on corporate governance. This Guide contains examples and illustrations to call upon companies to undertake ongoing self-reflection and evaluation of their corporate governance practices. These content elements are solely for the purpose of providing guidance only and should not be rigidly adopted by companies in isolation of their circumstances. The Guide does not attempt to establish a model or pattern for the optimum conduct of companies and should not be regarded as a “silver bullet” for good corporate governance.

What is the objective of the Guide?

Premised on the objective of bringing about cultural and behavioural change, this Guide serves to provide insights into best practices of corporate governance, including how such practices can be applied and actualised in substance rather than in form, so as to help businesses in building sustainable value.

Who should use the Guide?

Whilst this Guide is primarily targeted at listed issuers and their related corporations, non-listed companies including state-owned enterprises, small and medium enterprises (SMEs) and licensed intermediaries are encouraged to draw perspectives from this Guide.

The Guide particularly seeks to help directors to understand their duties towards the company and its stakeholders. It also seeks to guide the broader cross-section of players in the corporate governance ecosystem (particularly, management, gatekeepers and other custodians of corporate governance) to perform their responsibilities and drive the conduct of companies.

How to use the Guide?

This Guide should be read together with the MCCG.

In addition, this Guide has, amongst others, made references to Bursa Securities Listing Requirements, Capital Markets and Services Act 2007 ("CMSA"), Bank Negara Malaysia’s Policy Document on Corporate Governance and other relevant regulatory provisions. The enumerations cited in this Guide may not be a verbatim extract from the relevant source documents and as such, users should refer to the source documents for greater details on the references made.

What are the caveats that should be acknowledged in using the Guide?

This Guide is not:

☑ a “one-stop” solution to all corporate governance needs.
☑ an expression of opinion by any enforcement agency or regulator.
☑ exhaustive to cover all the various possible scenarios concerning corporate governance.
Structure of the Guide

The Guide has been developed based on a thematic approach to provide readers with a focused view of the MCCG, beginning with the board and its responsibilities before addressing audit and risk management and then closing off with corporate reporting and relationship with stakeholders. The Guide is divided into three individual Pull-outs which correspond to the respective Principles of MCCG. Each Pull-out comprises write-ups on the Practices and Step Ups of MCCG.

Pull-out I explains how the leadership of a company is driven by the board; and to be effective, boards need to consider the dimensions of responsibilities, composition and remuneration. A number of write-ups delve on how a board should be constituted and what it should look like. It should be noted that constituting a board is merely the first step in building a successful company, as much also depends on how the board discharges its responsibilities on an ongoing basis. The board cannot thrive in isolation; and for it to function successfully, a good support system should be put in place including the provision of timely and accurate information as well as counsel from the company secretary. In order for directors to be incentivised to contribute to the long-term success of the company, it is also essential to ensure that their remuneration packages are well-structured, transparent and clearly linked to the strategic objectives of the company.

Pull-out II explores how a robust audit committee and strong risk management and internal control framework can lead to the development of a healthy corporate governance culture. It should be noted that independence and financial literacy are the cornerstones of a well-functioning audit committee. The ability of its members to exercise their judgments in an informed and impartial manner is important for the fulfilment of the audit committee’s mandate. The write-ups also recognise that successful companies integrate effective governance structures and processes with performance-focused risk management and internal control at every level of the company and across all operations. There is also a focus on greater disclosures on the company’s risk management and internal control framework as well as the conduct of the internal audit function to stakeholders.

Pull-out III discusses how communication and engagement can help to foster meaningful relationship with stakeholders. The key to better relationship with stakeholders is firstly to recognise that stakeholders have a legitimate right in knowing how the company is faring, followed by ongoing efforts to keep open that channel of engagement with stakeholders. A trustworthy relationship can be maintained through a system of corporate reporting that is not only accurate, but also balanced and meaningful. Providing stakeholders with a comprehensive and closely-knitted picture of the company’s business will allow them to better appreciate the company’s objectives and the quality of its management. As general meetings are important platforms for directors and senior management to engage shareholders to facilitate greater understanding of the company’s affairs, the write-ups also explain how companies can undertake proactive measures to bring about greater participation of shareholders at general meetings.
Each Pull-out of the Guide is structured in the following manner:

a) **Introduction:** A lead-in that articulates and introduces the concepts and key areas which are covered in the Pull-out.

b) **Write-ups to the Practices and Step Ups of MCCG:** Narrative on the reasoning, facilitation for companies to internalise and apply the Practices and Step Ups of MCCG as well as regional/international developments (features contained are explained below).

c) **Appendices:** Sample policies and instruments that are designed for the utility and further customisation of companies based on their circumstances and nuances.

A number of key features showcased in the write-ups to the Practices and Step Ups are as follows:

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Feature</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case for change</td>
<td>The reasoning and value proposition for each Practice and Step Up are laid out for companies to appreciate the drivers of good corporate governance. This is particularly pertinent for Practices and Step Ups which amongst others, contain new concepts and notions which may not be well understood.</td>
<td></td>
</tr>
<tr>
<td>What could go wrong</td>
<td>The possible outcomes of poor corporate governance practices are described.</td>
<td></td>
</tr>
<tr>
<td>The practice in substance</td>
<td>Key considerations relating to the internalisation and application of the Practices and Step Ups are explored.</td>
<td></td>
</tr>
<tr>
<td>Dos and Don’ts</td>
<td>A quick and bite-sized list of actions items that the company should undertake and should avoid, are included.</td>
<td></td>
</tr>
<tr>
<td>Regional/ international perspectives</td>
<td>A section on regional/international perspectives is provided for users to be apprised on corporate governance practices in selected jurisdictions (as at the date of the publication of this Guide). The enumerations outlined are only for information purpose. They did not take into account the context and application of the corporate governance practices as well as the legal frameworks in these jurisdictions which may differ from the Malaysian perspectives.</td>
<td></td>
</tr>
<tr>
<td>Point for reflection</td>
<td>Insights into selected Practices and Step Ups, are highlighted. How misconceptions or lack of understanding can prevent meaningful application of corporate governance practices, are also discussed.</td>
<td></td>
</tr>
<tr>
<td>Investors’ perspectives</td>
<td>Views of institutional investors on key matters are shared. In recent times, a number of well-known institutional investors have begun to exert their influence over investee companies through their voting policies on a range of issues including board diversity, directors’ remuneration and tenure of independent directors.</td>
<td></td>
</tr>
<tr>
<td>Hot button issues</td>
<td>Contemporary and contentious issues are examined and the lessons drawn are reflected upon.</td>
<td></td>
</tr>
<tr>
<td>Red flags</td>
<td>Symptoms indicating broader corporate governance issues that companies should be wary of, are included. These red flags are marked as symbols in selected Practices and Step Ups.</td>
<td></td>
</tr>
<tr>
<td>Case studies</td>
<td>Analyses of prominent cases and their corporate governance implications are expounded.</td>
<td></td>
</tr>
<tr>
<td>Illustrative disclosures</td>
<td>Sample disclosures are provided to assist companies in their reporting and communication to stakeholders.</td>
<td></td>
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</tbody>
</table>
Application of the Guide

It should be noted that the MCCG took effect immediately upon its release and listed issuers are required to report on the application of the MCCG as outlined in paragraph 15.25(1) and (2) of Bursa Securities Listing Requirements, with effect from the financial year ending on or after 31 December 2017.

In this regard, it is worth highlighting that whilst the Guide is not a regulatory document by itself, in providing disclosures on the adherence to MCCG, paragraph 3.7(a), Practice Note 9 of Bursa Securities Listing Requirements encourages listed issuers to refer to this Guide.

**Paragraph 3.7(a), Practice Note 9 of Bursa Securities Listing Requirements**

In making the Corporate Governance Overview Statement and the Corporate Governance Report, a listed issuer must also consider the following:

Ensure that the Corporate Governance Overview Statement and the Corporate Governance Report:

i. contain adequate information to enable an informed assessment by shareholders and potential investors of its corporate governance practices; and

ii. align with the spirit and Intended Outcome of the MCCG.

For this purpose, a listed issuer should refer to the Corporate Governance Guide issued by the Exchange.
The Guide in one page

The Guide is structured with MCCG as the primary reference point and the write-ups of the Guide reflect the sequential order of the Practices and Step Ups contained in MCCG.

Pull-out I

Introduction
An overview on board leadership and effectiveness is provided.

Write-up to Practice 1.1
The roles and responsibilities of the board are addressed.

Write-up to Practice 1.2
The responsibilities of the chairman in leading the board are discussed.

Write-up to Practice 1.3
Coverage is provided on the separation of roles between the chairman and the chief executive officer.

Write-up to Practice 1.4
The roles and responsibilities of the company secretary are explored.

Write-up to Practice 1.5
The importance of proper and timely dissemination of information to directors is outlined.

Write-up to Practice 2.1
The establishment and implementation of a board charter are discussed.

Write-up to Practice 3.1
The establishment and implementation of a code of conduct and ethics are examined.

Write-up to Practice 3.2
The establishment and implementation of whistleblowing policy and procedures are covered.

Write-up to Practice 4.1
The need for at least half of the board to comprise independent directors is explored.

Write-up to Practice 4.2 and Step Up 4.3
Tenure limit of independent directors is discussed.

Write-up to Practices 4.4 and 4.5
Diversity of the board and senior management and the attendant disclosures are covered.

Write-up to Practice 4.6
Sourcing and nomination of board members are considered in detail.

Write-up to Practice 4.7
Commentary is provided on the chairmanship of the nominating committee.

Write-up to Practice 5.1
The assessment of board, board committees, individual directors as well as the attendant disclosures is covered.

Write-up to Practice 6.1
The formulation of remuneration policy and procedures for directors and senior management is examined.

Write-up to Practice 6.2
The establishment of a remuneration committee is discussed.

Write-up to Practices 7.1, 7.2 and Step Up 7.3
Disclosure considerations of directors and senior management’s remuneration are detailed.

Appendices
Sample policies and instruments relating to Pull-out I are provided.

Pull-out II

Introduction
An overview on audit and risk management is provided.

Write-up to Practice 8.1
The chairmanship of the audit committee is covered.

Write-up to Practices 8.2 and 8.3
The establishment of policies and procedures to assess the suitability, objectivity and independence of the external auditor is discussed.

Write-up to Step Up 8.4
Commentary is provided on the independence of the audit committee.

Write-up to Practice 8.5
Considerations relating to financial literacy of the audit committee members are covered.

Pull-out III

Introduction
The Introduction provides an overview on corporate reporting and relationship with stakeholders.

Write-up to Practice 11.1
The implementation of effective, transparent and regular communication between a company and its stakeholders is discussed.

Write-up to Practice 11.2
Considerations relating to integrated reporting are detailed.

Write-up to Practice 12.1
Coverage is provided on the timely dissemination of notice to annual general meeting.

Write-up to Practice 12.2
Commentary is provided on the attendance of directors during general meetings.

Write-up to Practice 12.3
The deployment of technology to facilitate greater participation of shareholders at general meetings is explored.

Appendices
Sample policies and instruments relating to Pull-out III are provided.
Corporate governance disclosures

Disclosure requirements on MCCG

Reliable and high quality information is the driver behind a conducive and active capital market. Stakeholders require access to regular, reliable and comparable corporate governance information in sufficient detail for them to assess the stewardship of the board as well as leadership of the management, and ultimately make informed decisions after ascertaining how their rights are protected.

Recognising the need to equip stakeholders with adequate information on how the affairs of the company are directed and managed with a view of promoting business prosperity and corporate accountability, paragraph 15.25 of Bursa Securities Listing Requirements requires listed issuers to disclose their application to the MCCG.

**Paragraph 15.25 of Bursa Securities Listing Requirements**

1. A listed issuer must ensure that its board of directors provides an overview of the application of the Principles set out in the MCCG, in its annual report. *Note: This is referred to as the “CG Overview Statement”.*

2. In addition, the listed issuer must disclose the application of each Practice set out in the MCCG during the financial year, to the Exchange in a prescribed format and announce the same together with the announcement of the annual report. The listed issuer must state in its annual report, the designated website link or address where such disclosure may be downloaded. *Note: This is referred to as the “CG Report”.*

“Apply or explain an alternative” disclosure approach

The MCCG adopts a novel approach of “apply or explain an alternative” to move away from a “box-ticking” approach and promote more meaningful application of corporate governance practices and disclosures. Under this approach, listed issuers must explain how they have applied the practices identified and where there is a departure; there must be clear and meaningful disclosure on why the practice was not applied and how the alternative practice achieves the Intended Outcome. The Intended Outcome is meant to provide listed issuers with the line of sight and intention of the practices.

In order for the “apply or explain an alternative” approach to work and be sustainable, listed issuers need to demonstrate genuine commitment to good governance and give proper consideration to the explanations. Stakeholders on the other hand, should engage listed issuers and scrutinise the disclosures made by them so as to ascertain if the explanations provide a meaningful representation of the listed issuers’ corporate governance practices. Communication by listed issuers on plans to adapt and improve corporate governance practices can serve to assure stakeholders that the business is being run for the long-term and in the interests of the stakeholders. Simply put, when there is a mutually reinforcing effort between listed issuers and stakeholders, particularly shareholders, the “apply or explain an alternative” model can be an effective tool in driving continuous improvement on corporate governance practices and disclosures.
Attributes of quality disclosures

In providing reliable and high quality disclosures on corporate governance, listed issuers should be guided by the following attributes which provide guidance on the desired qualitative characteristics of such reporting.

**Balanced** disclosures address the provision of an honest assessment of the listed issuer’s state of corporate governance for stakeholders to form an objective view. In this regard, listed issuers should seek to ensure that stakeholders are not misled as a result of the presentation of, or emphasis given to, information in the corporate governance disclosures or by the omission of material information from them. Disclosures which only offer a celebration of the positive elements, with limited details or a less than candid assessment of the negative aspects (e.g. regulatory actions imposed by regulators) may perpetuate mistrust. Key issues and incidences of failure should be explained alongside how the issues were managed, actions that were taken to remedy the failures as well as the lessons learnt. It is therefore important for listed issuers to provide balanced disclosures without fear of stigma.

Disclosing **meaningful** information entails providing complete information which is up-to-date, relevant and reflects the listed issuer’s ownership structure, governance model and specific circumstances (e.g. presence of special rights shareholder, existence of a franchisee agreement with the franchisor which impacts the corporate governance practices of the listed issuer). This will avoid deterring shareholders from the key information which can aid in their evaluation of the listed issuer’s state of corporate governance. In this context, it is important for listed issuers to illuminate stakeholders with insights on how a particular practice was applied. For example, in the case of disclosure on appointment of directors, there should be detailed disclosures on the sourcing and selection methods, process as well as the criteria used to select new directors. Moreover, in order to enhance the usefulness of disclosures, they should be made in a clear and simple manner, using plain language (i.e. avoiding legalistic, management-speak or technical terms). It is also important to ensure that disclosures are not cluttered with static information such as policies, charters and codes that have not changed, or long convoluted write-ups, so that the key information and messages are not lost in the volume of data presented. Where possible, such static information should be instead published on the listed issuer’s website.

**Comparable** corporate governance disclosures involve the provision of consistent information which enables and facilitates assessment and comparison of a listed issuer’s practices year on year as well as with that of other listed issuers. This will enable the listed issuer’s corporate governance practices to be measured and monitored in a consistent manner for effectiveness. In order to facilitate better comparability, it is important for the listed issuer to provide explanations on the factors that have led to a change in the application of a corporate governance practice (e.g. change in ownership structure).
CG Overview Statement

As stated in paragraph 15.25(1) of Bursa Securities Listing Requirements, a listed issuer is required to provide an overview of its application of the Principles set out in the MCCG in respect of the reporting financial year, in its annual report (“CG Overview Statement”). The obligations of the listed issuer in making the said statement are further clarified in Practice Note 9 of Bursa Securities Listing Requirements.

Paragraph 3.1A, Practice Note 9 of Bursa Securities Listing Requirements

In making the CG Overview Statement, a listed issuer must provide a summary of its corporate governance practices during the financial year with reference to the 3 Principles, which are:

(a) board leadership and effectiveness;
(b) effective audit and risk management; and
(c) integrity in corporate reporting and meaningful relationship with stakeholders.

Paragraph 3.1B, Practice Note 9 of Bursa Securities Listing Requirements

A listed issuer should highlight its key focus areas and future priorities in relation to its corporate governance practices through the CG Overview Statement.

The CG Overview Statement serves to provide stakeholders with an understanding of a listed issuer’s commitment to corporate governance and how the listed issuer’s corporate governance practices support its ability to create long-term value for stakeholders.

In producing the CG Overview Statement, a listed issuer must disclose a summary of its corporate governance practices during the financial year with reference to the 3 Principles. Listed issuers should outline their approach to corporate governance and the key features of their corporate governance framework. There should be a statement on the extent to which the listed issuer has applied the Practices encapsulated in the Principles of MCCG during the financial year and the linkages to the information presented in the CG Report. The listed issuer should also discuss how the practices support its overall corporate governance objectives, taking into account amongst others, the following overarching considerations:

- Improving the listed issuer’s corporate governance practices by creating a healthy and dynamic corporate culture that is driven by the board together with management;
- Increasing the effectiveness of the board oversight function through the establishment of objective audit functions and committees charged with the oversight of internal control, risk and reporting; and
- Enhancing the listed issuer’s communication with shareholders and other stakeholders through transparent and timely communication.

In relation to highlights on key focus areas and future priorities, listed issuers should seek to identify the corporate governance plans, premised on the considerations of the current reporting year and future reporting years. In this regard, there should be a discussion on the main areas of its corporate governance activities and priorities during the financial year (i.e. focus areas) with a focus on the key corporate governance aspects that the listed issuer fared well and/or less favourably during the financial year. In addition, there should be disclosures on the improvement considerations that the listed issuer expects to achieve within a designated timeframe and the forward-looking strategies that will help it to achieve its corporate governance objectives (i.e. future priorities).

The inclusion of such disclosures forms a basis for stakeholder engagement as the information allows stakeholders to understand the direction that a listed issuer is heading towards and how the results
CG Overview Statement accords listed issuers with the opportunity to profile their corporate governance agenda and showcase how they are attuned to the expectations of stakeholders.

**CG Report**

As stated in paragraph 15.25(2) of Bursa Securities Listing Requirements, a listed issuer is required to disclose the application of each Practice set out in the MCCG during the financial year to Bursa Malaysia Securities Berhad ("the Exchange") in a prescribed format ("CG Report") and announce the same together with the announcement of the annual report. The listed issuer must state in its annual report, the designated website link or address where the CG Report may be downloaded.

The obligations of the listed issuers in preparing the CG Report based on the prescribed format are further clarified in paragraphs 3.2 to 3.4, Practice Note 9 of Bursa Securities Listing Requirements. The prescribed format is made available on Bursa’s website.

Essentially, the CG Report provides a platform for listed issuers to better profile their strengths and corporate governance practices in a meaningful manner to stakeholders. The detailed disclosures encapsulated in the CG Report allow stakeholders to seamlessly assess the "corporate governance health" of listed issuers besides aiding regulators in monitoring the corporate governance practices of listed issuers to gain insights. In this regard, it is imperative for listed issuers to be cognisant that the prescribed format only serves as a structure and should not be treated as a “box-ticking tool”. Rather, listed issuers should internalise and exercise careful thought as well as consideration in providing disclosures that meaningfully represent their corporate governance practices.
Corporate Governance: Moving from Aspiration to Actualisation

Corporate Governance Guide

Pull-out I

Guidance on Board Leadership and Effectiveness

3rd Edition
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Introduction

Background

This Introduction to **Pull-out I ("Board Leadership and Effectiveness")** is designed to provide boards with broad guidance in promoting the application of good corporate governance within the company. The Introduction also intends to provide boards with direction in implementing the Practices and the Step Ups of **Principle A** in the **Malaysian Code on Corporate Governance ("MCCG")** and thus, should be read in conjunction with the write-ups on the individual Practices and Step Ups encapsulated in this Pull-out.

For about 2,000 years, man thought of earth as the centre of the universe. Indeed, this was most famously postulated by Aristotle and became the accepted wisdom until after the end of the Middle Ages, when Galileo’s observation dismantled the “truth” and disproved what was almost universally thought to be correct. Framers and thought leaders of corporate governance alike have always intended the board of directors to be the centre of the company’s “universe”, as it were, but unlike Aristotle’s theory, this model still holds true. It is widely accepted that a company’s corporate governance begins and ends with its board of directors.

The board has the power to shape the company’s direction and culture through its corporate governance philosophy and practices. In addition, as strange as it might sound, the board also influences the company’s corporate governance through its inaction, albeit in a negative way, leaving a vacuum that management and employees have to fill.

An effective board does not place itself in a comfortable setting and it does not remain static. A dynamic board should constantly evolve in response to the environment in which it operates. Challenge as well as teamwork are essential features of the board. Diversity in board composition is an important driver of a board’s effectiveness, creating a breadth of perspective among directors. Whilst the importance of constituting a board optimal for the company’s size and complexity is well understood, less appreciated is the need for the board to perform at the levels expected of it. Indeed, in the oft-cited story of Enron Corporation, its board was composed of eminent individuals who were all highly experienced and qualified. However, the board failed to discharge its duties adequately, ultimately leading to the company’s demise.

It is vital that board members see their directorships as a journey of stewardship rather than a position of privilege. The notion of stewardship points that directors have a responsibility not only to themselves but to the company, its shareholders and other stakeholders as well. Having said that, it is also important to iterate that good corporate governance is not against self-enrichment, as this is a key driver in a free economy. Rather, good corporate governance calls for directors to walk down the path of enrichment in an ethical and sustainable manner.

This Introduction is set out over four sections. **Section I** addresses board leadership whilst **Section II** explores board dynamics. **Section III** sheds light on the nominating committee and lastly, **Section IV** discusses on the remuneration committee.
Section I  Board leadership

Understanding board’s responsibilities

In framing the responsibilities of the board in leading the company, **Guidance to Practice 1.1 of MCCG** indicates that the board should not treat its responsibilities narrated in the **MCCG** as definitive and exhaustive. This approach recognises that companies are unique entities with their own circumstances and rigid prescriptions do not work. Considerations on the responsibilities of the board are covered in detail in the write-up to **Practice 1.1**.

Directors of a company, executive or non-executive, have an obligation to exercise unfettered judgment, in good faith with due care and skill. A director must be aware of the legal parameters that define his or her duties in law. A director owes fiduciary duties similar in some respects of those of a trustee. The diagram on the following page illustrates the core duties of a director.
The primary responsibilities and key duties of the board in this regard are well contained within the Companies Act 2016 as shown below.

### Section 211 (1) and (2) of Companies Act 2016 – Functions of Board

1. The business affairs of a company shall be managed by, or under the direction of the Board.

2. The Board has all the powers necessary for managing and for directing and supervising the management of the business and affairs of the company subject to any modification, exception or limitation contained in this Act or in the constitution of the company.

### Section 213 (1), (2) and (3) of Companies Act 2016 – Duties and responsibilities of directors

1. A director of a company shall at all times exercise his powers in accordance with this Act, for a proper purpose and in good faith in the best interest of the company.

2. A director of a company shall exercise reasonable care, skill and diligence with –
   - the knowledge, skill and experience which may reasonably be expected of a director having the same responsibilities; and
   - any additional knowledge, skill and experience which the director in fact has.

3. A director who contravenes this section commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding five years or to a fine not exceeding three million ringgit or both.

*Note: The above only represents an extract of the duties and responsibilities of directors.*

### Board’s role in setting strategy

It is commonly observed that for some companies, the board is content to set the strategy at the highest level whilst for other companies, the board’s approach is to be involved in strategy setting, even for each subsidiary.

In terms of strategy, there is a conscious shift by the MCCG which now calls upon boards to devote the necessary time and effort to set the company’s strategy, as opposed to endorsing it. It is acknowledged that some boards have a tendency to “outsource” strategy setting entirely to management, leaving the board with little or no input on the company’s long-term direction. It is illuminating to note that in high-performing companies, board members typically “roll their sleeves” and become involved intimately in the formation of corporate strategy. For example, General Electric Company holds its annual strategy session every mid-summer, and during this time board members and senior management break out into small groups, producing building blocks that make up the company’s multi-year strategy.

Besides setting the strategic direction of the company, the board must also institute a regular and formal board strategy review. This involves analysing the existing corporate strategy, examining progress towards designated objectives and evaluating current performance in light of these objectives. It should be a high-level review of both the internal and external factors affecting the company, conducted by the board and separate from any management review of strategy.

Board strategy reviews should be undertaken periodically (depending on the requirements of the company) and in the midst of rapidly changing environments and market conditions, at short intervals. Boards need to be vigilant in assessing the company’s performance in achieving its strategy. A report card (prepared by management twice a year) should incorporate exception reporting to assist the board to come to terms with what is not working and why, whilst re-examining the underlying strategic issues.

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1 General Electric Company, Proxy Statement, 8 March 2017
Rather than merely trying to anticipate changes in the marketplace, a board should also ensure that the company’s capabilities and resources are sufficient to manage uncertainties. In this regard, strategic plans should be flexible and this can be achieved by:

- scanning the business environment constantly and keeping abreast of changes that could materially affect the achievement of strategic objectives;
- exploring how business environmental shifts may impact strategy;
- inviting subject matter experts to address the board and senior management;
- ensuring accurate and timely information reaches the board and is deliberated by directors and management; and
- scheduling “break-out” sessions to allow the board to critique the current strategy.

**Ethical leadership by the board**

A company’s ethical culture is largely shaped by the tone at the top (i.e. the company’s leadership). Ethical principles and values need to originate from the leaders and be embedded across the company.

In this regard, the code of conduct and ethics would go a long way in setting out the company’s expectations with regard to business and professional behaviour and topics such as conflict of interest, insider trading, related party transactions, commitment against corrupt practices and of late, anti-money laundering and financing of terrorism.

Considerations on the establishment of a code of conduct and ethics are covered in detail in the write-up to **Practice 3.1**.

Whilst it is important for companies to develop codes of ethics and business conduct and for internal audit and compliance reviews to routinely uncover areas of concern, it would also be beneficial for companies to create an environment where management and employees can whistleblow on improper behaviour without being victimised for doing so. Improper behaviour is most commonly associated with corruption, but impropriety also extends to matters such as endangering the health and safety of workers, polluting the environment, and denying local communities their rightful dues when purchasing from them. Considerations on the establishment of a whistleblowing policy are covered in detail in the write-up to **Practice 3.2**.

**The role of chairman and chief executive officer (“CEO”)**

**Practice 1.2 of MCCG** sets out the role of the chairman and further, **Practice 1.3 of MCCG** promotes for the role of chairman of the board and the CEO to be held by two different individuals. Separation in this regard is essential as both roles are distinct, have different expectations and serve different primary audiences (as depicted below).

<table>
<thead>
<tr>
<th>The chairman</th>
<th>The CEO</th>
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<tbody>
<tr>
<td>Serves an audience of fellow directors. Runs the board efficiently and in an effective manner. Collectively with the board, the chairman holds the management team accountable towards meeting strategic objectives (covered in detail in the write-up to <strong>Practice 1.2</strong>).</td>
<td>Serves an audience of management team and employees. Contributes to strategy and runs the company to meet its objectives. The CEO is accountable to the board.</td>
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</tbody>
</table>
When each party is free to concentrate on his or her role, one can expect improved outcomes in terms of sharper focus and higher quality of deliberation. Similar to a thriving national democracy that features three distinct branches which share power and act as check and balance, namely the executive, legislative and judiciary, so does an appropriate balance of power between the chairman, CEO and the non-executive directors facilitate an accountable and high-performing board. Considerations on the separation of role between chairman and CEO are covered in detail in the write-up to Practice 1.3.

**Role of company secretary in supporting the board and its committees**

It is important for the board to be equipped with adequate resources to carry out its oversight duties. In this regard, as outlined in the write-up to Practice 1.4, the company secretary is slowly but surely transforming from being just an administrator and facilitator of board proceedings into an advisor on corporate governance. In fact, in Australia, the Chartered Secretaries Australia has rebranded itself as the Governance Institute of Australia, and in the United States, the Association of Corporate Secretaries changed its name to the Association of Corporate Secretaries and Governance Professionals. The increasing complexity of corporate law and listing rules, better awareness of corporate governance and higher acceptance of sustainability concepts, have all contributed to the importance of the company secretary.

The company secretary plays an important role in advising the board, usually through the chairman, on governance matters and in ensuring that there is an effective system of corporate governance in place. The company secretary also plays a key role in guiding and advising the board on compliance matters such as company law and listing requirements. In order to contribute and function effectively, the company secretary must be qualified, experienced and capable of carrying out duties attached to the post. In addition, the company secretary would need to keep himself or herself abreast with the many developments around corporate and securities law, listing rules and corporate governance practices. Accordingly, a structured training programme should be in place for the company secretary to maintain his or her knowledge and skills.

The board relies on the company secretary to furnish board papers and on this count, not only must the board papers be timely, they should also contain information at an adequate level of detail. Guidance to Practice 1.5 of MCCG calls for board papers to be circulated at least five business days before a board meeting, and whilst directors do not expect excessively voluminous papers, neither do they appreciate a one-page document that overly summarises a key matter. Directors should also be aware that selective disclosure of information in board papers may happen, in which risk factors, worst case scenarios or less flattering information is filtered out. It is important to recognise that selective reporting to the board may lead to skewed decisions and the process of board’s deliberation can only be enhanced through complete and balanced disclosure of information.

In terms of board discussions, it is in the directors’ enlightened interest that the deliberations are recorded in an adequate and timely manner. This includes comments by each director, how the directors voted and whether pertinent objections and reservations have been minuted accordingly. As the saying goes, “what is not minuted, is not said”. Considerations on information and support to directors are covered in detail in the write-up to Practice 1.5.

**Professional development and continuous education for directors**

It is as such important for every director to keep abreast of his or her responsibilities as a board member vis-à-vis the listed issuer. Every board is unique in terms of its own history, culture and dynamics. Workings of one board may not be entirely applicable on another board. Therefore, induction will be vital for newly appointed directors to orientate themselves in the new environment in order to contribute to the board.

A formalised orientation and education programme should be developed and provided to new members of the board to ensure that they understand:

- their roles and responsibilities;
- the board’s expectations in terms of their knowledge contribution;
• the nature of the company’s business;
• current issues faced; and
• strategies adopted by the company.

Induction programmes could comprise a combination of written materials, presentations and activities, such as meetings and site visits. Induction programmes of an interactive nature could also foster constructive relationships between the newly appointed director and existing directors and senior management.

Essential information during the induction of a new member may contain the following:

• Corporate information – company history, product and services information, strategic and business plans, financial accounts, major shareholders, corporate communications, business and industry environment, industry players, risk profile and appetite;
• Corporate governance framework – board charter, code of conduct and ethics, annual work plan\(^2\), board and directors’ details, committee structure and terms of reference, board processes, assurance providers, resources available, key stakeholders, policies and procedures; and
• Management information – names and background of senior management, organisational and management structure outline.

Directors who are well-informed are in a better position to evaluate proposals made by management, to ask the right questions of management and to be more effective as directors. The board must evaluate the training needs of its directors and ensure that they undertake relevant professional development and upskilling programmes. Effective board, committee and director performance assessments are key in the identification of training, education and development needs. Considerations relating to the assessment of the board, board committees and individual directors are covered in detail in the write-up to Practice 5.1.

Typically, the competencies of board members can be enhanced and refreshed by, amongst others:

• participating in seminars and workshops that highlight techniques to enhance shareholder value and methods to evaluate business performance and capital proposals;
• keeping themselves abreast of regulatory and legislative reforms that impact board and committee work;
• gaining understanding of financial statements and investment products which the company may be exposed to;
• participating in industry conferences and symposiums which strengthen professional networking and allows for the gaining of insights on customers and competitors; and
• visiting company’s operations sites to gain insightful perspectives of matters concerning the staff, factory, department or plantation (as the case may be).

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\(^2\) Annual work plan is a document that sets out and prioritises the board’s activities for the year to guide and ensure that the board focuses on important matters. It typically covers, amongst others, the annual review on the company’s business, strategic and risk management plan; annual budget; board succession and assessment review; board induction and training programme; key reporting dates for board committees; meeting with auditors and engagement with stakeholders.
Regulatory requirements concerning directors’ training are outlined below:

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<tr>
<th>Paragraph 15.08 of Bursa Securities Listing Requirements</th>
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**Directors’ training**

(1) A director of a listed issuer must ensure that he attends such training programmes as may be prescribed by the Exchange from time to time.

(2) The Exchange considers continuous training for directors of listed issuers as important to enable the directors to effectively discharge their duties. In this respect, the board of directors of a listed issuer must on a continuous basis, evaluate and determine the training needs of its directors. The subject matter of training must be one that aids the director in the discharge of his duties as a director.

(3) The board of directors must disclose in the annual report of the listed issuer, a statement on the training attended by its directors which includes the following information:

   (a) the board has undertaken an assessment of the training needs of each director;
   (b) a brief description on the type of training that the directors have attended for the financial year; and
   (c) in exceptional circumstances where any director has not attended any training during the financial year, valid justifications for the non-attendance of such director.

Note: Paragraph 2.2 of Practice Note 5 of Bursa Securities Listing Requirements (in respect of paragraph 15.08 (1)), also provides, amongst others that a director who is appointed for the first time as a director of a listed issuer must complete the Mandatory Accreditation Programme prescribed by the Exchange within 4 months from the date of appointment.

**Establishing a board charter**

Similar to a company that has its constitution as a fundamental guiding document, a board has the board charter as its “constitution”. The board charter plays a vital role in helping the board to focus on matters that are pertinent to the company whilst also reminding the board that such matters require consistent attention and are not just one-off items. The board charter sets out the board’s strategic intent, authority and terms of reference and serves as a primary source of reference and induction literature. As the board charter is an avenue to communicate the company’s approach to important governance practices, it should be accessible to all stakeholders via the company’s website. The following are some of the matters that should be considered when developing a board charter:

- a general outline of the board’s purpose, key values and principles;
- an overview of the board’s monitoring role;
- structure and membership of the board (including appointment of directors\(^3\), incorporating aspects of board independence and diversity);
- appointment of board committees;
- a formal schedule of matters reserved for the board including demarcation of responsibilities between board, board committees and management;
- a position description of the role of the chairman, CEO and executive directors as well as non-executive directors;

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\(^3\) The qualification of directors and other key officers is stated in paragraph 2.20A of Bursa Securities Listing Requirements which is described in Footnote 6 of this Introduction.
• expected time commitment of directors and limits on directorships (including a restriction of five directorships in listed issuers as stipulated in paragraph 15.06 of Bursa Securities Listing Requirements);

• agreed procedure on taking independent professional advice at the company’s expense in furtherance of the directors’ duties (whether as a board or in their individual capacity); and

• procedures for the development, undertaking, and improvement of board processes, including the assessment of performance and continuing education and development of the board, its committees and directors.

In a similar fashion, charters for each board committee should clearly set out the duties, rights and expectations for the committee. There needs to be harmony between the board charter and board committee charters, with careful attention paid to the delegation of authority from the board to the board committees. This delegation should not contradict the company’s authority matrix. A board committee charter may be granular and wide-ranging in describing the authority of the committee, but it should also be clear that ultimately, responsibility for decisions or recommendations taken by the board committee rests with the board as a whole.

Considerations on the establishment of a board charter are covered in detail in the write-up to Practice 2.1.

**Section II  Board dynamics**

The success of the board in fulfilling its oversight responsibility depends on its size, composition, and leadership qualities. A vigilant board, whilst supportive of management, must proactively participate in strategic decisions, challenge management with questions based on informed knowledge, oversee management’s plans, decisions and actions, monitor management’s ethical conduct, financial reporting and regulatory compliance and be capable of effectively achieving good governance and protecting stakeholders’ interests.

The diagram below provides guidance on the five key steps in establishing an effective board:

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
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<tbody>
<tr>
<td>Step 1</td>
<td>Determine the board’s authority, access to timely information, independent advice and company’s management, board size and committees in accordance with the company’s purpose, objectives and strategies.</td>
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<tr>
<td>Step 2</td>
<td>Develop roles and responsibilities and identify core competencies and the mix of skills required for the board and its committees.</td>
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<tr>
<td>Step 3</td>
<td>Establish a well-ordered process to elect and appoint board and board committee members.</td>
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<tr>
<td>Step 4</td>
<td>Develop key performance indicators for directors.</td>
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<tr>
<td>Step 5</td>
<td>Conduct annual assessment of the effectiveness and contribution of the board, its committees and individual directors.</td>
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</table>
Size and composition of the board

The composition of a board remains a key ingredient in influencing how the board functions and the dynamics between its members. The term “composition” has a number of dimensions – independence, skills, knowledge and other aspects of diversity. Whilst MCCG has steered clear of prescribing a fixed formula for the board’s composition, it does emphasise that the board should be composed of a strong element of independence (i.e. the board should comprise a group of independent directors who act as such in name and in substance). Whilst this is good practice for all companies, it is particularly pertinent for listed issuers where some stakeholders (i.e. non-controlling shareholders) have a direct financial interest in the company, as opposed to a private company in which the shareholders and management are often the same people.

Generally, the board comprises three distinct parties, namely, the chairman, the executive directors (usually led by the chief executive or managing director) and the non-executive directors (including the independent directors). Practice 4.1 of MCCG has called upon companies to have at least half of the board composed of independent directors in order to foster greater objectivity in the boardroom.

Considerations on the composition of the board having at least half or for Large Companies, a majority of independent directors are covered in detail in the write-up to Practice 4.1.

Independent directors

Independent directors can make significant contributions to a company’s decision-making by bringing in the quality of detached impartiality.

An independent director is especially important in areas where the interests of management, the company, the shareholders and other stakeholders diverge, such as executive performance and remuneration, related party transactions, environmental issues and audit. In this regard, an independent director ought to be able to approach any issues discussed or matters presented for approval at the board level, with a watchful eye and an inquiring mind.

An important facet of independent directors that is garnering increasing attention is their tenure of service. The argument in introducing limits to tenure of independent directors is that familiarity increases and objectivity decreases over time. Premised on the need to promote greater independence and objectivity, Practice 4.2 of MCCG calls for the board to limit the tenure of independent directors to nine years. The said Practice further calls upon an independent director who continues to serve on the board after such a period, to cease to be an independent director, and become a non-independent non-executive director. For companies that choose to retain the services of their independent directors after nine years, shareholders’ approval should be sought on an annual basis and after the twelfth year, shareholders’ approval is sought through a “two-tier” voting process as below.

- the first tier comprises approval of the Large Shareholder(s) of the company; and
- the second tier comprises approval of the shareholders other than Large Shareholder(s).

Step Up 4.3 of MCCG calls upon boards to have a policy to limit the tenure of their independent directors to nine years. Considerations relating to the tenure limit for independent directors are covered in detail in the write-up to Practice 4.2 and Step Up 4.3.

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4 Large Companies are companies on the FTSE Bursa Malaysia Top 100 Index; or companies with market capitalisation of RM2 billion and above, at the start of the companies’ financial year.

5 As stated in Guidance to Practice 4.2 of MCCG, Large Shareholder means a person who is entitled to exercise, or control the exercise of, not less than 33% of the voting shares in the company; is the largest shareholder of voting shares in the company; has the power to appoint or cause to be appointed a majority of the directors of the company; or has the power to make or cause to be made, decisions in respect of the business or administration of the company, and to give effect to such decisions or cause them to be given effect to.
Establishing a nominating committee is essential to ensure that there is a structured oversight process in recruiting, retaining, training and developing the best available executive and non-executive directors, and that board renewal and succession are managed effectively. Understanding the role played by the nominating committee is integral to understanding how interactions among the directors with varied backgrounds can have an impact on decision-making and outcomes. This will enable the nominating committee to build the right board structure and develop an effective functioning group, rather than a group of independently operating individuals or a group of collegial friends.

**Paragraph 15.08A of Bursa Securities Listing Requirements** mandates the establishment of the nominating committee which must comprise exclusively of non-executive directors, a majority of whom must be independent.

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**Paragraph 15.08A of Bursa Securities Listing Requirements**

**Nominating committee**

(1) A listed issuer must establish a nominating committee which comprises exclusively of non-executive directors, a majority of whom must be independent.

(2) The nominating committee must have written terms of reference dealing with its authority and duties which must include the selection and assessment of directors, and such information must be made available on the listed issuer’s website.

(3) The listed issuer must provide, in its annual report, a statement about the activities of the nominating committee in the discharge of its duties for the financial year. Such statement must include how the requirements set out in paragraph 2.20A of these Requirements are met and contain the following information:

   (a) the policy on board composition having regard to the mix of skills, independence and diversity (including gender diversity) required to meet the needs of the listed issuer;
   
   (b) the board nomination and election process of directors and criteria used by the nominating committee in the selection process; and
   
   (c) the assessment undertaken by the nominating committee in respect of its board, committees and individual directors together with the criteria used for such assessment.

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The nominating committee should establish clear and appropriate criteria on the selection and recruitment as well as on the annual assessment of the board, board committees and individual directors. Such criteria should be developed, taking into consideration the suitability of candidates against considerations such as competencies, commitment, contribution and performance, including the current composition of board and board committees, mix of skills and experiences of directors whilst taking into account the current and future needs of the company, boardroom diversity (including gender diversity) and other soft attributes required as company directors.

A far-sighted and effective nominating committee will normally keep an eye on the need for succession in the boardroom, identify appropriate candidates for board’s approval to fill casual vacancies and nominate candidates for the board’s consideration. Such activities should be carried out without being

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6 Paragraph 2.20A of Bursa Securities Listing Requirements stipulates that every listed corporation, management company or trustee-manager must ensure that each of its directors, chief executive or chief financial officer has the character, experience, integrity, competence and time to effectively discharge his role as a director, chief executive or chief financial officer, as the case may be, of the listed corporation, or the collective investment scheme.

7 Bursa Malaysia Securities Berhad has vide its directive dated 22 July 2014 clarified that a listed issuer is required to disclose in its annual report issued on or after 2 January 2015, its diversity policy for its board of directors in terms of gender, age and ethnicity as part of the enhanced disclosure requirements to paragraph 15.08A of Bursa Securities Listing Requirements.
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beholden to executive directors or controlling shareholders. The nominating committee and the board should devote sufficient time to review, deliberate and finalise the nomination and/or selection of directors. In a 2014 study conducted by PwC covering over 2,300 family businesses of varying revenue, only 16% have a documented succession plan. Closer to home, the PwC study stated that only 16% of the 50 Malaysian family business have such a plan8. Succession planning has gained added significance given contemporary thinking that independent directors should not stay beyond a certain period of time. If the board wants to increase the survivability of its company, it would do well to maintain succession planning on its radar.

On a related note, it is not often understood or appreciated that the succession planning process is closely linked to the performance evaluation of directors. To put it in another way, the assessment outcome has a bearing on the coming and going of directors. In essence, the assessment process for the board, board committees and individual directors, when done correctly, can impact the board in a few ways:

- gaps in skills, competency or experience are identified and plugged through recruitment of suitably qualified directors;
- under-performing directors receive notice that improvement is expected lest they find themselves being eased out of the board; and
- better ways of doing things are explored and considered.

In addition to leading the vetting of candidates and the necessary conversations around succession planning, particularly for the chairman of the board and the CEO, the chairman of the nominating committee also has the responsibility of assessing the performance of board, board committees and individual directors, be it newly appointed directors or existing ones. Considerations on nominating committee being chaired by an independent director or senior independent director is covered in detail in the write-up to Practice 4.7.

Boards can benefit from engaging an external and independent party to facilitate the assessment process. The said party is expected to deliver a neutral view of the board’s strengths and areas for improvement, and can also add insights gained from other evaluations. This is a benefit that is not often taken into account when considering the use of an external party. In respect of Large Companies, Guidance to Practice 5.1 of MCCG calls upon these companies to disclose the assessment process, whether external facilitators were involved, what were the major findings and how does the board intend to address weaknesses identified. Considerations on the board evaluation process are covered in detail in the write-up to Practice 5.1.

Board diversity

Diversity and inclusiveness are becoming increasingly important in tandem with the globalisation agenda whereby world barriers are being broken down as people connect more and more through trade, travel and migration. Indeed, two notable studies have concluded that companies which embrace diversity have performed better than their peers9.

Boards through their nominating committee should take appropriate measures to ensure that boardroom diversity is sought as part of their selection and recruitment exercise. In pursuing its diversity agenda, the board should begin by assessing its current diversity levels and establishing a policy that demonstrates clear commitment to developing a corporate culture which embraces the different aspects of diversity. The board should also formulate targets and measures (for example, where relevant, by way of key performance indicators or initiatives/development programmes/career

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9 In a regional study conducted by Korn Ferry in 2016 across the largest 100 companies in 10 Asia-Pacific countries (including Malaysia), it was found that companies with at least 10% female board representation recorded higher returns on assets and equity than companies which lack thereof. A global study by McKinsey in 2015 across 366 public companies in Canada, Latin America, United Kingdom, and United States revealed that companies in the top quartile for gender or racial and ethnic diversity are more likely to reap the benefits of diversity by having financial returns above their national industry medians.
advancement plans) of the board, the CEO and other senior management personnel. These targets and measures should be annually assessed and the progress should be monitored.

Nominating committees should put in place policies that actively support women to be directors by assisting women in senior management to build business networks, encouraging them to join boards as part of their professional development and addressing cultural impediments which prevent women from reaching senior management and board positions. The nominating committee should have measurable targets for achieving gender diversity. Nominating committees are strongly encouraged to annually assess their policies and outcomes to determine if they are effective. Where targets are not achieved, they should disclose their plans for improvement.

Gender diversity policies will only bring about desired outcomes if there is commitment and promotion of a corporate culture that embraces diversity. The MCCG recognises that benefits can accrue through all levels of the company, and has accordingly also asked that diversity be reflected in the senior management team. In particular, women are now recognised as an equal contributor to the prosperity of companies and the wider economy. Volvo, for example, has long involved women in the design and development of its cars, including an all-female focus group, engineering teams and designers. Considerations on board diversity are covered in detail in the write-up to Practices 4.4 and 4.5.

In relation to sourcing of directors, Practice 4.6 of MCCG calls upon independent sources to identify suitably qualified candidates. As stated in Guidance to Practice 4.6 of MCCG, companies should disclose how newly appointed non-executive directors are identified – were they recommended by board members, or were other means used to locate and recruit them. If non-executive directors were recommended by current board members, the onus is on the company to explain why alternative channels were not considered. Considerations in relation to sourcing of directors are covered in detail in the write-up to Practice 4.6.

Section IV Remuneration committee

Establishing a committee to assist the board in developing and administering a fair and transparent procedure for setting policy on remuneration of directors and senior management is important because this would ensure that remuneration packages are determined on the basis of the directors’ and senior management’s merit, qualification and competence, having regard to the company’s operating results, individual performance and comparable market statistics. The remuneration committee’s remit should cover not only directors’ remuneration but also that of the senior management team. In some companies, the committee addresses remuneration for the whole company. In all cases, both salient features of the company’s remuneration structure and the work of the committee in arriving at the structure should be disclosed by the company.

As stated in Guidance to Practice 6.2 of MCCG, the remuneration committee should only consist of non-executive directors and a majority of them must be independent directors, drawing advice from experts, if necessary. Directors who are shareholders should abstain from voting at general meetings to approve their fees. Similarly, executive directors should not be involved in deciding their own remuneration.

It is clearly important for the remuneration of directors and senior management to be determined adequately and fairly. Whilst not new concepts, the terms “adequately” and “fairly” have been gaining increasing attention in recent years in relation to directors’ remuneration. Firstly, it is no longer acceptable for directors and senior management to be remunerated without a reasonable basis for arriving at the quantum. There needs to be an appreciable link between the directors and senior management’s remuneration packages and how the company is performing, and also appropriate reasoning behind how remuneration is structured (i.e. whether short term or long term).

10 Madslien, J 2004, Girl Power softens Volvo’s edges, BBC
Secondly, consideration needs to be given to the ratio between the directors and senior management’s average remuneration versus that of the wider employee group. In this regard, the following questions may be asked:

- Is the ratio excessive or within reasonable levels? Would the company be able to justify a substantial increase in directors’ or senior management’s remuneration when the average pay of the broader group of employees remains the same?

- What would the perception of stakeholders be on the remuneration awarded to directors and senior management? Requirements on transparency of remuneration structure, activism of stakeholders and the media have combined to force the topic of remuneration onto the public space.

Considerations on remuneration policies and procedures of directors and senior management as well as the establishment of remuneration committee are covered in detail in the write-up to Practices 6.1 and 6.2 respectively.

In line with contemporary thinking, the MCCG also emphasises that disclosure not only refers to features of the company’s remuneration structure, but extends to identifying directors and senior management along with their remuneration. The MCCG intends for stakeholders to be able to assess whether the remuneration of directors and senior management is commensurate with their performance and the company’s performance.

Directors should bear in mind that the intent of disclosure is not for frivolous reasons but for investors and other key stakeholders to assess the reasonableness of remuneration, in light of the company’s circumstances, performance and prospects. This disclosure forms a key input in a shareholder’s evaluation of the directors and how they have discharged their stewardship duties. In particular, companies who put their remuneration structure to vote can expect shareholders to support if the bases behind the structure are clear, reasonable and defensible.

Considerations on the disclosure of directors and senior management’s remuneration are covered in detail in the write-up to Practices 7.1 and 7.2 as well as Step Up 7.3.
Practices and
Step Ups
Board leadership

MCCG Intended Outcome 1.0
Every company is headed by a board, which assumes responsibility for the company’s leadership and is collectively responsible for meeting the objectives and goals of the company.

MCCG Practice 1.1
The board should set the company’s strategic aims, ensure that the necessary resources are in place for the company to meet its objectives and review management performance. The board should set the company’s values and standards, and ensure that its obligations to its shareholders and other stakeholders are understood and met.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why
The case for change
The board is the apex governing body of a company that is responsible for leading the company and ensuring that the interests of shareholders and stakeholders alike are protected whilst enabling the company to achieve long-term sustainability. For a company to be well governed and managed, it is paramount for the board to consist of capable, dedicated, ethical and dynamic directors.

Directors appointed to the board play an integral role by undertaking to oversee and manage the strategies and matters of the board. A McKinsey survey covering approximately 1,600 directors globally yielded surprising results in this regard – one of which is that only 21% of directors claimed to have complete understanding of the strategy of their company. Strikingly, about a quarter of directors have only a limited understanding (or none at all) of their company’s strategy. This certainly makes for a sobering reading.

What could go wrong:
- Implementation of poor strategies and policies that do not align with the objectives of the company.
- Management does not follow the direction of the board.
- The company is unable to address the challenges it faces.
- Company is unable to respond to the dynamic nature of the business circumstances.
- Inadequate focus on strategies in the meetings.
- Too much emphasis on short-term financial performance measures.
- Environmental, economic and social (“EES”) aspects of sustainability are not embedded in the strategy and operations of the company.

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1 Bhagat, C et al 2013, Tapping the strategic potential of boards, McKinsey
**The practice in substance**

**Practice 1.1 of MCCG** calls upon the board to set the company’s strategic aims and ensure that the necessary resources are in place for the company to meet its objectives and review management performance. **Practice 1.1 of MCCG** also calls the board to set the company’s values and standards, and ensure that its obligations to its shareholders and other stakeholders are understood and met.

**Guidance to Practice 1.1 of MCCG** further outlines the factors that would enable a board to discharge its responsibilities. All directors should objectively discharge their duties and responsibilities at all times as fiduciaries in the interests of the company. Every director is required to keep abreast of his responsibilities as a director and of the conduct, business activities and development of the company.

Key considerations relating to the application of this Practice are discussed below:

**What are the key responsibilities of the board?**

**Guidance to Practice 1.1 of MCCG** states that the board in meeting its goals and objectives of the company, should amongst others, undertake the following responsibilities:

- **together with senior management, promote good corporate governance culture within the company which reinforces ethical, prudent and professional behaviour;**
  
  The board should foster a healthy corporate governance culture which is founded on the principles of transparency, objectivity and integrity. The board should set the “tone from the top” by formalising and committing to ethical values.

- **review, challenge and decide on management’s proposals for the company, and monitor its implementation by management;**
  
  The board should bring objectivity and breadth of judgment by scrutinising management’s proposals. The board should satisfy itself that management has taken into account all appropriate considerations in tabling the proposals. The board must demarcate the day-to-day operational functions of the management and the overall responsibilities of the board by clarifying the duties and responsibilities of the both parties. In addition, the board must ensure that the goals and targets set for management are met and in line with the company’s long-term objectives.

- **ensure that the strategic plan of the company supports long-term value creation and includes strategies on economic, environmental and social considerations underpinning sustainability;**

  Stakeholders are now more aware of the impact that businesses have on the economy, environment and society. This impact may be positive or negative. As such, relevant economic, environmental and social considerations should be embedded in the company’s business strategies and operations.

  Sustainability-related issues, can significantly impact a company’s risk profile, potential liabilities, reputation and overall value. For example,
companies involved in the oil and gas industry are increasingly faced with the challenges of volatile crude oil prices, geopolitical risks, climate change, and emission reductions – all of which has a bearing on the company. Having in place a sound sustainability policy would enable the company to be well-placed to deal with these challenges and create value in the long term.\(^2\)

- **supervise and assess management performance to determine whether the business is being properly managed;**

  The board must ensure that there are measures in place against which management’s performance can be assessed. The board is obligated to oversee the performance of management whilst maintaining a relationship that is supportive yet vigilant. There should be a comprehensive process for requesting, and considering reports from the nominating committee on the performance of the board, board committee and individual directors.

  The board should also put in place key performance indicators (“KPIs”) for the executive management to ensure the management’s strategy and performance would align with the company’s strategic objective. The KPIs should relate with the company’s business activities, the targets set by the board and the company’s short, medium and long-term objectives. The KPIs may include the following:

  - financial performance and targets (e.g. earnings before interest, tax, depreciation and amortisation; returns on asset; returns on equity; and earnings per share);
  - strategic performance in line with the company’s strategic plan and direction including short, medium and long-term value of the business (e.g. market share, market development and sustainability ratings);
  - operational performance (e.g. productivity rate, time to market new products, reduction in carbon footprint); and
  - corporate culture of the company (e.g. outcome of cultural surveys and pulse checks, regulatory and supervisory findings pertaining to the company).

- **ensure there is a sound framework for internal controls and risk management;**

  The board should ensure that there is a framework of prudent and effective internal control and risk management systems which enables risk to be assessed and managed. Further considerations on the establishment of framework for internal controls and risk management are provided in the write-up to Practices 9.1 and 9.2.

- **understand the principal risks of the company’s business and recognise that business decisions involve the taking of appropriate risks;**

  The board should be cognisant of the significant financial and non-financial elements that could result in exposures and alter the risk profile of the company. Considerations in this regard are provided in the write-up to Practices 9.1 and 9.2.

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\(^2\) Guidance can be drawn from Bursa Malaysia Sustainability Reporting Guide which aims to assist listed issuers in improving their sustainability-related disclosures and Bursa Malaysia Sustainability Toolkits which have been designed to provide more detailed guidance on some of the steps that listed issuers can take to embed sustainability into their organisations and meet their disclosure obligations.
- **set the risk appetite and establish a sound framework to manage risk;**

  The board should set the risk appetite within which the board expects management to operate and ensure that there is an appropriate risk management framework to identify, analyse, evaluate, monitor and respond to risks factors. Detailed considerations on the framework of internal controls and risk management are provided in the write-up to Practices 9.1 and 9.2.

- **ensure that senior management has the necessary skills and experience, and there are measures in place to provide for the orderly succession of board and senior management;**

  The board should ensure that candidates appointed to senior management positions are of sufficient calibre and that the collective competence of senior management would allow them to effectively lead the operations of the company. The board should also be satisfied that there are plans in place to provide for the orderly succession of board members and senior management. The absence of succession planning can result in hasty promotion of individuals who may be unsuitable or not ready for the position.

  When putting a succession plan in place, it might not be necessary to identify persons by name relative to a position on the board. Instead, a clear direction as to what the board is facing and the type and depth of experience required in order for the board to continue functioning effectively should be considered by the board in its succession planning programme.

  In considering a senior management vacancy, the board should benchmark internal candidates against external applicants. A well thought-out succession plan considers a process that recruits employees, develops their skills and abilities, and prepares them for advancement. Succession planning involves:

  - developing a recruitment and communication strategy;
  - identifying expected critical position vacancies;
  - determining critical positions;
  - identifying current and future competencies;
  - identifying gaps in current employees’ competency levels;
  - identifying high calibre internal candidates;
  - developing individual development plans for employees;
  - developing and implementing coaching and mentoring programmes; and
  - assisting with leadership transition and development, i.e. the right leader at the right time.

- **ensure that the company has in place procedures to enable effective communication with stakeholders;**

  The board should promote effective and timely communication with its stakeholders. The procedures in this regard should include how feedback received from its stakeholders is considered by the company when making business decisions. Considerations in this regard are provided in the write-up to Practice 11.1.
• **ensure the integrity of the company’s financial and non-financial reporting.**

The board should ensure that there is a sound framework on corporate reporting, including financial and non-financial reporting. Due cognisance should be given to the disclosures on corporate governance, sustainability and other non-financial aspects. The board should draw guidance from relevant documents such as:

- Statement on Risk Management and Internal Control: Guidelines for Directors of Listed Issuers issued by the Taskforce on Internal Control with the support and endorsement of the Exchange;
- Sustainability Reporting Guide and Toolkits by Bursa Malaysia;
- Management Discussion and Analysis Disclosure Guide by Bursa Malaysia; and
- Guidance on Disclosures in Notes to Quarterly Report by Bursa Malaysia.

**What are key aspects that the board should be cognisant of in leading the company?**

The board’s roles and responsibilities and related considerations such as effective conduct in meeting its obligations may be articulated in a formal and authoritative document which is commonly known as board charter. Refer to the write-up to **Practice 2.1** for detailed considerations regarding the board charter.

The responsibilities of the board in leading the company are closely related to four distinct elements:

- setting the strategic direction;
- monitoring the outcome of efforts to reach that direction;
- setting the company’s culture and outlining its values; and
- meeting obligations to shareholders and stakeholders.

A company’s culture and its strategic direction are intrinsically linked. The culture and the resultant ethical tone determine how much risk the directors are willing to take to achieve their goals, and set the moral boundaries in the pursuit of these aspirations. The diagram below illustrates the process of how culture and strategy drive the outcome of a company’s actions.
Therefore, the first step to be addressed by the board is to include strategy setting and review of culture as an integral part of matters reserved for the board’s deliberation and decision.

In setting the strategy and direction of a company, it is imperative that appropriate measures and processes are put in place to allow the directors and management to:

- create, review and assess strategic decisions of the company;
- understand what are the key drivers of company performance;
- ensure that the company’s strategy is in line with the operations and external environment; and
- evaluate and understand potential risks and incorporate risk management as well as sustainability considerations into strategic decision-making.

Management is key in collecting, scrutinising and elucidating strategic options to the board for its review and consideration. Hence, it is important that both management and the board work cohesively to successfully formulate and implement the company’s business strategy.

In defining the board’s role in maximising shareholders value whilst considering the interests of stakeholders and setting and monitoring strategies that cater to the growth of sustainable performance of the company, it is helpful for the board to consider some key parameters, as follows:

- Directors must showcase critical thinking in setting goals and strategies during board meetings. The personal needs of a director cannot supersede the needs of the board. Questions on business operations that lead to insights into strategy, performance, investment decisions, hiring or removal of key personnel and risk assessment must take priority. In certain instances, directors can be seen micromanaging by picking up on a small point and challenging it for the sake of showing who is right or what could have been done differently. Trivial matters must not be discussed in length and hindsight discussions should be minimalised.

- When devising a strategic plan, the board must include the elements of strategic risk, i.e. linking business strategy to the critical risks the company faces including, but not limited to, sovereign risk, risks related to reputation, ethics, e-commerce, and safety, health, and environment (not just financial or insurable hazards) and should not just relate the level of risk to size of investment. There are many cases of small and apparently inconsequential investments having very serious consequences on large companies.

- Off-site strategy session serves as a valuable platform to explore strategic issues in depth for several days. The factors that should be considered in having off-site strategy sessions include nature of strategy discussions, off-site plans, number and identity of invitees, as well as timing of off-site strategy sessions. However, board should be cognisant that organising an off-site session may be challenging in certain instances as it may be difficult to get all directors present to participate. Directors may have their responsibilities on other boards coinciding with the scheduling. It may also not be applicable for companies with a large board structure where discussion on issues may take longer than anticipated.

3 What Is and Isn’t Micromanaging, 2013, Strategy+business
5 Bhagat C et.al 2013, Tapping the strategic potential of boards, McKinsey
Visits to operational sites or key subsidiaries assist in deepening the board’s understanding of the company, in particular for the non-executive directors. For example, in the case of The Home Depot, Inc., directors are required to visit four stores annually and have in-depth meetings with four different members of the senior management team. The involvement of directors by frequently “spot checking” is a useful way of ensuring the management is kept on its toes. This also gives the directors an opportunity to directly talk to operational staff and receive feedback on their implemented plans.

The board should receive both, information on financial and non-financial matters in relation to the company’s performance including, but not limited to information on company’s performance benchmarked against its competitors and industry players. The board must specify the required information to management and work with management on refining the board information package to tailor it to the board’s needs and wants. Examples of non-financial information may include:

- market positioning and performance of key brands;
- customer satisfaction index;
- employee turnover rate and satisfaction;
- product development and research; and
- social and environmental performance.

The case study on the following page demonstrates the importance for board members to scrutinise the information that has been presented to them.

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### Case study: Transmile Group Berhad (Malaysia)

#### Background:
- Two independent directors of Transmile, who were members of the audit committee at the material time, were charged in court under Section 122B(b)(bb) of the Securities Industry Act 1983 for knowingly authorising the furnishing of a misleading statement to the Exchange in relation to the company’s quarterly report on the unaudited consolidated results for the financial year ended 31 December 2006.

#### Facts:
- Transmile reported to the Exchange that its revenue was RM 338.4 million for the last quarter of 2006 and RM 989 million for the financial year ended 31 December 2006. Transmile had in fact suffered losses for financial year end 31 December 2006.
- A special audit further revealed that Transmile had actually suffered combined losses up to RM496 million for the years 2005 and 2006. In 2006, its losses were RM126.3 million instead of a profit of RM157.5 million and in 2005, its losses were RM369.6 million instead of a profit of RM84.4 million as reported.
- The two former independent directors of the company were found to be guilty and a sentence of one year imprisonment and a fine of RM300,000 (in default six months imprisonment) were meted out against both individuals.
- In the aftermath of the incident, the company was classified as a Practice Note 17 company and its securities were subsequently delisted.

#### Lessons Drawn:
- Directors are entrusted with duties and responsibilities to safeguard the interests of the company and that of its stakeholders. It is therefore clear that directors must carefully review the information that is presented to them prior to approval, with due regard to the information that they know about the company when undertaking that review. Directors are expected to ask questions of management with respect to issues that arise from their review of the documents.

- Boards should ensure that the information required to aid them in performing their duties is provided in a timely and orderly manner. Directors should allocate time to consider their information needs and the integrity of information by asking the following:
  - what information would they require to perform their roles effectively?
  - what measures should be put in place to ensure their information needs are met and the integrity of the information is intact?
  - when should the information be given to them?
  - in what form must the information be presented to the board?

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*Enforcement 2017, Securities Commission Malaysia*
It is vital for the board to take interest on whether the data regarding the company including its performance is properly recorded and maintained so as to be assured of the integrity of the information presented to them. Management should present the information in a clear and systematic format that can be easily understood by the board. A typical report can be set out under the following headings:

- an executive summary that clarifies major themes of the report and its main conclusions;
- emerging issues that may affect business in the future;
- strategic issues for discussion;
- market and competitor news;
- financial and non-financial performance;
- key value drivers’ performances;
- business unit performance; and
- company’s performance in relation to strategic initiatives.

What are symptoms or indicators which may indicate concerns on the discharge of duties by the board?

The following would be considered as red-flags in this regard:

- lack of oversight over management by the board;
- presentation made to the board does not have sufficient information to guide the board or contains too much information that leaves the board with little time for thoughtful and reflective deliberations and that hinders the board in scrutinising the management;
- lack of alignment between the board’s strategic goals and the management’s goals;
- inadequate focus by the board on the core issues that are impacting the company; and
- insufficient time spent by the board to educate themselves on the company’s operations.

Regional/international perspectives

As in the case of Malaysia, the board’s role in strategy and ethics has been addressed in corporate governance codes around the world.

- **United Kingdom**
  - Corporate Governance Code, Supporting Principles of A1

- **South Africa**
  - King’s Code IV Report on Corporate Governance for South Africa, Recommended Practice 1 of Principle 1 and Recommended Practice 13 of Principle 3

- **Singapore**
  - Code of Corporate Governance, Guideline 1.1 (a) and (e)

- **Australia**
  - Australian Stock Exchange Corporate Governance Council’s Corporate Governance Principles and Recommendations, Commentary of Recommendation 1.1 and Commentary of Principle 3
<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
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<tbody>
<tr>
<td>Singapore</td>
<td>The Board’s role is to:</td>
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<tr>
<td></td>
<td>a. provide entrepreneurial leadership, set strategic objectives, and ensure that the necessary financial and human resources are in place for the company to meet its objectives; and</td>
</tr>
<tr>
<td></td>
<td>e. set the company’s values and standards (including ethical standards), and ensure that obligations to shareholders and other stakeholders are understood and met.</td>
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<tr>
<td></td>
<td><em>(Guideline 1.1)</em></td>
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<tr>
<td>Australia</td>
<td>Usually the board of a listed entity will be responsible for:</td>
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<td></td>
<td>• providing leadership and setting the strategic objectives of the entity.</td>
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<tr>
<td></td>
<td><em>(Commentary of Recommendation 1.1)</em></td>
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<tr>
<td></td>
<td>The board of a listed entity should lead by example when it comes to acting ethically and responsibly and should specifically charge management with the responsibility for creating a culture within the entity that promotes ethical and responsible behaviour <em>(Commentary of Principle 3).</em></td>
</tr>
<tr>
<td>United</td>
<td>The board should set the company’s strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance.</td>
</tr>
<tr>
<td>Kingdom</td>
<td>The board should set the company’s values and standards and ensure that its obligations to its shareholders and others are understood and met <em>(Supporting Principles of A1).</em></td>
</tr>
<tr>
<td>South</td>
<td>Members of the governing body should assume collective responsibility for steering and setting the direction of the organisation, approving policy and planning; overseeing and monitoring of implementation and execution by management; and ensuring accountability for organisational performance <em>(Recommended Practice 1 of Principle 1).</em></td>
</tr>
<tr>
<td>Africa</td>
<td>The governing body should oversee that the organisation’s core purpose and values, strategy and conduct are congruent with it being a responsible corporate citizen <em>(Recommended Practice 13 of Principle 3).</em></td>
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</table>
The board chairman

MCCG Intended Outcome 1.0
Every company is headed by a board, which assumes responsibility for the company’s leadership and is collectively responsible for meeting the objectives and goals of the company.

MCCG Practice 1.2
A Chairman of the board who is responsible for instilling good corporate governance practices, leadership and effectiveness of the board is appointed.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

The case for change

The chairman is a key pivot in board dynamics, being one of the three cornerstones of the board – the other two being the chief executive/managing director (representing executive directors) and the senior independent director/independent director who usually leads the non-executive directors.

The chairman can be regarded as a position, or it can be seen as a role. It may be just semantics, but each word implies different approach that fundamentally determines the success of the chairman.

A position is a point of reference about something or someone whereas a role is a position that comes with a great deal of responsibilities and an expectation that these responsibilities will be carried out.

American academic Jeffrey A. Sonnenfeld remarked that structurally and practically, everything is in place for the board – rules, policies, procedures, the need for committees and the number of meetings. Nevertheless, what has often been ignored is that the board is a social system and many of the key factors for a successful social system apply to the board as well. Clearly, this includes the need for an effective leader – beginning with the chairman.

It would be fair to say that the chairman’s will and tenacity have more of a bearing on his impact than his status. The board can only be as effective as the chairman allows it to, and it can also be overrun by vested interests and personal agendas should the chairman allow this to happen as well.

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The practice in substance

The chairman should be appointed by the board and the chairman’s primary role is to preside over meetings of directors and ensure the smooth functioning of the board in the interest of good corporate governance.

Given the prevalence of the scorecard methodology and how easily it is now understood, it is perhaps helpful to present example traits of an effective chairman in the same manner.

The Chairman’s Scorecard

<table>
<thead>
<tr>
<th>A baseline authority</th>
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<tbody>
<tr>
<td>The chairman is fundamentally well regarded due to his or her character, integrity, experience and accomplishments.</td>
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</table>

<table>
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<tr>
<th>Socially adept, not awkward</th>
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<tr>
<td>The chairman understands the dynamics of the board, the social ties amongst members and any potentially disruptive power plays.</td>
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</table>

<table>
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<tr>
<th>Mirror-gazing</th>
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<tbody>
<tr>
<td>Not content with the status quo, the chairman seeks ways to improve himself and the board.</td>
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<table>
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<tr>
<th>“Unconfused”, not “I’m confused”</th>
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<tbody>
<tr>
<td>The chairman knows that understanding the matters brought for deliberation is key to informed decision making.</td>
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</table>

Activist and change coach Joan Garry coined an apt term for the chairman, concisely, she recognises that an effective chairman is a valued “thought partner” to the chief executive and the directors. Again, the theme behind this argument is that the chairman’s role is not a matter of procedure but a responsibility to encourage a high-performing board through continuous debate and challenge.

It would also be useful to take note of the signs that a chairman is not effective. They include the following:

- being unable to control board proceedings, either from an agenda perspective or from a time perspective, including allowing board papers to be submitted late or not at all;
- micro-managing;
- allowing factions to develop;

Hot-button issue

Casting a long shadow

Should a retiring chief executive or managing director remain on the board as chairman? This is a corporate governance issue that many commentators have grappled with.

There is a great deal of debate with proponents arguing that such a presence “casts a long shadow” over the board whilst opponents counter-argued by valuing the leadership, advice and experience of these individuals.

The technology company Intel needs no introduction to all of us. Its products have permeated daily life for the last 50 years, but what is less known outside of corporate governance circles is that Intel’s four CEOs, starting from the legendary Andy Grove, went on to become chairmen of the board upon their retirement, in an orderly and announced succession plan.

The problem with this practice is that the chairman may think the company should be run in a certain way. When the strategy diverts from what they had implemented, the CEO-turned chairman, might influence the board to hinder the performance and strategy of the new CEO. It is important to complement the incumbent CEO with a balanced board that would not interfere with his or her strategy for the company.

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2 Garry J 2017, The Five Star Board Checklist
• himself or herself joining a faction; and
• other directors developing alternative channels of communication with the management team, excluding the chairman.

**Point for reflection**

Although this may be apparent, it is worth noting that a company does not always stay in a normal, “business-as-usual” state of affairs. An effective chairman recognises that his or her company will be in a number of phases throughout its life, and adapts himself accordingly.

Below are examples of scenarios that the board chairman could find himself or herself in their course of duty:

<table>
<thead>
<tr>
<th>Planned change</th>
<th>Turnaround</th>
<th>Crisis</th>
</tr>
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<tbody>
<tr>
<td>Change is upon the company but this is known beforehand, (e.g. regulatory change, a new product or new market). Can the chairman ensure that management is fully prepared for the transition?</td>
<td>The company finds itself falling behind in its market and all of a sudden, things are no longer rosy. This is often a cumulative effect from inaction of the last few years. Can the chairman galvanise the chief executive officer and the board to “turn the ship” around?</td>
<td>Events throw &quot;a spanner in the works&quot;. These could range from fraud, accidents, and regulatory investigations to hostile takeovers. Some events may cast doubt on ability of the company to continue. Can the chairman lead the company through the crisis?</td>
</tr>
</tbody>
</table>

Additional considerations relating to the application of this Practice are discussed below:

**What are the responsibilities of the chairman?**

The chairman is primarily responsible for the workings of the board so as to ensure the smooth functioning of the board in the interest of good corporate governance. The key responsibilities that are customarily undertaken by the chairman based on **Guidance to Practice 1.2 of MCCG** are outlined below:

- Provides leadership for the board so that the board can perform its responsibilities effectively:
  - Ensures that the board plays a full and constructive part in the determination of the company’s strategies and policies, and that board decisions taken are in the company’s best interests and fairly reflect board’s consensus; and
  - Ensures that procedures are in place to govern the board’s operations.
- Sets the board agenda and ensures that board members receive complete and accurate information in a timely manner:
  - Plans the board meeting agenda in advance alongside the company secretary and the chief executive officer. Other directors and key members of management may also be consulted;

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<table>
<thead>
<tr>
<th>Responsibilities of the Chairman</th>
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<tr>
<td>Ensures the provision of accurate, timely and clear information to the other directors; and</td>
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<tr>
<td>Ensures all directors are properly briefed on issues arising at board meetings in a timely manner.</td>
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<tr>
<td>Leads board meetings and discussions:</td>
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<tr>
<td>Ensures that adequate time is available for thorough deliberation of key issues; and</td>
</tr>
<tr>
<td>Ensures that decisions are taken on a sound and well-informed basis, including by ensuring that all strategic and critical issues are considered by the board.</td>
</tr>
<tr>
<td>Encourages active participation and allows dissenting views to be freely expressed:</td>
</tr>
<tr>
<td>Promotes a culture of openness and debate whilst ensuring that no one director dominates the discussion; and</td>
</tr>
<tr>
<td>Obtains suggestions and comments from directors and encourages those who are less vocal to be more proactive in providing views.</td>
</tr>
<tr>
<td>Manages the interface between board and management:</td>
</tr>
<tr>
<td>Acts as the main conduit between management and the board; and</td>
</tr>
<tr>
<td>Develops a positive relationship with the chief executive officer.</td>
</tr>
<tr>
<td>Ensures appropriate steps are taken to provide effective communication with stakeholders and that their views are communicated to the board as a whole:</td>
</tr>
<tr>
<td>Acts as a spokesperson for the board; and</td>
</tr>
<tr>
<td>Acts as the main representative of the company alongside the managing director at shareholders’ meetings and on other occasions where key or major actions are taken or statements are made in the name of the company.</td>
</tr>
<tr>
<td>Leads the board in establishing and monitoring good corporate governance practices in the company:</td>
</tr>
<tr>
<td>Leads the creation of an effective corporate governance system, including the establishment of board and committee charters, a committee structure and induction as well as ongoing education programmes for directors; and</td>
</tr>
<tr>
<td>Oversees and facilitates board, committee and board member evaluation reviews and succession planning alongside the chairman of the nominating committee.</td>
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</tbody>
</table>

The responsibilities of the chairman of a financial institution in leading the board and being responsible for the effective overall functioning of the board are enumerated in **Standard 9.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance**.

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4 As stated in **Standard 9.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance**, the chairman must ensure that appropriate procedures are in place to govern the board’s operation; ensure that decisions are taken on a sound and well-informed basis, including by ensuring that all strategic and critical issues are considered by the board, and that directors receive the relevant information on a timely basis; encourage healthy discussion and ensure that dissenting views can be freely expressed and discussed; and lead efforts to address the board’s developmental needs.
Should companies appoint a deputy chairman?

Subject to the company’s constitution, Paragraph 1 of the Third Schedule of Companies Act 2016 stipulates that the “directors may elect one of their numbers as chairperson of the board and determine the period for which he is to hold office”.

There are no prescriptions that call for the appointment of a deputy chairman. However, it is not uncommon for companies to appoint a deputy chairman to deputise and assist in providing leadership to the board. In instances whereby the board is led by a non-independent chairman and the board intends to appoint a deputy chairman, it would be advisable for the board to appoint an independent deputy chairman. In the absence of the chairman, the deputy chairman usually chairs the meetings of the board. The deputy chairman also often acts as a “sounding board” and confidant to the chairman in the execution of his or her role.

Examples of tasks or duties performed by the deputy chairman are shown below:

- assists the chairman in conducting meetings in his or her absence;
- ensures there is a strong relationship between the board and the chairman;
- promotes constructive dialogues between non-executive and executive directors;
- provides assistance and support to the chairman during meetings; and
- ensures the board and chairman are communicating well with stakeholders.

Regional/international perspectives

As with Malaysia, the responsibilities of a chairman are well enumerated across other global jurisdictions.

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5 The Third Schedule of the Companies Act 2016 sets out the provisions governing proceedings of the board.
<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>The chairman and the CEO should in principle be separate persons, to ensure an appropriate balance of power, increased accountability and greater capacity of the board for independent decision making <em>(Guideline 3.1).</em></td>
</tr>
<tr>
<td></td>
<td>The chairman should:</td>
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<tr>
<td></td>
<td>(a) lead the board to ensure its effectiveness on all aspects of its role;</td>
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<tr>
<td></td>
<td>(b) set the agenda and ensure that adequate time is available for discussion of all agenda items, in particular strategic issues;</td>
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<tr>
<td></td>
<td>(c) promote a culture of openness and debate at the board;</td>
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<tr>
<td></td>
<td>(d) ensure that the directors receive complete, adequate and timely information;</td>
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<tr>
<td></td>
<td>(e) ensure effective communication with shareholders;</td>
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<tr>
<td></td>
<td>(f) encourage constructive relations within the board and between the board and management;</td>
</tr>
<tr>
<td></td>
<td>(g) facilitate the effective contribution of non-executive directors in particular; and</td>
</tr>
<tr>
<td></td>
<td>(h) promote high standards of corporate governance.</td>
</tr>
<tr>
<td></td>
<td>The responsibilities set out above provide guidance and should not be taken as comprehensive list of all the duties and responsibilities of a chairman <em>(Guideline 3.2).</em></td>
</tr>
<tr>
<td>Australia</td>
<td>The chair of the board is responsible for leading the board, facilitating the effective contribution of all directors and promoting constructive and respectful relations between directors and between the board and management <em>(Commentary to Recommendation 2.5).</em></td>
</tr>
<tr>
<td>United</td>
<td>The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role <em>(Principle A.3).</em></td>
</tr>
<tr>
<td>Kingdom</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>The governing body should elect an independent non-executive member as chair to lead the governing body in the objective and effective discharge of its governance role and responsibilities <em>(Recommended Practice 31).</em></td>
</tr>
<tr>
<td></td>
<td>The chair’s roles and responsibilities and term in office, as well as that of the lead independent should be documented in the charter of the governing body or elsewhere <em>(Recommended Practice 33).</em></td>
</tr>
</tbody>
</table>
Separation in the roles of chairman and chief executive officer

MCCG Intended Outcome 1.0
Every company is headed by a board, which assumes responsibility for the company’s leadership and is collectively responsible for meeting the objectives and goals of the company.

MCCG Practice 1.3
The positions of Chairman and CEO are held by different individuals.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

The case for change

The chairman and the CEO are two key levers of a company. The chairman is responsible for marshalling the effective functioning of the board including the collective oversight of management. The CEO meanwhile spearheads the business and day-to-day management of the company.

Given the different nature of responsibilities that rests with the chairman and CEO, having these positions combined could potentially diminish the board’s role in exercising objective oversight over management. Conflicts could be particularly prevalent in the areas of performance evaluation, executive remuneration, succession planning and the appointment of new directors. A representative of the California Public Employees’ Retirement System (“CalPERS”) once argued at the ExxonMobil’s Annual General Meeting (“AGM”) in United States that having a dual chairman and CEO is “like grading your own exam papers”.1

The combination of these roles may also lead to an excessive concentration of power that is vested in one individual. At its worst, this could result in the infamous corporate governance issue of “imperial CEOs”.

What could go wrong:
- The oversight role of the board over management is diminished.
- Deliberations in the boardroom are controlled by one individual.
- The director who assumes the position of chairman and CEO is accorded with unchecked powers, giving rise to potential abuse.
- Time commitment of the combined CEO and chairman is impaired which hinders the effective discharge of duties for both positions.

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1 Larcker, DF and Tayan, B 2016, Chairman and CEO: The Controversy over Board Leadership Structure, Stanford University
Given the ever increasing workload of board members in light of changing market dynamics and rising stakeholders’ expectations, coupling the position of a chairman and CEO could also raise serious concerns on the time commitment of said director. The greater time commitment expected of directors is well encapsulated in a study by McKinsey which revealed that high-performing boards typically spend at least 40 days for boardroom activities³.

Premised on the need to promote accountability and facilitate division of responsibilities between the chairman and CEO, enumerations such as the aforementioned Practice 1.3 of MCCG and Standard 11.3 of Bank Negara Malaysia’s Policy Document on Corporate Governance⁴ call for separation between the chairman and CEO.

**The practice in substance**

It is therefore important for the company to ensure that the positions of chairman and CEO are held by different individuals with a view of averting instances whereby one individual can dominate the board’s discussions and decision-making.

The division in the roles of the chairman and CEO should be clearly defined in the board charter.

Key considerations relating to the application of this Practice are outlined below:

**What are the factors that should be considered when demarcating the roles of the chairman and CEO?**

Unless the roles are clear, the relationship between the CEO and the board including the chairman, risks devolving into misunderstandings, loss of trust, and ineffectiveness. To this end, it is important for the board to clearly define the respective functions and set out the boundaries of the chairman and the CEO.

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² Scott, G 2004, Unfinished Business: Abolish the Imperial CEO, Journal of Corporate Accounting and Finance
³ Bhagat, C & Kehoe, C 2014, High performing boards: What’s on their agenda?, McKinsey
⁴ The chairman of the board must not be an executive, and must not have served as a CEO of the financial institution in the past five years.
Pertinent considerations in carrying out the demarcation are outlined below:

- articulate the expected time commitment in the service contracts of the chairman and CEO;
- define the criteria for evaluating the chairman and CEO, taking into account the responsibilities outlined in the board charter and job descriptions;
- provide the CEO with the room to perform, but be prepared to intervene when the need arises; and
- clarify the nature and extent of the other directorships that can be held by the chairman and CEO.

What are the safeguards that should be put in place to foster greater objectivity in the boardroom when the company has an executive chairman?

An inherent safeguard is built from the application to Practice 4.1 of MCCG which stipulates that “at least half of the board comprises independent directors. For Large Companies, the board comprises a majority independent directors”. This allows for more effective oversight of management as well as to support objective and independent deliberation, review and decision-making.

In addition, companies may consider appointing a deputy independent chairman and/or a senior independent director to serve as a sounding board to the chairman and in leading the performance evaluation of the chairman. The appointment of a deputy independent chairman and/or senior independent director would particularly go a long way in fostering objectivity in instances whereby the chairman and the CEO are related.

What are some of the symptoms which may indicate that power is concentrated in one individual director?

The board should be watchful of some of the following indicators which may indicate concentration of power in one individual director.

**Dos**
- Clearly delineating the roles and responsibilities of the chairman and CEO in the company’s board charter.
- Articulating the time commitment that is expected of the chairman and CEO.
- Promoting a culture of openness and constructive challenge that allows for a diversity of views to be considered by the board.

**Don’ts**
- Not putting in place clear procedures for clarity on the roles and responsibilities of the chairman and CEO as well as how conflicts in this regard can be dealt with.

<table>
<thead>
<tr>
<th>Echo chambers</th>
<th>Disparity in remuneration</th>
<th>Risk taking</th>
</tr>
</thead>
<tbody>
<tr>
<td>The boardroom is reduced to an “echo chamber” whereby deliberations are centred around echoing the sentiments of an individual director. Succinctly put, there is a tendency for the views of the said individual to be deferred to and agreed with.</td>
<td>An individual director is being rewarded with a grossly excessive remuneration package and the “pay gap” vis-à-vis other directors and management personnel is hugely significant, after normalising factors such as responsibilities, credentials and performance.</td>
<td>An individual director who has the propensity to engage in or push for imprudent risk taking due to vested interests.</td>
</tr>
</tbody>
</table>
Regional/international perspectives

Alongside Malaysia, selected jurisdictions across the globe have emphasised the need to separate the positions of the chairman and CEO in order to promote accountability amongst board and management.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board ((Provision A.2.1)). The chairman should on appointment meet the independence criteria set out in B.1.1(^5). A chief executive should not go on to be the chairman of the same company. If exceptionally a board decides that a chief executive should become a chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report ((Provision A.3.1)).</td>
</tr>
<tr>
<td>Australia</td>
<td>The chair of the board of a listed entity should be an independent director, and in particular, should not be the same person as the CEO of the entity ((Recommendation 2.5)).</td>
</tr>
</tbody>
</table>

\(^5\) Provision B.1.1 of United Kingdom’s Corporate Governance Code relates to the determination of a director’s independence.
Company secretary

**MCCG Intended Outcome 1.0**
Every company is headed by a board, which assumes responsibility for the company’s leadership and is collectively responsible for meeting the objectives and goals of the company.

**MCCG Practice 1.4**
The board is supported by a suitably qualified and competent Company Secretary to provide sound governance advice, ensure adherence to rules and procedures, and advocate adoption of corporate governance best practices.

⚠️ The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

### Why The case for change

The responsibility of the modern day company secretary has evolved from merely advising on administrative matters to now advising boards on governance matters, board policies and procedures as well as pertinent regulatory requirements (e.g. company and securities regulations and listing requirements including disclosure obligations). In the oft-cited words of the learned judge, Lord Denning, “a company secretary is no longer a clerk”\(^1\).

As the focus on directors’ accountability and performance increases, directors are increasingly demanding company secretaries to act as a key resource support so as to ensure that the board operates effectively and governance practices are upheld.

In this regard, the breadth of a company secretary’s role has radically shifted from that of a “note taker” at board meetings or “administrative servant of the board”\(^2\) to one which encompasses broader corporate governance functions as shown in the diagram below.

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1. Tricker, B 2012, *The significance of a company secretary*, Hong Kong Institute of Chartered Secretaries
The undertakings of a company secretary are also becoming more outward-focused and not just confined to internal matters. Company secretaries are increasingly expected to be more involved outside the company’s boundaries to interact with shareholders, public bodies and regulators.

The recognition of company secretaries as a central point for governance matters is driven in large part from the fact that company secretaries work closely with the board and the chairman, in particular, placing them in a position to influence the formulation of agenda and the direction of debates in the boardroom. They are well-placed to provide viewpoints, perspectives and challenges, thus, influencing the tone at the top. Company secretaries are also often the only people to know first-hand how the decisions made by the board have been reached as they are privy to board discussions.

Given that company secretaries are well-placed to shape the corporate governance culture of a company, regulators have recognised the need to elevate the position and function of company secretaries to allow them to assume a stronger role in promoting governance. Similarly, Standard 15.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance also encapsulates enumerations for financial institutions in this regard.

**The practice in substance**

It is therefore important for the board to ensure that it is supported by a suitably qualified and competent company secretary. The company secretary should play an important role in advising the board on governance matters and in ensuring that there is an effective system of corporate governance in place.

Key considerations relating to the application of this Practice are outlined below:

**Who can be a company secretary?**

Requirements concerning the appointment of a company secretary are primarily outlined in the Companies Act 2016 as shown on the following page.

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3 Standard 15.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance states that “the company secretary is responsible for supporting the effective functioning of the board. In discharging this role, the company secretary provides counsel to the board on governance matters and facilitates effective information flows between the board, the board committees and senior management.


Section 235(1), (2) and (3) of Companies Act 2016

(1) A company shall have at least one secretary who shall be —
   (a) a natural person;
   (b) eighteen years of age and above; and
   (c) a citizen or permanent resident of Malaysia,
       who shall ordinarily reside in Malaysia by having a principal place of
       residence in Malaysia.

(2) A secretary shall be —
   (a) a member of a body as set out in the Fourth Schedule; or
   (b) a person licensed by the Commission under section 20G of the

(3) For the purposes of paragraph (2)(a), the Minister may prescribe any
    professional body or any other body by notification in the Gazette and may
    impose any terms and conditions as he thinks fit.

Note: The above only represents an extract.

Section 236(3) of Companies Act 2016

No person shall be appointed as a secretary unless
(a) he has consented in writing to be appointed as a secretary;
(b) he is qualified under subsection 235(2); and
(c) he is not disqualified under section 2384.

Fourth Schedule of Companies Act 2016

Approved bodies [in relation to Section 235(2)(a)]

1. Malaysian Institute of Chartered Secretaries and Administrators
2. Malaysian Institute of Accountants
3. Malaysian Bar
4. Malaysian Association of Company Secretaries
5. Malaysian Institute of Certified Public Accountants
6. Sabah Law Association
7. Advocates Association of Sarawak

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4 Section 238 of the Companies Act 2016 states that the company secretary will be disqualified if he is an undischarged bankrupt; convicted of any offence referred to under Section 198 (i.e. offences relating to the disqualification of a director); or has ceased to be a holder of a practicing certificate issued by the Registrar under Section 241 (i.e. registration with Registrar).
What are some of the key attributes of an effective company secretary?

Company secretaries would need more than technical skills to appreciate what corporate governance practices are needed in a company and why. Technical skills must be complemented by emotional intelligence, interpersonal skills, and experience to ensure that they know how the practices would typically be implemented to work effectively.

Some of the attributes (non-exhaustive) that are commonly observed in a high-performing company secretary are outlined below:

- Possesses sound knowledge in company and securities law, finance, governance, company secretaryship and other areas of compliance such as the listing requirements;
- Diligently undertakes continuous professional development to keep abreast of relevant corporate governance and regulatory requirements;
- Is respectful, diplomatic, and effective in communicating;
- Is an active listener;
- Brings issues to the surface, especially those relating to reputational risk;
- Describes common concerns and interests;
- Generates alternative solutions;
- Respects confidences;
- Demonstrates appreciation for all parties;
- Disagrees constructively; and
- Emphasises commercially-minded approaches.

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5 The Corporate Secretary: The Governance Professional 2016, International Finance Corporation
What are the primary responsibilities of a company secretary?

The key responsibilities of company secretaries are outlined below:

**Corporate governance advisory**
- Advise the board on its roles and responsibilities;
- Monitor corporate governance developments and assist the board in applying governance practices to meet the board’s needs and stakeholders’ expectations (e.g. advising directors to abstain from decision making in conflict of interest situations);
- Ensure adherence to the board’s and board committees’ policies and procedures; and
- Facilitate the orientation of new directors and assist in directors’ training and development.

**Compliance advisory**
- Provide updates and assist the board with interpreting regulatory requirements related to company and securities regulations as well as listing requirements;
- Advise the board on its obligatory requirements to disclose material information to shareholders and financial markets in a timely manner; and
- Notify the chairman of any possible violations of regulatory requirements.

**Information flows and meetings**
- Manage board and board committee meeting logistics, attend and record minutes of board and board committee meetings as well as facilitate board communications; and
- Ensure that the decisions of the board and board committees are relayed to management to act upon.

**Stakeholder communication**
- Manage processes pertaining to the general meetings; and
- Serve as a focal point for stakeholders’ communication and engagement on corporate governance issues.
Can the role of a company secretary be combined with that of another position?

As observed in many countries including Malaysia, it is not uncommon for the role of the company secretary to be combined with another position. For example, due to the compliance aspect present in the company secretary’s role, some companies have opted to combine the position of a company secretary with that of head of legal or compliance.

Notwithstanding the above, it should be noted that if the company secretary function is combined with another position, care should be taken to ensure that the effectiveness of the company secretary including its governance role is not compromised. The company secretary’s governance role requires impartiality when providing advice on governance issues. In this regard, both the board and the company secretary should ensure that there is no conflict between the functions performed in both positions.

In establishing reporting lines, it is important to ensure that company secretaries have direct access to the chairman and other directors to act as a conduit to the board. As company secretaries are officers of the company with legal responsibilities to assist in the proceedings of the company, it is essential for this position to be taken in a serious light by the company. Accordingly, company secretaries with appropriate standing and authority will be able to position issues sufficiently, and drive the board to ultimately discharge their functions with stature and credibility.

At all times, the appointment and removal of the company secretary should be determined by the board. A job description for the company secretary should be established with an annual performance evaluation conducted by the board, taking into account the responsibilities assigned to the company secretary.

Can the role of a company secretary be outsourced?

As in the case of many countries including Malaysia, there are no legal prescriptions which restrict the role of a company secretary from being outsourced. In this regard, some companies may decide to outsource the role of a company secretary to an external person. This would usually be the case in instances where the company deems an external person to be better able to render the service as a result of his or her specialist knowledge or ability to function more productively.

In the event that the company decides to outsource the role of a company secretary, it is imperative for the board to ensure that the relevant criteria, such as qualification, skills, experience and time commitment have been considered and assessed. The board should exercise oversight on how the external person fulfils his or her role as a company secretary.

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6 It should be noted that Section 242 of Companies Act 2016 prohibits a person to act in a dual capacity as both a director and a secretary in a situation that requires or authorizes anything to be done by a director and a secretary.
7 The Company Secretary as Polyarch 2016, International Finance Corporation
8 Section 236(1) of Companies Act 2016 states that “the board shall appoint a secretary and determine the terms and conditions of such appointment” whilst Section 239 of Companies Act 2016 states “the board may remove a secretary from his office in accordance with the terms of appointment or the constitution”.

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Regional/international perspectives

Alongside Malaysia, selected jurisdictions such as United Kingdom, Singapore and Australia have enumerated provisions on the advisory role of the company secretary, particularly in relation to corporate governance.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
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<tbody>
<tr>
<td>Singapore</td>
<td>Directors should have separate and independent access to the company secretary. The role of the</td>
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<td></td>
<td>company secretary should be clearly defined and should include responsibility for ensuring that</td>
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<td></td>
<td>board procedures are followed and that applicable rules and regulations are complied with. Under</td>
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<td>the direction of the Chairman, the company secretary’s responsibilities include ensuring good</td>
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<tr>
<td></td>
<td>information flows within the Board and its board committees and between Management and non-</td>
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<tr>
<td></td>
<td>executive directors, advising the Board on all governance matters, as well as facilitating</td>
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<td></td>
<td>orientation and assisting with professional development as required. The company secretary</td>
</tr>
<tr>
<td></td>
<td>should attend all board meetings (Guideline 6.3).</td>
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<tr>
<td></td>
<td>The appointment and the removal of the company secretary should be a matter for the Board as a</td>
</tr>
<tr>
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<td>whole (Guideline 6.4).</td>
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<tr>
<td>United Kingdom</td>
<td>Under the direction of the chairman, the company secretary’s responsibilities include ensuring</td>
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<td></td>
<td>good information flows within the board and its committees and between senior management and</td>
</tr>
<tr>
<td></td>
<td>non-executive directors, as well as facilitating induction and assisting with professional</td>
</tr>
<tr>
<td></td>
<td>development as required. The company secretary should be responsible for advising the board</td>
</tr>
<tr>
<td></td>
<td>through the chairman on all governance matters (Supporting Principles of B.5).</td>
</tr>
<tr>
<td></td>
<td>All directors should have access to the advice and services of the company secretary, who is</td>
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<tr>
<td></td>
<td>responsible to the board for ensuring that board procedures are complied with. Both the</td>
</tr>
<tr>
<td></td>
<td>appointment and removal of the company secretary should be a matter for the board as a whole</td>
</tr>
<tr>
<td></td>
<td>(Provision B.5.2).</td>
</tr>
</tbody>
</table>
Country | Provision(s)
---|---
Australia | The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board (Recommendation 1.4).

The company secretary of a listed entity plays an important role in supporting the effectiveness of the board and its committees. The role of the company secretary should include:

- advising the board and its committees on governance matters;
- monitoring that board and committee policy and procedures are followed;
- coordinating the timely completion and despatch of board and committee papers;
- ensuring that the business at board and committee meetings is accurately captured in the minutes; and
- helping to organise and facilitate the induction and professional development of directors.

Each director should be able to communicate directly with the company secretary and vice versa.

The decision to appoint or remove a company secretary should be made or approved by the board (Commentary to Recommendation 1.4).
Information and support for directors

MCCG Intended Outcome 1.0
Every company is headed by a board, which assumes responsibility for the company’s leadership and is collectively responsible for meeting the objectives and goals of the company.

MCCG Practice 1.5
Directors receive meeting materials, which are complete and accurate within a reasonable period prior to the meeting. Upon conclusion of the meeting, the minutes are circulated in a timely manner.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why The case for change
Information is the lifeblood of a board. Owing to the oversight nature of their roles, directors (particularly non-executive directors) inherently lack in-depth knowledge on the operations of a company in comparison to senior management. Directors rely on management for the information necessary to carry out their oversight duties.

In a similar vein, management cannot properly execute the directives of the board if those views are not communicated in an effective and timely manner. Thus, information flow between the board and management is critical to the proper functioning of both, as well as the execution of a company’s strategic plan and many other critical processes.

What could go wrong:
• Lack of robust challenge during board and board committees’ deliberations due to lack of, inaccurate or unclear information and information not being provided to the board in a timely manner.
• Minutes of meeting do not serve as an evidence of the board and board committees’ proceedings at material time due to poorly captured meeting minutes.
• Directives from the board are not carried out accordingly in a timely manner by management.
Point for reflection

The changing corporate landscape and rising stakeholders’ expectations have resulted in directors being more proactive by **deepening their commitment** and becoming more engaged in their roles. Directors are also increasingly devoting more time to strategic and forward-looking aspects (i.e. spending more time to “scan the road ahead” rather than just looking in the “rear-view mirror”)\(^1\).

This shift has naturally driven the **volume of information** that is being presented to boards. A Thomson Reuters global survey in 2013 (“Board Governance Survey”) which covered more than 125 general counsels and company secretaries across a cross-section of industries highlighted that on average, companies prepared 92 board books annually; each an average of 116 pages. This represents a 50% uplift from the average pages reported in the prior year (2012).

Directors are also increasingly seeking additional sources of strategic context and financial insights. The aforementioned survey revealed that over 70% of directors reported a need for competitor insights, financial analytics and industry information – all of which are sought outside of traditional board materials.

The trend on the intensity and complexity of information disseminated to directors is expected to continue as companies increasingly compete in the **data-driven marketplace**, owing to technological advances such as “big data”.

Recognising the importance of sound and timely information flow to board effectiveness, regulators have enumerated provisions to allow directors to receive relevant information prior to meetings whilst also ensuring that the proceedings and decisions of the board are properly recorded for further action.

### Third Schedule of Companies Act 2016\(^2\)

#### Paragraph 4 (Notice of meeting)

A notice of a meeting of the Board shall be sent to every director who is in Malaysia, and the notice shall include the date, time and place of the meeting and the matters to be discussed.

#### Paragraph 13 (Minutes)

The Board shall ensure that the minutes of all proceedings at meetings of the Board are kept.

The rights of directors to rely on information and seek resources in furtherance of their services as directors are provided for in **Companies Act 2016** and **Bursa Securities Listing Requirements**.

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\(^1\) Casal, C and Caspar C 2014, *Building a forward looking board*, McKinsey

\(^2\) As stated in **Section 212 of the Companies Act 2016**, “Subject to the constitution, the provisions set out in the **Third Schedule** shall govern the proceedings of the Board”.
Section 215(1) of Companies Act 2016

A director in exercising his duties as a director may rely on information, professional or expert advice, opinions, reports or statements including financial statements and other financial data, prepared, presented or made by –

(a) any officer of the company whom the director believes on reasonable grounds to be reliable and competent on the matters concerned;

(b) as to matters involving skills or expertise, any other person retained by the company in relation to matters that the director believes on reasonable grounds to be within the person’s professional or expert competence;

(c) another director in relation to matters within the director’s authority; or

(d) any committee to the board of directors on which the director did not serve in relation to matters within the committee’s authority.

Paragraph 15.04 of Bursa Securities Listing Requirements

Rights of directors

Unless otherwise provided by or subject to any applicable laws or these Requirements, a listed issuer must ensure that every director has the right to the resources, whenever necessary and reasonable for the performance of his duties, at the cost of the listed issuer and in accordance with a procedure to be determined by the board of directors, including but not limited to –

(a) obtaining full and unrestricted access to any information pertaining to the listed issuer;

(b) obtaining full and unrestricted access to the advice and services of the company secretary; and

(c) obtaining independent professional or other advice.

Provisions for financial institutions in this regard are encapsulated in Standard 9.6\(^3\) (minutes of meeting) and Standard 9.7\(^4\) (access to advice from third party experts) of Bank Negara Malaysia’s Policy Document on Corporate Governance.

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\(^3\) As stated in Standard 9.6 of Bank Negara Malaysia’s Policy Document on Corporate Governance, the board must ensure that clear and accurate minutes of board meetings are maintained to record the decisions of the board, including the key deliberations, rationale for each decision made, and any significant concerns or dissenting views. The minutes must indicate whether any director abstained from voting or excused himself from deliberating on a particular matter.

\(^4\) As stated in Standard 9.7 of Bank Negara Malaysia’s Policy Document on Corporate Governance, the financial institution must provide the board with access to advice from third party experts on any matter deliberated by the board as and when required, and the cost of such advice shall be borne by the financial institution.
The practice in substance

As stated in Guidance to Practice 1.5 of MCCG, in order to facilitate robust deliberations, the chairman together with the company secretary should ensure that directors are provided with sufficient information and time to prepare for board meetings.

The information provided should be of a quality which is appropriate to enable decision-making on the issues at hand. In other words, the information should be accurate, clear, comprehensive, timely, and inform the director of what is expected of him or her on that issue.

Upon conclusion of the meeting, all directors should ensure that the minutes of meetings accurately reflect the deliberations and decisions of the board or board committees, including whether any director abstained from voting or deliberating on a particular matter.

Key considerations relating to the application of this Practice are discussed below:

**How should the board formulate its meeting agenda?**

The board meeting serves as an avenue for governance discussions and decision-making by the board. Whilst the minimum number of meetings is not prescribed, it would be in the best interest of the company for the board to meet regularly (i.e. at least five meetings if not more frequently as circumstances dictate).

In this regard, the board (led by the Chairman) should be in control of the meeting agenda, rather than delegating the development of board agenda to management or the company secretary.

A carefully prepared board agenda will enhance the board’s productivity and strengthen its strategic and supervisory role. The agenda should be prepared, taking into account the formal schedule of matters reserved for the board’s decision.

A range of matters that should be periodically included in a board agenda is outlined on the following page.

**Dos**

- Encapsulating the right of directors to seek additional resources and formalising the relevant procedures for the furtherance of their duties in the board charter.
- Confining the use of circular resolutions to administrative matters.
- Preparing in advance an annual tentative calendar for the scheduling of the board or board committee meetings (usually performed in the last quarter of the current financial year).
- Establishing procedures to ensure that matters arising from the board or board committee meetings are acted upon.

**Don’ts**

- Having irregular and infrequent board and board committee meetings.
- Omitting matters reserved for the board and terms of reference of the respective committees in developing the meeting agenda.
A similar process can be adopted in developing the agenda for meetings of board committees.
What materials or information should be provided to directors before a board or board committee meeting?

The information provided (meeting pack) should at the very least include the following:

<table>
<thead>
<tr>
<th>Notice and agenda</th>
<th>Previous meeting minutes</th>
<th>Board or board committee papers</th>
</tr>
</thead>
<tbody>
<tr>
<td>The notice and agenda shall include the date, time and place of the meeting and the matters to be discussed.</td>
<td>Prior to approving the previous meeting minutes at the upcoming board or board committee meeting, every director should have the opportunity to review them, and make any necessary corrections.</td>
<td>The papers should address the core issues on which the board or board committee must deliberate. In developing the papers, prior exploration of the issues by management may help to gather relevant information and frame issues.</td>
</tr>
</tbody>
</table>

In the process of handling information, attention should be paid to the following:

- graphical presentations may be utilised but care must be taken that they are not overwhelming in terms of superfluous information or misleading;
- long management presentations which leave little time for thoughtful, reflective deliberations or presentations that are too short and contain little value to the board should be avoided;
- filtering of unfavourable information (e.g. key risk factors, worst case scenarios, less flattering information) should be avoided; and
- information should be used to assist the board in discharging its role and should not be scrutinised to an extent of obsession where the board micromanages the company.

When should the meeting materials be distributed to the board or board committee?

As stated in Guidance to Practice 1.5 of MCCG, the meeting materials should be circulated at least five business days in advance of the board meeting.

The general rule of thumb may also be applied for meetings of board committees. It is important for directors to be provided with sufficient time to review the relevant materials and prepare for meetings. In order to ensure information and documents are disseminated in a timely and efficient manner, companies should leverage on technology to deliver documents to directors.
What should be encapsulated in the meeting minutes of the board or board committees?

The purpose of the minutes is to accurately record the proceedings and decisions made during the meeting. The way in which they are prepared may also assist to establish that directors applied their minds sufficiently to the matters under consideration in the discharge of their duties.

The minutes of the meeting proceedings should be prepared with, but not limited to, the following details:

Suggested content of meeting minutes (non-exhaustive):

- the name of the company;
- the time, date and place at which the meeting was held (including the time at which the meeting was opened and closed);
- names of those present and in attendance, as well as any apologies (for absence or lateness);
- those who arrived or left during the meeting and the time at which they did so;
- the agenda and other materials that the board members received either before or during the meeting;
- what was decided and why – resolutions passed and actions to be taken by the board and delegates (including deadlines);
- fundamental questions raised and key points of discussions;
- any dissent, abstentions (and reasons provided for them); and
- any conflicts of interest including what the conflict was and how the board handled the situation.

What procedures should be put in place to facilitate timely circulation of accurate meeting minutes upon conclusion of the meeting?

The chairman of the board should agree with the board members and company secretary upon a procedure for circulating and approving minutes, taking into account the nuances of the company.

In drafting the minutes, the company secretary should, where relevant, seek the clarification from technical experts within management (e.g. chief executive officer, chief operating officer) to ensure that the draft minutes appropriately capture relevant technical points and issues discussed at the meeting.

The draft minutes should be reviewed by the chairman of the meeting prior to being circulated to all board members or board committee members for approval. Any amendments that may be required should be communicated to the company secretary within the time period agreed in the procedure.

As a general rule of thumb, meeting minutes shall be entered into the books within 14 days of the relevant meeting date.

Circular resolution

It would not be reasonable to expect the board to meet on every decision especially where it is administrative in nature. For this reason, the practice of using circular resolutions is sometimes deployed by companies.

However, caution should be exercised as there is a risk that the written resolutions are circulated to avoid discussion or scrutiny on certain contentious matters.

In this regard, the following safeguards should be applied:

- relevant information pertaining to the said resolution to be passed should be attached to the circular resolution which is circulated to the directors, so as to enable the directors to make an informed decision;
- circular resolutions which do not require the signature of all directors’ should still be circulated to the entire board. This is to ensure that the board, as a whole, is aware of decisions that are being made; and
- summary of circular resolutions, which have been passed since the last board meeting, should be circulated for notation of the board and minuted.

Boards should refrain from using circular resolutions to approve complex matters requiring rigorous deliberation.

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5 Board Meetings Practice Guide: Good decision making through effective meetings 2015, Institute of Directors New Zealand
**Case study: James Hardie Industries Limited (Australia)**

**Background:**
- The Australian Securities and Investments Commission (“ASIC”) brought civil penalty proceedings against the directors and an officer (company secretary) of James Hardie Industries Limited for contravening Section 180(1) of the Corporations Act 2001 in Australia which relates to failure to act with care and diligence as officers and directors of a corporation.

**Facts:**
- The James Hardie group of companies had been involved in the manufacture and sale of products containing asbestos. The subsidiaries responsible for the distribution of these products were subject to claims for damages for personal injury. In response, the board of James Hardie Industries Limited (i.e. parent company) decided to separate the relevant subsidiaries from the rest of the group, by creating the Medical Research and Compensation Foundation (“Foundation”) to manage and pay out asbestos claims made against the subsidiaries.
- The minutes of the meeting of the board of James Hardie on 15 February 2001 recorded that the board had approved a draft Australia Stock Exchange (“ASX”) announcement containing statements to the effect that the Foundation was "fully-funded" and would have "sufficient funds to meet all legitimate compensation claims".
- On the next day, a finalised ASX announcement was made (in similar form to the draft ASX announcement, including the reference to “fully funded”) which was ultimately shown to be incorrect as there were not sufficient funds to meet all claims. It was discovered that the Foundation was underfunded by over $1 billion. The ASIC then commenced proceedings against the directors and officer (i.e. general counsel and company secretary) of James Hardie.
- The directors in their defence submitted that the minutes tendered as evidence of the board meeting in February were false and no draft ASX announcement was tabled at the meeting, or approved by resolution of the board. They further submitted that the board’s subsequent adoption of the minutes was also false, as the minutes adopted were not an accurate record of the proceedings of that February meeting. The respondents admitted that the errors in the minutes had not been picked up because of a lack of care.
- The High Court found that the minutes were a *contemporaneous record of the board meeting* and were the only direct evidence of the proceedings of that meeting. The High Court found that the directors and officer of James Hardie were in breach of their duty of care [Section 180(1) of the Corporations Act 2001] by failing to prevent the company from making false or misleading statements to the market.

**Lessons Drawn:**
- Directors should **exercise care when reviewing and approving minutes** to ensure they are an accurate record of the meeting proceedings. Otherwise, directors may be faced with evidence in a proceeding that does not correctly reflect the relevant state of events.
Regional/international perspectives

As in the case of Malaysia, numerous jurisdictions have enumerated provisions to govern the supply of information to directors as well as the recording of meeting minutes in order to enhance the effectiveness of board or board committee meetings.

For example, the Hong Kong Corporate Governance Code and Corporate Governance Report has detailed prescriptions on the setting and distribution of board meeting agenda, the supply of information to directors and the capturing and dissemination of meeting minutes.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>Arrangements should be in place to ensure that all directors are given an opportunity to include matters in the agenda for regular board meetings <em>(Provision A.1.2)</em>.</td>
</tr>
<tr>
<td></td>
<td><strong>Notice of at least 14 days should be given of a regular board meeting</strong> to give all directors an opportunity to attend. For all other board meetings, reasonable notice should be given <em>(Provision A.1.3)</em>.</td>
</tr>
<tr>
<td></td>
<td>Minutes of board meetings and meetings of board committees should record in sufficient detail the matters considered and decisions reached, including any concerns raised by directors or dissenting views expressed. Draft and final versions of minutes should be sent to all directors for their comment and records respectively, <strong>within a reasonable time</strong> after the board meeting is held <em>(Provision A.1.5)</em>.</td>
</tr>
<tr>
<td></td>
<td>There should be a procedure agreed by the board to enable directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the issuer’s expense. The board should resolve to provide separate independent professional advice to directors to assist them perform their duties to the issuer <em>(Provision A.1.6)</em>.</td>
</tr>
<tr>
<td></td>
<td>For regular board meetings, and as far as practicable in all other cases, an agenda and accompanying board papers should be sent, in full, to all directors. These should be sent in a timely manner <em>(Provision A.1.2)</em>.</td>
</tr>
<tr>
<td>Country</td>
<td>Provision(s)</td>
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<td></td>
<td>manner and <strong>at least 3 days before the intended date of a board or board committee meeting</strong> (or other agreed period) (<em>Provision A.7.1</em>).</td>
</tr>
<tr>
<td></td>
<td>Management has an obligation to supply the board and its committees with adequate information, in a timely manner, to enable it to make informed decisions. The information supplied must be complete and reliable. To fulfil his duties properly, a director may not, in all circumstances, be able to rely purely on information provided voluntarily by management and he may need to make further enquiries. Where any director requires more information than is volunteered by management, he should make further enquiries where necessary. So, the board and individual directors should have <strong>separate and independent access to the issuer's senior management</strong> (<em>Provision A.7.2</em>).</td>
</tr>
<tr>
<td></td>
<td>All directors are entitled to have access to board papers and related materials. These papers and related materials should be in a form and quality sufficient to enable the board to make informed decisions on matters placed before it. <strong>Queries raised by directors should receive a prompt and full response, if possible.</strong> (<em>Provision A.7.3</em>).</td>
</tr>
</tbody>
</table>
Board charter

**MCCG Intended Outcome 2.0**

There is demarcation of responsibilities between the board, board committees and management.

There is clarity in the authority of the board, its committees and individual directors.

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**MCCG Practice 2.1**

The board has a board charter which is periodically reviewed and published on the company’s website. The board charter clearly identifies—

- the respective roles and responsibilities of the board, board committees, individual directors and management; and
- issues and decisions reserved for the board.

(The application of this Practice in its entirety entails the **establishment of a board charter** as well as a **periodic review** and **publication of the board charter** on the company’s website.)

⚠️ The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

### Why

**The case for change**

Whilst the general roles and responsibilities of boards are well founded, the expectations on directors have evolved significantly owing to changes in the corporate landscape. High-profile board failures, the boom in responsible investing, and the disruptive forces of technology are placing directors under an unprecedented level of pressure from shareholders, regulators and other stakeholders.

In response to this change, directors today are expected to deal with a breadth of issues in a timely manner. A study of over 1000 global companies by McKinsey in 2015 (as shown on the following page) highlighted that directors are increasingly deepening their commitment, investing more time and going beyond the minimum prescribed to engage more deeply on aspects such as strategy, performance management and stakeholder management.

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What could go wrong:

- Expectation gap between the board, management and other stakeholders regarding the board’s role.
- Selected individuals having unfettered power of decision-making.
- Directives by the board are not acted upon in a timely manner by management.
- Deliberations and decision-making are dominated by certain individuals.
- Lack of a structured approach to board proceedings, resulting in ineffective deliberation and decision-making process.
In tandem with this heightening demand for greater accountability, it is imperative for the board to clarify its responsibilities as well as that of the board committees, individual directors and management. Considering the accountabilities through the lens of each of these positions can provide the board with a holistic view of corporate governance. As the former CEO of Medtronic and a veteran of ten corporate boards, William George puts it, “one’s perspective on board governance depends on the board seat one holds”.

To this end, the establishment of a board charter would go a long way in defusing potential tensions at the outset by clearly defining the roles of the respective parties as well as establishing well-understood boundaries. The board charter will serve as an authoritative policy document that sets out the board’s strategic intent, authority and terms of reference.

Point for reflection

There is an increasing blurring of lines between the roles of the board and management. Directors today are demanded to be more vigilant in the operations and drivers of businesses including having an understanding of the technical details. Directors are also expected to have a granular understanding of the business model, be able to challenge assumptions underlying the strategies proposed and to master the complexities of risk management. Such expectations call for boards to become more involved and engaged, thus leading to the “oversight versus micromanagement debate”.

The blurring of lines becomes more apparent when the company is at a critical stage of development or when it goes through periods of stress, crisis or trust deficit, all of which necessitates a greater intervention amongst directors.

As the board cannot both manage and oversee, it is essential for the delineation of roles to be clearly crystallised to avoid overlaps in the points of accountability. Being the focal point of the company, the board should at all times exercise collective oversight of the board committees and management.

1 The CEO guide to boardsA 2016, McKinsey Quarterly
"HOW"

**The practice in substance**

It is therefore clear that the board should formalise a board charter to serve as a primary reference and literature that guides the governance and conduct of the board.

Given that the charter is an avenue to communicate the company’s approach to governance, the document should be published on the website and made accessible to all stakeholders of the company. This would allow stakeholders to understand the practices put in place by the directors in discharging their responsibilities towards the company and its stakeholders.

Similar to Practice 2.1 of MCCG, Standard 8.2 of Bank Negara Malaysia’s *Policy Document on Corporate Governance* states that the board must have a board charter that sets out the mandate, responsibilities and procedures of the board and the board committees, including the matters reserved for the board’s decision.

Key considerations relating to the application of this Practice are outlined below:

**What should be encapsulated within a board charter?**

The following are some of the matters that should be considered when developing a board charter:

- a general outline of the board’s purpose, key values, ethos and principles;
- an overview of the board’s monitoring role;
- structure and membership;
- a formal schedule of matters reserved for the board, including the type and nature of issues, transactions and thresholds and the process for deliberation;
- appointment of board committees;
- roles and responsibilities of the board, board committees and individual directors;
- expectations on time commitment and protocols for accepting new directorships;
- director’s orientation and education programme;
- agreed upon procedures in enlisting independent professional advice at the company’s expense in furtherance of the directors’ duties (whether as a board or in their individual capacity); and
- procedures for the development, undertaking, and improvement of board processes, including the assessment of performance and continuing education and development of the board, its committees and directors.

**Dos**

- Having a periodic discussion between the board and management to ensure the content set out in the board charter reflects the company’s current needs.
- Ensuring the board charter is sufficiently detailed to capture the types and nature of issues that are to be dealt with by the board, board committees, individual directors and management.
- Making the delegation of authority clear and ensuring that such delegation is in line with the legal and regulatory requirement.

**Don’ts**

- Having a board charter which is overly broad and general, which is of little value to shareholders to understand the delineation of roles and responsibilities within the board or between the management and the board.
- Maintaining that the responsibilities of the various parties as encapsulated in the legal and regulatory requirement is the be-all and end-all.
- Utilising an existing board charter template that does not reflect the company’s needs and nuances.
- Poor implementation of the elements contained in the board charter.
Illustrative outline of board charter

Outline of board charter:

- Introduction
- Role of the board
- Board reserved powers and responsibilities
- Board membership, independence and conduct
- Role of the chairman
- Role of the company secretary
- Delegation to management
- Committees
- Meetings
- Declaration of interests
- Access to management
- Access to independent professional advice
- Induction and training
- Review of board performance and charter

Salient features of the Charter:

- **Matters reserved for the board** – identifies issues that need to be finally decided on by the Board.
- **Role profiles** – defines and clearly separates the roles of the Group Chairman and the Group Chief Executive, as well as the Board’s expectations of the chairmen of the Board Committees.
- **Delegation to management** – outlines that the Chief Executive Officer is responsible to the Board for the development and implementation of strategy, as well as the day to day management.
- **Terms of reference of board committees** – outlines the approved mandates of each Board Committee.

The Board undertakes an annual assessment of its performance including its performance against the requirements of its charter, the performance of individual Committees and the performance of individual Directors.

*Source: Telstra Ltd Board Charter October 2015 (Australia)*
What are the underlying principles to consider when demarcating the responsibilities between board, board committees and management?

In carrying out the delineation of responsibilities, the board should be guided by the following principles:

**Delegate, not abdicate**

As stated in Section 211(1) of Companies Act 2016, “the business and affairs of a company shall be managed by, or under the direction of the Board”.

It should be noted that whilst the board may appropriately delegate its authority to board committees or management, it should not abdicate its responsibility and should at all times exercise collective oversight of the board committees and management.

The board should not delegate matters to a committee or management to an extent that would significantly hinder or reduce the board’s ability to discharge its functions.

**Supplement, not supplant**

The board may engage on the field but shall not excessively intervene on the operational and implementation role of management.

The over interference with the management of the company’s processes, people and administration, in a manner which is intrusive may slow down or even inhibit business processes. Such actions of micromanagement could also create conflict and lead to demotivated management.

A case study which involves a director wrongfully imposing his will to a member of the management team for an unlawful purpose is described on the following page:

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2 Section 216(2) of Companies Act 2016 states that where the directors have delegated any power, the directors are responsible for the exercise of the power by the delegatee as if the power had been exercised by the directors themselves. Section 216(3) of Companies Act 2016 states that the directors are not responsible under subsection (2) if — (a) the directors believed on reasonable grounds at all times that the delegatee would exercise the power in conformity with the duties imposed on the directors under this Act and the constitution of the company, if any; and (b) the directors believed on reasonable grounds, in good faith and after making a proper inquiry, if the circumstances indicated the need for the inquiry, that the delegatee was reliable and competent in relation to the power delegated.
Case study: MEMS Technology Berhad (Malaysia)

Background:

- A non-independent non-executive director and the chief financial officer of MEMS Technology Berhad (“MEMS”) were charged in April 2009 under Section 122B(bbb) of the Securities Industry Act 1983 (“SIA”) for authorising the furnishing of misleading information to the Exchange.

Facts:

- MEMS had reported its revenue to be approximately RM73.4 million. Its profit after tax was reported to be RM21.5 million for the twelve month period ended 31 July 2007.

- Subsequent investigations by authorities uncovered that the substantial shareholder and non-executive director of MEMS had directed the chief financial officer of the company to generate falsified documents to support fictitious orders. This was carried out through the records of a wholly owned subsidiary of MEMS, namely, SenzPak (M) Sdn Bhd.

- Evidence from the investigation also revealed that MEMS’ revenue was overstated by RM30.2 million due to the fictitious registered sales transactions for the twelve month period ended 31 July 2007.

- Both individuals pleaded guilty to the charges on February 2010. The court imposed a prison sentence of six months in addition to fines of RM300,000 each.

- MEMS was directed to rectify and reissue its accounts for the year ended 31 July 2007 and 2008. MEMS was also required to restate and re-announce its financial results for the six-month period ended 31 January 2009.

Lessons Drawn:

- There should be clearly defined responsibilities between the board and management with no one individual having unfettered powers to wrongfully impose his or her will on the affairs of the company. Adequate checks and balances should be put in place to safeguard against the potential of override of controls or other inappropriate influence over the governance processes and procedures.

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3 Enforcement 2017, Securities Commission Malaysia
What are the key steps involved in developing and reviewing a board charter?

The process involved in the development and review of board charter is depicted below:

- **Collect Information**: Document existing board policies, and practices, including “unwritten” practices that regulate corporate conduct.
- **Analyze Documentation**: Analyze documentation to identify discrepancies between existing policies and practices, as well as areas where no formal policies exist.
- **Obtain Board Approval**: All directors must participate in the review and approval process of the board charter. This ensures that directors are aware of their roles and responsibilities encapsulated within the charter.
- **Draft Charter**: The board may provide guidance to the company secretary in formulating and drafting the board charter. Larger companies may consider engaging an external consultant to address complex governance matters.
- **Conduct Periodic Review**: A periodic review is recommended to ensure that the charter reflects current needs and nuances of the company.

The board should review its board charter periodically or as changes arise (e.g. restructuring and strategic initiatives) to ensure that the allocation of responsibilities reflects the dynamic nature of the relationship necessary for the company to adapt to changing circumstances.
Regional/international perspectives

As in the case of Malaysia, many jurisdictions including United Kingdom, Singapore and Australia have called for clear demarcation of roles and responsibilities between board and management.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>Every company should prepare a document with guidelines setting forth:</td>
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<tr>
<td></td>
<td><em>(a)</em> the matters reserved for the Board’s decisions; and</td>
</tr>
<tr>
<td></td>
<td><em>(b)</em> clear directions to Management on matters that must be approved by the Board.</td>
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<tr>
<td></td>
<td>The type of material transactions that require board approval under such guidelines should be disclosed in the company’s Annual Report.</td>
</tr>
<tr>
<td></td>
<td><em>(Guideline 1.5)</em></td>
</tr>
<tr>
<td>Australia</td>
<td>A listed entity should disclose:</td>
</tr>
<tr>
<td></td>
<td><em>(a)</em> the respective roles and responsibilities of its board and management; and</td>
</tr>
<tr>
<td></td>
<td><em>(b)</em> those matters expressly reserved to the board and those delegated to management.</td>
</tr>
<tr>
<td></td>
<td><em>(Recommendation 1.1)</em></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management <em>(Provision A.1.1)</em>.</td>
</tr>
</tbody>
</table>
Establishing and implementing a code of conduct and ethics

**MCCG Intended Outcome 3.0**

The board is committed to promoting good business conduct and maintaining a healthy corporate culture that engenders integrity, transparency and fairness.

The board, management, employees and other stakeholders are clear on what is considered acceptable behaviour and practice in the company.

**MCCG Practice 3.1**

The board establishes a *Code of Conduct and Ethics* for the company, and together with management implements its policies and procedures, which include managing conflicts of interest, preventing the abuse of power, corruption, insider trading and money laundering.

The *Code of Conduct and Ethics* is published on the company’s website.

(\(\text{The application of this Practice in its entirety entails the establishment of a Code of Conduct and Ethics by the board and implementation of its policies and procedures alongside management as well as the publication of the Code of Conduct and Ethics on the company's website.}\))

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

**The case for change**

Lessons learnt from the numerous episodes of corporate misconducts (e.g. corruption, fraudulent reporting and insider trading) in recent years point towards a common denominator, which is *ethics*. Accounts of such incidences may be peppered with references to terms such as “market complexity”, “financial intermediation” and “creative accounting”, but at their very heart lies the failure of ethics. In many instances, unethical behaviour went unchecked, proliferated and eventually became the norm within the company.

A close examination of misconducts revealed that lapses in the ethical framework allowed some individuals to push, and in several cases, break the boundaries of what is permissible. As quoted in a speech by the President of Federal Reserve Bank of New York, William Dudley, “ethical problems in companies originate not with a few bad apples but with the barrel makers”\(^1\). In other words, the problems originate from the *ethical culture* of the company.

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Ethical culture reflects the prevailing attitudes and behaviours within the company. It is how individuals react not only to legislations (“black and white”), but to all of the ethical dilemmas (“shades of grey”).

For an ethical culture to become part of a company’s DNA, the existing ethical framework must be supplemented by human governance, a governance structure that is human-centric, principles-based and relies on conviction to make decisions.

A company’s culture is largely shaped by the company’s leadership. Ethical principles and values need to originate from the leaders and be cascaded across the company. This notion is well encapsulated by the oft-cited phrase of “tone at the top, tune in the middle, and beat at the feet”.

To this end, a well-designed Code of Conduct and Ethics could go a long way in shaping the corporate culture and driving conduct within a company. It serves as both an internal guideline and an external statement of corporate values and commitment. It could also act as a central point of reference for employees to support day-to-day decision-making.

On the contrary, lack of ethical guidance could lead to diminution of personal accountability. In a survey performed by KPMG in 2013 across a cross-section of approximately 100 listed issuers in Malaysia, respondents opined that the most prevalent factor which contributed to unethical behaviour was poor communication of the company’s values or Code of Conduct and Ethics.

Factors that contributed to the unethical behaviour occurring in the respondents’ organisation

Source: KPMG Malaysia Fraud, Bribery and Corruption Survey 2013
Recognising the need to foster an ethical culture that is grounded on ethical, prudent and professional behaviour, **Standard 18.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance** (as with Practice 3.1 of MCCG) has emphasised the need for boards of financial institutions to formalise a Code of Ethics and ensure its implementation.

The practice in substance

The board should therefore commit to ethical values through a Code of Conduct and Ethics and ensure the implementation of appropriate internal systems to support, promote and ensure its compliance.

The board should also satisfy themselves that the Code of Conduct and Ethics is taken seriously throughout the company, and make it known that they will take serious action against any conscious and recurring breaches. The policies of the Code of Conduct and Ethics should be integrated into company-wide management practices and be periodically reviewed.

Key considerations relating to the application of this Practice are outlined below:

**What are the factors that should be taken into account in developing a Code of Conduct and Ethics?**

David Murray lists the following critical success factors for the formulation of a Code of Conduct and Ethics:

<table>
<thead>
<tr>
<th>Clear purpose</th>
<th>Understanding of predecessor codes</th>
<th>Understanding of existing values and principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>The board and senior management should know why they want to develop a code and what benefits it entails.</td>
<td>If a previous code is outdated, there should be clarity on why this is the case and, if there is an industry specific code, adequate care should be taken that there is no conflict between the two.</td>
<td>The code has to be based on these existing values, otherwise employees will not be able to associate with or endorse the contents.</td>
</tr>
</tbody>
</table>

In addition, companies would need to answer the following basic but critical questions, which are:

- Does the company adhere in practice to a Code of Conduct and Ethics?
- What should be the coverage of the Code of Conduct and Ethics? *(Note: Guidance to Practice 3.1 of MCCG states that the Code of Conduct and Ethics should be comprehensive and cover all aspects of the business.)*

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2 As stated in **Standard 18.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance**, the implementation includes maintaining a record of breaches of the code of ethics and addressing such breaches in a manner that upholds high standards of integrity.

Ethics should articulate practices and guide the behaviours of directors, management and employees.

- How to obtain buy-in for the company’s Code of Conduct and Ethics?
- What are the measures which can help to reinforce the practices contained in the company’s Code of Conduct and Ethics?

What should be encapsulated in a Code of Conduct and Ethics?

As stated in Guidance to Practice 3.1, the Code of Conduct and Ethics should describe measures put in place to:

- handle actual or potential conflict of interest;
- prevent corrupt practices which include the offering and acceptance of gifts and other form of benefits;
- encourage the reporting of unlawful or unethical behaviour;
- protect and ensure the proper use of the company’s assets; and
- ensure compliance with laws, rules and regulations.

In addition, companies may consider the following list of issues and risk areas that could be addressed in the said document, either under their own subject heading or as part of a broader topic:

Example of areas that can be covered in a Code of Conduct and Ethics (non-exhaustive):

- anti-trust/competitive information/fair competition;
- tender/procurement/purchasing;
- anti-money laundering, anti-terrorism financing and proceeds of unlawful activities;
- confidential and proprietary information;
- record keeping and document retention;
- political participation, contribution and lobbying;
- outside employment and other activities;
- holding directorships in other entities;
- donation and sponsorship;
- gifts, entertainment, favours and other items of value to/from stakeholders;
- health and safety;
- marketing, sales, advertising, and promotions;
- securities trading and insider information;
- personal conduct;
- harassment (sexual and other forms of discrimination); and
- employment practices and affirmative actions.

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4 The Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 and the accompanying guidelines issued by Bank Negara Malaysia provide for the offence of money laundering and terrorism financing and the measures to be undertaken for the prevention of money laundering and terrorism financing offences.
How can the board set the tone in driving ethical culture within the company?

The foundation of an ethical culture largely depends on the leadership, and the responsibility begins with the board.

The directors should lead by example and embody the ethical values that are being espoused. The board together with management should also put in place policies and procedures which engender ethical conduct throughout all levels of the company. This includes the implementation of appropriate internal systems to ensure adherence to the Code of Conduct and Ethics.

The roles and responsibilities of the board in driving effective ethical leadership are depicted as follows:

As illustrated above, ethical leadership is results-driven. It is about achieving strategic objectives and positive outcomes.

In this regard, the board is responsible to steer the strategic direction of the company in terms of ethics. The board should determine the way in which ethical considerations are to be approached, conducted and addressed. In order to give effect to the company’s ethical strategy, management then implements and executes the strategy in accordance with the policy and plans (including the Code of Conduct and Ethics) which are approved and overseen by the board. The board finally ensures that there is accountability for the actions through, amongst others, reporting and disclosure by the management to the board on ethical matters. This in turn forms the basis for reviewing strategic direction which starts the cycle anew.

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5 From Pledge to Practice: A Guide to implement the Corporate System Malaysia 2014, Corporate Integrity System Malaysia

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Corporate Integrity System Malaysia

In 2011, the Corporate Integrity System Malaysia ("CISM") initiative was introduced to secure the cooperation of companies to develop their own anti-corruption programmes. This initiative was driven by the Malaysian Anti-Corruption Commission alongside other regulatory bodies and government agencies.

The CISM initiative encourages companies to take personal responsibility for matters concerning ethics and integrity. It outlines a framework to help companies and businesses in identifying gaps and obstacles that they face in pursuing corporate integrity.

Under CISM, companies are called upon to sign the Corporate Integrity Pledge (a unilateral declaration that the organisation will not commit corrupt acts) and submit an annual report on integrity initiatives. As of the end of 31 December 2016, there are over 800 signatories who have committed to this initiative.
Regional/international perspectives

Alongside Malaysia, enumerations for companies to have a code of conduct and ethics have been established in many countries including Australia and South Africa.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>A listed entity should:</td>
</tr>
<tr>
<td></td>
<td>(a) have a code of conduct for its directors, senior executives and employees; and</td>
</tr>
<tr>
<td></td>
<td>(b) disclose that code or a summary of it. (Recommendation 3.1)</td>
</tr>
<tr>
<td>South Africa</td>
<td>6. The governing body should ensure that codes of conduct and ethics policies:</td>
</tr>
<tr>
<td></td>
<td>a. encompass the organisation’s interaction with both internal and external stakeholders and the broader society; and</td>
</tr>
<tr>
<td></td>
<td>b. address the key ethical risks of the organisation (Practice 6)</td>
</tr>
<tr>
<td></td>
<td>7. The governing body should ensure that the codes of conduct and ethics policies provide for arrangements that familiarise employees and other stakeholders with the organisation’s ethical standards. These arrangements should include:</td>
</tr>
<tr>
<td></td>
<td>a. publishing the organisation’s codes of conduct and policies in the organisation’s website, or on other platforms or through other media as is appropriate;</td>
</tr>
<tr>
<td></td>
<td>b. the incorporation by reference, or otherwise, of the relevant codes of conduct and policies in supplier and employee contracts; and</td>
</tr>
<tr>
<td></td>
<td>c. including the codes of conduct and ethics policies in employee induction and training programmes. (Practice 7)</td>
</tr>
<tr>
<td>Country</td>
<td>Provision(s)</td>
</tr>
<tr>
<td>---------</td>
<td>--------------</td>
</tr>
<tr>
<td></td>
<td>8. The governing body should delegate to management the responsibility for implementation and execution of the codes of conduct and ethics policies. <strong>(Practice 8)</strong></td>
</tr>
<tr>
<td></td>
<td>9. The governing body should exercise ongoing oversight of the management and ethics and, in particular, oversee that it results in the following:</td>
</tr>
<tr>
<td></td>
<td>a. Application of the organisation’s ethical standards to the processes for the recruitment, evaluation of performance and reward of employees, as well as the sourcing of suppliers.</td>
</tr>
<tr>
<td></td>
<td>b. Having sanctions and remedies in place for when the organisation’s ethical standards are breached.</td>
</tr>
<tr>
<td></td>
<td>c. The use of protected disclosure or whistleblowing mechanisms to detect breaches of ethical standards and dealing with such disclosures appropriately.</td>
</tr>
<tr>
<td></td>
<td>d. The monitoring of adherence to the organisation’s ethical standards by employees and other stakeholders through, among others, periodic independent assessments. <strong>(Practice 9)</strong></td>
</tr>
</tbody>
</table>
Establishing and implementing whistleblowing policies and procedures

MCCG Practice 3.2
The board establishes, reviews and together with management implements policies and procedures on whistleblowing.

MCCG Intended Outcome 3.0
The board is committed to promoting good business conduct and maintaining a healthy corporate culture that engenders integrity, transparency and fairness.

The board, management, employees and other stakeholders are clear on what is considered acceptable behaviour and practice in the company.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why
The case for change

Corporate crimes including fraud and corruption are one of the main obstacles to sustainable socioeconomic development for emerging and developed economies alike. Weaknesses in averting such crimes would undermine governance, leading to knock-on effects which include distortion of market mechanisms like fair competition, diminution of domestic and foreign investments as well as loss of future business opportunities for stakeholders.

Estimates show that the worldwide cost of corruption equals to more than 5% of global Gross Domestic Product with over US$1 trillion paid in bribes each year\(^1\). The prevalence of such incidences and the profound impact that stems from them highlight the importance of building a corporate culture that supports the giving and receiving of “bad news”, i.e. **creating a candid environment of openness and honesty** and the presentation of unfavourable information.

In the absence of a well-designed internal complaint framework for employees to raise concerns about illegal or unethical activity that they are aware of through their work (or better known as **whistleblowing policy and procedures**), companies risk falling into a vicious cycle, as illustrated on the following page.

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\(^1\) *Integrity in Practice 2014, Organisation for Economic Co-operation and Development*
Over the years, whistleblowing has proven to be the most prevalent detection technique to uncover white collar crimes in corporations. In many instances, employees accounted for most of the whistleblowing tips that led to the discovery of fraud.

In KPMG’s forensic survey titled “Global Profiles of the Fraudster 2016”, it was found that 44% of fraudsters were detected as a result of a tip, complaint and formal whistleblowing reports either via hotline or other than formal hotline channels.

The observation that whistleblowing is a major line of defence against fraud and corruption was corroborated by numerous other research studies including the Global Fraud Study (2016) by Association of Certified Fraud Examiners, as illustrated below:
The practice in substance

As stated in Guidance to Practice 3.2 of MCCG, the board should encourage employees to report genuine concerns in relation to breach of a legal obligation (including negligence, criminal activity, breach of contract and breach of law), miscarriage of justice, danger to health and safety or to the environment and the cover-up of any of these in the workplace.

As with the MCCG, Bank Negara Malaysia’s Policy Document on Corporate Governance recognises that whistleblowing can serve as an important tool in preventing misconducts at the “get-go” stage. Standard 18.2 of the said document has impressed upon the need for financial institutions to establish a whistleblowing policy, accompanied with relevant procedures and avenues for legitimate concerns to be objectively investigated and addressed. The provision further states that individuals must be able to raise concerns about illegal, unethical or questionable practices in confidence and without the risk of reprisal.

Regulatory requirements have also placed a positive obligation on selected gatekeepers (e.g. external auditors and audit committees) to whistleblow given their position of power and nexus to confidential proceedings. In such instances, the failure to whistleblow by these gatekeepers would constitute an offence.

The Capital Market and Services Act 2007 enumerates provisions concerning obligation of external auditors to whistleblow on matters under their purview.

Section 320(1) of Capital Market and Services Act 2007 (“CMSA”)

If an auditor, in the course of the performance of his duties as an auditor of a listed corporation, is of the professional opinion that there has been a breach or non-performance of any requirement or provision of the securities laws, a breach of any of the rules of the stock exchange or any matter which may adversely affect to a material extent the financial position of the listed corporation, the auditor shall immediately submit a written report on the matter –

(a) in the case of a breach or non-performance of any requirement or provision of the securities laws, to the Commission;

(b) in the case of a breach or non-performance of any of the rules of a stock exchange, to the relevant stock exchange and the Commission; or

(c) in any other case which adversely affects to a material extent the financial position of the listed corporation, to the relevant stock exchange and the Commission.

Inaction as an offence

As with gatekeepers such as external auditors and audit committee, any individual to whom any gratification is given, promised or offered is obligated to whistleblow.

Section 25(1) of Malaysian Anti-Corruption Commission Act 2009 states that, “any person to whom any gratification is given, promised or offered, in contravention of any provision of this Act shall report such gift, promise or offer together with the name, if known, of the person who gave, promised or offered such gratification to him to the nearest officer of the Commission or police officer”.

Any person who fails to comply with the aforementioned provision is deemed to have committed an offence.
The obligation of an audit committee is meanwhile outlined in Bursa Securities Listing Requirements.

**Paragraph 15.16 of Bursa Securities Listing Requirements**

**Reporting of breaches to the Exchange**

Where an audit committee is of the view that a matter reported by it to the board of directors of a listed issuer has not been satisfactorily resolved resulting in a breach of these Requirements, the audit committee must promptly report such matter to the Exchange.

Key considerations relating to the application of this Practice are discussed below:

**What are the common barriers faced by companies in implementing whistleblowing policy and procedures and how can they be managed?**

Factors that commonly pose a challenge in operationalising whistleblowing as well as the pertinent steps that can be taken to manage such challenges are outlined below:

<table>
<thead>
<tr>
<th>Operational barrier</th>
<th>Emotional barrier</th>
<th>Cultural barrier</th>
</tr>
</thead>
<tbody>
<tr>
<td>The whistleblowing process is not fully embedded throughout the company and reporting lines are not operating effectively with lack of communication to all employees on available avenues.</td>
<td>Whistleblowers are commonly deterred from reporting incidents to management due to reasons such as fear of trouble and potential dismissal. In accordance with the regulatory provisions in Companies Act 2016 and CMSA², the board must ensure that employees are not discriminated against their lawful employment or livelihood as a result of whistleblowing on non-observance of regulations. Further provisions on the protection of whistleblowers are outlined in Whistleblowers Protection Act 2010 (covered in the ensuing pages of this write-up).</td>
<td>Whistleblowers are commonly viewed with a negative connotation such as “source of friction”. This perception can make it difficult to blow the whistle although individuals recognise that it is good for the company and other stakeholders. To this end, the board should set the tone by communicating that every employee has a role to play in detecting, preventing and correcting misconducts and that whistleblowing is an important means for that purpose. Moral support should also be provided to whistleblowers (e.g. demonstration of appreciation as opposed to outright skepticism and disbelief of the complaints or concerns received from the whistleblower).</td>
</tr>
</tbody>
</table>
What are the key considerations that the board should take into account when assessing whether the whistleblowing policies and procedures in place are effective and adequate?

In assessing the adequacy and effectiveness of the whistleblowing policies and procedures, the board must first undertake an assessment of the existing internal control measures that have been established by the company. This will allow the board to evaluate if the framework in place is effective and adequate to identify and combat illegal, unethical or questionable practices within the company. Some of the key considerations in relation to the assessment are as follows:

- How does the company identify illegal, unethical or questionable practices?
- What form of risk management programme does the company have in relation to the said practices?
- What is being done within the company to better prevent the said practices or at least discover it sooner?
- What processes are in place to investigate the said practices and take corrective action?

What are the elements that should be considered in developing and reviewing the whistleblowing policy and procedures?

The board or the board committee charged with the responsibility of overseeing integrity matters should consider the following:

- Are whistleblowing procedures documented and communicated throughout the company?
- Does the whistleblowing policy make clear that it is both safe and acceptable for employees to raise concerns about wrongdoing?
- Were the whistleblowing procedures arrived at through a consultative process? Do management and employees “buy into” the process?
- Are concerns raised by employees (and others) responded to within a reasonable timeframe?
- Are procedures in place to ensure that all reasonable steps are taken to prevent the victimisation of whistleblowers?
- Are there procedures to ensure that all reasonable steps are taken to keep the identity of whistleblowers confidential?
- Has a senior person been identified to whom confidential concerns can be disclosed? Does this person have the authority and determination to act if concerns are not raised with, or properly dealt with, by line management and other responsible individuals?
- Are success stories on whistleblowing publicised and made known?
- Does management understand how to act if a concern is raised? Do they understand that employees (and others) have the right to blow the whistle?

A sample whistleblowing policy is outlined in Appendix I of this Pull-out.

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2 Audit Committee Handbook 2017, KPMG
**Who should be the recipients of whistleblowing reports?**

The whistleblowing report should be addressed to an independent individual in the company who is not subject to undue influence or pressure by management. Individuals who may be considered appropriate ("designated parties") include:

- member of the audit committee (overall oversight);
- senior independent director (usually for complaints relating to directors and other senior management positions);
- head of internal audit department;
- head of a dedicated department that handles investigations of misconduct or any other related matters and has a direct reporting line to independent directors; and
- designated person of an independent advice centre (i.e. an independent entity that provides consultancy services which is tailored to the company’s requirements. This method is commonly deployed by multinational companies).

Where the whistleblowing report involves a breach of statutory provisions, an official report should also be made to the relevant regulatory authorities, upon consultation with the designated parties within the company.

**What is the nature of protection accorded to whistleblowers?**

The mere existence of a whistleblowing policy, although crucial, cannot operate in isolation. As commonly cited, “a whistleblowing policy without protection mechanisms is a paradox”. A survey conducted by the Organisation for Economic Co-operation and Development in 2015 showed that 85% of the global companies surveyed have mechanisms in place to report suspected serious corporate misconduct, but over one-third of these either did not have a written policy of protecting whistleblowers from reprisals or did not know if such a policy existed. It is therefore incumbent on the board to provide employees with effective protection.

A company must therefore ensure that there are mechanisms in place to accord whistleblowers with anonymity and access to management and selected representatives of the board, if needed. The company should also express zero tolerance for retaliation and if such acts were committed, they should be punishable.

It is also important to note that protection can extend beyond that provided by companies. In Malaysia, under the Whistleblower Protection Act 2010, a whistleblower who makes a disclosure in good faith to an enforcement agency is accorded with certain protection subject to the provisions of the said Act as follows:

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2 Commiting to Effective Whistleblower Protection 2016, Organisation for Economic Co-operation and Development

4 Revocation of whistleblower protection is set out in Section 11 of Whistleblower Protection Act 2010. Circumstances which would result in a revocation of whistleblower protection, amongst others, include frivolous and vexatious whistleblowing disclosures.

5 Defined in accordance with Section 2 of Whistleblower Protection Act 2010, “enforcement agency” means, amongst others, any ministry, department, agency or other body set up by the Federal Government, State Government or local government; or a body established by a Federal law or State law, which is conferred with investigation and enforcement functions.
• Protection of confidential information [Section 7(1)(a) of Whistleblower Protection Act 2010];
• Immunity from civil and criminal action [Section 7(1)(b) of Whistleblower Protection Act 2010]; and
• Protection from detrimental action [Section 7(1)(c) of Whistleblower Protection Act 2010];

and for the purpose of Section 7(1)(c), the protection shall be extended to any person related to or associated with the whistleblower.

Where

Regional/International perspectives

Similar to the case of Malaysia, enumerations for companies to establish whistleblowing policy and procedures are codified across the globe.

For example, United Kingdom and Singapore have placed the responsibility on the audit committee to review and ensure that whistleblowing arrangements are in place for appropriate follow-up actions.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee’s objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action (Provision C.3.5).</td>
</tr>
<tr>
<td>Singapore</td>
<td>The audit committee should review the policy and arrangements by which staff of the company and any other persons may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee’s objective should be to ensure that arrangements are in place for such concerns to be raised and independently investigated, and for appropriate follow-up action to be taken. The existence of a whistleblowing policy should be disclosed in the company’s Annual Report, and procedures for raising such concerns should be publicly disclosed as appropriate (Guideline 12.7).</td>
</tr>
</tbody>
</table>
Presence of independent directors on the board

**MCCG Intended Outcome 4.0**

Board decisions are made objectively in the best interests of the company taking into account diverse perspectives and insights.

**MCCG Practice 4.1**

At least half of the board comprises independent directors. For **Large Companies**, the board comprises a majority independent directors.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the intended outcome.

**Why**

The case for change

Independent directors have the mandate of bringing objectivity to the oversight function of the board. The objectivity inherent to these directors allows them to debate with and challenge the senior management team in a relatively more unbiased manner compared to executive directors, who play a key role in developing strategic direction and running the business.

Whilst the roles of independent directors are well-defined, there are growing observations that independent directors are often impeded in standing up for their views, thus, affecting their ability to influence decision-making by the board.

The underlying causes commonly hindering independent directors from acting independently in name and deed can be attributed to the following practical barriers outlined on the following page\(^1\).

---

\(^1\) *Growth and Emerging Market Report 2016, International Organisation of Securities Commission*
Practical barriers for independent directors:

<table>
<thead>
<tr>
<th>Personal authority</th>
<th>Positional authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual directors may display traits of a domineering character and high-handed leadership style (commonly observed in charismatic managing directors). Such directors may regard challenge as causing offence or a trait of disloyalty.</td>
<td>The positions of chairman and managing director are vested with a high degree of power, conferring them with positional authority. In the absence of balancing factors, there is a natural tendency for their views to be deferred to and agreed with.</td>
</tr>
</tbody>
</table>

Information asymmetry

Due to limited engagement with the company, independent directors generally lack detailed knowledge about the business. Lack of granular understanding can deprive independent directors of the confidence to challenge management and evaluate their responses.

Cultural environment

The emphasis placed on harmony makes it difficult for board members to express divergent points of view.

It is clear that, lacking the counterweight, directors, even those with all the requisite elements and levers of independence often find it difficult to move boldly against convention, rally for support and facilitate a robust deliberation process in the boardroom. Succinctly put, the collective voice of the incumbent independent directors may be encumbered.

The reasoning behind calling upon companies to have a prescribed number of independent directors is thus to create a “critical mass” of directors, who can encourage, support and drive each other in the value creation and sustainability of the business\(^2\).

The practice in substance

Whilst there is no absolute formula in determining an ideal composition of independent directors, boards with a balanced or higher proportion of independent directors would certainly go a long way in alleviating boardroom dominance, stereotype discussions and complacency. Meaningful application of this practice would mean that boards must go beyond the existing prescriptions in Bursa Securities Listing Requirements.

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\(^2\) Independent Non-Executive Directors: A Search for True Independence in Asia 2010, Chartered Financial Analyst ("CFA") Institute
Composition of the board of directors

(1) A listed issuer must ensure that at least 2 directors or 1/3 of the board of directors of a listed issuer, whichever is the higher, are independent directors.

(2) If the number of directors of the listed issuer is not 3 or a multiple of 3, then the number nearest 1/3 must be used.

In addition, Standard 11.6 of Bank Negara Malaysia’s Policy Document on Corporate Governance outlines that the board of financial institutions must have a majority of independent directors at all times.

Key considerations relating to the application of this Practice are discussed below:

How to harness the collective wisdom and benefit from the greater participation of independent directors?

- Having a private session of independent directors without the presence of executive directors and senior management is increasingly recognised as a good practice. It is commonplace for company secretaries to organise a private session of independent directors after the meeting of a board or board committee and the frequency of such sessions will vary based on the nuances of the company. Apart from independent directors, these sessions will typically involve key gatekeepers of the company such as external and internal auditors. This provides independent directors with the opportunity to candidly share concerns about the company and exchange views on potential improvements in governance.

- Having in place a balanced or higher proportion of independent directors allows these directors to rotate across board committees. The committees will be able to benefit from greater checks and balances, and deliberations would be enhanced from the contributions of directors with diverse backgrounds.

3 In Camera Directors’ Meetings 2013, Minden Gross LLP

Dos

- Minimising or limiting independent directors sitting on subsidiaries.
- Developing a policy to rotate independent directors across board committees.
- Providing independent directors with a platform to meet privately without the presence of executive directors.

Don’ts

- Accepting the separation of chairman and CEO as a substitute for not having a balanced board or a majority of independent directors.
- Maintaining that adherence to Bursa Securities Listing Requirements (i.e. one third of the board comprising independent directors) is the be-all and end-all.
- Having in place an internal policy on meritocracy that overrides the element of independence.
Why should a company limit the same independent directors from sitting across group entities?

Whilst common directors can contribute to group alignment, excessive overlaps of independent directors (as shown in the diagram below) may result in conflict of interest situations. Directorships in multiple entities within the group may also potentially create undue dependence in terms of remuneration received by independent directors, thus, raising concerns on the objectivity of these directors.

The need for financial institutions to minimise excessive common directorships in group entities is highlighted in Standard 11.11 of Bank Negara Malaysia’s Policy Document on Corporate Governance.

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**Diagram:**

```
+-------------------+
| Holding company   |
|                   |
+-------------------+   +-------------------+
| Listed company X  |   | Listed company Y  |
|                   |   |                   |
+-------------------+   +-------------------+   +-------------------+
| Subsidiary I      |   | Subsidiary III    |   | Subsidiary IV     |
|                   |   |                   |   |                   |
|                   |   |                   |   |                   |
| Independent A     |   |                   |   |                   |
```

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How do owner-managed companies with a small board size structure their composition of independent directors?

In owner-managed companies (particularly those with a small board size), whilst the chairman and managing director may be two different individuals, they are often related to each other and/or to the controlling shareholders.

In such a situation, the need for a majority of independent directors becomes even more imperative to prevent deliberations and decision-making from being dominated by a select group of individuals, comprising family members.

An example of a structure for a board size with five members and related chairman-managing director is outlined below:

```
+-------------------+
| Family members    |
|                   |
| Chairman          |
| Managing Director |
| Independent       |
| Independent       |
| Independent       |
```

---
Regional/international perspectives

Similar to the case of Malaysia, there has been a move by global regulators (as noted in countries like United Kingdom and Australia) to prescribe a more even balance of independent and non-independent directors on the board.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>The chairman should on appointment meet the independence criteria. A chief executive should not go on to be chairman of the same company. If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report (Provision A.3.1). Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors (Provision B.1.2).</td>
</tr>
<tr>
<td>Australia</td>
<td>A majority of the board of a listed entity should be independent directors (Recommendation 2.4). The chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the CEO of the entity (Recommendation 2.5).</td>
</tr>
</tbody>
</table>

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4 A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.
Tenure of independent directors

**MCCG Intended Outcome 4.0**
Board decisions are made objectively in the best interests of the company taking into account diverse perspectives and insights.

**MCCG Practice 4.2**
The tenure of an independent director does not exceed a cumulative term limit of nine years. Upon completion of the nine years, an independent director may continue to serve on the board as a non-independent director.

If the board intends to retain an independent director beyond nine years, it should justify and seek annual shareholders’ approval. If the board continues to retain the independent director after the twelfth year, the board should seek annual shareholders’ approval through a two-tier voting process.

**MCCG Step Up 4.3**
The board has a policy which limits the tenure of its independent directors to nine years.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

The case for change

The notion of independence is inherently situational and is more than anything, a state of mind. Viewed as a solution for balancing influence, independent directors are expected to display a strong element of objectivity, both in appearance (“perceived independence”) as well as of mind (“independence in thought and action”) as illustrated below.

**What could go wrong:**
- Lack of a robust challenge process during board deliberations.
- Implementation of poor decisions by the company and perpetuation of poor decision-making due to the tendency of directors to defend their previous actions and/or lack of robust deliberations.
- Inability of the board to respond to the evolving and changing business circumstances.
In order to carry out their mandate effectively, independent board members must have the intellectual honesty and moral courage to advocate professional views without fear or favour. The presence of such attributes will allow independent directors to constructively challenge decisions proposed by other board members and contribute in meaningful ways to the strategic objectives and stewardship of companies.

The definition of an independent director is well-enumerated in **paragraph 1.01 of Bursa Securities Listing Requirements**.

**Paragraph 1.01 of Bursa Securities Listing Requirements**

**Definition of an independent director**

Independent director means a director who is independent of management and free from any business or other relationship which could interfere with the exercise of independent judgement or the ability to act in the best interests of an applicant or a listed issuer. Without limiting the generality of the foregoing, an independent director is one who –

(a) is not an executive director of the applicant, listed issuer or any related corporation of such applicant or listed issuer (each corporation is referred to as “said Corporation”);

(b) has not been within the last 2 years and is not an officer (except as a non-executive director) of the said Corporation. For this purpose, “officer” has the meaning given in section 2 of the Companies Act;

(c) is not a major shareholder the said Corporation;

(d) is not a family member of any executive director, officer or major shareholder of the said Corporation;

(e) is not acting as a nominee or representative of any executive director or major shareholder of the said Corporation;

(f) has not been engaged as an adviser by the said Corporation under such circumstances as prescribed by the Exchange or is not presently a partner, director (except as an independent director) or major shareholder, as the case may be, of a firm or corporation which provides professional advisory services to the said Corporation under such circumstances as prescribed by the Exchange; or

(g) has not engaged in any transaction with the said Corporation under such circumstances as prescribed by the Exchange or is not presently a partner, director or major shareholder, as the case may be, of a firm or corporation (other than subsidiaries of the applicant or listed issuer) which has engaged in any transaction with the said Corporation under such circumstances as prescribed by the Exchange.

*Note: Practice Note 13 of Bursa Securities Listing Requirements provides clarification on certain aspects of the definition of independent director.*

Similar provisions are applicable for financial institutions under **Standard 11.7 of Bank Negara Malaysia’s Policy Document on Corporate Governance**.

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2 CalPERS Revises Governance Policy, Adopts 12 Years as Threshold for Director Independence on Corporate Boards 2016, CalPERS
In addition to the factors outlined above, the length of service of an independent director is increasingly being recognised as a key element in the review of a director’s independence. Whilst it is recognised that independence is ultimately a subjective element, there are heightened concerns amongst stakeholders that extended tenure may give rise to independent directors having a close relationship with board and management and thus, becoming too sympathetic to their interests or too accepting of their work. Tenure is also increasingly regarded as a potential indicator of entrenchment and thus, the need for board refreshment.

Against this backdrop, the MCCG has stipulated a limit on the tenure of independent directors. As with many other jurisdictions, the yardstick adopted by the MCCG is a cumulative (consecutive or intermittent) term of nine years.

Why is a quantitative tenure limit of nine years prescribed?

It is important to note that the establishment of quantitative tenure limits is not arbitrary but rather it is based on well-founded empirical and research studies.

For example, a prominent research study undertaken by a distinguished scholar from INSEAD Business School in 2013 highlighted that the objectivity and performance of independent directors commonly reach a turning point between the seventh to eleventh year. The said turning point is the period at which an independent director has accumulated the benefits of institutional knowledge but has yet to accumulate the costs of entrenchment. Beyond this point, there is commonly a shift in an independent director’s performance (from rigorous oversight to complacency). The performance and objectivity of independent directors against tenure are illustrated in the diagram below:

Given that long tenures of independent directors may potentially erode the board’s objectivity, the board should consider utilising tenure limits as a mechanism to facilitate board renewal and thus, enhance the effectiveness of the board. As an exemplary practice, Step Up 4.3 of MCCG urges companies to establish a policy which limits the tenure of their independent directors to 9 years. A similar enumeration is also encapsulated in Bank Negara Malaysia’s Policy Document on Corporate Governance.

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3 Huang, S, 2013, Zombie Boards: Board Tenure and Firm Performance, Essays on Corporate Finance
4 Standard 11.9 of Bank Negara Malaysia’s Policy Document on Corporate Governance states that the tenure limits for independent directors should generally not exceed nine years, except under exceptional circumstances or as part of transitional arrangements towards full implementation of the succession plans of the financial institution.
The practice in substance

Recognising that all companies are not homogenous, Practice 4.2 of MCCG provides companies with the flexibility, in exceptional circumstances, to retain an independent director beyond nine years. As stated in Practice 4.2, “if the board intends to retain an independent director beyond nine years, it should justify and seek annual shareholders’ approval. If the board continues to retain the independent director after the twelfth year, the board should seek annual shareholders’ approval through a two-tier voting process”. In the case of Large Companies however, Guidance to Practice 4.2 of MCCG recommends that they are not encouraged to retain an independent director for a period of more than twelve years.

The aforementioned two-tier voting process is encapsulated in the timeline below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Appointment according to Bursa Securities Listing Requirements</th>
<th>Annual shareholders’ approval</th>
<th>Annual shareholders’ approval through two-tier voting process</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td></td>
<td></td>
<td></td>
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<td>10</td>
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<td>11</td>
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<td>12</td>
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<tr>
<td>13</td>
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<td></td>
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<tr>
<td>13+</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Key considerations relating to the application of Practice 4.2 and Step Up 4.3 of MCCG are discussed below:

How can the nominating committee or board assess if a long-serving independent director continues to be “independent in mind”?

In assessing whether a long-serving independent director continues to be “independent in mind”, the nominating committee should consider if the said director displays some of the following key characteristics:

- possesses sufficient self-esteem and confidence to stand up for an independent point of view;
- approaches any transaction that requires board’s approval with a watchful eye and an inquiring mind (professional scepticism);
- is unafraid to express an unpopular stance on issues or express disagreement on matters and actively pursues them with the rest of the board and with the management team; and
- does not shy away from asking hard and uncomfortable questions during board deliberations and willing to delve deeper if the responses provided are not satisfactory.

Dos

✓ Conducting a thorough annual assessment on directors’ independence and outlining the reasons for determining that a director is independent notwithstanding the long tenure.

✓ Incorporating enabling provisions in the company’s constitution to allow for the operationalisation of two-tier voting as enumerated in Practice 4.2 of MCCG.

Don’ts

× Maintaining that an annual assessment of directors’ independence is a substitute for not obtaining shareholders’ approval.

× Providing generic justification to accompany a resolution seeking to retain a long-serving independent director (e.g. “tenure has not impacted the independent director and the board is of the view that the said director continues to be independent”).

× Reducing shareholders’ approval via the two-tier voting process to an advisory vote.
What are the potential indicators of entrenchment amongst independent directors?

Some of the signs of entrenched independent directors include the following:

- failure of independent directors to act independently because of strong personal ties that have developed over the years;
- tendency of independent directors to defend decisions and policies that have been supported in the past, but now, are no longer relevant; and
- lack of new insights and the display of passivity during deliberations.

In addition, it is important to note that as stated in the Guidance to Practice 4.2 of MCCG, there could also be occasions where an independent director may become a "dependent" director due to prolonged insular recruitment processes and attractive remuneration packages and material benefits.

What should a justification to retain a long-serving independent director contain?

The board in proposing to retain an individual independent director beyond 9 years, should seek shareholders’ approval annually and provide strong justification in the explanatory notes to the resolution in the notice of AGM.

However, it should be noted that disclosure in this area has been generally poor. As stated in the “Analysis of Corporate Governance Disclosures in Annual Reports” performed by Bursa Malaysia in 2016 across 280 listed issuers, listed issuers were commonly found to provide weak justification for re-appointing independent directors beyond 9 years. In many instances, the explanatory notes to the resolution in the notice of AGM provided the same justification for several independent directors.

In this regard, boards should provide shareholders with clear and strong justification so as to enable shareholders to make an informed decision on whether the said director should be re-elected as an independent director. The considerations that should be contained in the justification to retain a long-serving independent director are as follows:

- nature of the assessment performed to evaluate the independence of the said independent director;
- the outcome of the assessment and the bases for arriving at that outcome;
- a statement by the board as to whether the said director can continue to perform his or her duties without being subjected to undue influence; and
- additional considerations such as the peculiarities of the company itself, possession of special knowledge and commitment displayed by the said director.

Hot-button issue

In the past, there have been instances whereby an independent director upon the end of his or her tenure is replaced by a family member, giving rise to a scenario dubbed as "independence can be inherited". Whilst such an appointment is not an outright breach of regulatory requirements, it may cast serious doubts on the ability of the director to exercise objective judgment.

Independent directors who are elected in the aforementioned circumstances are likely to have a sense of loyalty to the controlling shareholders or the directors who have nominated them, thus, potentially impairing their "independence of mind".

Companies should therefore internalise the spirit of law and endeavour to make sustained changes in order to truly benefit from the presence of independent directors.
How does the two tier-voting process operate?

Under the two-tier voting process, shareholders’ votes will be cast in the following manner at the shareholders’ meeting:

- **Tier 1:** Only the Large Shareholder(s)\(^5\) of the company votes; and
- **Tier 2:** Shareholders other than Large Shareholder(s) votes.

The decision for the aforementioned resolution is determined based on the vote of Tier 1 and a simple majority of Tier 2. If there is more than one Large Shareholder, a simple majority of votes determines the outcome of the Tier 1 vote. The resolution is deemed successful if both Tier 1 and Tier 2 vote in favour of the resolution.

Examples of possible scenarios and the corresponding outcomes are outlined below:

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Successful/ not successful</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario I</td>
<td>✔️</td>
<td>✔️</td>
<td>Successful</td>
</tr>
<tr>
<td>Scenario II</td>
<td>Abstained</td>
<td>✔️</td>
<td>Not successful</td>
</tr>
<tr>
<td>Scenario III</td>
<td>✔️</td>
<td>✗</td>
<td>Not successful</td>
</tr>
<tr>
<td>Scenario IV</td>
<td>✗</td>
<td>✔️</td>
<td>Not successful</td>
</tr>
</tbody>
</table>

**Regional/international perspectives**

Alongside Malaysia, many jurisdictions including United Kingdom, India, Hong Kong and Singapore have put in place tenure limits for independent directors. The quantitative limits placed and approach adopted are outlined on the following page:

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\(^5\) As stated in the *Guidance to Practice 4.2 of MCCG*, Large Shareholder means a person who is entitled to exercise, or control the exercise of, not less than 33\% of the voting shares in the company; is the largest shareholder of voting shares in the company; has the power to appoint or cause to be appointed a majority of the directors of the company; or has the power to make or cause to be made, decisions in respect of the business or administration of the company, and to give effect to such decisions or cause them to be given effect to.
<table>
<thead>
<tr>
<th>Country</th>
<th>Tenure limit</th>
<th>Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>9 years</td>
<td>Comply or explain (Provision B.1.1 of Corporate Governance Code)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note: The board should state its reasons if it determines that a director is independent notwithstanding that the independent director has served on the board for more than nine years.</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>9 years</td>
<td>Comply or explain (Provision A.4.3 of Corporate Governance Code and Corporate Governance Report)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note: Appointment beyond the ninth year should be subject to a separate resolution for the approval of shareholders.</td>
</tr>
<tr>
<td>Singapore</td>
<td>9 years</td>
<td>Comply or explain (Guideline 2.4 of Code of Corporate Governance)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note: The independence of any director who has served on the Board beyond nine years from the date of his first appointment should be subject to particularly rigorous review.</td>
</tr>
<tr>
<td>India</td>
<td>10 years</td>
<td>Mandatory</td>
</tr>
<tr>
<td></td>
<td></td>
<td>[Section 149(10) and (11) of Companies Act 2013]</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note: Director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board’s report.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Notwithstanding the above, no independent director of a public listed company shall hold office for more than ten years, but such independent director shall be eligible for appointment after three years of ceasing to become an independent director.</td>
</tr>
</tbody>
</table>
Diversity on boards and in senior management

**MCCG Intended Outcome 4.0**
Board decisions are made objectively in the best interests of the company taking into account diverse perspectives and insights.

**MCCG Practice 4.4**
Appointment of board and senior management are based on objective criteria, merit and with due regard for diversity in skills, experience, age, cultural background and gender.

**MCCG Practice 4.5**
The board discloses in its annual report the company’s policies on gender diversity, its targets and measures to meet those targets. For **Large Companies**, the board must have at least 30% women directors.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

**Case for change**

Diversity is a critical attribute of a well-functioning leadership team. It is widely accepted that a more diverse leadership team better reflects the realities of the society, strengthens strategy formulation and risk management by adding varying perspectives and enhances the overall credibility of the company.

Boards need a diverse range of perspectives to respond to the shifting market landscape:

- changes in business model – a mix of insights is needed to understand the different drivers that are impacting the business model of the industry. These drivers may include innovation in the financial markets and the emergence of disruptive technologies.
- changes in consumer demands – strategic direction from the leadership level need to match and respond to real-time market signals from consumers.
- new and emerging risks – discussions at leadership level need to be broadened and enriched to cover nascent risk areas such as cybersecurity, reputational and social risks.

On the contrary, experiences from the past have shown that the effectiveness of board and senior management can be severely hampered by lack of diversity which creates "groupthink" and "blind spots".

A growing body of research and empirical studies has shown that the pursuit of the diversity agenda makes business sense as companies which embrace diversity are associated with stronger financial performance. For example, a regional study conducted by Korn Ferry in 2016 across the largest 100 companies in 10 Asia Pacific countries, including Malaysia illustrated that companies with at least 10% female board representation recorded higher

**What could go wrong:**

- Prevalent instances of board members and senior management advocating common views which dilute objective assessment and challenge process during the deliberations.
- Lack of fresh insights and new perspectives at the leadership level which hinders the company from driving innovation.
- Adoption of overzealous stance by the board which could result in an unhealthy tension between directors and also between the board and management.
returns (Return on Assets and Return on Equity) than companies which lack thereof.\(^1\)

Similarly, a global study by McKinsey in 2015 covering 366 public companies across a range of industries in Canada, Latin America United Kingdom, and United States revealed that companies in the top quartile for gender or racial and ethnic diversity are more likely to reap the “diversity’s dividend” by having financial returns above their national industry’s medians. The “diversity’s dividend” for gender-diverse and ethically-diverse companies is illustrated in the diagram below:

![Diversity’s dividend](image)

**Point for reflection**

It is commonplace for companies to erroneously view “meritocracy” and “diversity” as a trade-off. Indeed, the “Analysis of Corporate Governance Disclosures in Annual Reports” performed by Bursa Malaysia in 2016 across 280 listed issuers revealed striking findings in this regard. As highlighted in the analysis, a substantial majority of listed issuers disclosed that whilst they were aware of the enumeration under the predecessor **Malaysian Code on Corporate Governance (MCCG 2012)** which calls for companies to have a policy formalising its approach to boardroom diversity, their policy was to make appointments to the board based on merit. This is compounded by the fact that only 5% of the said listed issuers disclosed the targets and measures to appoint more women on boards.

To this end, it is imperative for companies to dispel the misconception and view the elements “meritocracy” and “diversity” as complementary to each other. The pursuit of meritocratic ideals without due consideration of diversity could result in a missed opportunity for the board to consider a breadth of perspectives. Likewise, the pursuit of diversity without due consideration of merit criteria could result in “tokenism”, whereby the appointed director is unable to add tangible value to the board.

As Scott Page (an academician in Sante Fe Institute, United States) explains, the aforementioned situation is akin to comparing “apples to a fruit basket”. An apple, like a director candidate, may be evaluated as desirable based on his or her individual characteristics. In contrast, the fruit basket is evaluated on the basis of how the arrangement of fruits complement each other as a whole. It is therefore important for both the factors to be considered when selecting board members.\(^4\)

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1. **Building diversity in Asia Pacific Boardrooms** 2016, Korn Ferry
2. Diversity’s dividend” refers to the benefits that can be gathered by companies that put in place constructive diversity policies and procedures.
3. Hunt et.al 2015, **Why Diversity Matters**, McKinsey
Given the value proposition of diversity, markets globally are increasingly recognising the need for companies to incorporate diversity as a key strategic consideration. In Malaysia, such efforts are primarily carried out through disclosure-based requirements.

**Paragraph 15.08A(3)(a) of Bursa Securities Listing Requirements**

The listed issuer must provide, in its annual report, a statement about the activities of the nominating committee in the discharge of its duties for the financial year. Such statement must include how the requirements set out in paragraph 2.20A of these Requirements are met and contain the following information:

(a) the policy on board composition having regard to the mix of skills, independence and diversity (including gender diversity) required to meet the needs of the listed issuer;

Note: Bursa Malaysia Securities Berhad has vide its directive dated 22 July 2014 clarified that a listed issuer is required to disclose in its annual reports issued on or after 2 January 2015, its diversity policy for its board of directors in terms of gender, age and ethnicity as part of the enhanced disclosure requirements to paragraph 15.08A of Bursa Securities Listing Requirements.

It should also be noted that paragraphs 9.19(12), (14) and (14A) of Bursa Securities Listing Requirements outlines that the announcements of changes in the board of directors, chief executive and chief financial officer of a listed issuer must include the gender of the person appointed.

In addition, paragraphs 3, 4 and 4A in Part A, Appendix 9C of Bursa Securities Listing Requirements outline that the particulars of each director, chief executive and key senior management of a listed issuer in its annual report must include the gender of such director, chief executive and key senior management.

**The practice in substance**

In fostering diversity, boards should formalise a policy, set targets and annually assess both the targets and the company’s progress in achieving them.

In tandem with the heightened emphasis on the dimension of gender, boards should also demonstrate clear commitment to developing a corporate culture that also embraces the aspect of gender diversity.

Key considerations relating to the application of Practices 4.4 and 4.5 are discussed on the following page.

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5 Paragraph 2.20A of Bursa Securities Listing Requirements stipulates that every listed corporation, management company or trustee-manager must ensure that each of its directors, chief executive or chief financial officer has the character, experience, integrity, competence and time to effectively discharge his role as a director, chief executive or chief financial officer, as the case may be, of the listed corporation, or the collective investment scheme.
What are the elements that can be considered in the formulation of a diversity policy?

Suggestions for the content of a diversity policy (non-exhaustive):

- Communicate the definition of diversity and recognise that diversity includes numerous dimensions including skills, experience, age, ethnicity, and gender.
- Articulate the benefits of diversity and the importance of being able to attract and retain board members and senior management personnel from a wide pool of talent.
- Express the company’s commitment to diversity at the leadership level and employee level.
- Ensure that recruitment and selection practices at all levels (from the board downwards) are appropriately structured so that a diverse range of candidates are considered and that there are no conscious or unconscious biases that might discriminate against certain candidates.
- Identify and implement programmes that will assist in the development of a more diverse pool of skilled and experienced employees that, over time, will prepare them for senior management and board positions.
- Introduce key performance indicators (“KPIs”) for senior management personnel to measure the achievement of diversity objectives and link part of their remuneration (either directly or as part of a “balanced scorecard” approach) to the achievement of those objectives. Examples of such KPIs could amongst others include number of suitable candidates sourced for leadership positions, reduction in incidences of discrimination cases reported and participation of employees in diversity programmes organised by the company.

Adapted from the Australian Stock Exchange Corporate Governance Council’s Corporate Governance Principles and Recommendations 2014

What are the key elements that should be included in providing disclosures on gender diversity?

Elements that should be contained in relation to disclosures on gender diversity are outlined in Practice 4.5 of MCCG as follows:

- policies on gender diversity;
- targets set on gender diversity; and
- measures undertaken to meet the aforementioned targets.

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Guidance 5.2 of the Malaysian Code on Institutional Investors (“MCII”) urges that institutional investors should assess the quality of disclosures made by investee companies on the application of the Corporate Governance Code. This, amongst others, includes disclosure of diversity targets and policies, including gender, age and ethnicity. In tandem with this clarion call by the MCII, the Retirement Fund Incorporated of Malaysia encourages its investee companies to disclose their workforce ethnicity composition in the annual report*.

Similar efforts are also evident on the global front. For example, during the second quarter of 2017, the world’s largest asset manager, Blackrock voted for eight proposals to call upon companies in the United States and Canada to adopt policies in facilitating board diversity. During the same period, Blackrock also voted against board members at five companies who were on nominating committees but failed to respond to investors’ concerns about diversity7.

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* Guideline 3.2.1 of Corporate Governance Principles and Voting Guidelines 2014, Retirement Fund Incorporated
7 Blackrock supports effort to boost number of women board members 2017, The Star
An illustrative disclosure in this regard is outlined below:

**Illustrative disclosure**

**Policy statement**

Since the launch of the **Board Diversity Policy** in 2012, the Board has made progress in broadening the diversity of the Board and senior management. In 2015, the Board reviewed the policy to ensure that it continues to drive the benefits of a diverse Board and workforce across the business.

The Board agreed that the ambitions and objectives set out in the policy remain relevant targets against which to measure our progress (i.e. maintain a level of at least **30% female directors on the Board over the short to medium term**).

**Progress Update**

Changes to the Board were made during the year to 2 April as the Board experienced two retirements and one resignation. Despite the reduced overall size of the Board, the percentage of women on the Board remains strong at **36% at time of publication**.

The Board remains committed to maintaining at least a **30% female representation on the Board**, whilst ensuring that diversity in its broadest sense remains a central feature. As a result, the Nomination Committee will continue to recommend appointments to the Board based on diversity measured against meritocracy and other objective criteria such as skills and experience the individual offers.

The Board is also committed to strengthening the pipeline of senior female executives within the business and has taken steps to ensure that there are no barriers to women succeeding at the highest levels within Mark & Spencer.

**Other measures on gender diversity include:**

- assist the development of a pipeline of high-calibre candidates by encouraging a broad range of senior individuals within the business to take on additional roles to gain valuable Board experience;
- consider candidates for appointment as non-executive directors from a wider pool, including those with little or no listed company board experience;
- ensure long lists of potential non-executive directors include 50% female candidates;
- only engage executive search firms who have signed up to the voluntary Code of Conduct on gender diversity and best practice;
- report annually against these objectives and other initiatives taking place within the Company which promote gender and other forms of diversity; and
- report annually on the outcome of the Board evaluation, the composition and structure of the Board as well as any issues and challenges the Board is facing when considering the diverse make-up of the Company.

*Adapted from Marks and Spencer’s annual report for the financial year end 2 April 2016*
How can the board articulate the diversity of skills that the board is seeking to achieve in its composition?

It is increasingly regarded as a good governance practice for the nominating committee or board to outline a skills matrix in relation to its board composition. A company’s board skills matrix typically illustrates the mix of skills that the board currently has (current skill set) and is looking to achieve in its membership (envisioned or ideal skill set).

Facilitated by the company secretary, the nominating committee should also consider reflecting on any gaps in skills that may be created by the upcoming retirement of a director or any change in the company’s strategic direction. This will enable the nominating committee to have a productive discussion on how the board and board committees are constituted currently and also how the nominating committee believes they should best be constituted in the future.

In this regard, the matrix will serve to guide the board in the selection of new candidates besides providing stakeholders with a collective view to evaluate the competencies of the board. It is therefore important that the desired skill sets are regularly reviewed by the nominating committee to ensure alignment with the objective, strategic direction and emerging challenges faced by the company.

A hypothetical example of a board skills matrix for a development financial institution based on the suggested skill set prescribed by the Bank Negara Malaysia’s Guidelines on Corporate Governance for Development Financial Institutions 2011 is depicted below. (Note: The difference between current skill set and the ideal skill set indicates existing gaps that the board is seeking to bridge):

Appendix II of this Pull-out outlines a sample assessment to determine the knowledge, skills and experience of the current board, in light of the company’s business and strategies.

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Guidelines 2.17 and 2.18 of Bank Negara Malaysia’s Guidelines on Corporate Governance for Development Financial Institutions 2011
Regional/international perspectives

Similar to Malaysia, many countries including United Kingdom and Australia have (via their respective codes of corporate governance) urged companies to put in place policies and procedures on diversity in order to facilitate greater inclusion and diversity, particularly on gender.

Case study: Mangalore Chemical and Fertilisers Ltd (India) *

**Background:**
- Section 149(1) of the Companies Act 2013 in India and the subsequent guidelines (Clause 49 of the Listing Agreement) issued by the Securities and Exchange Board of India (“SEBI”) made it mandatory for all listed companies to have at least one woman on their boards, either as an executive or a non-executive director, before April 1, 2015.

**Facts:**
- In order to meet the aforementioned requirement, Ritu Mallya was appointed to be the sole women director (non-executive director) on the board of Mangalore Chemical and Fertilisers Ltd. Ritu Mallya is the step-mother of the controlling shareholder and the then Executive Director of the said company, i.e. Vijay Mallya.
- The appointment was met with strong objections from stakeholders who were unconvinced that the company would benefit from fresh perspectives emanating from an insider and family member of the current management. The company was heavily criticised for making a “token” appointment and hence, diluting the intention of the requirement which aims to enhance board effectiveness.

**Lessons Drawn:**
- Companies should internalise the spirit of law and endeavour to make sustained changes in order to truly benefit from diversity.
- At all times, the appointment of board members should be based on objective criteria, merit and with due regard for diversity.

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* Galani, U. 2015, *Keeping it in the family*, Reuters
<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>A separate section of the annual report should describe the work of the nomination committee including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company <em>(Provision B.2.4).</em></td>
</tr>
<tr>
<td>Australia</td>
<td>A listed entity should:</td>
</tr>
<tr>
<td></td>
<td>(a) have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity’s progress in achieving them;</td>
</tr>
<tr>
<td></td>
<td>(b) disclose that policy or a summary of it; and</td>
</tr>
<tr>
<td></td>
<td>(c) disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity’s diversity policy and its progress towards achieving them, and either:</td>
</tr>
<tr>
<td></td>
<td>1) the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined “senior executive” for these purposes); or</td>
</tr>
<tr>
<td></td>
<td>2) if the entity is a “relevant employer” under the Workplace Gender Equality Act, the entity’s most recent “Gender Equality Indicators”, as defined in and published under that Act.</td>
</tr>
<tr>
<td></td>
<td><em>(Recommendation 1.5)</em></td>
</tr>
</tbody>
</table>
Sourcing of directors

**MCCG Intended Outcome 4.0**

Board decisions are made objectively in the best interests of the company taking into account diverse perspectives and insights.

**MCCG Practice 4.6**

In identifying candidates for appointment of directors, the board does not solely rely on recommendations from existing board members, management or major shareholders. The board utilises independent sources to identify suitably qualified candidates.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

**The case for change**

The intensifying nature of globalisation, the emergence of novel technologies and the continuous pressure on companies to innovate have heightened the need for professional boards. Board members are now increasingly expected to possess a granular understanding of the business model, ability to challenge assumptions underlying the strategies proposed and scrutinise the risks that entail.

However, evidence from corporate governance failures has shown that the influence of “informal networks” on board appointments and opaque selection criteria are significant barriers to the professionalisation of boards.

**Point for reflection**

Anecdotal evidence suggests that controlling shareholders cum directors often nominate friends, former colleagues or relatives to the board regardless of their experience, qualifications or objectivity.1

This is compounded by the general tendency for boards to source for directors who are well-known to at least one of the existing board members.

It is also common to come across the same group of directors forming a chain of network by holding directorships within a pool of companies.

Directors who are elected in the aforementioned manner are also likely to have a sense of loyalty to the controlling shareholders or the directors who have nominated them. In such a setting, the beholden directors are likely to be rubber

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1 Board Member Nomination and Election 2012, Organisation for Economic Co-operation and Development
stamping proposals in the boardroom without duly probing the matters under discussion.2

In order to reduce instances of insular nomination methods, regulators are increasingly emphasising the importance of transparency and objectivity in directors’ nomination and election processes.

**Paragraph 2.20A of Bursa Securities Listing Requirements**

**Qualification of directors and other key officers**

Every listed corporation, management company or trustee-manager must ensure that each of its directors, chief executive or chief financial officer has the character, experience, integrity, competence and time to effectively discharge his role as a director, chief executive or chief financial officer, as the case may be, of the listed corporation, or the collective investment scheme.

*Note: In order to enable directors to devote sufficient time to carry out their responsibilities, paragraph 15.06 of Bursa Securities Listing Requirements restricts a director of an applicant or a listed issuer from holding more than 5 directorships in listed issuers.*

**Paragraph 15.08A(3)(b) of Bursa Securities Listing Requirements**

The listed issuer must provide, in its annual report, a statement about the activities of the nominating committee in the discharge of its duties for the financial year. Such statement must include how the requirements set out in paragraph 2.20A of these Requirements are met and contain the following information:

(b) the board nomination and election process of directors and criteria used by the nominating committee in the selection process.

Meanwhile, under **Standard 10.2 of Bank Negara Malaysia’s Policy Document on Corporate Governance**, directors and potential directors of financial institutions must have been assessed by the board nominations committee to have complied with the fit and proper requirements shown below.

<table>
<thead>
<tr>
<th>Fit and proper criteria for financial institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Probity, personal integrity and reputation</strong></td>
</tr>
<tr>
<td>Person must have the personal qualities such as honesty, integrity, diligence, independence of mind and fairness.</td>
</tr>
<tr>
<td><strong>Competence and capability</strong></td>
</tr>
<tr>
<td>Person must have the necessary skills, ability, experience and commitment to carry out the role.</td>
</tr>
<tr>
<td><strong>Financial integrity</strong></td>
</tr>
<tr>
<td>Person must manage his or her debts or financial affairs prudently.</td>
</tr>
</tbody>
</table>

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2 *Corporate Governance Better Policies for Board Nomination and Election in Asia 2013, Organisation for Economic Co-operation and Development*

3 *Bank Negara Malaysia’s Guidelines on Fit and Proper Criteria for Key Responsible Persons*
The practice in substance

A formal and transparent procedure should be established for sourcing and appointing new directors to the board, taking into account factors such as skills, experience, personal attributes and diversity required of directors, both collectively and individually.

Key considerations relating to the application of this Practice are discussed below:

What are the different approaches that the nominating committee can deploy in sourcing for board candidatures?

In exercising objectivity in the selection process, the nominating committee should seek to have access to a wide selection of candidates. Above and beyond referrals from directors, shareholders and management, this may include utilising the following sources:

- directors’ registry (e.g. Institute of Corporate Directors Malaysia);
- industry and professional associations (e.g. 30% Club);
- open advertisements (refer to the illustrative example on the following page); and
- independent search firms.

The nominating committee should clearly articulate the screening criteria to the relevant parties in order to maximise the effectiveness of the search conducted.

An illustrative example of an open advertisement for board member position is outlined below.

Illustrative example (Open advertisement)

**Position:** Board Member (Non-Executive Director)

**Company background**

Zotefoams PLC is a world leader in cellular materials technology. Using a unique manufacturing process with environmentally friendly nitrogen expansion, the company produces lightweight foams. Its technology gives rise to many potentially disruptive manufacturing solutions supplying a diverse range of clients including leaders in the aerospace, automotive, sports and leisure sectors. Zotefoams has a well-established global brand with subsidiaries and joint ventures in the US and Asia.

**Specification:**

As a Non-Executive Director of the Board, key responsibilities will include the following:

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4 Background information required under paragraph 1, Appendix 8A of Bursa Securities Listing Requirements includes personal details (i.e. name, age, gender, nationality, qualification, designation and independence status); working experience and occupation; directorships in public companies and listed issuers; details of any interests in the securities of the listed issuer and its subsidiaries; family relationship with any director and/or major shareholder of the listed issuer; any conflict of interests; and list of convictions for offences within the past five years (save for traffic offences) as well as particulars of any public sanction or penalty imposed by the relevant regulatory bodies during the financial year.
- Support the Chairman in ensuring that the Board provides effective direction for, and oversight of, the management of the Group and its compliance with its statutory and regulatory responsibilities.

- Provide input into the setting of the Group’s strategic aims, the development of deliverable plans to achieve these objectives, and the assessment of the effectiveness of the delivery by the executive management of these plans.

- Help set the Group’s values and standards and ensure that its obligations to its customers, shareholders, finance providers, regulators and others are understood and met.

- Attend and contribute to the effective running of meetings of other Board committees (e.g. Nomination, Remuneration) as required.

- Spend time with management as required providing input and advice on strategic and technology-related matters within the Non-Executive Director’s own business experience and capabilities.

- Communicate effectively and build strong relationships with all key stakeholders.

**Experience and skill sets:**

- Recent experience as an Executive in an industrial business.

- Engineering or science based background.

- International operations and manufacturing.

- Selling internationally to multi-sector business customers.

- Familiarity with components/materials businesses.

- Business for which intellectual property is highly significant.

- It would be beneficial for candidates to have some Board member experience of a Public Listed Company and as an Executive who have been involved in setting up manufacturing operations outside of the United Kingdom.

**Source:** Website of Zotefoams PLC of United Kingdom August 2017

**How should the board inform stakeholders of their approach in selecting directors?**

As mentioned above, paragraph 15.08A(3)(b) of Bursa Securities Listing Requirements requires the nominating committee of the listed issuer to set out a statement in the annual report on the board nomination and election process of directors and the criteria used by the nominating committee in the selection process.

In addition, Guidance to Practice 4.6 of MCCG calls upon the nominating committee to disclose in the company’s annual report how candidates were sourced including whether such candidates were recommended by the existing board members, management or major shareholders.

If the selection of candidates was solely based on recommendations made by existing board members, management or major shareholders, the nominating committee should explain why other sources were not used.
In the appointment of a new director, what are the steps that the board may undertake to appoint suitably qualified candidates?

The board may consider undertaking the following process as illustrated below.
Regional/international perspectives

Similar to Malaysia, United Kingdom has placed an emphasis on the need for the boards to deploy a formal and transparent process for the selection of directors, including encouraging the use of external search consultancy or open advertising.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company (Provision B.2.4).</td>
</tr>
</tbody>
</table>
Chairmanship of the nominating committee

MCCG Intended Outcome 4.0
Board decisions are made objectively in the best interests of the company taking into account diverse perspectives and insights.

MCCG Practice 4.7
The Nominating Committee is chaired by an Independent Director or the Senior Independent Director.

Why
The case for change

The nominating committee is a key gatekeeper in the process of recruiting directors, evaluating their performance and driving the continuous performance of the board.

As such, objectivity is integral to avoid entrenching unconscious bias in the activities undertaken by nominating committee. It is no surprise that the aspect of independence in the composition of this committee is reinforced by MCCG, particularly for the chairman of the nominating committee.

This is because the effectiveness of the nominating committee to a large extent depends on the effectiveness of its chairman. In addition to leading the vetting of candidates, the chairman also has the responsibility of leading the assessment of the board, board committees and individual directors. Inevitably, the time will also come when directors will depart from the company and it is incumbent upon the chairman of the nominating committee to lead the necessary conversations around succession planning, particularly for the chairman of the board and chief executive officer.

What could go wrong:

- Lack of oversight by the nominating committee on the chairman of the board. This would particularly be the case if the chairman of the nominating committee is the same as the chairman of the board.
- Preferential selection of candidates in sourcing and nomination of directors (i.e. directors are appointed based on existing prior relationships or recommendations and do not go through the nomination process).
- Inability of the independent directors to add any tangible value to the corporate governance practices of the company.
The practice in substance

Bursa Securities Listing Requirements have reflected the composition of the nominating committee.

**Paragraph 15.08A(1) of Bursa Securities Listing Requirements**

**Nominating committee**

A listed issuer must establish a nominating committee which comprises exclusively of non-executive directors, a majority of whom must be independent.

A review of annual reports across the top 100 listed issuers (by market capitalisation) as at 31 December 2016 revealed that 85 listed issuers have already appointed independent directors as the chairman of the nominating committees.

As with other board committees of a financial institution, Standards 12.3 and 12.4 of Bank Negara Malaysia’s Policy Document on Corporate Governance also require the chairman of a financial institution’s nominating committee to be an independent director and distinct from the chairman of the board.

The MCCG has consciously avoided naming only the senior independent director as the ideal chairman of the nominating committee, providing a degree of flexibility for companies.

This is because whilst the senior independent director is generally regarded as an ideal chairman of the nominating committee, there could be other circumstances that allow another independent director to act more effectively as the chairman of the nominating committee. For example, the senior independent director may regard being free of board committee duties as paramount to maintaining his neutrality and continuing to be an effective conduit for other independent directors to voice their concerns.

In another scenario, an independent director may be from a human resource background, and having gained experience and insights in recruitment, sociology and the dynamics of boardroom relationships, could contribute more effectively as the nominating committee chairman.

**Point for reflection**

Appointing an independent director as chairman is only the first step towards an effective nominating committee. It is just as vital for the chairman to discharge his duties in the manner envisaged.

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1 Review undertaken by KPMG Management & Risk Consulting Sdn Bhd in 2017
Key considerations relating to the application of this Practice are discussed below:

**Should the nominating committee be chaired by an independent director or a senior independent director?**

This should be determined by the board after having considered the merits and disadvantages of either the independent director or senior independent director acting as the committee chairman based on, amongst others, the considerations as outlined in the preceding page.

Given that the senior independent director is commonly a confidant to the other directors, he or she would be well-placed to oversee the assessment of the board’s chairman, taking into account a broad range of perspectives. Hence, in companies that have a senior independent director, it is commonplace for the senior independent director to be appointed as the chairman of the nominating committee.

**In addition to chairing the nominating committee, what are the other common functions undertaken by a senior independent director?**

The duties that are customarily performed by a senior independent director are outlined below (taking into account Guidance to Practices 2.1 and 4.7 of MCCG):

- acts as a sounding board to the chairman (e.g. offer counsel to the chairman on matters such as board dynamics and concerns of stakeholders);
- serves as an intermediary for other directors when necessary (e.g. facilitate confidential discussions with directors who may have concerns which they believe have not been properly considered by the board or which they feel may not be appropriate to raise in open forum or with the chairman directly);
- acts as point of contact for shareholders and other stakeholders particularly on concerns which cannot be resolved through the normal channels of the chairman and/or chief executive officer;
- provides leadership support and advice to the board in the event that the board is undergoing a period of stress (e.g. conflict between the chairman and chief executive officer or the strategy being followed by the chairman and/or executive officer is not supported by the board);
- leads the succession planning and appointment of board members, including the future chairman and chief executive officer; and
- leads the annual review of board effectiveness, ensuring that the performance of each individual director is assessed objectively and holistically (i.e. the views of all the directors are obtained in an impartial manner).

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2 Guidance on Board Effectiveness 2011, Financial Reporting Council (United Kingdom)
Regional/international perspectives

Similar to Malaysia, a number of jurisdictions has called for the nominating committee to be chaired by an independent director.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>The nominating committee should comprise at least three directors, the majority of whom, including the nominating committee chairman, should be independent. The lead independent director, if any, should be a member of the nominating committee <em>(Guideline 4.1)</em>.</td>
</tr>
<tr>
<td>Australia</td>
<td>The board of a listed entity should:</td>
</tr>
<tr>
<td></td>
<td>(a) have a nomination committee which:</td>
</tr>
<tr>
<td></td>
<td>(1) has at least three members, a majority of whom are independent directors; and</td>
</tr>
<tr>
<td></td>
<td>(2) is chaired by an independent director.</td>
</tr>
<tr>
<td></td>
<td><em>(Recommendation 2.1)</em></td>
</tr>
<tr>
<td>United</td>
<td>A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship <em>(Provision B.2.1)</em>.</td>
</tr>
<tr>
<td>Kingdom</td>
<td>The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors <em>(Provision B.6.3)</em>.</td>
</tr>
</tbody>
</table>

Where
Evaluation for board, board committees and individual directors

**MCCG Intended Outcome 5.0**

Stakeholders are able to form an opinion on the overall effectiveness of the board and individual directors.

**MCCG Practice 5.1**

The board should undertake a formal and objective annual evaluation to determine the effectiveness of the board, its committees and each individual director. The board should disclose how the assessment was carried out and its outcome.

For Large Companies, the board engages independent experts periodically to facilitate objective and candid board evaluations.

(The application of this Practice in its entirety entails the undertaking of a formal and objective annual evaluation to determine the effectiveness of the board, its committees and each individual director as well as the disclosure of how the assessment was carried out and its outcome. In addition, for Large Companies, the application of this Practice in its entirety would also entail the periodic engagement of independent experts by the board to facilitate objective and candid board evaluations.)

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

The case for change

Board evaluation or the process of self-evaluation by the board, is an essential process for the board to examine itself to ensure that the board is operating efficiently and effectively. This evaluation process allows the board to address issues such as leadership, delegation of duties and responsibilities and reviews of existing processes within the board.

The evaluation of boards has become a norm worldwide ever since it was first introduced in the Cadbury Report 1992 (United Kingdom).

Besides being a good governance practice, performance evaluation is a useful tool that is used by the board to consider the accomplishments of individuals and the groups of individuals within the board. It also provides an avenue for revisiting what could have been done better and incorporating lessons into future behaviour of the board. When done effectively, it could help the board to improve their relationship with management and stakeholders.

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What could go wrong:

- Pertinent issues concerning the board, board committees and directors are not detected and consequently, opportunities for improvement are not identified.
- Lack of linkage between the evaluation exercise and the professional development programme for directors.
- Stakeholders are unable to appreciate the bases for governance changes at the leadership level.
The most notable changes that can stem from an effective board evaluation are as follows:

- improvement in ways the board engages with management on strategy;
- better succession planning for the chief executive officer and outgoing directors;
- improvement in how meetings are conducted and information is disseminated;
- improvement in the function of the board through revised and enhanced meeting agendas; and
- more clearly defined roles of directors\(^2\).

It is important to acknowledge that the board, like any group within the company, must be evaluated just like its employees. In broad terms, evaluation for the board, board committees and individual directors revolves around the themes outlined below\(^3\):

**How the board leads**
Examine how the directors were chosen, the skills and experience the director brings to bear and the leadership style.

**How the board manages**
Evaluate the manner in which board meetings and boardroom activities are conducted, including board dynamics. Consider potential red flags such as “a board within a board”\(^4\).

**How the board contributes**
Review the manner in which board members interact and participate as well as how decisions are made.

Given the importance of this process, it is no surprise to see that the evaluation of the board, board committees and individual directors has continued to gain increasing traction over the recent years. The rationale behind this Practice is that directors should not be excused from the process of review and improvement. Leading boards in fact have come to view the exercise in a positive light, i.e. as an opportunity to change the status quo.

However, it is no exaggeration to say that looking in the mirror is a much harder proposition than looking at someone else. Directors, in particular executive ones, are accustomed to evaluating their senior management, suppliers and the like, but when it comes to one’s self, peers and the chairman, this becomes a much harder task.

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\(^2\) Behan, B 2017, *Engaging Directors on Board Composition*, Board Evaluation & CEO Succession Planning

\(^3\) Larcker, D et.al 2017, *How Boards Should Evaluate Their Own Performance*, Harvard Business Review

\(^4\) “board within a board” means a dynamic when a subset of directors has an outside influence on board decisions.
Why evaluations do not always work out:

<table>
<thead>
<tr>
<th>Self-rater bias</th>
<th>Back scratching</th>
<th>The status quo feel</th>
</tr>
</thead>
<tbody>
<tr>
<td>The director has a view of himself or herself that far exceeds what he or she would score if measured objectively (&quot;Dunning-Kruger effect&quot;).</td>
<td>Directors rate each other favourably and the end result is a consistent curve with no real opportunities offered for improvement.</td>
<td>Despite signs of under-performance, there is resistance to change and in particular, outside assistance is rejected as such directors fear the results of an evaluation.</td>
</tr>
</tbody>
</table>

Further, although it is considered an important process in ensuring the boards effectiveness, the stumbling block with board assessments is also in terms of its disclosure. Whilst many boards across the globe disclose that they have completed an evaluation, very few have been able to provide details on how the evaluation process was conducted®.

**How**

The practice in substance

It is important for a board to ensure that its directors are capable and qualified to lead and contribute towards the company’s growth. An effective board evaluation would result in constructive changes to the dynamism of the board, which would most often involve changes to board composition (e.g. succession planning). In fact, some of the best boards with highly engaged directors have developed action plans consisting of many different items, largely because their board evaluation process has stimulated many good ideas.

The following are some key issues that have to be considered in executing board evaluation:

- Does the board include discussions on governance matters in their meetings or are they overlooked for other matters of importance?
- Does the board have sufficient time to review and assess material information to provide quality and professional review?
- Is the composition of the board in terms of skills, knowledge, experience and business outlook well-suited for the company?
- Are there open and constructive conversations when discussing issues during board meetings?
- Are the performance of the board committees during the year evaluated?
- What are the weaknesses and shortcomings of the board and how to overcome them®?

In order to improve the disclosure on how boards are assessed and for the process to be transparent, **Bursa Securities Listing Requirements** have put the onus of driving the evaluation process on the nominating committee.

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**Paragraph 2.20A of Bursa Securities Listing Requirements**

**Qualification of directors and other key officers**

Every listed corporation, management company or trustee-manager must ensure that each of its directors, chief executive or chief financial officer has the character, experience, integrity, competence and time to effectively discharge his role as a director, chief executive or chief financial officer, as the case may be, of the listed corporation, or the collective investment scheme.

**Paragraph 15.08A(3)(c) of Bursa Securities Listing Requirements**

The listed issuer must provide, in its annual report, a statement about the activities of the nominating committee in the discharge of its duties for the financial year. Such statement must include how the requirements set out in paragraph 2.20A of these Requirements are met and contain the following information:

(c) the assessment undertaken by the nominating committee in respect of its board, committees and individual directors together with the criteria used for such assessment.

Likewise, the need to conduct an annual evaluation of the board, board committees and individual directors is encapsulated in Standard 13.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance. Similar to Practice 5.1 of MCCG, Guidance 13.2 of the said document by Bank Negara Malaysia also calls for a periodic externally facilitated evaluation. The evaluation process is therefore a significant portion of the nominating committee’s work, and adequate time should be budgeted in order to achieve a meaningful outcome.

It is not uncommon for boards to enlist external advisors to facilitate the assessment process. Indeed, Practice 5.1 of MCCG calls for Large Companies to engage independent experts on a periodic basis to facilitate objective and candid board evaluations. However, it should be noted that regardless of which party executes the process, the outcome is very much dependent on the directors’ mind set.

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**Point for reflection**

**Do evaluations work?**

**Box-ticking exercise**

A director who views his board seat as a legal necessity would likewise regard the evaluation process as a chore to be dispensed with as quickly and painlessly as possible. This director’s tendency is to give uniform ratings to all questions and pass on opportunities for suggestions.

**Outcome:**

Missed opportunity to identify improvement considerations.

**Carefully designed and thoughtfully responded board evaluation exercise**

A director who understands that whilst performance may be good, the evaluation process supports the “we can be better” mentality. For example, an evaluation of the board’s composition may lead to recruitment of a director who can cover the board’s “blind spot” within an industry.

**Outcome:**

Input obtained for potential governance changes that could lead to enhancement in effectiveness of the board, board committees and individual directors.
The most commonly used evaluation methods are questionnaires, informal review and an interview. These methods and the related processes are further explained in the ensuing paragraphs.

**Questionnaires**

Questionnaires are tailor-made to the company’s needs to ensure that questions posed are pertinent as the requirement of the boards differ within the industries. They are circulated on paper or online. The questions are pre-set and the director fills in the answers. There is minimal interaction and discussion involved in this process.

The result or summary of the evaluation is then shared with the chairman of the board or the chairman of the nominating committee.

**Informal review**

An informal review process involves the board evaluating its members on a more frequent and less formal basis. This results in a more immediate feedback to the board on their performance.

The directors assess the performance of the group or individual directors immediately after meetings based on the presentations, contribution of the directors during the meeting, communication between the members and how they reached their decisions during the meeting.

This process allows the board to respond to the issues that could impair the board on a timely basis.

**Interview process**

A widely recognised method that provides a positive contribution towards the assessment process is using an interview process. A properly structured and executed interview process which includes one-to-one conversation with each board members could yield multiple comments and observations. The board members involved in the process tend to be more engaged in communicating than in filling out forms and questionnaires. This leads to better results that allow the board to draw insights and formulate plans on recruitment and retention of directors.

It is also helpful to recognise that not all directors are expected to perform at the same level in order to merit a positive rating. For example, a director who has just joined the board would not be expected to exhibit the same familiarity as another director who has been serving for a longer period (e.g. five years). The key consideration is whether the new director has carried out his duties and discharged his responsibilities appropriately.

**Evaluation can be broadly grouped into two categories, internal and external evaluation.**

**Internal evaluation**

Internal evaluation of the board is often undertaken by the nominating committee, the board itself or facilitated by the company secretary. This process is normally conducted using questions that are either specifically tailor-made for

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the board or using available templates. Where the board conducts the evaluation, the process is usually led by the chairman of the board or the chairman of the nominating committee. For this process to be successful, the board must ensure the questions posed are aimed towards the betterment of the company as a whole.

In conducting an internal evaluation, the board should also consider drawing input from those who have a close nexus to the proceedings and activities of the board (e.g. company secretary and senior management). This may help yield findings that may not have surfaced from conventional methods.

**External evaluation**

An external evaluation is undertaken to provide objectivity that could, at times, be lacking when carrying out the process internally. By enlisting a third party expert, the evaluation exercise will also benefit from a rigorous methodology and professional viewpoints. As stated in Guidance to Practice 5.1 of MCCG, “a board evaluation which is periodically facilitated by a professional, experienced and independent party will lend greater objectivity to the assessment by providing an unbiased perspective on a director’s performance and his ability to contribute effectively to the board”.

**The action plan that can be drawn up upon conclusion of the evaluation is explained below:**

When an evaluation has been completed, the nominating committee or the external evaluator must devise an action plan and consider how the findings should best be communicated to the board in the interest of improving its effectiveness. There are a number of options, including the following:

- the original assessment should be presented to the directors or as a perspective to which the evaluator (internal or external) has contributed the context, judgment and recommendations, on a no-name basis;
- quotes and comments obtained from the respective directors who were evaluated may be used (e.g. in relation to strengths and improvement considerations) whilst maintaining appropriate anonymity;
- recommendations and/or action plans for enhancements, based on the evaluation results are tabled to the board;
- concerns regarding individuals should be identified; and
- directors should have informal discussions on the evaluation process, i.e. structure, content, coverage, and to accord directors an avenue to voice their feedback.

The success of the evaluation process often depends on the board chairman. An effective board chairman will engage directors in an open and honest debate, and facilitate the identification of priorities, agreed actions, responsibilities and timeframes.

Investors and other stakeholders should request for the board to provide their action plan from the last evaluation to know the extent of the actions taken by the board. This would show how well the board functions and how strong the evaluation process is within the board.
Key considerations relating to the application of this Practice are discussed below:

**What criteria can be used to evaluate the board, board committee or individual director’s performance?**

Guidance on the assessment criteria which should be customised to the needs of the company, is outlined below:

### Board or board committee performance:

- key responsibilities as noted in the charter and legal and regulatory requirements;
- board mix and composition (including independence and skill sets);
- culture and approach for risk governance;
- oversight of risk management systems and internal controls;
- agenda setting and meeting preparation;
- board dynamics and cohesiveness; and
- boardroom activities, i.e. directors’ involvement in providing input on matters relating to the company’s strategic or financial operations.

### Individual directors’ performance:

- meeting preparation and attendance;
- will and ability to critically challenge and ask the right questions;
- active participation by providing constructive views and sharing their experiences during meetings in contribution to the development of strategy;
- commit to serve the company with due diligence, integrity;
- commit the required time to fulfil the role and perform their responsibilities effectively;
- technical knowledge on specific industry/company activities/processes;
- focus on creating shareholder value;
- understanding the company and industry in terms of risks and direction;
- willingness to listen and acknowledge other viewpoints;
- character and integrity in dealing with potential conflict of interest situations;
- ability to work with other directors and management; and
- confident to stand up for a point of view.

Sample evaluation forms for committees and individual directors are provided in the following Appendices of this Pull-out:

- **Appendix III**: Board and board committees evaluation form
- **Appendix IV**: Directors’/key officers’ evaluation form
- **Appendix V**: Audit committee evaluation form
- **Appendix VI**: Audit committee members’ self-evaluation and peer evaluation form
What should be disclosed for the evaluation of a board, board committee or individual director’s performance?

As required by **paragraph 15.08A(3)** of Bursa Securities Listing Requirements, disclosure of the activities of the nominating committee in the annual report must, amongst others, include the assessment undertaken by the nominating committee in respect of its board, committees and individual directors together with the criteria used for such assessment.

However, disclosure in this area has not kept pace with the requirements and expectations of stakeholders over the recent years. The “Analysis of Corporate Governance Disclosures in Annual Reports 2015-2016 by Bursa Malaysia”, an analysis of 280 listed issuers, noted that although listed issuers disclosed that they conducted performance evaluations of their board, board committees and individual directors, only 56% disclosed the criteria for evaluation of individual directors, 40% disclosed criteria for evaluation of board committees and 65% disclosed criteria for evaluation of the board.

In addition to the aforementioned requirement, companies should also endeavour to provide detailed information on its evaluation exercise to keep stakeholders well-informed by, amongst others, disclosing the factors taken into account in deciding on the method of evaluation, the results of the evaluation and how such results were utilised (e.g. training needs analysis of individual directors).

Further, **Guidance to Practice 5.1 of MCCG** states that the nominating committee of Large Companies should disclose the following information in its annual report:

- how the evaluation was conducted, the criteria used such as the assessment of fit and properness, contribution and performance, calibre and personality of directors;
- whether an independent expert was engaged, or was it internally facilitated;
- key strengths and/or weaknesses that were identified from the evaluation; and
- steps or enhancements proposed to be undertaken to mitigate or address the weaknesses identified.

In addition to the above, when an independent third party is used to carry out the board evaluation, the board should disclose the identity of the third party.

The illustrative disclosure on the following page provides an example of disclosure on an externally facilitated evaluation process carried out by SuperGroup PLC in United Kingdom.
What are the advantages of an externally facilitated evaluation?

Apart from an inherent level of objectivity, external advisors can frequently pinpoint areas of weakness as the advisor would likely have accumulated a database of results from their experience of conducting similar assessments for other boards and board committees. Based on their experience, the advisors can also share insights on what makes boards function well and what are the typical improvement areas for the board within its industry to consider relating to the company’s current evaluation process. Consequently, the advisors could suggest improvements to methodology.

This evaluation method also presents a more objective view as the evaluation would be conducted by a third-party and not a person connected to the company. This would enable the evaluator to notice matters that would have slipped under the radar by an in-house evaluation.
How often should companies conduct an externally facilitated evaluation?

There are no numerical prescriptions provided on the frequency of an externally facilitated evaluation, as these will vary for each company based on its circumstances.

A review of annual reports across the top 100 Malaysian listed issuers in December 2016 (by market capitalisation) which have conducted an externally facilitated evaluation revealed that the average frequency for such an exercise is once every three years. This trend appears to be consistent with that in foreign jurisdictions. The United Kingdom’s Corporate Governance Code, for example, calls upon FTSE 350 companies to enlist third-party experts for their evaluation exercise once every three years.

What measures can the nominating committee or board undertake to enhance the effectiveness of the evaluation exercise?

In a series of interviews carried out by Stanford University in 2016 with close to 200 directors, the following recommendations were identified:

- conduct a diagnostic where each director’s input is solicited around a variety of critical topics: board effectiveness, committee effectiveness, current board composition, the forward-looking needs of the board;
- provide a detailed report of the findings with the inclusion of recommended actions based upon short, medium, and long-term timeframes; and
- identify a point person on the board who is accountable for managing the process and following through on the recommendations.

What are the symptoms of or indicators that could affect and impede the effectiveness of an evaluation exercise?

The following would be considered as a red-flag for the board, and in particular the nominating committee which may affect the evaluation process and their action plans:

- the evaluation method being used leans towards a box-ticking exercise;
- the issues of behaviour and attitude are overlooked in the evaluation process;
- a lack of imperative on the need to change and improve the board; and
- action plans are not part of the board’s agenda once the evaluation process is completed.

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8 Provision B.6.2 of United Kingdom’s Corporate Governance Code
9 Board of Directors Evaluation and Effectiveness 2016, Rock Center for Corporate Governance at Stanford University and the Miles Group
Regional/international perspectives

As with the MCCG, corporate governance provisions around the world, including those in United Kingdom and Australia have emphasised on the evaluation process as a key activity for the board.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
</table>
| United Kingdom | The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors *(Principle B.6).*  
Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company *(Provision B.6.2).* |
| Australia    | A listed entity should:  
(a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and  
(b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.  
When disclosing whether a performance evaluation has been undertaken the entity should, where appropriate, also disclose any insights it has gained from the evaluation and any governance changes it has made as a result *(Recommendation 1.6 and Commentary to Recommendation 1.6).* |
Remuneration policy and procedures for directors and senior management

**MCCG Intended Outcome 6.0**
The level and composition of remuneration of directors and senior management take into account the company’s desire to attract and retain the right talent in the board and senior management to drive the company’s long-term objectives.

Remuneration policies and decisions are made through a transparent and independent process.

**MCCG Practice 6.1**
The board has in place policies and procedures to determine the remuneration of directors and senior management, which takes into account the demands, complexities and performance of the company as well as skills and experience required. The policies and procedures are periodically reviewed and made available on the company’s website.

(The application of this Practice in its entirety entails the establishment of directors and senior management’s remuneration policies and procedures as well as the periodic review and publication of the said policies and procedures on the company’s website.)

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

**The case for change**

The issue of directors’ remuneration is often a contentious subject between the shareholders and the board, especially if the board performance over the past years appears unsatisfactory. Shareholders often question the board and seek clarification on any increase to the tabled resolution on remuneration in order to ascertain whether the remuneration paid is commensurate with the performance of the directors.

The need for fair and transparent remuneration policy and procedures is now more apparent than ever, acknowledging that the current business environment is becoming more complex with rising stakeholder expectations, globalisation, technological advances and innovation in business models – all of which necessitate remuneration packages to be aligned with the company’s long-term business sustainability.

In order to ensure that their investments are well-managed, shareholders are demanding companies to be led by directors and executives of good calibre. To this end, remuneration plays a vital role in attracting and retaining highly skilled directors and executives. In attempting to hire and retain talent, it is important to understand that the complexity of remuneration is without doubt increasing.

**What could go wrong:**

- Remuneration packages lead to imprudent risk-taking and “toxic behaviour” by directors and senior management personnel (e.g. venturing into new and risky business lines without appropriate due diligence in anticipation of unusually high profits).
- Conflict of interests between directors or senior management vis-à-vis the company.
- Objectivity of independent directors is compromised due to misaligned incentives (e.g. excessive payment via share schemes to independent directors).
- Failure of the company to attract and retain talent particularly at the leadership level.
with the ever growing forms of remuneration (cash, benefits, shares, etc.) and structure (short, medium or long term).

Some of the factors to be taken into account in today’s remuneration policy and procedures for companies are shown below:

A study carried out by the Institute of Directors (“IOD”) on shareholders in the United Kingdom (2015) revealed that pay for big business leaders is the biggest threat to public trust in business. In the survey, shareholders opined that the remuneration of directors has grown disproportionately large and has become largely divorced from performance. It would not be a surprise if such concerns are amplified for companies operating in less competitive industries.

In a free market economy, it is almost inconceivable to think that companies need to defer to some form of legislation or restriction when it comes to attracting and remunerating the “best and brightest”. However, it is important to note that companies do have to earn the right to operate from the community in which they reside, and part of this invariably involves the structuring of appropriate remuneration schemes.

The MCCG has called upon companies to make known their remuneration levels for directors and senior management in detail. Bursa Securities Listing Requirements\(^1\), likewise, also require detailed disclosure of directors’ remuneration on a named basis for listed issuers. With the Companies Act 2016 mandating the approval of directors’ fees and benefits by shareholders at a general meeting\(^2\), remuneration levels will no longer be hidden from view. As remuneration becomes plainly visible, the next question naturally asked by stakeholders will be regarding the link between the company’s performance and the remuneration of its directors and senior management.

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\(1\) Paragraph 11, Part A, Appendix 9C of Bursa Securities Listing Requirements

\(2\) Section 230 of Companies Act 2016
The practice in substance

_Bursa Securities Listing Requirements_ have outlined some factors on how remuneration should be structured for executive and non-executive directors.

**Paragraph 7.23 of Bursa Securities Listing Requirements**

Fees payable to non-executive directors shall be by a fixed sum, and not by a commission on or percentage of profits or turnover. Salaries payable to executive directors may not include a commission on or percentage of turnover.

Under the _Companies Act 2016_, listed issuers are required to seek shareholders’ approval at a general meeting for directors’ fees and benefits.

**Section 230(1) of the Companies Act 2016 – Approvals for fees of directors**

The fees of the directors, and any benefits payable to the directors including any compensation for loss of employment of a director or former director:

(a) of a public company; or
(b) of a listed company and its subsidiaries,

shall be approved at a general meeting.

**Section 340(1)(c) of the Companies Act 2016 – Annual General Meeting**

Every public company shall hold an annual general meeting in every calendar year in addition to any other meetings held during that period, to transact the following business:

(c) the appointment and the fixing of the fee of directors.

A listed issuer must reflect in its constitution, the provision with regards to annual shareholder approval for director’s fees, and any benefits payable to directors pursuant to **paragraph 7.24 of Bursa Securities Listing Requirements**.

**Paragraph 7.24 of Bursa Securities Listing Requirements**

The fees of directors, and any benefits payable to directors shall be subject to annual shareholder approval at a general meeting.

In order to ensure financial institutions are well governed and transparent, _Bank Negara Malaysia_ has outlined guiding principles for remuneration paid to directors as primarily outlined in Standards 19.2 and 19.4 of Bank Negara Malaysia’s Policy Document on Corporate Governance.

**Dos**

- Ensuring that the remuneration policy and procedures are also in line with the risk strategy and corporate values of the company.
- Drawing input from those in charge of internal control and risk management functions to ensure that risk exposures and risk outcomes are adequately considered in the design of remuneration policies and procedures.

**Don’ts**

- Exempting certain directors from the company’s remuneration scheme (e.g. nominee directors).
- Not having in place any remuneration policy and being deliberately vague on how executive directors’ remuneration is determined.
- Remunerating all directors with a fixed sum which does not commensurate with their workload and responsibilities.
It is important to appreciate that none of the aforementioned regulatory requirements are intended to suppress directors and executives’ remuneration. A nation’s economy depends greatly on the drive, motivation and entrepreneurial spirit of its business community, and fair and appropriate remuneration would only help to sustain this direction.

What is pertinent in relation to this Practice is that companies can articulate the design of their remuneration policies and procedures, and explain satisfactorily the drivers that had influenced its design.

Some considerations with regards to such policy and procedures are provided below:

Remuneration policies and procedures should be designed in such a way that they support the strategies and long-term vision of the company. They should be structured to provide incentives for directors and senior management to pursue the long-term growth objectives of the company. The main challenge faced by most remuneration committees in this regard is in relation to the process of developing remuneration policies and procedures which take into consideration the best practices, market benchmarks as well as the views of stakeholders.

The diagram on the following page illustrates the steps that can be considered by the remuneration committee in drawing up remuneration policies and procedures.
The growth of a company depends on the ability to attract and retain people of the quality required by the board on a long term basis (as depicted below):

1. Decide on who the policy and procedures will relate to e.g. directors, senior management & within the group of companies.
2. Determine how best to measure the performance of the company e.g. earnings per share, total shareholder return, share price growth, etc.
3. Decide on the criteria required to benchmark the company’s performance against other companies, industries, indices, etc.
4. Determine the type of option schemes applied (Short-Term Incentives & Long-Term Incentives) & the conditions attached if they are applied.
5. Decide on how the performance of the company in achieving its targets is linked to the compensation elements.
6. Determine which elements of remuneration will apply, procedure on payout & how will it be linked to performance of the individual & company.
7. Develop and make available the remuneration policies and procedures on the company’s website, taking into consideration the performance achievement, needs & expectations of the individuals.
8. Review the policy and procedures on an annual basis to ensure it is still applicable, relevant & updated to reflect current & better practices.

The figure below provides an example of the process undertaken by BP PLC (United Kingdom) in determining the company’s remuneration policies and procedures for 2016:

1. Assess performance
   - Checked performance against safety and value measures.
   - Reviewed the measures against targets set.
2. Review outcomes with board committees
   - Sought views from audit and safety, ethics and environmental assurance committees to ensure a thorough review of performance.
3. Align with employees
   - Considered outcomes in relation to BP’s group leaders and the broader comparator group of United States and United Kingdom employees in professional and managerial roles.
4. Apply discretion
   - Used judgment to reflect the broader market environment and outcomes for shareholders.

Source: BP PLC (United Kingdom) annual report for the financial year end 31 December 2016

One of the remuneration committee’s key tasks is to develop and agree on the remuneration policy and procedures with the board, including the fee structure and level of remuneration for executive directors of the board and senior management. The board should determine who makes up senior management and if any other group of employees should be covered by the remuneration policy and procedures.
Point for reflection

The ambit of a well-considered remuneration policy and procedures should not only be limited to directors and senior management, but also include other groups within the company’s ecosystem (e.g. gatekeepers).

Gatekeepers

Gatekeepers refer to the group of individuals who act in a risk management and internal controls capacity, such as internal auditors. Remuneration of gatekeepers should be independent of the business lines or functions that they have a responsibility over.

Key considerations relating to the application of this Practice are discussed below:

How should remuneration policy and procedures be determined?

The board should consider the need for the remuneration to commensurate with the level of responsibility of its directors and senior management. There should be appropriate incentives to attract talent as well as nurture and retain high calibre directors and senior management, whilst taking into account the interests of other stakeholders, including shareholders and employees. In addition, the remuneration policy and procedures should also be aligned with the business strategy and long-term objectives of the company.

It is perhaps useful to consider the elements that can be incorporated in a remuneration policy, particularly for directors and senior management:

Suggestions for the content of a remuneration policy (non-exhaustive):

- Scope of coverage to clarify who is covered by the remuneration policy (i.e. directors, senior management and other group of employees deemed necessary by the remuneration committee and board).
- Link between the remuneration policy and business strategy (i.e. what the current remuneration strategy is, what the overall business strategy entails and whether the remuneration strategy supports the business strategy).
- Criteria for determining pay levels (e.g. market benchmarks, level of responsibility, individual’s experience, expertise and performance as well as the company’s performance).
- Components of remuneration packages (e.g. fixed components covering fees or salary and variable components such as short-term and long-term incentives).
- Nature of commitments that would entail in the event of early termination of directors and senior management (e.g. severance payment).
- Description of the ways in which current and future risks are taken into account in the remuneration packages and how the company seeks to adjust remuneration to consider long-term performance (e.g. deferred remuneration that is vesting upon performance conditions, clawback provisions or downward revaluation of remuneration awards in the event of the untoward).
- An outline of the procedures for ensuring executive incentives are subjected to stress testing and modelling to ensure their appropriateness under different performance outcomes.
- A protocol for assessing the integrity of remuneration proposals submitted by management and external advisors.
Remuneration packages for executive directors and senior management should involve a balance between fixed and performance-linked (variable) elements. The relative weightage of fixed and variable remuneration for performance varies with level of responsibility, complexity of the role and typical market practice.

The executive remuneration should be set at a competitive level for similar roles within comparable markets to recruit and retain high quality executive directors and senior management. Individual pay levels should reflect the performance of the individual, skills and experience as well as responsibility undertaken. It is the remuneration committee’s duty, when recommending incentive schemes, to ensure that the linkage between pay and performance is robust.

A summary of the main components of the typical remuneration package for executive directors and senior management as well as their key objectives is set out below.

<table>
<thead>
<tr>
<th>Base salary and benefits</th>
<th>Short term incentives</th>
<th>Long term incentives retention</th>
</tr>
</thead>
<tbody>
<tr>
<td>• consists of base salary and benefits</td>
<td>• creates a performance culture</td>
<td>• long-term focus</td>
</tr>
<tr>
<td>• includes payment for performing the day job</td>
<td>• supports short-term operational objectives</td>
<td>• purports to align executives to shareholders</td>
</tr>
<tr>
<td>• recognises status and responsibilities</td>
<td>• rewards achievement of financial and short-term personal targets</td>
<td>• retains key talents</td>
</tr>
<tr>
<td>• provides basic benefits, including retirement funding, vehicle and/or housing allowances, etc.</td>
<td></td>
<td>• addresses skills shortages</td>
</tr>
<tr>
<td>• has in place severance arrangements</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

As for non-executive directors, the remuneration should take into account fee levels and trends for similar positions in the market and the time commitment required from the director (estimated number of days per year). Such packages should take into consideration any additional responsibilities undertaken such as a director acting as chairman of the board, chairman of a board committee or as the senior independent director.

Non-executive directors are normally remunerated by way of fees and other benefits payable (in the form of cash and by a fixed sum) that are approved by shareholders on an annual basis.
In determining the fees for non-executive directors, the following approaches have been commonly identified:

<table>
<thead>
<tr>
<th>Fee approach</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed fees</td>
<td>A simplistic approach that sees an all-inclusive lump sum fee being paid to directors. Chairpersons typically receive a fixed fee irrespective of the committees they serve on, or the additional responsibilities that they assume.</td>
</tr>
<tr>
<td>Fixed board fee plus set fees for either chairperson or member of a committee</td>
<td>This is the most common approach used to determine non-executive fees.</td>
</tr>
<tr>
<td>Fixed fees for each category of meeting, based on a pre-arranged agenda for the ensuing year</td>
<td>The determination of fees is based on an aggregated fee per meeting.</td>
</tr>
<tr>
<td>Fixed fees for each category of meeting, with the provision that there is no payment for non-attendance</td>
<td>The determination of fees based on an aggregated fee per meeting, with a condition that attendance is a pre-requisite for payment.</td>
</tr>
</tbody>
</table>

The illustrative disclosure on the following page outlines examples of the components in the remuneration packages for executive directors and non-executive directors.
Executive directors’ remuneration consists of the following components:

The total reward framework has three components and, in aggregate, is benchmarked against relevant financial services competitors:

- Fixed remuneration – takes into account the size and complexity of the role, individual responsibilities, experience, skills and disclosed market-related pay levels in the financial services industry;

- Short-term incentives ("STI") – are determined based on an STI target set using similar principles to those used for fixed remuneration, and on individual, divisional and Group performance objectives for the year. Performance is measured against risk-adjusted financial targets and non-financial targets that support the Group’s strategy; and

- Long-term incentives ("LTI") – are designed to align the remuneration of executives to the long-term performance of the Group and the interests of shareholders. The amount of the award takes into account market benchmarks, individual performance over time, succession potential and key skills.

### Illustrative disclosure

#### Fixed remuneration (34%)

- **Comprises:**
  - cash salary;
  - salary sacrificed items (items such as cars, electronic devices and other personal expenses; and
  - employer superannuation contributions in line with statutory obligations

#### At risk remuneration (variable reward) (66%)

<table>
<thead>
<tr>
<th></th>
<th>Short-term incentive (STI) (34%)</th>
<th>Long-term incentive (LTI) (32%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum opportunity</td>
<td>150% of Target STI</td>
<td>Comprises performance share rights which vest over a four-year period if performance hurdles are achieved.</td>
</tr>
<tr>
<td>Cash STI</td>
<td>50% of Total STI</td>
<td></td>
</tr>
<tr>
<td>Deferred STI</td>
<td>Restricted shares or share rights</td>
<td></td>
</tr>
<tr>
<td></td>
<td>50% of Total STI</td>
<td></td>
</tr>
</tbody>
</table>

#### Non-executive directors’ remuneration consists of the following components:

<table>
<thead>
<tr>
<th>Remuneration component</th>
<th>Paid as</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base fee</td>
<td>Cash</td>
<td>This fee is for service on the Westpac Banking Corporation board. The base fee for the chairman covers all responsibilities, including all board committees.</td>
</tr>
<tr>
<td>Committee fees</td>
<td>Cash</td>
<td>Additional fees are paid to other non-executive directors for chairing or participating in board committees.</td>
</tr>
<tr>
<td>Employer superannuation contributions</td>
<td>Superannuation</td>
<td>Reflects statutory superannuation contributions which are capped at the superannuation maximum contributions base as prescribed under the Superannuation Guarantee legislation.</td>
</tr>
<tr>
<td>Subsidiary board and advisory board fees</td>
<td>Cash</td>
<td>Fees are for service on subsidiary boards and advisory boards. These fees are paid by the relevant subsidiary.</td>
</tr>
</tbody>
</table>

Source: Westpac Group Annual Report 2016 (Australia)
Regional/international perspectives

As with Malaysia, many jurisdictions have enumerated provisions for companies to put in place fair and transparent remuneration policy and procedures as well as to disclose them.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
</table>
| Singapore    | There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors (*Principle 7*).  
               | The remuneration committee should review and recommend to the Board a general framework of remuneration for the Board and key management personnel (*Guideline 7.2*).                                             |
| Australia    | A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders (*Principle 8*). |
| United Kingdom | Executive directors’ remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied (*Principle D1*).  
                 | There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors (*Principle D2*).  
                 | Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role (*Provision D.1.3*).                                                 |
| South Africa | The governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the achievement of strategic and positive outcomes in the short, medium and long term (*Principle 14*). |
Remuneration committee

**MCCG Intended Outcome 6.0**

The level and composition of remuneration of directors and senior management take into account the company’s desire to attract and retain the right talent in the board and senior management to drive the company’s long-term objectives.

Remuneration policies and decisions are made through a transparent and independent process.

**MCCG Practice 6.2**

The board has a Remuneration Committee to implement its policies and procedures on remuneration including reviewing and recommending matters relating to the remuneration of board and senior management.

The Committee has written Terms of Reference which deals with its authority and duties and these Terms are disclosed on the company’s website.

(The application of this Practice in its entirety entails the establishment of a remuneration committee by the board as well as the formulation and disclosure of the terms of reference of the remuneration committee on the company’s website.)

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

**The case for change**

Compared to the other board committees, the remuneration committee is often regarded as a singular purpose committee (i.e. its function is only in respect of remuneration for directors and senior management). Whilst this may be true, to view the remuneration committee of having less of a responsibility compared to other committees is to diminish its standing within the board ecosystem.

The logic behind the remuneration committee is for a group of individuals, familiar with the company but also responsive to the views of shareholders (and the other stakeholders), to be accountable in the determination of executive remuneration, but with no personal financial interest in the decisions thereof.

Oliver Williamson, in his now widely-referenced book\(^2\), wryly commented that in the absence of a remuneration committee, “directors would appear to write their own contracts with one hand and sign them with the other”.

Consequently, it has become common for boards of listed issuers, as well as not-for-profit and non-governmental organisations, to constitute a committee tasked with reviewing the remuneration framework, policy and procedures. Typically, the coverage is for directors and senior management, but some committees choose to cover the entire company.

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1 Greenbury, R 1995, *Directors’ Remuneration*

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The real challenge for this Practice is less about constituting a remuneration committee; it is more of whether the committee has a real say over the company’s remuneration affairs. Frequently, the committee functions only as a rubber stamp to gloss over remuneration already determined by the controlling shareholders and/or executive management.

**The practice in substance**

**Bursa Securities Listing Requirements** do not prescribe a remuneration committee, but aspects of directors’ remuneration in terms of disclosure, types of remuneration payable and requirement for shareholder approval have been enumerated.

Meanwhile, **Standard 12.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance** has mandated the establishment of a remuneration committee for financial institutions. **Guidance 12.2** of the said document allows them to combine the nominating committee and remuneration committee.

It is important to note that the remuneration committee’s meetings are typically planned well in advance to coincide with the review process over remuneration. The results and recommendations arising from the committee’s review are then tabled to the board for approval.

Some of the better practices adopted by the remuneration committee of companies are as follows:

- the committee is chaired by an independent director;
- it reviews and recommends remuneration scheme for directors that stretches over a few years, whilst annually reviewing remuneration for the wider employee group;
- the committee is cognisant that remuneration for certain groups may need to be looked at with due regard to specific consideration (e.g. remuneration of internal auditors should be determined by the audit committee so as not to impair the objectivity); and
- separate sessions are held with the nominating committee as a formal forum to gather insights on the performance of directors and senior management with a view of integrating these considerations in recommending the remuneration of directors and senior management.

**Dos**

- Nominate an independent chairman to lead the committee.
- Spend adequate time to fully comprehend the complexities of remuneration scheme (e.g. clawback and vesting provisions).
- Avoid overlapping advisors – in some companies, it was observed that the management team had engaged the same consultants that the committee had enlisted. Although this could be beneficial to the company, it could also lead the committee to an impasse if conflicting reports are received.
- Conduct periodic review of the remuneration structure and policy to ensure retention of key personnel.

**Don’ts**

- Overriding the work of the remuneration committee (e.g. bonuses are paid out before the committee has met).

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*Corporate Governance Guide*  
*Pull-out I*  
*Guidance on Board Leadership and Effectiveness*
Facets of well-run remuneration committees:

**Objective**
The committee members exercise objectivity and are not conflicted in determining remuneration.

**Principled**
The committee has adopted a framework that is based on sound principles (e.g., *Principles for Sound Compensation Practices and Implementation Standards by the Financial Stability Board*).

**Counseled**
Professional assistance is sought, when required, to lend objectivity to the committee’s review.

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**Point for reflection**
Remuneration, whilst a great motivating factor for employees, should not be viewed in isolation. Often, dissatisfaction with remuneration is a symptom of a wider malaise, and the remuneration committee may sometimes find it useful to consider wider issues on culture, ethics and strategic direction. This is where interaction with the nominating committee can be useful.

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Key considerations relating to the application of this Practice are discussed below:

**What are the key responsibilities of a remuneration committee?**

A remuneration committee should have a charter or terms of reference that clearly sets out its role and provides it with all the necessary powers to perform that role. Some of the suggested responsibility areas that can be considered when outlining the terms of reference of a remuneration committee are as follows:

- support the board in actively overseeing the design and operation of the company’s remuneration system;
- review and recommend to the board on the remuneration of non-executive directors, particularly on whether the remuneration remains appropriate to each director’s contribution, by taking into account the level of expertise, commitment and responsibilities undertaken;
- review and recommend to the board on the total individual remuneration package for executive directors and senior management personnel including, where appropriate, bonuses, incentive payments within the terms of the agreed remuneration policy and based on individual performance;
- oversee the qualitative and quantitative disclosures of remuneration made in the annual report and notice to general meetings; and
- provide clarification to shareholders during general meetings on matters pertaining to remuneration of directors and senior management as well as the overall remuneration framework of the company.

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**Hot-button issue**
A few years ago, a company listed on the New York Stock Exchange gained wide publicity – perhaps not the type coveted – when its chairman received a US$100 million “severance” pay. The “severance” event, written in his contract, was in relation to him relinquishing his position as chief executive officer (he however remained as board chairman).

The amount of payment made clearly raises questions on the considerations that were taken into account in formulating his remuneration package. It also highlights the need for remuneration committee to be more vigilant of such clauses (i.e. severance payment) in the contracts of directors and senior management.
An illustrative disclosure on the terms of reference of a remuneration committee that serves to assist the board in developing and administrating a fair and transparent remuneration procedure for directors, senior management and other key personnel is provided below:

**Illustrative disclosure**

Terms of reference of the remuneration committee:

a) to review and make recommendations to the Board in relation to the Westpac Group Remuneration Policy (Group Remuneration Policy) and to assess the Group Remuneration Policy’s effectiveness and its compliance with Prudential Standards;

b) to review and make recommendations to the Board in relation to the individual remuneration levels of the Chief Executive Officer (CEO), Non-executive Directors, Group Executives, other executives who report directly to the CEO, other persons whose activities in the Committee’s opinion affect the financial soundness of Westpac, any person specified by Australian Prudential Regulatory Authority, and any other person the Board determines;

c) to review and make recommendations to the Board in relation to the remuneration structures for each category of persons covered by the Group Remuneration Policy;

d) to review and make recommendations to the Board on corporate goals and objectives relevant to the remuneration of the CEO, and the performance of the CEO in light of these objectives;

e) to review and make recommendations to the Board on short-term incentive (STI) and long-term incentive (LTI) plans and outcomes for Westpac’s Group Executives;

f) to review and make recommendations to the Board in relation to approving any and all equity based plans (Equity Plans); and

g) to oversee general remuneration practices across the Westpac Group; and

h) to oversee the enterprise-wide programme of work known as the "Workforce Revolution" (i.e. high-performance workforce and culture).

Source: Westpac Banking Corporation Ltd.’s website 2017 (Australia)

It is also important for the board to ensure that the committee comprises board members who will not benefit personally from their decisions (i.e. individuals concerned must abstain from discussing their own remuneration) and who will give due regard to the interest of shareholders and other stakeholders.

**Can the remuneration committee be combined with the nominating committee?**

Some listed issuers choose to combine the nominating and remuneration committees (calling them as such). Indeed, a cursory review of the top ten largest listed issuers on Bursa Malaysia (based on market capitalisation) revealed that seven listed issuers have combined the committees³.

Given the increased workload of a combined committee, the ability of the committee to accord due attention on the matters discussed and time

---

³ Of the ten largest listed issuers on Bursa Malaysia, by market capitalisation as at 31 December 2016, seven listed issuers have combined their nominating and remuneration committee. This includes a financial services group (the combining of such committees is permitted by Bank Negara Malaysia).
commitment of the members would need to be considered accordingly in deciding as to whether a stand-alone remuneration committee should be established.

**How should the remuneration committee be composed?**

As stated in the Guidance to Practice 6.2 of MCCG, in order to foster objectivity in the deliberations and decision-making of the remuneration committee, it is essential to ensure that the committee consist of only non-executive directors with a majority of them being independent directors. At all times, it is important to ensure that executive directors are not involved in deciding their own remuneration.

Executive directors may, however, be invited to participate in selected meetings of the remuneration committee to provide insights, particularly on considerations relating to the performance of the company. The committee may also draw advice and enlist the professional services of experts, if necessary.

The size of the remuneration committee may differ depending upon the requirement of the company and the extent of responsibilities delegated to the committee. The objective is to allow the committee to function efficiently and for all members with appropriate levels of experience and knowledge to participate. Companies may also have a policy of rotating its remuneration committee members whilst taking into account the need to weigh a member’s experience and knowledge against the risk of complacency.

**How often should the remuneration committee meet?**

The frequency of meetings for a remuneration committee is not prescribed. This should be driven by the needs of the committee, in line with the complexities involved in determining the remuneration packages of directors and senior management.

More frequent meetings may be called as the need arises, especially when there are major changes to the composition of executive directors and/or changes to the corporate structure of the company or its group.

A review of annual reports across the top 50 Malaysian listed issuers (by market capitalisation) in 2016 revealed that remuneration committees averaged 4 meetings a year.

**What are some of the common challenges that are faced by the remuneration committee?**

Examples of commonly faced challenges in this regard include:

- Recommending the remuneration of directors whose appointments are made outside the purview of the nominating committee, i.e. directors appointed by major shareholders or the government;
- Presence of dominant directors or controlling shareholders who could influence the committee’s decisions; and
- Small boards may find it difficult to rotate members of remuneration committee to bring in fresh perspectives.
Regional/international perspectives

Similar to Malaysia, many jurisdictions including United Kingdom, Singapore and Australia have enumerated provisions for the establishment of a remuneration committee.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>The Board should establish a remuneration committee with written terms of reference which clearly set out its authority and duties. The remuneration committee should comprise at least three directors, the majority of whom, including the remuneration committee chairman, should be independent. All of the members of the remuneration committee should be non-executive directors (<em>Guideline 7.1</em>).</td>
</tr>
<tr>
<td>Australia</td>
<td>The board of a listed entity should:</td>
</tr>
<tr>
<td></td>
<td>(a) have a remuneration committee which:</td>
</tr>
<tr>
<td></td>
<td>(1) has at least three members, a majority of whom are independent directors; and</td>
</tr>
<tr>
<td></td>
<td>(2) is chaired by an independent director.</td>
</tr>
<tr>
<td></td>
<td>(<em>Recommendation 8.1</em>)</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>The board should establish a remuneration committee of at least three, or in the case of smaller companies, two independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board (<em>Provision D.2.1</em>).</td>
</tr>
</tbody>
</table>
Disclosure of remuneration

MCCG Intended Outcome 7.0
Stakeholders are able to assess whether the remuneration of directors and senior management is commensurate with their individual performance, taking into consideration the company’s performance.

MCCG Practice 7.1
There is detailed disclosure on named basis for the remuneration of individual directors. The remuneration breakdown of individual directors includes fees, salary, bonus, benefits in-kind and other emoluments.

MCCG Practice 7.2
The board discloses on a named basis the top five senior management’s remuneration component including salary, bonus, benefits in-kind and other emoluments in bands of RM50,000.

MCCG Step Up 7.3
Companies are encouraged to fully disclose the detailed remuneration of each member of senior management on a named basis.

What could go wrong:
Disclosures are inaccurate, vague, irreconcilable or simply downright confusing. Some of the items below would also constitute a breach of Bursa Securities Listing Requirements.

Examples include the following:
- Lumping the remuneration of executive and non-executive directors;
- Omitting remuneration of certain directors, e.g. those appointed during the year or who have retired;
- Disclosing remuneration received from the company (listed issuer) but not its subsidiaries; and
- Choosing not to disclose the nature of “other emoluments”.

Why
The case for change

Directors’ remuneration has often attracted fascination (or controversy) and public attention due to the somewhat opaque manner in which remuneration is determined and disclosed. In a world where transparency is being valued more and more, clarity in directors’ remuneration has become the “new normal”.

With regards to senior management, given that behind every successful company is a great management team (and vice-versa), stakeholders should also be allowed to determine if the senior management team is being appropriately compensated (or whether they are being paid excessively or their pay is commensurate with their performance). It is important to assure shareholders that the senior management team is also paid with a long-term view of the company’s performance. Incentivised remuneration which includes stock options redeemable in different years is one of the common methods used to reward senior management over time.

By making the compensation of the senior management team transparent, it can also help make a meaningful comparison between teams in the same industry and across other industries. Companies can ensure that their senior management personnel are paid well within the industry norms, thus, preventing them from being lured away by competitors. More pertinently, the enhanced transparency will encourage a culture whereby executive remuneration is anchored to appropriate and defensible bases.
Point for reflection

Remuneration of directors and senior management have recently been under the “microscope” with a growing clamour for transparency. Incidences of high or excessive pay-outs have led to stakeholders increasingly questioning the legitimacy of company directors and senior management’s level of pay, even more so when performance of the company is dipping and share price has remained flat or fallen. The disparity between the level of pay between those at the leadership level and an average employee’s remuneration at the lower level in a company (commonly referred to as the pay gap) is another oft-cited contention.

This sentiment may be unfair, as external events over which the directors and senior management have limited control, may have caused the downswing in a company’s performance and they too need to be compensated accordingly for their efforts. As such, regulatory reforms have tried to address their concerns by empowering stakeholders in various ways, such as by equipping them with detailed information, including the considerations involved in formulating the remuneration of directors and senior management.

Commonly cited reasons for obscuring disclosure of directors’ remuneration on an individual basis:

<table>
<thead>
<tr>
<th>Security</th>
<th>No added value</th>
<th>Avoiding the spiral effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies often cite privacy and security as reasons for not disclosing.</td>
<td>A commonly used catch-all reason given by boards in annual reports is that such disclosure does not add any value for the reader.</td>
<td>Less cited is the desire to avoid a culture of benchmarking, so as to drive remuneration levels upwards (the “Lake Wobegon effect”).</td>
</tr>
<tr>
<td>However, it should be noted that the previous disclosure regime (in bands of RM 50,000) already enabled a good estimate of a director’s remuneration. As such, the need for greater transparency clearly outweighs any security concerns.</td>
<td>Shareholders pay attention, now more than ever, to the level of remuneration the directors are paid. Shareholders have been known to vote against payment of directors’ fees in instances where the performance of the company has been poor.</td>
<td>This argument, however, does not take into account of the fact that if remuneration becomes transparent, benchmarking would be done easily, thus, providing a standard level of remuneration within industries and curbing executives from drawing remuneration which is excessively higher than the industry average.</td>
</tr>
</tbody>
</table>

1 Disclosure of directors’ remuneration in bands of RM50,000 was required under the predecessor paragraph 11, Part A, Appendix 9C of Bursa Securities Listing Requirements.

2 The Lake Wobegon effect is a term used to describe the natural human tendency to overestimate one’s capabilities, and has been linked to a spiral effect on levels of remuneration as the median remuneration is pushed increasingly higher.
Apart from the MCCG, the Companies Act 2016 and Bursa Securities Listing Requirements have also enumerated the following prescriptions on disclosure of directors’ remuneration.

**Paragraph 2, Part 1, Fifth Schedule of Companies Act 2016 – contents of directors’ report**

The report shall state, in respect of the directors or past directors of the company, the amount of –

(a) fees and other benefits distinguished separately, paid to or receivable by them from the company or its subsidiary companies, inclusive of all fees, percentages, bonuses, commissions, compensation for loss of office, any contribution in respect of them under any pension or retirement benefit scheme and inclusive of commission paid or payable for subscribing or agreeing to subscribe or procuring or agreeing to procure subscriptions for any shares in or debentures of the company or of its holding company or any subsidiary of the company:

Provided that where a director or any firm of which the director is a member, acts for the company in a professional capacity, the amount paid to the director or to his firm for services rendered to the company in that capacity shall not be included in all fees, percentages, bonuses, commissions, compensation for loss of office, any contribution in respect of them under any pension or retirement benefit scheme and inclusive of commission paid or payable for subscribing or agreeing to subscribe or procuring or agreeing to procure subscriptions for any shares in or debentures of the company or of its holding company or any subsidiary of the company but shall be shown separately whether by way of note or otherwise;

(b) by the way of a note or otherwise, the estimated money of any other benefits received or receivable by them otherwise than in cash from the company or from any of its subsidiary companies;

(c) the total of the amount paid or receivable by any third party in respect of the services provided to the company or any of its subsidiary companies by any director or past director of the company; and

(d) the total amount, if any, of any indemnity given to or insurance effected for any director, officer or auditor of the company.
Paragraph 11, Part A, Appendix 9C of Bursa Securities Listing Requirements

The contents of the annual report should include:

The remuneration of directors of the listed issuer (including the remuneration for services rendered to the listed issuer as a group) for the financial year on a named basis, stating the amount received or to be received from the listed issuer and on a group basis respectively. The disclosure must include the amount in each component of the remuneration (e.g. directors’ fees, salaries, percentages, bonuses, commission, compensation for loss of office, benefits in kind based on an estimated money value) for each director.

As for financial institutions, Paragraph 5, Appendix 4 of Bank Negara Malaysia’s Policy Document on Corporate Governance requires disclosure of the total amount of remuneration awards for the chief executive officer and directors for the financial year, including a breakdown of fixed and variable remuneration; deferred and non-deferred remuneration; and the different forms of remuneration used (e.g. cash, shares and share–linked instruments).

All in all, it can be said that the disclosure prescription is straight-forward in practice (with information readily available internally), but as noted earlier, the barriers are not tangible; rather they are psychological hurdles that boards must overcome to truly claim that transparency is the order of the day.

The disclosure of remuneration on a named basis may initially be uncomfortable, but once becomes widespread it will gradually be taken to be a business-as-usual disclosure and eventually form the “new normal”. In the absence of detailed remuneration disclosure, it would be easier to perpetuate an information environment that is characterised by anomalies, thus, leading to distortion of the remuneration system. Succinctly put, transparency fosters confidence in investors by allowing them to understand companies’ basis and motivation behind their remuneration frameworks.

Key considerations relating to the application of Practices 7.1 and 7.2 and Step Up 7.3 are discussed below:

Are there fixed categories of remuneration to disclose?

The MCCG uses the terms “fees, salary, bonus, benefits in-kind and other emoluments”. These are broadly speaking the main categories of remuneration. The classifications, however, are not cast in stone and the company can accommodate more categories as deemed appropriate (e.g. share-based payment).

An illustrative disclosure showing directors’ remuneration on an individual or named basis with the different categories of remuneration is provided on the following page.
Illustrative disclosure

Remuneration of executive and non-executive directors of BP:

<table>
<thead>
<tr>
<th>UK (£)</th>
<th>Director’s fees</th>
<th>Salaries</th>
<th>Benefits*</th>
<th>Others**</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year ended 31 December 2016</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Independent Non-executive Directors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mr. Carl-Henric Svanberg(^a)</td>
<td>785,000</td>
<td>-</td>
<td>58,000</td>
<td>-</td>
<td>843,000</td>
</tr>
<tr>
<td>Mr. Nils Andersen(^b)</td>
<td>23,000</td>
<td>-</td>
<td>6,000</td>
<td>-</td>
<td>29,000</td>
</tr>
<tr>
<td>Mr. Paul Anderson</td>
<td>165,000</td>
<td>-</td>
<td>32,000</td>
<td>-</td>
<td>197,000</td>
</tr>
<tr>
<td>Mr. Alan Boeckmann</td>
<td>168,000</td>
<td>-</td>
<td>17,000</td>
<td>-</td>
<td>185,000</td>
</tr>
<tr>
<td>Mr. Admiral Frank Bowman</td>
<td>162,000</td>
<td>-</td>
<td>14,000</td>
<td>-</td>
<td>176,000</td>
</tr>
<tr>
<td>Mr. Antony Burgmans(^c)</td>
<td>47,000</td>
<td>-</td>
<td>21,000</td>
<td>-</td>
<td>68,000</td>
</tr>
<tr>
<td>Ms. Cynthia Carroll</td>
<td>140,000</td>
<td>-</td>
<td>28,000</td>
<td>-</td>
<td>168,000</td>
</tr>
<tr>
<td>Mr. Ian Davis</td>
<td>136,000</td>
<td>-</td>
<td>2,000</td>
<td>-</td>
<td>138,000</td>
</tr>
<tr>
<td>Professor Dame Ann Dowling(^d)</td>
<td>150,000</td>
<td>-</td>
<td>2,000</td>
<td>-</td>
<td>152,000</td>
</tr>
<tr>
<td>Mr. Brendan Nelson</td>
<td>130,000</td>
<td>-</td>
<td>30,000</td>
<td>-</td>
<td>160,000</td>
</tr>
<tr>
<td>Ms. Phuthuman Nhleko(^c)</td>
<td>48,000</td>
<td>-</td>
<td>3,000</td>
<td>-</td>
<td>51,000</td>
</tr>
<tr>
<td>Ms. Paula Rosput Reynolds(^e)</td>
<td>140,000</td>
<td>-</td>
<td>17,000</td>
<td>-</td>
<td>157,000</td>
</tr>
<tr>
<td>Sir John Sawers</td>
<td>148,000</td>
<td>-</td>
<td>19,000</td>
<td>-</td>
<td>167,000</td>
</tr>
<tr>
<td>Mr. Andrew Shilston</td>
<td>190,000</td>
<td>-</td>
<td>5,000</td>
<td>-</td>
<td>195,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,432,000</td>
<td>2,166,000</td>
<td>378,000</td>
<td>10,808,000</td>
<td>15,784,000</td>
</tr>
</tbody>
</table>

*Chairman of the Board.

\(^a\) Appointed on 31 October 2016.

\(^b\) Retired on 14 April 2016.

\(^c\) In addition, Professor Dame Ann Dowling received £25,000 for chairing and being a member of the BP technology advisory council.

\(^d\) The 2015 number has been restated to reflect tax treatment.

*Benefits for Non-executive Directors include travel and other expenses relating to the attendance at board and other meetings. Amounts disclosed have been grossed up using a tax rate of 45%, where relevant, as an estimation of tax due.

**Comprises of annual bonuses, share-based payments, and pension scheme contribution, other benefits and inducement fees.

<table>
<thead>
<tr>
<th>UK (£)</th>
<th>Salaries</th>
<th>Benefits*</th>
<th>Bonuses</th>
<th>Share-based payments</th>
<th>Pension scheme contribution</th>
<th>Others**</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year ended 31 December 2016</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Executive Director</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mr. Bob Dudley</td>
<td>1,434,000</td>
<td>57,000</td>
<td>1,313,000</td>
<td>4,432,000</td>
<td>1,706,000</td>
<td>-</td>
<td>8,942,000</td>
</tr>
<tr>
<td>Dr. Brian Gilvary</td>
<td>732,000</td>
<td>67,000</td>
<td>669,000</td>
<td>2,433,000</td>
<td>256,000</td>
<td>-</td>
<td>4,157,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,166,000</td>
<td>124,000</td>
<td>1,982,000</td>
<td>6,865,000</td>
<td>1,962,000</td>
<td>-</td>
<td>13,099,000</td>
</tr>
</tbody>
</table>

*Benefits for Executive Directors include car-related benefits, security assistance, insurance and medical benefits.

**Comprises of director’s fees, other benefits and inducement fees.

Source: BP Group Annual Report and Form 20-F 2016 (United Kingdom)

Material risk takers

In addition to directors and senior management, there is also increased scrutiny on the remuneration of material risk takers in financial institutions.

A material risk taker refers to an officer who is not a member of senior management and who can materially commit/control significant amounts of the financial institution’s resources or whose actions are likely to have a significant impact on the risk profile of the financial institution. Alternatively, material risk takers could also refer to those who are among the most highly remunerated officers within the financial institution.

As stated in Standard 19.3 of Bank Negara Malaysia’s Corporate Governance Policy Document, the remuneration of directors, member of senior management and other material risk taker must be approved by the board annually. In providing information relating to the design and structure of the remuneration system (Paragraph 4, Appendix 4 of the said Policy Document), a description should also be provided on the types of officers who are considered as material risk takers.
Who are members of the top five senior management team for which disclosure is propounded under Practice 7.2?

The top five senior management team members refers to the **five highest paid senior management** members in the company.

A member of the senior management team would generally refer to an individual who holds the highest level of management responsibility and decision-making authority within the company. As a rule of thumb, this would include the chief executive officer (who is not a director), other members of the C-suite or direct reports to the chief executive officer.

An illustrative disclosure showing the detailed remuneration of the top five members of the senior management team (on a named basis) is provided below:

### Illustrative disclosure

Summary compensation table for the other top five key management and senior management for the financial year ended 31 March 2016:

<table>
<thead>
<tr>
<th>Name</th>
<th>Fixed Remuneration</th>
<th>Variable Bonus</th>
<th>Provident Fund</th>
<th>Benefits</th>
<th>Total Cash &amp; Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bill Chang, CEO Group Enterprise</td>
<td>Earned $909,996</td>
<td>Paid Out $1,698,580</td>
<td>$2,341,249</td>
<td>$14,960</td>
<td>$66,072</td>
</tr>
<tr>
<td>Hui Weng Cheong, COO, AIS</td>
<td>Earned $663,000</td>
<td>Paid Out $1,080,922</td>
<td>$1,198,625</td>
<td>$7,570</td>
<td>$446,002</td>
</tr>
<tr>
<td>Jeann Low, Group Chief Corporate Officer</td>
<td>Earned $909,996</td>
<td>Paid Out $1,327,711</td>
<td>$1,403,332</td>
<td>$13,540</td>
<td>$62,163</td>
</tr>
<tr>
<td>Yuen Kwan Moon, CEO Consumer Singapore</td>
<td>Earned $720,000</td>
<td>Paid Out $1,093,265</td>
<td>$1,470,000</td>
<td>$14,960</td>
<td>$61,948</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>Earned $4,771,756</td>
<td>Paid Out $8,627,634</td>
<td>$9,926,931</td>
<td>$59,022</td>
<td>$1,135,759</td>
</tr>
</tbody>
</table>

*Source: Singapore Telecommunications Ltd Annual Report 2016*
Do listed issuers have to provide disclosures on a listed issuer level or group level?

As enumerated in paragraph 11, Part A, Appendix 9C of Bursa Securities Listing Requirements, listed issuers have to produce disclosures on both levels, namely, at the listed issuer level and group level. An example of disclosure in this regard is outlined below (note: categories of remuneration outlined below are non-exhaustive):

<table>
<thead>
<tr>
<th>Group</th>
<th>Fees (RM '000)</th>
<th>Meeting Allowance (RM '000)</th>
<th>Salaries (RM '000)</th>
<th>Bonus (RM '000)</th>
<th>Other emoluments (RM '000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Executive Directors (“NEDs”)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NED I</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NED II...</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Executive Directors (“EDs”)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ED I</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ED II...</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Listed issuer</th>
<th>Fees (RM '000)</th>
<th>Allowance (RM '000)</th>
<th>Salaries (RM '000)</th>
<th>Bonus (RM '000)</th>
<th>Other emoluments (RM '000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Executive Directors (“NEDs”)</td>
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<tr>
<td>NED I</td>
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<td>NED II...</td>
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<tr>
<td>Executive Directors (“EDs”)</td>
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<tr>
<td>ED I</td>
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<td>ED II...</td>
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</tbody>
</table>

It is also important to note that in the event the directors do not receive any additional remuneration for services rendered in the subsidiaries (apart from that received at the listed issuer level), a statement to that effect should be reflected in the annual report of the listed issuer.

Regional/international perspectives

As in the case of Malaysia, enumerations on disclosure of directors’ remuneration (and to some extent, remuneration of the senior management team) have been established in numerous jurisdictions.

3 Refers to the listed issuer and its subsidiaries
<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>The company should report to the shareholders each year on the remuneration of directors, the CEO and at least the top five key management personnel (who are not also directors or the CEO) of the company. The company should fully disclose the remuneration of each individual director and the CEO on a named basis (<em>Guideline 9.1</em>).</td>
</tr>
<tr>
<td>Australia</td>
<td>The directors’ report for a financial year for a company must also include (in a separate and clearly identified section of the report):</td>
</tr>
<tr>
<td></td>
<td>(a) discussion of board policy for determining, or in relation to, the nature and amount (or value, as appropriate) of remuneration of the key management personnel;</td>
</tr>
<tr>
<td></td>
<td>(b) discussion of the relationship between such policy and the company’s performance; and</td>
</tr>
<tr>
<td></td>
<td>(c) the prescribed details in relation to the remuneration of each member of the key management personnel. (<strong>Section 300A</strong>)</td>
</tr>
<tr>
<td></td>
<td><em>Note:</em> Only an extract of Section 300A is outlined above. Section 9 of the Corporations Act 2001 stipulates that “key management personnel” for an entity has the same meaning as in the accounting standards. The Australian Accounting Standards Board (AASB) defines key management personnel as “those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity” (<em>AASB 124 – Related Party Disclosures</em>).</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>The directors of a quoted company must prepare a directors’ remuneration report for each financial year of the company (<strong>Section 420(1)</strong>) augmented by Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008).</td>
</tr>
</tbody>
</table>
United Kingdom’s Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

Part 3 - Annual Report of Remuneration

Paragraph 4
The directors’ remuneration report must, for the relevant financial year, for each person who has served as a director of the company at any time during that year, set out in a table in the form set out in paragraph 5 (“the single total figure table”) the information prescribed by paragraphs 6 and 7 below.

Paragraph 5
The form of the table required by paragraph 4 is –

<table>
<thead>
<tr>
<th>Single Total Figure Table</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
</tr>
<tr>
<td>---------------------------</td>
</tr>
<tr>
<td>Director 1</td>
</tr>
<tr>
<td>Director 2</td>
</tr>
</tbody>
</table>

Paragraph 6
(1) In addition to the columns described in paragraph 7, columns –

(a) must be included to set out any other items in the nature of remuneration which are not set out in the columns headed “(a)” to “(e)”; and

(b) may be included if there are any sub-totals or other items which the directors consider necessary in order to assist the understanding of the table.

(2) Any additional columns must be inserted before the column marked “Total”.

Paragraph 7
(1) the sums that are required to be set out in the columns are –

(a) in the column headed “a”, the total amount of salary and fees;

(b) in the column headed “b”, all taxable benefits;

(c) in the column headed “c”, money or other assets received or receivable for the relevant financial year as a result of the achievement of performance measures and targets relating to a period ending in that financial year;

(d) in the column headed “d”, money or other assets received or receivable for periods of more than one financial year where final vesting is determined as a result of the achievement of performance measures or targets relating to a period ending in the relevant financial year and is not subject to the achievement of performance measures or targets in a future financial year;

(e) in the column headed “e”, all pension related benefits; and

(f) in the column headed “Total”, the total amount of the sums set out in the previous columns.

Note: The above only represents an extract.

4 Excluding those which result from awards made in a previous financial year and where final vesting is determined as a result of the achievement of performance measures or targets relating to a period ending in the relevant financial year or those receivable subject to the achievement of performance measures or targets in a future financial year.
Appendix I: Whistleblowing policy

The following is an illustration of a Whistleblowing Policy. In ensuring effectiveness, this sample must be tailored in accordance to the company’s needs and circumstances.

Objective of this Policy

All employees are encouraged to raise genuine concerns about possible improprieties in matters of financial reporting, compliance and other malpractices at the earliest opportunity, and in an appropriate way.

This Policy is designed to:

(a) promote and maintain high transparency and accountability in the workplace;
(b) promote good corporate governance practices in the workplace;
(c) ensure that employees can raise concerns without fear of reprisals and safeguard such person’s confidentiality;
(d) protect a whistleblower from reprisal as consequence of making a disclosure;
(e) provide a transparent and confidential process for dealing with concerns;
(f) protect the long term reputation of the company;
(g) support the company’s values; and
(h) maintain a healthy working culture and an efficient company.

This policy not only covers improprieties in matters of financial reporting, but also:

• negligence in carrying out work obligations;
• fraud;
• corruption, bribery or blackmail;
• criminal offences;
• failure to comply with a legal or regulatory obligation;
• miscarriage of justice;
• endangerment of an individual’s health and safety; and
• concealment of any, or a combination, of the above.
Principles

The principles underpinning the Policy are as follows:

- internal procedures to facilitate necessary whistleblowing, in a timely and responsible manner, are in place and made known to all employees of the company;
- all disclosures will be treated fairly and properly, and addressed in an appropriate and timely manner;
- the company will not tolerate harassment or victimisation of anyone raising a genuine concern;
- the identity and personal information of the whistleblower will be protected and kept confidential, unless the individual agrees otherwise or unless otherwise required by law;
- the whistleblower and the alleged wrongdoer will be treated fairly. The whistleblower will be informed of the status of his disclosure and the alleged wrongdoer will be given an opportunity to respond to all allegations at an appropriate time (not necessarily at the start, or during, the investigation);
- personal information, including the identity of the whistleblower and the alleged wrongdoer shall only be revealed on a ‘need-to-know’ basis;
- the company will ensure no one will be at risk of suffering reprisal as a result of raising a concern even if the individual is mistaken. The company, however, does not extend this assurance to someone who maliciously raises a matter he knows is untrue; and
- any form of retaliation against individuals who have reported a wrongdoing or who have facilitated with the investigations is a breach of the principal obligation of all staff members to uphold the highest values and integrity.

Covered concerns

A disclosure relating to, but not limited to, either of the following concerns or wrongdoings by any person in the conduct of the business shall be reported:

a) corruption, bribery and fraud;

b) negligence in carrying out work obligations;

c) criminal offence or any breach of the laws of Malaysia;

d) acceptance of gifts/favour beyond the threshold allowed by the company;

e) misuse and/or misappropriation of the company’s funds or assets;

f) impropriety (including financial and operational, etc.) within the company;

g) gross mismanagement within the company (including serious potential breach to the interest of society and environment);

h) breach of code of ethics of the company, including sexual, physical or other abuse of human rights; and

i) act or omission which jeopardises the health and safety of the company’s employees or the public.
Reporting procedure

If any employee believes reasonably and in good faith that malpractices exist in the workplace, the employee should report this immediately to the line manager. However, if for any reason the employee is reluctant to do so, then the employee should report the concerns to either the:

- appointed persons; or
- Senior Independent Director or the Chairman of the Audit Committee.

Employees concerned about speaking to another member of staff or who wants to seek advice on how to raise a concern, can speak in confidence, to an independent third party by calling the whistle-blowing hotline [hotline number]. The independent party will provide the employee with counselling advice. These concerns will be reported to the company without revealing the identity of the whistleblower.

If these channels have been followed and if employees still have unresolved concerns or if employees feel the matter is grave in nature that it cannot be discussed with any of the appointed persons above, they should contact the Senior Independent Director or the Chairman of the Audit Committee at [telephone number and e-mail], being the director identified in the company’s annual report as one to whom concerns may be conveyed.

Employees who have raised concerns internally will be informed of who is handling the matter, how they can make contact with them and if there is any further assistance required.

Employees’ identities will not be disclosed without prior consent. Where concerns cannot be resolved without revealing the identity of the employee raising the concern (i.e. if the evidence is required in court), a dialogue will be carried out with the employee concerned as to whether and how the matter can progress further.

Consequences of wrongdoing or wrongful disclosure

If the Person (i.e. the whistleblower) has, or is found to have:

- committed a wrongdoing;
- taken serious risks which would likely cause a wrongdoing to be committed;
- made a disclosure not in accordance with the requirements of this policy (for instance, dishonest, mischievous or malicious complaints); or
- participated or assisted in any process pursuant to this policy otherwise than in good faith.

The corrective actions to be taken against that Person will be determined by the Managing Director (“MD”) or, if so delegated by the MD, the senior management, which may include, disciplinary measures, formal warning or reprimand, demotion, suspension or termination of employment or services or monetary or other forms of punishment.
Protection

The identity and personal information of the whistleblower will be protected and kept confidential, unless the whistleblower agrees otherwise or unless otherwise required by law.

The whistleblower will be protected from reprisal, including any form of harassment and victimisation, as a consequence of his disclosure.

The whistleblower will be protected under the Whistleblower Protection Act 2010 if he or she makes a disclosure in good faith to an enforcement agency.

If a whistleblower reasonably believes that he or she is being subjected to reprisal, including harassment and victimisation, as a consequence of whistleblowing, he may consult or report to the appointed persons:

[Insert list of officers and contacts]
Appendix II: Board skills matrix form

This form, which is not exhaustive in nature, illustrates a board skills matrix which may be used as a general assessment of the composition, knowledge, skills and experience of the current board. This form may also be used for disclosure in the company’s annual report as a summary within the directors’ profile section.

This sample evaluation form may be customised, depending on the circumstances of the company.

For Section B to Section H, the board may decide to respond with either of the following options:

<table>
<thead>
<tr>
<th>Option 1</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Above average</td>
<td>Average</td>
<td>Below average</td>
<td>Poor</td>
</tr>
<tr>
<td>or</td>
<td></td>
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<tr>
<td>Option 2</td>
<td>Yes</td>
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<td></td>
<td>No</td>
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<td></td>
<td>Yes</td>
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<td>No</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Skill sets</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>V</th>
<th>...</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Composition</strong></td>
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<td>Executive Director</td>
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<td>Non-Independent Non-Executive Director</td>
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<td>Independent Non-Executive Director</td>
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<td>Senior Independent Director</td>
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<td>Age</td>
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<tr>
<td>Years of service in the company</td>
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<td>Gender</td>
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<td><strong>B. Strategy and entrepreneurship</strong></td>
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<td>Experience in developing corporate strategies for growth</td>
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<tr>
<td>Operates or has relevant industry experience in operating businesses</td>
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<tr>
<td><strong>C. Legal and regulatory requirements</strong></td>
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<tr>
<td>Ability to understand, interpret and effectively apply legislative and regulatory changes (including pertinent laws of Malaysia, Bursa Securities Listing Requirements and other legislations)</td>
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</tbody>
</table>

1 The roman numerals represent the individual directors.
### Table: Skill sets

<table>
<thead>
<tr>
<th>Skill sets</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>V</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knowledge on legal, regulatory and business requirements in other countries/regions in which the company operates</td>
<td></td>
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<tr>
<td><strong>D. Corporate governance, risk management and internal controls</strong></td>
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<tr>
<td>Working knowledge on duties and responsibilities of the board, board committees and directors</td>
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<tr>
<td>Hands-on experience in the fields of governance, risk and controls</td>
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<tr>
<td><strong>E. Audit, accounting, financial reporting and taxation</strong></td>
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<tr>
<td>Understands financial statements, including ability to read, analyse and interpret financial statements</td>
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<tr>
<td>Working knowledge on auditing (external and/or internal auditing)</td>
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<tr>
<td>Familiar with IFRS/MFRS/FRS and their implications to the company</td>
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<tr>
<td>Working knowledge of the Malaysian tax regime and key provisions affecting the company</td>
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<tr>
<td><strong>F. Human capital</strong></td>
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<tr>
<td>Understands and is familiar with human resource legislation and issues</td>
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<tr>
<td>Experience in the field of talent retention, capacity building, performance evaluation and skill set development (for directors, senior management and employees)</td>
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<tr>
<td><strong>G. Sales and marketing</strong></td>
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</tr>
<tr>
<td>Experience in sales function, including promoting and marketing products/services</td>
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</tr>
<tr>
<td>Understands threats from competitors and how to address them</td>
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<td></td>
</tr>
<tr>
<td><strong>H. Information technology</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Knowledge on information systems in relation to the operations of the company</td>
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</tr>
<tr>
<td>Awareness on potential threats to cyber security and system integrity in the company</td>
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<tr>
<td><strong>I. Production and quality assurance</strong></td>
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</tr>
<tr>
<td>Familiar with products and services of the company</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Skill sets</td>
<td>I</td>
<td>II</td>
<td>III</td>
<td>IV</td>
<td>V</td>
<td>...</td>
</tr>
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<td>--------------------------------------------------</td>
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<tr>
<td>Understands quality issues of products/services</td>
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</tr>
</tbody>
</table>

Checked and compiled by: ________________________

Name: ____________________

Designation: ____________________
Appendix III:
Board and board committee evaluation form

This sample exhibit, which is not exhaustive, illustrates key questions which may be used to assist the process of evaluating the board and board committee.

This sample evaluation form may be customised, depending on the circumstances of the companies concerned.

The Evaluation Form provides ratings from one (1) to four (4), or ‘yes’ and ‘no’, with the indicators illustrated below, to be responded in relation to the nature of the questions:

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, always</td>
<td>Yes, most of the time</td>
<td>Yes, but seldom</td>
<td>No</td>
</tr>
<tr>
<td>or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 □</td>
<td>3 □</td>
<td>2 □</td>
<td>1 □</td>
</tr>
<tr>
<td>Above average</td>
<td>Average</td>
<td>Below average</td>
<td>Poor</td>
</tr>
<tr>
<td>or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes □</td>
<td></td>
<td></td>
<td>No □</td>
</tr>
<tr>
<td>or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td></td>
<td></td>
<td>No</td>
</tr>
</tbody>
</table>

Where a particular criterion is deemed not applicable, it shall be indicated as ‘Not Applicable’ in the comment box.

Section A: Board mix and composition

1. Does the board review the divisions of responsibilities to reflect changing business circumstances which the company may experience?

   | Yes □ | | | No □ |
   | Comment: |

2. Have probable or potential areas of conflicts that may impair independence of the independent directors been resolved? Please state under the comments section on how the conflicts were resolved.

   | 4 □ | 3 □ | 2 □ | 1 □ |
   | Comment: |

3. Does the board have the right blend of knowledge and experience to optimise performance and strategy?

   | 4 □ | 3 □ | 2 □ | 1 □ |
   | Comment: |
4. Are the right matters for deliberation and decision being reserved for the board?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
</table>

**Comment:**

5. Are roles and responsibilities of the board and individual directors clearly defined in the board charter?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
</table>

**Comment:**

6. Does the board work functionally as a team through a mutually respectful and dynamic working relationship that fosters trust and esteem?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
</table>

**Comment:**

7. Do board deliberations bring value and improve the quality of management’s decision-making?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
</table>

**Comment:**

8. Does the board establish its own performance criteria for its directors (addressing attendance, preparedness, and participation with candour)?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
</table>

**Comment:**

9. Are the directors re-nominated only if they satisfactorily perform based on the established criteria?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
</table>

**Comment:**

10. Have all directors been complying with the company’s independence policies or code of conduct/ ethics without any breaches?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
</table>

**Comment:**

11. Is the number of board members suitable or appropriate for the company taking into account the size and complexity of the company’s operations?

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
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</thead>
</table>

**Comment:**
Section B: Quality of information and decision making

12. Is adequate information on important issues in relation to the company’s business sufficiently provided before board meetings?

4 □ 3 □ 2 □ 1 □

Comment:

13. Is adequate and sufficient information presented to facilitate decision-making on subject matters, i.e. is the information presented in a concise manner, highlighting key issues and risk areas with appropriate details for additional scrutiny, allowing directors to appreciate and assess agenda items of board meetings and to take effective decisions?

4 □ 3 □ 2 □ 1 □

Comment:

14. Are board meetings carried out in an “open communication” setting with directors contributing in a timely and positive manner for each resolution of concerns?

4 □ 3 □ 2 □ 1 □

Comment:

15. During the deliberation on matters where certain directors have conflict of interests, including related party transactions, do the directors concerned abstain from the deliberation and decision making?

Yes □ [ ] [ ] [X] No □

Comment:

16. Do all directors have adequate access to management and/or the Chairman?

4 □ 3 □ 2 □ 1 □

Comment:

17. Is there an approved set of documented procedures or specific criteria used by the board, for directors to seek professional advice with the cost borne by the company?

Yes □ [ ] [ ] [X] No □

Comment:

18. Have board meeting minutes been prepared in a timely manner and reflect the decision making process of the board appropriately?

4 □ 3 □ 2 □ 1 □

Comment:
19. Does the board have in place, a set of approved procedures for its members with regard to conflict resolution?

| Yes □ | | No □ |

Comment:

20. Does the boardroom culture promote constructive, candid and rigorous deliberations with diversity in opinions being valued? (For this question, please indicate your rating based on the description below)

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Board members rarely express their views and disagreements.</td>
</tr>
<tr>
<td>2</td>
<td>Board members occasionally engage in rigorous challenge, particularly on risky transactions.</td>
</tr>
<tr>
<td>3</td>
<td>Board members engage in healthy discussions with no one individual director dominating discussions.</td>
</tr>
<tr>
<td>4</td>
<td>Board members are unafraid to take an unpopular stance and there is a culture of openness whereby views are freely expressed and debated to allow diverse perspectives to be considered.</td>
</tr>
</tbody>
</table>

21. Suggest the changes that you would like to see in terms of the quality and quantity of information provided to the Board.

Comment:

Section C: Boardroom activities

22. Do you believe that the board understands its role, authority and priorities?

| Yes □ | | No □ |

Comment:

23. Does the board effectively evaluate the company’s values, mission, and strategic and business plans, and echo this consideration on key issues during the financial year under review?

| □ 4 | □ 3 | □ 2 | □ 1 |

Comment:

24. Has the board identified a suitable performance framework, i.e. key performance indicators, to monitor executive and senior management’s performance?

| Yes □ | | No □ |

Comment:
25. Has the board sufficiently identified and managed risks that may have a considerable impact on the company?

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<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
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Comment:

26. Has the board reviewed the company’s system of internal control and considered its adequacy and integrity on a regular basis?

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Comment:

27. Does the board periodically review the allocation of powers between management and the board as delineated in the “Limits of Authority” (or its equivalent) and determine if these are consistent with the changing needs of the business?

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</table>

Comment:

28. Does the board oversee the development and implementation of a stakeholder communication policy for the company?

Yes □  No □

Comment:

29. Does the board ensure that feedback received from stakeholders is considered by the company when making business decisions?

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Comment:

30. Has the board established a succession plan for the chairman/executive directors and senior management and reviewed it from time to time?

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Comment:

31. With each director’s nomination, does the board consider the mix of the director’s characteristics, experience, diverse perspectives and skills that is appropriate for the company?

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Comment:

32. Does the board address boardroom diversity and take steps to ensure that women candidates are sought as part of its recruitment process?

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<th>2 □</th>
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</table>

Comment:
33. Does the board perform its responsibilities in setting and reviewing the remuneration of directors in order to attract and retain suitable directors for the effective functioning of the board?

<table>
<thead>
<tr>
<th>Yes □</th>
<th></th>
<th>No □</th>
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<td>Comment:</td>
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34. Does the chairman oversee an effective decision-making process and ensure crucial alternatives are considered?

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<td>Comment:</td>
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</table>

35. Does the chairman aim to ensure the board’s workload is appropriately managed and, where suitable, allocated to established board committees with specific terms of reference approved by the board?

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36. Have board members provided significant input and devoted enough time in discussing the business strategy, financial performance and position, and annual business plan?

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<td>Comment:</td>
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</tbody>
</table>

37. Does the board adopt guidelines addressing the competing time commitments that are faced when directors serve on multiple boards?

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<td>Comment:</td>
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38. Did board members devote enough time during the year to the affairs of the company?

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<td>Comment:</td>
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</tbody>
</table>
39. Did the board accord adequate attention to discuss strategic issues that impact the company’s value creation process? (For this question, please indicate your rating based on the description below)

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<thead>
<tr>
<th>Rating</th>
<th>Description</th>
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<tbody>
<tr>
<td>1</td>
<td>The board only endorsed the strategic plan set by management.</td>
</tr>
<tr>
<td>2</td>
<td>The board held discussions with management and was fairly involved in setting the strategic plan of the company.</td>
</tr>
<tr>
<td>3</td>
<td>The board was intimately involved in the formulation of strategic plan with adequate review of the factors affecting the company and the views of stakeholders.</td>
</tr>
<tr>
<td>4</td>
<td>The board devoted adequate time and effort to set the company’s strategic plan with a periodic review of the plan amidst the changing business environment and expectations of stakeholders.</td>
</tr>
</tbody>
</table>

40. What are the two potential improvements that you would like to see in terms of boardroom conduct and activities?

Section D: Board’s relationship with the management

41. Does the board encourage management to undertake “open communication” with the board members?

42. Is there sufficient support provided by the board towards management in terms of working partnership and strategic oversight?

43. What are the two potential improvements that you would like to see in terms of execution of the board’s directives by management?
### Performance evaluation sheet - board committees

<table>
<thead>
<tr>
<th></th>
<th>Rating</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Does each committee have the right composition?</td>
<td>1 2 3 4</td>
</tr>
<tr>
<td></td>
<td>i) ________________ committee</td>
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<tr>
<td></td>
<td>ii) ________________ committee</td>
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<td>iii) ________________ committee</td>
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<td></td>
<td>iv) ________________ committee</td>
<td>□ □ □ □</td>
</tr>
<tr>
<td>2.</td>
<td>Is the committee providing useful recommendations in assisting the board for better decision-making, and does it consequently make board meetings more efficient and effective?</td>
<td>1 2 3 4</td>
</tr>
<tr>
<td></td>
<td>i) ________________ committee</td>
<td>□ □ □ □</td>
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<tr>
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<td>ii) ________________ committee</td>
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<td>iii) ________________ committee</td>
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<td>iv) ________________ committee</td>
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<tr>
<td>3.</td>
<td>Do the members of the committee have sufficient, recent and relevant expertise in fulfilling their role?</td>
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<tr>
<td></td>
<td>i) ________________ committee:</td>
<td>1 2 3 4</td>
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<td></td>
<td>Director A ________________</td>
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<td>Director B ________________</td>
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<td></td>
<td>Director C ________________</td>
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<td>ii) ________________ committee:</td>
<td>1 2 3 4</td>
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<tr>
<td></td>
<td>Director A ________________</td>
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<td>Director B ________________</td>
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<td>Director C ________________</td>
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<td>iii) ________________ committee:</td>
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<td>Director A ________________</td>
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<td>Director B ________________</td>
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<td>Director C ________________</td>
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<td>Rating</td>
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**iv) ________________ committee:**

- Director A ________________  □ □ □ □
- Director B ________________  □ □ □ □
- Director C ________________  □ □ □ □

4. Are committee chairs properly discharging their responsibilities, deploying resources and expertise, and providing appropriate reporting and recommendations to the board?

- i) ________________ committee  □ □ □ □
- ii) ________________ committee  □ □ □ □
- iii) ________________ committee  □ □ □ □
- iv) ________________ committee  □ □ □ □

5. Are the appointments of board and committee chairman based on appropriate criteria?

- Are the responsibilities of the position, including the ability, experience and expected performance of the candidate properly considered?

- i) ________________ committee  □ □ □ □
- ii) ________________ committee  □ □ □ □
- iii) ________________ committee  □ □ □ □
- iv) ________________ committee  □ □ □ □

6. Is the communication by the board committees of sufficient quality?

- i) ________________ committee  □ □ □ □
- ii) ________________ committee  □ □ □ □
- iii) ________________ committee  □ □ □ □
- iv) ________________ committee  □ □ □ □
<table>
<thead>
<tr>
<th></th>
<th>Question</th>
<th>Rating</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.</td>
<td>Are the board committee meeting minutes well prepared and comprehensively documented?</td>
<td>1 2 3 4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>i) __________________________ committee</td>
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<td></td>
<td>ii) __________________________ committee</td>
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<td>iii) __________________________ committee</td>
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<tr>
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<td>iv) __________________________ committee</td>
<td>□ □ □ □</td>
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<tr>
<td>8.</td>
<td>Is the board well informed on a timely basis regarding the committee’s deliberations?</td>
<td>1 2 3 4</td>
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<tr>
<td></td>
<td>i) __________________________ committee</td>
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<td>iii) __________________________ committee</td>
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<td>iv) __________________________ committee</td>
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</table>

Checked and compiled by:

_____________________
Name: Designation:
Appendix IV:
Directors’/key officers’ evaluation form

This sample exhibit, which is not exhaustive, illustrates key questions which may be used to assist the process for the annual evaluation of board directors and key officers, where applicable, and/or evaluation prior to appointment and/or re-appointment.

This sample evaluation form may be customised, depending on the circumstances of the company.

The Evaluation Form provides ratings from one (1) to four (4), or ‘yes’ and ‘no’, with the indicators illustrated below, to be responded in relation to the nature of the questions:

<table>
<thead>
<tr>
<th>4 □</th>
<th>3 □</th>
<th>2 □</th>
<th>1 □</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, always</td>
<td>Yes, most of the time</td>
<td>Yes, but seldom</td>
<td>No</td>
</tr>
<tr>
<td>or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 □</td>
<td>3 □</td>
<td>2 □</td>
<td>1 □</td>
</tr>
<tr>
<td>Above average</td>
<td>Average</td>
<td>Below average</td>
<td>Poor</td>
</tr>
<tr>
<td>or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes □</td>
<td>No □</td>
<td></td>
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<tr>
<td>Yes</td>
<td>No</td>
<td></td>
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</tbody>
</table>

Where a particular criterion is deemed not applicable, it shall be indicated as ‘Not Applicable’ in the comment box.

**Name of director/key officer:**

---

**Section A: Fit and Proper**

1. Has not been questioned, of his/her honesty, integrity, professional conduct or business ethics/practices which are deceitful, oppressive or improper and investigated on complaints lodged

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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<td>Comment:</td>
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</table>

2. Has shown willingness to maintain effective internal control systems and risk management practices

<table>
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<tr>
<th>Yes □</th>
<th>No □</th>
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<tbody>
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</table>
3. Possesses relevant qualification, knowledge, experience and ability to understand the technical requirements, risk and management of the company’s business

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</table>
| **Comment:**

**Section B: Contribution and performance**

4. Probes management to ensure management has taken, and suggests management to take into consideration the varying opportunities and risks whilst developing strategic plan (this plan may or may not be in writing as long as minutes of meeting provide a discussion of such strategy)

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| **Comment:**

5. Probes management when there are red flags/concerns which could, amongst others, indicate possible non-compliance of regulatory requirements

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| **Comment:**

6. Provides logical honest opinions on issues presented and is not afraid of expressing disagreement on matters during the meeting, if any

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| **Comment:**

7. Receives feedback from board and/or committee and incorporates feedback obtained into decision-making process in an objective manner

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| **Comment:**

8. Defends own stand through constructive deliberations at board and/or committee meetings, where necessary

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| **Comment:**

9. Tackles conflicts and takes part in proposing solutions

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</table>
| **Comment:**
10. Offers practical and realistic advice to board and/or committee discussions

![Score Table]

Comment:

11. Takes initiative to demand for additional information, where necessary

![Score Table]

Comment:

12. Tests quality of information and assumptions

![Score Table]

Comment:

13. Reviews and relates short-term concerns to long-term strategy

![Score Table]

Comment:

14. Contributes to risk management initiatives

![Score Table]

Comment:

15. Contributes personal knowledge and experience into the consideration and development of strategy

![Score Table]

Comment:

16. Facilitates objective-oriented decision-making process

![Score Table]

Comment:

17. Prioritises context of issues to be in line with objectives

![Score Table]

Comment:

18. Effectively and proactively follows up on areas of concern

![Score Table]

Comment:
19. Demonstrates willingness to devote time and effort to understand the company, its business and displays readiness to participate in events outside the boardroom such as site visits

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**Comment:**

**Section C: Calibre and personality**

20. Acts in good faith and with integrity

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**Comment:**

21. Attends meetings well prepared and adds value to board and/or committee meetings

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**Comment:**

22. Works constructively with peers, the company secretary and senior management

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</table>

**Comment:**

23. Offers insight to matters presented with requisite knowledge and skills, and shares information

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**Comment:**

24. Encourages others to get things done, is decisive and action-oriented

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**Comment:**

25. Articulates in a non-confrontational and comprehensible manner

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**Comment:**
26. Understands individual roles and responsibilities and ensures contribution is contemporary with developments

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Comment:

27. Behaviour engenders mutual trust and respect within the Board and with other key officers

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Comment:

28. Communicates effectively with shareholders

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Comment:

29. Constructively challenges and contributes to the development of strategy

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Comment:

30. Scrutinises the performance of management in meeting agreed goals and objectives and monitors reporting of performance

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Comment:

31. Satisfies himself/herself that financial information is accurate and financial controls and systems of risk management are robust and defensible

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Comment:

Checked and compiled by:

_____________________

Name:

Designation:
Appendix V:
Audit committee evaluation form

This sample exhibit, which is not exhaustive in nature, illustrates key questions which may be used to assist the process for the annual evaluation of audit committee.

Additional questions may need to be included, depending on the circumstances of the company concerned. The Evaluation Form provides ratings from one (1) to four (4), or ‘yes’ and ‘no’, with the indicators illustrated below, to be responded in relation to the nature of the questions:

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<tbody>
<tr>
<td>Yes, always</td>
<td>Yes, most of the time</td>
<td>Yes, but seldom</td>
<td>No</td>
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or

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<tbody>
<tr>
<td>Above average</td>
<td>Average</td>
<td>Below average</td>
<td>Poor</td>
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or

| Yes □ | | | No □ |
| Yes | | | No |

Where a particular criterion is deemed not applicable, it shall be indicated as ‘Not Applicable’ in the comment box.

Section A: Quality and composition

1. Are the AC’s expectations clearly discussed with, and understood by management, auditors and other advisors?

   | Yes □ | | | No □ |
   | Comment: |

2. Does the AC receive timely information in carrying out its responsibilities as set out under the AC Charter?

   | 4 □ | 3 □ | 2 □ | 1 □ |
   | Comment: |

3. Does the AC chairman have adequate time scheduled to fulfil his/her responsibilities, possess knowledge of the relevant matters and is equipped with strong leadership skills?

   | Yes □ | | | No □ |
   | Comment: |
4. Does the AC, together with the nominating committee, develop a succession plan for the AC members, including the AC chairman?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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Comment:

Section B: Skills and competencies

5. Is the AC’s independence at a satisfactory level?

| 4 □ | 3 □ | 2 □ | 1 □ |

Comment:

6. Is the AC confident in dealing with any complex and difficult matters brought before it?

| 4 □ | 3 □ | 2 □ | 1 □ |

Comment:

7. How consistent and appropriate is the AC in probing and challenging the matters that are presented to it?

| 4 □ | 3 □ | 2 □ | 1 □ |

Comment:

8. If there has been any case whereby the AC is of the view that a matter reported to the board has not been satisfactorily resolved and resulting in a breach of the Listing Requirements, has the AC reported such matter to Bursa Securities? (N/A if no such occurrence)

| Yes □ | No □ |

Comment:

Section C: Meeting administration and conduct

9. Does the AC regulate its own procedures (i.e. calling of meetings, notice to be given of such meetings, the voting and proceedings of such meetings, keeping of minutes, and custody, production and inspection of such minutes)?

| Yes □ | No □ |

Comment:

10. Are quorums for AC meetings met by having a presence of majority independent directors?

| 4 □ | 3 □ | 2 □ | 1 □ |

Comment:
11. Are AC meetings run effectively, with adequate time spent on important or emerging issues?

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Comment:

12. Are AC members able to speak freely during AC meetings?

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Comment:

13. Is the agenda and associated information (e.g. meeting minutes, financial statements) distributed before AC meetings to allow its members adequate time to study and understand the information?

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Comment:

14. Does the AC Chairman support contribution on meeting agendas from board members, management, the external auditors and the internal auditors?

| Yes | No |

Comment:

15. Does the AC hold sessions with key members of management (including operational managers), if necessary, to understand business risks?

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Comment:

16. Does the AC review and report to the board, the quarterly results and year-end financial statements, before approval by the board, focusing particularly on:

i. Changes in or implementation of major accounting policy changes;
ii. Going concern assumption and ability of the company;
iii. Significant matters highlighted including financial reporting issues, significant judgments made by management, significant and unusual events or transactions, and how these matters are addressed; and
iv. Compliance with applicable approved financial reporting standards and other legal requirements?

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Comment:
17. Does the AC receive both financial and non-financial information from management to assist in its review of quarterly results and year-end financial statements?

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18. Does the AC have full and unrestricted access to any information pertaining to the company or its subsidiaries, wherever necessary and reasonable for the performance of its duties?

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19. Does the AC appraise the external auditors, internal auditors and management on the experience and adequacy of the company’s accounting and finance staff?

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20. Does the AC review and make recommendations to the board on the appointment, re-appointment, and removal of external auditors?

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21. Does the AC review the appointment, replacement or dismissal of the Head of the Internal Audit function, to ensure continued objectivity of internal audit function?

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22. Does the AC review the level of fees payable for external audit services provided to ensure the quality of external audit is not compromised?

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23. Does the AC regularly review the adequacy (including the scope, methodology, competency, resources and authority) and performance (including compliance with relevant standards and regulations, quality of internal audit and quality of report) of the internal audit function?

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24. Does the AC review the internal audit plan, processes and results of internal audit assessments or investigation undertaken?

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Comment:

25. Where an accounting treatment is open to a different approach, does the AC consider the appropriateness of the associated accounting policies adopted by discussing with management and, where necessary, the external auditors, before decision is made?

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Comment:

26. Has the AC’s established and approved policies governing the provision of non-audit services (by quantum and type) for which external auditors are specifically excluded?

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Comment:

27. Has the AC’s established and approved policies governing the provision of non-audit services for which the external auditors can be engaged without referral to the AC?

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Comment:

28. Has the AC’s established and approved policies governing the provision of non-audit services for which a case-by-case decision is necessary?

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<tr>
<th>Yes □</th>
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Comment:

29. Does the AC keep the nature and extent of non-audit services provided by the external auditors under review?

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<th>Yes □</th>
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Comment:

30. Does the AC meet with the lead audit partner, and other members of the audit team if necessary, at least annually, without the presence of management, to discuss issues arising from the audit, evaluation of the systems of internal control, and any other matters that the auditor may wish to raise with the AC and vice versa?

<table>
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<tr>
<th>Yes □</th>
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Comment:
31. Does the AC have private sessions with the internal audit and external audit that facilitates candid discussions of pertinent issues?

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Comment:

32. Does the AC review the management letters and reports written by the external and internal auditors respectively and monitor the process to conclude that all important matters are resolved/addressed?

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Comment:

33. Does the AC review adjustments to the financial statements that resulted from the external audit?

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34. Does the AC supervise management takes action on recurring finding?

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Comment:

35. Does the AC understand and approve the process used by management to identify and disclose related party transactions?

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Comment:

36. Does the AC review all related party transactions and conflict of interest situations that may arise within the Group, including any transaction, procedure or course of conduct that may raise questions of management integrity?

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Comment:

37. Does the AC review the validity, completeness and accuracy of disclosures in the financial statements, interim reports and related formal statements prepared?

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<th>Yes □</th>
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Comment:

38. Does the AC review the arrangements by which staff may raise concerns in confidence about possible improprieties in the company?

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Comment:
39. Does the AC Chairman report to the full board after each meeting?

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40. Where disagreements between the AC and board cannot be resolved, is adequate time set aside for discussion of the issue with a view of resolving the disagreement?

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Comment:

Checked and complied by:

_____________________
Name: 
Designation:
Appendix VI:
Audit committee members’ self and peer evaluation form

This sample exhibit, which is not exhaustive in nature, illustrates key questions which may be used to assist the process for the annual evaluation of audit committee members, and/or evaluation prior to appointment.

This sample evaluation form may be customised, depending on the peculiar circumstances of the companies concerned.

The Evaluation Form provides ratings from one (1) to four (4), or ‘yes’ and ‘no’, with the indicators illustrated below, to be responded in relation to the nature of the questions:

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<th>1 □</th>
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<tbody>
<tr>
<td>Yes, always</td>
<td>Yes, most of the time</td>
<td>Yes, but seldom</td>
<td>No</td>
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</table>

or

<table>
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<th>3 □</th>
<th>2 □</th>
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<tbody>
<tr>
<td>Above average</td>
<td>Average</td>
<td>Below average</td>
<td>Poor</td>
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</table>

or

| Yes □ | | | No □ |
| Yes | | | No |

Where any criterion is deemed not applicable, it shall be indicated as ‘Not Applicable’ in the comment box.

Name of AC Member:

1. The AC Member exhibits trustworthiness, dynamic participation, integrity, capability to handle conflict constructively, sturdy interpersonal ability, and the enthusiasm to tackle problems proactively.

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2. The AC Member has the appropriate experience to meet the objectives of the AC’s Charter, including financial literacy.

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3. Given the company’s business and risk environment, assess the skills and experience of the AC Member to analyse and critically evaluate the information presented to the AC.

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Comment:

4. Assess the AC Member’s understanding of the company’s significant financial and non-financial risks.

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Comment:

5. How strong is the AC Member’s understanding of the company’s compliance processes?

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Comment:

6. Evaluate the AC Member’s understanding of financial and statutory reporting requirements.

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Comment:

7. Evaluate the AC Member’s understanding of the company’s significant accounting policies, accounting estimates and financial reporting practices.

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Comment:
Corporate Governance: Moving from Aspiration to Actualisation

Corporate Governance Guide

Pull-out II

Guidance on Effective Audit and Risk Management

3rd Edition
www.bursamalaysia.com
This Corporate Governance Guide ("Guide") is issued by Bursa Malaysia Berhad for users to gain an understanding and appreciation on the application of corporate governance practices especially in relation to those set out in the Malaysian Code on Corporate Governance.

This Guide is provided for reference purposes only and is not exhaustive in its coverage. Users must exercise discernment and diligence in the use of this Guide. It is the boards’ and company officers’ responsibility to obtain independent, professional advice regarding any specific set of facts or issues before using or relying on it.

All applicable laws, regulations and existing Bursa Securities Listing Requirements should be referred to in conjunction with this Guide.

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Background

This Introduction to Pull-out II ("Effective Audit and Risk Management") is designed to provide companies with broad guidance in making suitable arrangements for their audit and risk management processes as well as to assist directors serving on audit committees in carrying out their role. The Introduction also intends to provide companies with direction in implementing the relevant enumerations of Principle B in the Malaysian Code on Corporate Governance ("MCCG") and thus, should be read in conjunction with the write-ups on the individual Practices and Step Ups encapsulated in this Pull-out.

In today’s complex and evolving business environment, an effective audit and risk management process can make a strong contribution to a “no surprises” environment. Being vigilant of uncertainties requires companies to anticipate future challenges, understand what is on the horizon, and address risk more strategically – all of which calls for greater oversight, accountability and transparency.

In this regard, a robust audit committee can be a key feature of a strong corporate governance culture underpinned by effective audit and risk management. In discharging its mandate, it is imperative for audit committees to be supported by fundamental building blocks, namely an appropriate structure and foundation, well-defined responsibilities, an understanding of current and emerging issues as well as a proactive, risk-based approach to its work.

An audit committee’s relationship with the board, management and internal and external auditors plays a pivotal role in driving its effectiveness. The essential features of these interactions are a frank, open working relationship and a high level of mutual respect. The audit committee must be prepared to listen to their views (i.e. management, internal and external auditors), deliberate on the issues candidly and take a robust stance when necessary.

Every company needs to consider in detail what audit and risk management arrangements are best suited for its particular circumstances as what works best for one company may not necessarily be ideal for another. These arrangements need to be proportionate to the task and will vary according to the size, maturity, complexity and risk profile of the company. Nevertheless, there are certain guiding principles and practices which underlie the effectiveness of an audit and risk management process and they can help to ensure that company-specific approaches are applied effectively (i.e. by the right people with the right information, procedures and perspectives).

This Introduction is set out over three sections. **Section I** addresses the establishment and effectiveness of the audit committee. **Section II** explores the audit committee’s responsibilities in overseeing the areas of financial reporting, related party transactions and conflicts of interests, internal control environment, internal audit and external audit. **Section III** meanwhile sheds light on the communication of audit, risk management and internal control matters.
Section I: Establishment and effectiveness of the audit committee

Establishment and terms of reference

Given the importance of an audit committee to the governance structure of a company, the establishment of this committee is mandated for listed issuers through paragraph 15.09 of Bursa Securities Listing Requirements. The need for a charter or written terms of reference and minimum functions of the audit committee (covered in Section II of this Introduction) is set out in paragraphs 15.11 and 15.12 of Bursa Securities Listing Requirements. Similar provisions are also encapsulated for financial institutions in Standard 12.1 and Appendix I of Bank Negara Malaysia’s Policy Document on Corporate Governance.

The audit committee charter must be approved and adopted by the board and it must set out in sufficient detail the specific duties, responsibilities and authority of the audit committee. Such terms of reference will not only help committee members focus on their roles but the disclosure of such on the company’s website will also enable stakeholders to be apprised of their responsibilities.

Once established, the charter should be assessed, reviewed and updated periodically by the committee or as and when there are changes to the regulatory requirements and changes to the direction or strategies of the company that may affect the audit committee’s role.

The committee should recommend any changes to its terms of reference to the board for the latter’s approval. The assessment of the committee’s terms of reference should be a rigorous process, taking into consideration the company’s circumstances and any new regulations that may have an effect on the audit committee’s responsibilities.

Composition and membership

Appointments to the audit committee should be made by the board on the recommendation of the nominating committee, in consultation with the audit committee chairman. In determining the composition and membership of the audit committee, the board should take into account factors such as size, independence and desired skills and qualities of the members.

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<tr>
<th>Size</th>
<th>Independence</th>
<th>Skills and qualities</th>
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<tr>
<td>The size of the audit committee will vary depending on the needs of the company, the board and the extent of responsibilities delegated. Paragraph 15.09(1)(a) of Bursa Securities Listing Requirements mandates that the audit committee must be composed of not fewer than 3 members.</td>
<td>As stated in paragraph 15.09(1)(b) of Bursa Securities Listing Requirements, all the audit committee members must be non-executive directors, with a majority of them being independent directors. Paragraph 15.10 of Bursa Securities Listing Requirements prescribes that the chairman of the audit committee must be an independent director. Considerations on independence are covered in detail in the write-ups to Practice 8.1 and Step Up 8.4.</td>
<td>An appropriate level of expertise, experience and commitment amongst members is essential to the fulfilment of the committee’s mandate. At least one member of the audit committee must fulfil the financial expertise requisite of paragraph 15.09(1)(c) of Bursa Securities Listing Requirements. Considerations on financial literacy and other pertinent qualities are covered in detail in the write-up to Practice 8.5.</td>
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Meetings

It is for the audit committee chairman, in consultation with the company secretary, to decide on the frequency and timing of the audit committee’s meetings. There should be as many meetings as the audit committee’s roles and responsibilities require. It is recommended that there should be at least five meetings during the year, held to coincide with the key dates within the financial reporting (quarterly results and annual reporting) and audit cycle. The audit committee should meet prior to the release of the company’s quarterly results and annual reports to discuss on the proposed disclosures.

In terms of duration, sufficient time must be allocated to thoroughly address all items in the agenda and for all parties involved to ask questions or provide input. Audit committee members should be assured that they have covered all the agenda items without feeling pressured to rush discussions and decision-making.

The audit committee secretary plays an important role in organising and providing assistance during audit committee meetings. Generally, the company secretary is the audit committee secretary.

Other relevant considerations in organising an audit committee meeting are outlined below:

**Quorum**

In order to form a quorum in respect of an audit committee meeting, the majority of members present must be independent directors (paragraph 15.18 of Bursa Securities Listing Requirements).

**Agenda**

A comprehensive agenda helps committee members stay focused on their objective.

Where necessary, the agenda should include input from the chief executive officer, finance director, the internal and/or external auditors.

The audit committee chairman is accountable for the agenda and should not delegate it to management.

**Participants**

The chief executive officer, head of internal audit, external auditor or any other members of the management team and external experts may be invited to attend the meetings when the agenda calls for their insights.

**Paragraph 15.13 of Bursa Securities Listing Requirements** stipulates that a listed issuer must ensure that other directors and employees attend any particular audit committee meeting only at the audit committee’s invitation, specific to the relevant meeting.

**Timing**

Sufficient interval should be allowed between audit committee meetings and board meetings to allow any work arising from the audit committee meeting to be carried out and reported to the board as appropriate.
Rights and resources

**Paragraph 15.17 of Bursa Securities Listing Requirements** empowers audit committee with the rights to carry out its work in an unhindered manner.

| Paragraph 15.17 of Bursa Securities Listing Requirements |
| Rights of the audit committee |
| A listed issuer must ensure that wherever necessary and reasonable for the performance of its duties, an audit committee must, in accordance with a procedure to be determined by the board of directors and at the cost of the listed issuer – |
| (a) have authority to investigate any matter within its terms of reference; |
| (b) have the resources which are required to perform its duties; |
| (c) have full and unrestricted access to any information pertaining to the listed issuer; |
| (d) have direct communication channels with the external auditors and person(s) carrying out the internal audit function or activity; |
| (e) be able to obtain independent professional or other advice; and |
| (f) be able to convene meetings with the external auditors, the person(s) carrying out the internal audit function or activity or both, excluding the attendance of other directors and employees of the listed issuer, whenever deemed necessary. |

In furtherance of their duties, audit committees may enlist the services of external experts or advisors such as valuers, engineers or tax consultants at the cost of the company in accordance with a procedure determined by the board.

Performance evaluation

**Paragraph 15.20 of Bursa Securities Listing Requirements** states that the nominating committee of a listed issuer must review the term of office and performance of an audit committee and each of its members annually to determine whether such audit committee and members have carried out their duties in accordance with their terms of reference. Sample exhibits on the assessment of the audit committee as a whole and individual audit committee members are provided in Appendix V and Appendix VI of Pull-out I.

Assessment of the audit committee as a whole. Considerations include:
- Quality and composition;
- Skills and competencies; and
- Meeting administration and conduct.

Assessment of individual audit committee members. Considerations include:
- Skills, experience and understanding;
- Calibre and personality; and
- Participation and contribution.

Upon completion of the review, the nominating committee should deliberate on the outcome and provide suggestions to the board on appropriate remedial actions for the audit committee. For example, relevant training or education programmes may be recommended for audit committee members to carry out their duties in a more informed manner.
Audit committee relationships and communications

The broadening responsibilities, rising complexities of accounting and risk issues as well as the heightening demand of stakeholders call for audit committees to be more focused than ever in enhancing their efficiency and effectiveness. Vital to achieving these are the strength and collegiality of the audit committee’s working relationship with the board of directors, management, internal and external auditors.

Better practices call for continuous engagement between the audit committee (particularly the chairman of the committee) and senior management (including executive members of the board) of the company, as well as the internal and external auditors. These engagement sessions serve as a platform for relevant issues affecting the company to be surfaced to the attention of the audit committee in a timely manner.

A brief summary of the audit committee’s working relationship with the aforementioned parties is outlined below:

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<tr>
<th>Relationship with the board</th>
<th>Relationship with management</th>
<th>Relationship with internal and external auditors</th>
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<tr>
<td>As the board is ultimately responsible for the oversight of the company, it needs to be consistently kept informed by the audit committee of its activities.</td>
<td>It is the responsibility of the audit committee to satisfy itself that management has maintained a sound internal control system and prepared complete and reliable financial statements and disclosures in accordance with the applicable approved accounting standards and in compliance with relevant rules and regulations. In doing so, the audit committee should continuously apply critical and probing view as well as effectively challenge the assertions made by management in this regard.</td>
<td>Both internal and external auditors provide integral support to the audit committee by acting as a sounding board. The audit committee should have direct and unrestricted access to the auditors without the presence of management. During these sessions, the audit committee can and should follow up on areas of concern identified by the internal and external auditors. The audit committee should also make inquiries on significant discussions between management and the auditors.</td>
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<tr>
<td>Any irregularities, significant findings or matters of concern under the purview of the audit committee should be communicated to the board immediately.</td>
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<td>Any relevant proposals requiring substantive action by the board should also be submitted promptly in writing in order to provide board members ample time to review and consider the proposals.</td>
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In its working relationship with management, the audit committee should endeavour to achieve an adequate understanding of the representations made by management and scrutinise these matters accordingly.
Some of the key questions that should be posed to management include:

- What is your assessment of the overall control environment including ability to detect/identify in a timely manner related party transactions and conflict of interest situations?
- What processes do you have in place to ensure material errors will not occur?
- What materiality level did you employ in assessing whether the financial reports presented are of a true and fair view?
- What are the most significant estimates and judgments you made in preparing the financial report? What was the range of values used in those estimates? Justify the appropriateness of the underlying assumptions and the reliability of information/methodologies/tools used.
- What are the nature and size of year-end adjustments and related party transactions?
- Did any non-recurring transactions materially impact the financial results? If so, what were they and what was the impact?
- What were the major financial reporting standards and regulatory changes instituted during the year and what was their impact?
- What are the significant differences existing in the financials between the current and prior period? Why have these variances occurred?
- Is the financial result significantly different from the budget? If so, why?
- Which aspects of the company’s financial viability and sustainability do you feel least comfortable with?
- Have there been any disagreements between management and the internal or external auditors? If so, what were they and how were they resolved?

**Section II**

**Roles and responsibilities of the audit committee**

**Understanding of roles and responsibilities**

An effective audit committee should be critically aware of its responsibilities, fully understand and embrace them, and recognise what is necessary to fulfil them. The audit committee must be vigilant, informed and diligent in fulfilling its oversight responsibilities. As outlined in paragraph 15.12 of Bursa Securities Listing Requirements, every audit committee should at the very least assume the following fundamental responsibilities:
In addition to the aforementioned responsibility areas, audit committees of financial institutions are also required to review the accuracy and adequacy of the chairman’s statement in the directors’ report, corporate governance disclosures, interim financial reports and preliminary announcements in relation to the preparation of financial statements\(^1\).

**Oversight of financial reporting**

**Paragraph 15.12(1)(g) of Bursa Securities Listing Requirements** requires the audit committee to review the quarterly results and year-end financial statements prior to approval by the board of directors, focusing particularly on –

(i) changes in or implementation of major accounting policy changes;

(ii) significant matters highlighted including financial reporting issues, significant judgments made by management, significant and unusual events or transactions, and how these matters are addressed; and

(iii) compliance with accounting standards and other legal requirements.

It is essential for the audit committee to ensure that the finance function within a company is carried out by the right personnel with the skills, experience, training and authority suitable to the industry and the complexity of the company’s business.

Apart from having the right personnel, audit committees should also ensure that the finance function is equipped with adequate resources (i.e. human capital and technology) and the right infrastructure (i.e. financial and accounting systems) to support the financial reporting process.

In reviewing the quarterly results and year-end financial statements, the audit committee should also be vigilant of significant adjustments arising from the external audit (e.g. impairment of assets during the global oil and gas downturn) and the appropriateness of the going concern assumption used in preparation of the financial statements. The audit committee is encouraged to consult the external auditors on these matters if the need arises.

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\(^1\) Paragraph 10, Appendix 1 of Bank Negara Malaysia’s Policy Document on Corporate Governance
In general, the audit committee should focus on the following when reviewing financial statements of the company:

- monitoring the integrity of the company’s financial information such as ensuring information is supported by proper documents, reviewing the relevance and consistency of the accounting principles used (including criteria and principles used for consolidation) and understanding the effects of any changes in the accounting policies and practices, either as a result of changes in regulatory requirements or mooted by management for better accounting treatment;
- understanding the methods used to account for any complex and unusual transactions where their treatment may be open to different approaches and any significant accounting policy issues or audit adjustments recommended by auditors (those agreed by management and those waived);
- ensuring any significant accounting policy issues or audit adjustments recommended by auditors are communicated early enough to enable appropriate actions to be taken, as needed;
- assessing the company’s financial position/condition including risk of tax exposures and considering the question of going concern;
- assessing the process of how transactions are recorded in the system to ensure accuracy, completeness and consistency of financial information, including compliance with the relevant accounting standards and other legal requirements;
- considering related party transactions, the financial impact of such transactions and whether they have been entered into according to the terms stipulated in the shareholders’ mandate or in the best interests of the company;
- requesting external auditors to present their findings on internal control weaknesses noted during their statutory audits and highlighting findings which are disputed by management or where management has not agreed to implement remedial actions to rectify the reported weaknesses; and
- understanding non-financial information which is relevant in assisting the audit committee to gain further insights into the company’s financial results (e.g. the impact of capacity utilisation on the company’s profit margin and the impact of the actions by competitors on the company’s revenue).

Appendix I of this Pull-out sets out a list of indicators that the audit committees should be aware of in relation to financial reporting and a sample questionnaire that can be customised to seek management’s representation on a range of financial reporting matters.

Review of conflict of interest situations and related party transactions

The audit committee is tasked under paragraph 15.12(1)(h) of Bursa Securities Listing Requirements to review and report to the board on any related party transactions (including recurrent related party transactions) and conflict of interest situations that may arise within the listed issuer or group. This includes any transaction, procedure or course of conduct that raises questions of management’s integrity. The audit committee should therefore ensure that the transactions carried out are amongst others, in the best interest of the listed issuer as well as not detrimental to the minority shareholders².

Conflicts of interest situations generally refer to circumstances where a person with a vested interest in the company is in a position or has the opportunity to influence the company’s business or other decisions in ways that could lead to personal gain or advantage of any kind (“interested parties”).

Examples of situations that are likely to give rise to conflicts of interest amongst others include the following:

- where the interested party(ies) have an interest in a business that competes or is likely to compete, either directly or indirectly, with the business of the company or its subsidiaries (collectively “the group”);

² Refer to paragraph 3(a), Appendix 10C of Bursa Securities Listing Requirements
- where the interested party(ies) conduct or have an interest in business transactions involving goods or services, either directly or indirectly, with the group;
- where the interested party(ies) provide or receive financial assistance from the group; and
- where the interested party(ies) lease property to or from the group.

A related party transaction meanwhile is a transaction entered into by the listed issuer or its subsidiaries which involves the interest, direct or indirect, of a related party. **Paragraph 1.01 of Bursa Securities Listing Requirements** defines a related party in relation to a corporation as a director, major shareholder or person connected with such director or major shareholder. Transactions that fall within the ambit of related party transactions include the acquisition, disposal or leasing of assets, establishment of joint ventures, provision of financial assistance, provision or receipt of services or any business transaction or arrangement entered into by the listed issuer or its subsidiaries.

The various persons who are included in the definition of a related party as stated in **Chapter 10 of Bursa Securities Listing Requirements** are depicted below.

In addition to **Bursa Securities Listing Requirements**, companies (including listed issuers) which come under the purview of reporting within the **Malaysian Financial Reporting Standard 124** (Related Party Disclosures) are required to provide disclosures on related party transactions which are defined as the “transfer of resources, services or obligations between a reporting entity and a related party”, regardless of whether a price is charged.

Companies should also be cognisant of **Section 228 of Companies Act 2016** which prescribes the obligations of a company (i.e. to obtain prior shareholder approval at a general meeting) in respect of transactions involving a director or substantial shareholder of the company or its holding company, or its subsidiary, or a person connected with a director or substantial shareholder.

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3 Major shareholder refers to a person who has an interest in 10% or more of the total number of voting shares in the corporation; or 5% or more of the total number of voting shares in the corporation where such person is the largest shareholder of the corporation.

4 **Paragraph 10.02(1)(ii) of Bursa Securities Listing Requirements.**

5 An entity is related to a reporting entity if it has control or joint control over the reporting entity; has significant influence over the reporting entity; or is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

6 A substantial shareholder is a person who has not less than 5% of the voting shares in the company.
Taking into account the aforementioned enumerations, it is therefore incumbent on companies, particularly listed issuers through the audit committee, to determine how to address conflict of interest situations and monitor compliance with related party transaction policy and/or mandate, including transactions or situations that warrant timely internal and regulatory disclosures and appropriate review and reporting.

To this end, the audit committee should ensure that management establishes a comprehensive framework for the purposes of identifying, evaluating, approving, reporting and monitoring such situations and transactions. It is essential to ensure that the framework put in place enables related party transactions and conflict of interest situations to be brought to the attention of the audit committee for its consideration.

Key factors which must be addressed by the audit committee in its oversight of conflict of interest situations and related party transactions are as follows:

- identification of the interested and related parties as well as the nature of such potential transactions; and
- reasonableness of the conflict of interest situations or the related party transactions to ensure that interested parties and related parties do not abuse their powers to gain an unfair advantage.

In undertaking an assessment on the reasonableness of the conflict of interest situations or the related party transactions, audit committees may be guided by the following considerations:

- Are the terms of the transaction (including the price) fair, reasonable and on normal commercial terms?
- What impact will the transactions have on the financial statements?
- Are there business reasons or economic substance for the company to enter into the transaction with the related party and not a third party?

Examples of matters to be tabled to the audit committee on related party transactions are outlined in Appendix III of this Pull-out.

In addition, it is important for the audit committee to look into transactions that do not neatly fall within the definition of a related party transaction as stated in Chapter 10 of Bursa Securities Listing Requirements but may still involve a certain level of conflict of interest due to the close proximity (e.g. relationship) of the counterparties with individuals (such as employees) within the listed issuer who are involved in the transactions.

In certain instances, the audit committee may also be faced with the possibility of undisclosed conflict of interest situations or related party transactions. Hence, it is important for the audit committee to ensure that the comprehensive framework mentioned above is able to identify questionable transactions or potential conflict of interest situations or related party transactions. For this purpose, the audit committee should request management to provide the following information:

- background information on the company’s trading partner and transacting parties;
- information on the trading partners’ directors and substantial shareholders;
- identity of related parties;
- information about the key business partners, major customers, major suppliers and parties to key contracts; and
- salient terms or arrangements of the transactions.
Assessment of internal control environment

The audit committee must determine whether management has implemented effective and adequate internal controls to preserve the company’s value creation. The internal control framework of a company should address the following inter-related components:

- **Control environment**: This sets the tone and culture of the company. It is the foundation of all aspects of internal controls, providing discipline and structure. It includes the integrity, ethical values and competency of the personnel.

- **Risk assessment**: Identifies and analyses relevant risks that prevent the company from achieving its objectives and forms the basis for determining how those risks should be managed.

- **Control activities**: These are the policies and procedures that help ensure the necessary actions are taken to address risks impeding the achievement of the company’s objectives, and maintaining these risks within an acceptable risk appetite.

- **Information and communication**: Identifies, captures and communicates information in a form and timeframe that enables personnel to carry out their responsibilities.

- **Monitoring activities**: Assesses the performance of the control system on a continuing basis.

It is important to note that the design of internal controls in silos and without reference to their associated risks can lead to an imbalance and consequently, certain key risk areas may be left unaddressed. It is thus imperative for the internal control system to be embedded in the operations of the company and be capable of responding quickly to evolving business risks, whether they arise from factors within the company or from changes in the business environment. Succinctly put, the internal control system should form an integral part of the company’s day-to-day business processes.

Given the evolving nature of risks in the marketplace and the dense agenda of the audit committee, it is also increasingly regarded as a better practice for companies to have a separate board-level committee, namely, risk management committee to provide dedicated oversight on risk management matters. In assessing the company’s risk management framework and policies, the board committee overseeing risk management matters should, amongst others, consider the following:

- the principal risks and the process of identification, evaluation and management of the principal risks;
- the alignment between risk management execution and the implementation of the company’s overall strategy;
- the effectiveness of measures deployed by management to address those risks (i.e. accept, avoid, transfer or mitigate the risks);
- corrective measures undertaken to remedy failings and/or weaknesses;
- ability of the company to meet changes in significant risks and respond to constant changes to the business and/or external environment;
- scope and quality of management’s ongoing monitoring of risks and robustness of the risk management process;
- communication and monitoring of risk assessment results to the board; and
- actual and potential impact of any failing or weakness, particularly those related to financial performance or conditions affecting the company.

Considerations on risk management and internal control system are covered in detail in the write-up to **Practices 9.1 and 9.2**. Discussion on the establishment of a risk management committee is provided in write-up to **Step Up 9.3**.
Evaluation on internal audit

Each listed issuer by virtue of paragraph 15.27 of Bursa Securities Listing Requirements is required to establish an internal audit function that reports directly to the audit committee. This function serves as an important source of advice for the audit committee by bringing an objective and disciplined approach to evaluate and improve the effectiveness of risk management, internal control and governance processes.

The internal audit function which can either be performed in-house or outsourced, including outsourced to group internal auditors (i.e. internal auditor of the holding company or subsidiary of the holding company) must be premised on the requirements of an “independent and objective” function. At all times, the audit committee should ensure that the internal audit function has a reporting line which enables it to be independent of management so as to exercise objectivity. The audit committee should be responsible for deciding on the appointment and removal as well as the performance evaluation and remuneration of those in the internal audit function. The internal audit function should also be accorded with direct and unrestricted access to information, records, physical properties and personnel to enable it to fulfil its mandate.

The audit committee should be involved in deciding the remit of the internal audit function including its objectives, strategies, roles and responsibilities, scope and remuneration. In order to position and formalise the internal audit function, a mandate in writing (i.e. the internal audit charter or terms of reference) should be established and approved by the audit committee.

In undertaking a review of effectiveness of the internal audit function, the audit committee should satisfy itself that the quality, experience and expertise of the function is appropriate for the business of the company. The audit committee should also consider the actions that management has undertaken to implement the recommendations of the function and whether these properly support the effective working of the internal audit function.

Considerations relating to the internal audit function are covered in detail in the write-up to Practices 10.1 and 10.2.

Evaluation on external audit

External auditors play a vital role in the process of accountability to shareholders. Their primary role is to form an opinion on the financial statements of the company, including accounting and other records relating to those financial statements and thereafter report to the shareholders in general meetings. In their course of work, they may identify and, where appropriate, quantify the financial risk that may result in adjustments to the financial statements.

As stated in paragraph 15.12(2) of Bursa Securities Listing Requirements, the audit committee is required to recommend the nomination of a person or persons as external auditors.

The audit committee’s recommendation on the appointment of external auditors should be based on an assessment of the independence and capabilities of the external auditors as well as the effectiveness of the audit process. Paragraph 15.21 of Bursa Securities Listing Requirements outlines the factors (shown below) that a listed issuer must consider, among others, in appointing an external auditor:

- Adequacy of the experience and resources of the accounting firm
- Persons assigned to the audit
- Accounting firm’s audit engagements
- Size and complexity of the listed issuer’s group being audited
- Number and experience of supervisory and professional staff assigned to the particular audit
In the event of removal or resignation of the external auditors, it is imperative for the audit committee to look into the reasons thereof, especially when the impending removal or resignation arises from an inability to resolve contentious matters that affect financial reporting.

**Paragraph 15.22 of Bursa Securities Listing Requirements** stipulates where external auditors are removed from office or give notice to the listed issuer of their desire to resign as external auditors of listed issuer, the listed issuer must forward to the Exchange a copy of any written representations or statement of circumstances connected with the resignation made by the external auditors at the same time as copies of such representations or statement of circumstances are submitted to the Registrar pursuant to section 284 of Companies Act.

In overseeing the external audit process, **paragraph 15.12(1)(a)-(d) of Bursa Securities Listing Requirements** states that the audit committee must review with the external auditor - the audit plan, external auditor’s evaluation of the system of internal controls, audit report and assistance given by the employees of the listed issuer to the external auditor.

The audit committee needs to be aware of the scope and approach of the external audit. Whilst the audit plan is the external auditor’s responsibility, it is important that the audit committee fully understands the plan. At the start of each annual external audit cycle, the audit committee needs to consider the external auditor’s overall strategy, including planned levels of materiality and proposed resources to execute the external audit plan, and evaluate whether it is consistent with the scope of the external audit engagement.

In order to accomplish this effectively, the audit committee should perform the following:

- discuss with the external auditor before the audit commences, the nature and scope of the audit, including the terms as detailed in the external auditor’s engagement letter. This will clarify the responsibilities of the company and the external auditor and other logistical matters; and
- study and evaluate the audit plan, especially the approach to be deployed by the external auditor.

The elements encapsulated in a typical audit plan are outlined below:

- scope of the audit, timing of the audit and reporting deadlines;
- audit team;
- key areas of business risk and significant transactions for the group, as appropriate;
- major accounting systems and systems of internal control to be reviewed;
- extent of planned testing of controls;
- areas where contention may arise;
- nature and extent of audit procedures to be performed, including materiality level;
- identification or anticipation of significant changes for the financial report as a result of new or revised accounting policies and/or regulatory requirements;
- locations to be visited and audit procedures to be undertaken in respect of those locations not visited;
- liaison with subsidiaries’ auditors on consolidation of financial statements;
- coordination with internal audit to avoid duplication of efforts and to optimise audit efficiency;
- the extent to which the planned audit scope can be relied upon to detect errors or irregularities (i.e. fraud); and
- frequency of meetings with the audit committee and any reports or other deliverables the audit committee and management are likely to receive.
Following the audit and before signing off the auditor’s audit report in the financial statements, the external auditor would normally present the following to the audit committee:

- a report, detailing the results and significant findings from the audit;
- the external auditor’s audit report which notably includes opinion relating to the financial statements and key audit matters; and
- a management letter concerning improvement measures that management should consider pertaining to weaknesses or deficiencies in the internal control system.

In this regard, the audit committee should request the external auditors to present their findings on internal control weaknesses noted during the financial audit and highlight findings which are disputed by management or where management has not agreed to implement corrective actions which would rectify the reported weaknesses.

As part of an ongoing monitoring process, the audit committee should review the management letter issued and consider management’s responsiveness to the external auditors’ findings and recommendations, particularly on internal control deficiencies that need to be addressed.

Considerations relating to the oversight of external auditors by the audit committee are covered in detail in the write-up to Practices 8.2 and 8.3.

Section III

Communication on audit, risk management and control

Pursuant to paragraph 15.15(1) and (2) of Bursa Securities Listing Requirements, a listed issuer must ensure that its board of directors prepare an audit committee report at the end of each financial year and clearly set it out in the annual report. The audit committee report must contain, at the very least, the following information as stated in paragraph 15.15(3) of Bursa Securities Listing Requirements.

**Paragraph 15.15(3) of Bursa Securities Listing Requirements**

**Audit committee report**

The audit committee report must include the following:

(a) the composition of the audit committee, including the name, designation (indicating the chairman) and directorship of the members (indicating whether the directors are independent or otherwise);

(b) [deleted]

(c) the number of audit committee meetings held during the financial year and details of attendance of each audit committee member;

(d) a summary of the work of the audit committee in the discharge of its functions and duties for that financial year of the listed issuer and how it has met its responsibilities; and

(e) a summary of the work of the internal audit function.

Note: As stated in Paragraph 2, Appendix 4 of Bank Negara Malaysia’s Policy Document on Corporate Governance, financial institutions are required to disclose the attendance of each director at board and board committee meetings during the financial year and discuss the roles and responsibilities of the board and the board committees.
The audit committee report should describe relevant significant issues in a concise and understandable form, tailored to the specific circumstances of the listed issuer. Merely disclosing the audit committee’s terms of reference or charter without describing how the committee actually carried out its roles and responsibilities during the financial year would not be particularly useful for stakeholders.

The “Analysis of Corporate Governance Disclosures in Annual Reports” performed by Bursa Malaysia over the last three years has identified the following elements (non-exhaustive) which were encapsulated in the audit committee report of listed issuers that exhibited good disclosures in this regard:

- details such as the dates when the audit committee met with the external and internal auditors without the presence of management and the topics discussed;
- discussion on developments (e.g. changes in accounting standards) which had a significant impact on the listed issuer’s financial statements and analyses of the impact;
- statement that there was assurance provided by the chief financial officer to the audit committee on matters which involve judgments and estimates;
- discussion on how the audit committee reviewed related party transactions and conflict of interest situations;
- details on the policies and procedures in place to assess the suitability and independence of the external auditor;
- discussion on the non-audit services rendered by the external auditor; and
- discussion on the internal audit assignments as well as the independence and competency of the internal audit function.

In addition to the audit committee report, paragraph 15.26(b) of Bursa Securities Listing Requirements requires the board of the listed issuer to provide a statement about the state of risk management and internal control of the listed issuer as a group. The statement should contain sufficient and meaningful information needed by stakeholders to make an informed assessment of the main features and adequacy of the listed issuer’s risk management and internal control system. Further, paragraph 15.23 of Bursa Securities Listing Requirements provides for the external auditors to review the statement made by the board of directors of a listed issuer, with regard to the state of risk management and internal control of the listed issuer and report the results thereof to the board of directors of the listed issuer.

It is also important to note that the chairman of the audit committee should be present at the annual general meeting to answer questions on the audit committee’s activities and on matters that are within the scope of the audit committee’s responsibilities.
Practices and Step Ups
Chairman of the audit committee

MCCG Intended Outcome 8.0

There is an effective and independent Audit Committee.

The board is able to objectively review the Audit Committee’s findings and recommendations. The company’s financial statement is a reliable source of information.

MCCG Practice 8.1

The Chairman of the Audit Committee is not the Chairman of the board.

⚠️ The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why

The case for change

Whilst all directors have a duty to act in the best interests of the company, the audit committee has a specific role which is to provide objective oversight in the areas of financial reporting, related party transactions and conflicts of interest, internal control environment, internal audit and external audit processes.

This need for objectivity is particularly imperative for the chairman of the audit committee as the effectiveness of the committee is often dependent on his or her leadership. The chairman is expected to demonstrate courage to deal with tough issues and support other members to do the same, especially in probing management on areas where subjectivity is inherent (e.g. choice of accounting policies and estimates made in arriving at the figures recorded in the financial statements).

Recognising the need for objectivity amongst audit committee members, regulators have placed a heightened focus on the composition of this committee with an emphasis on its chairman, as shown below:

Paragraph 15.09(1)(a) and (b) of Bursa Securities Listing Requirements

A listed issuer must appoint an audit committee from amongst its directors which fulfils the following requirements:

(a) the audit committee must be composed of not fewer than 3 members; and

(b) all the audit committee members must be non-executive directors, with a majority of them being independent directors.

Paragraph 15.10 of Bursa Securities Listing Requirements

The members of an audit committee must elect a chairman among themselves who is an independent director.

What could go wrong:

- Lack of objective review and scrutiny on the findings of the audit committee by the board.
- Deliberations and decision-making of the audit committee is dominated by a single individual.
- Omission of key discussion matters from the agenda of the audit committee.
- Lack of oversight on the effectiveness of the audit committee by the board.
Paragraph 15.18 of Bursa Securities Listing Requirements

In order to form a quorum in respect of a meeting of an audit committee, the majority of members present must be independent directors.

In addition to being independent, it is of paramount importance for the chairman of the audit committee to be distinct from the chairman of the board. Having these positions assumed by the same person may impair objectivity of the board’s review of the audit committee’s findings and recommendations. Such a situation may also potentially lead to concentration of power in a single director. The need for financial institution to maintain a distinction between the chairman of the board and chairman of the audit committee is enumerated in Standard 12.4 of Bank Negara Malaysia’s Policy Document on Corporate Governance which states that “to promote robust and open deliberations by the board on matters referred by the board committees, the chairman of the board must not chair any of the board committees”.

In addition, the separation of these two positions is necessary to enable the chairman of audit committee to devote sufficient time to the affairs of the committee. Being the chairman of the board and board committee would result in the said director being subjected to additional responsibilities, thus, making the performance of his or her duties fairly onerous.

Point for reflection

In tandem with global trends, audit committees continue to be the most time-consuming committee in corporate Malaysia. A review of annual reports across the top 50 listed issuers (by market capitalisation) in 2016 revealed that audit committees averaged 6.6 meetings a year compared to nominating committees (4.4 meetings) and other board sub-committees (4.5 meetings).

<table>
<thead>
<tr>
<th>Board Committee</th>
<th>Average Number of Meetings Held By Board Committees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit</td>
<td>6.5</td>
</tr>
<tr>
<td>Nomination</td>
<td>4.5</td>
</tr>
<tr>
<td>Others</td>
<td>4</td>
</tr>
</tbody>
</table>

Audit committees are often tasked with not only overseeing a company’s financial reporting and internal controls, but also a gamut of other responsibilities which include oversight of risk, compliance and corporate governance matters.

The need for audit committee members to be apprised of relevant developments also demands additional time and professional commitment. Over the recent years, there have been major developments in the accounting and auditing landscape such as the introduction of the New Auditor’s Report and revisions to accounting standards, all of which necessitate continuous professional development.

Investors’ perspectives

The composition of audit committee, particularly in relation to the independence of the chair is a focus area of institutional investors.

Blackrock, for example, has taken the position that the chairman of a committee in its investee companies should be independent. In its voting guidelines, Blackrock further reinforces that it is preferable for the chairman of the board not to chair board committees.

In instances where the audit committee is not comprised solely of independent directors, Blackrock will consider voting against the re-election of the chairman of the audit committee or the non-independent member of the audit committee particularly if there are other corporate governance issues.

1 Corporate governance and proxy voting guidelines 2015, Blackrock
The practice in substance

In structuring its audit committee, the board should ensure that the chairman of the audit committee is distinct from the chairman of the board. In addition, as stated in paragraph 15.10 of Bursa Securities Listing Requirements, the chairman of the audit committee must be an independent director.

Key considerations relating to the application of this Practice are discussed below:

What are the key responsibilities of an audit committee chairman?

An audit committee chairman is responsible for ensuring that audit committee meetings run efficiently and each agenda item is thoroughly and thoughtfully discussed by all members of the committee. The committee chairman is often the key contact between the committee members and members of the board, as well as senior management and the auditors. Responsibilities of an audit committee chairman, amongst others, are as below:

What are some of the key attributes of an effective audit committee chairman?

The chairman of the audit committee should be recognised for his or her leadership and vision, and be acknowledged by other committee members and management as being able to set and manage the audit committee’s agenda.

Attributes of an effective audit committee chair (non-exhaustive):

- an independent, proactive leader with confidence and integrity;
- a highly respected and experienced board member, who possesses strong financial literacy skills and time available to develop and closely monitor the committee’s agenda;
- a person with an excellent working knowledge of audit committee practices;
- a good listener and communicator who can facilitate successfully;
- a person who is able to champion open and frank discussion with discipline; and
- a person who is tenacious and prepared to ask the tough questions.

Can the chairman of the audit committee chair another board committee within the same company?

There are no restrictions for the chairman of the audit committee to chair another board committee within the same company as possibilities of conflicts of interest are minimal under normal circumstances.
In some instances, companies may find it value-adding for the chairman of the audit committee to chair another board committee, given the synergies that are involved between these two committees (e.g. audit committee and risk management committee or in the case of some financial institutions, audit committee and financing committee).

However, as mentioned above, the board should be cognisant of the workload of the audit committee chairman in deciding if he or she can assume the chairmanship of another board committee without compromising the standard of work performed.

**Regional/international perspectives**

As in the case of Malaysia, jurisdictions such as Australia and United Kingdom have enumerated prescriptions for the chairman of the audit committee to be distinct from the chairman of the board in order to enable the audit committee chairman to give full commitment and exercise independent judgment.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>The board of a listed entity should have an audit committee which is chaired by an independent director, who is not the chair of the board [Recommendation 4.1(a)(2)].</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>The board should establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors. In smaller companies, the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman (Provision C.3.1).</td>
</tr>
</tbody>
</table>

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2 A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.
Oversight of external auditors by the audit committee

**MCCG Intended Outcome 8.0**
There is an effective and independent Audit Committee.

The board is able to objectively review the Audit Committee’s findings and recommendations. The company’s financial statement is a reliable source of information.

**MCCG Practice 8.2**
The Audit Committee has a policy that requires a former key audit partner to observe a cooling-off period of at least two years before being appointed as a member of the Audit Committee.

**MCCG Practice 8.3**
The Audit Committee has policies and procedures to assess the suitability, objectivity and independence of the external auditor.

⚠️ The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

The case for change

An audit has value to financial statement users because it is performed by a competent third party who is viewed as having no interest in the financial success of the company. Investors take comfort in the fact that independent professionals have performed the required procedures and have a reasonable basis for the opinion that they render in the financial statements.

Given that audit quality is integral to the informed decision-making of investors, safeguards should be put in place to preserve the integrity and credibility of the audit process. A high level of scrutiny is also increasingly being placed by stakeholders on the work of external auditors. Independent audit regulators across the globe are now increasingly focusing on the drivers of audit quality via their inspection efforts. The Global Annual Survey of Audit Inspection 2016 by the International Forum of Independent Audit Regulators revealed that whilst there is a general decline in the inspection findings, a lack of consistency in the execution of audits and systems of quality control, including in the critical area of external auditors’ independence, continue to remain as causes for concern.

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1. Concept release on auditor independence and audit firm rotation 2011, Public Company Accounting Oversight Board of United States
Recognising that promoting audit quality is not within the sole purview of external oversight bodies, regulators have also placed audit governance responsibilities on the audit committee, including in the selection and evaluation of the external auditor. For example, Bursa Securities Listing Requirements call upon audit committees to be proactive in overseeing the external audit process.

**What could go wrong:**
- Compromised objectivity of the external auditor.
- Lack of expertise and experience by the external auditor to conduct the audit process.
- Lack of robust focus on the critical areas of risk concerning financial reporting.
- Lack of value obtained from the external auditor beyond the scope of statutory external audit (e.g., audit findings are not contextualised to the industry and business).

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**Common significant deficiencies in audit engagements**

<table>
<thead>
<tr>
<th>Category</th>
<th>Major audit firms</th>
<th>Other audit firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue recognition</td>
<td>15%</td>
<td>21%</td>
</tr>
<tr>
<td>Inventory</td>
<td>18%</td>
<td>41%</td>
</tr>
<tr>
<td>Group audits</td>
<td>7%</td>
<td>29%</td>
</tr>
<tr>
<td>Sampling</td>
<td>9%</td>
<td>27%</td>
</tr>
<tr>
<td>Related-party transactions and balances</td>
<td>38%</td>
<td>25%</td>
</tr>
</tbody>
</table>

*Note: Major audit firms refer to audit firms with more than 10 partners and audit more than 50 public interest entities ("PIE") clients with a total market capitalisation of above RM20 billion.*

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*Annual Report 2016, Audit Oversight Board (Malaysia)*
Paragraph 15.12 of Bursa Securities Listing Requirements

Functions of the audit committee

A listed issuer must ensure an audit committee, amongst others, discharges the following functions:

(1) review the following and report the same to the board of directors of the listed issuer:
   (a) with the external auditor, the audit plan;
   (b) with the external auditor, his evaluation of the system of internal controls;
   (c) with the external auditor, his audit report;
   (d) the assistance given by the employees of the listed issuer to the external auditor;
   (i) any letter of resignation from the external auditors of the listed issuer;
   (j) whether there is reason (supported by grounds) to believe that the listed issuer’s external auditor is not suitable for re-appointment; and
(2) recommend the nomination of a person or persons as external auditors.

Paragraph 15.17(d) and (f) of Bursa Securities Listing Requirements

Rights of the audit committee

A listed issuer must ensure that wherever necessary and reasonable for the performance of its duties, an audit committee must, in accordance with a procedure to be determined by the board of directors and at the cost of the listed issuer –

(d) have direct communication channels with the external auditors and person(s) carrying out the internal audit function or activity; and
(f) be able to convene meetings with the external auditors, the person(s) carrying out the internal audit function or activity or both, excluding the attendance of other directors and employees of the listed issuer, whenever deemed necessary.

Note: Only requirements pertaining to the external auditor are extracted from paragraphs 15.12 and 15.17 of Bursa Securities Listing Requirements.

Paragraph 15.21 of Bursa Securities Listing Requirements

External auditor

In appointing an external auditor, a listed issuer must consider, among others –

(a) the adequacy of the experience and resources of the accounting firm;
(b) the persons assigned to the audit;
(c) the accounting firm’s audit engagements;
(d) the size and complexity of the listed issuer’s group being audited; and
(e) the number and experience of supervisory and professional staff assigned to the particular audit.
Similar provisions are also encapsulated for financial institutions in Bank Negara Malaysia’s Policy Document on Corporate Governance. For example, Appendix 1 of the said document requires the audit committee to foster a quality audit of the financial institution by exercising oversight over the external auditor, in accordance with the expectations set out in the Bank Negara Malaysia’s Policy Document on External Auditor³.

**The practice in substance**

In assessing the suitability, objectivity and independence of the external auditor, the audit committee should establish policies and procedures which cover all aspects of the audit service provided by the audit firm.

The audit committee’s recommendation on the appointment of an external auditor should be based on an assessment of the independence and capabilities of the external auditor as well as the effectiveness of the audit process.

**Key considerations relating to the application of these Practices ( Practices 8.2 and 8.3 of MCCG)** are discussed on the following page.

³ The Policy Document on External Auditor by Bank Negara Malaysia outlines the qualifications of an external auditor to be appointed by a financial institution.
What are policies and procedures that can be put in place by an audit committee to assess the suitability (in terms of capabilities, objectivity and independence) of the external auditor?

Examples of policies and procedures (non-exhaustive) that can be established by the audit committee in this regard are outlined below:

**Examples of policies:**

- Having in place a policy on the **appointment, re-appointment and removal of external auditor** (including selection and qualification criteria)\(^4\).
- Establishing a policy on the **types of non-audit services** that are prohibited and **limits to the level of fees for non-audit services** rendered by the external auditor.
- Having in place a policy to govern the **appointment of a former key audit partner** as a member of the audit committee and/or employee.

**Examples of procedures:**

- **Obtaining written assurance from the external auditors** confirming that they are, and have been, independent throughout the conduct of the audit engagement in accordance with the terms of all relevant professional and regulatory requirements.
- Developing a list of **audit quality indicators** by the audit committee to monitor effectiveness of the external audit process. Examples of such indicators may include:
  - adequacy of audit scope;
  - ability of the external audit firm to meet audit deadlines;
  - timeliness in escalating audit issues to the audit committee;
  - allocation of resources to significant audit risk areas; and
  - effectiveness of the external audit firm’s recommendations in addressing weaknesses observed during previous audits, particularly on internal controls relevant to financial reporting process.
- Performing an **annual evaluation on the performance of the external auditor** and undertaking follow-up measures thereafter (note: a sample exhibit on the evaluation of external auditor is provided in **Appendix II** of this **Pull-out**).  

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\(^4\) Paragraph 15.21 of Bursa Securities Listing Requirements outlines the considerations in appointing an external auditor.
What are the salient areas that should be considered in evaluating an external audit firm’s capabilities to conduct the audit?

In evaluating the external auditor’s capabilities in relation to its expertise, experience, network and reputation, the audit committee should give consideration to a range of factors as set out below.

Relevant considerations in evaluating an external audit firm’s capabilities (non-exhaustive):

- the audit firm’s reputation and its presence in the industry;
- qualifications of its professionals, including the breadth and depth of resources and experience of the team members;
- networking ability and competency to address overseas subsidiaries not audited by the firm (i.e. its liaison capability with the secondary auditors);
- audit methodology employed by the firm such as the underlying methodology and materiality used to determine the nature, extent and timing of testing required;
- the internal quality control processes in place (e.g. independent quality control review and approach to audit judgments); and
- how the audit firm delivers value other than through the provision of the statutory audit report.

How can the audit committee avert potential threats to an external auditor’s independence?

Two key issues that commonly bear on the external auditor’s independence are the provision of non-audit services as well as the appointment of former key audit partners as director or an employee of the company who is in a position to exert significant influence over the preparation of financial statements.

As mentioned above, the audit committee should put in place policies and procedures to aid in the safeguarding of the external auditor’s independence and objectivity, taking into consideration relevant professional and regulatory requirements.

Provision of non-audit services

Provision of non-audit services by the external auditor to a company may result in misaligned incentives. In such instances, external auditors may be exposed to the possibility of reviewing part of their own work or have their objectivity challenged by over-reliance on the fee generated and the familiarity developed with the company.

Appointment of former key audit partners

There may be serious concerns to objectivity when a member of an audit engagement team joins the company (the audit client) and is in a position to exert significant influence over the preparation of the company’s financial statements.

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5 The engagement partners, the individuals responsible for the engagement of quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the auditor will express an opinion.
Provision of non-audit services

Prior to the provision of any non-audit services by the external auditor, the audit committee should review and approve the acceptance of such engagements, drawing guidance from the By-Laws (on Professional Ethics, Conduct and Practice) by the Malaysian Institute of Accountants (“MIA”). If the non-audit service results in concerns on independence to an extent that they cannot be reduced to an acceptable level by the application of safeguards, the non-audit service shall not be accepted.

Examples of non-audit services that shall not be provided by the external auditors of a PIE pursuant to the By-Laws (on Professional Ethics, Conduct and Practice) by the MIA are outlined below.

<table>
<thead>
<tr>
<th>Prohibited non-audit services (non-exhaustive)*:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information;</td>
</tr>
<tr>
<td>• valuation services if the valuations would have a material effect on the financial statements;</td>
</tr>
<tr>
<td>• preparation of tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the financial statements;</td>
</tr>
<tr>
<td>• internal audit services that relate to a significant part of the internal controls over financial reporting, financial accounting systems or amount or disclosures that are material to the financial statements;</td>
</tr>
<tr>
<td>• design or implementation of information systems that form a significant part of the internal control or information on financial reporting, accounting records or financial statements;</td>
</tr>
<tr>
<td>• acting in an advocacy role on behalf of the company to resolve a dispute or litigation when the amounts involved are material to the financial statements;</td>
</tr>
<tr>
<td>• recruiting services with respect to a director, officer or senior management personnel who would be in a position to exert significant influence over the preparation of accounting records or the financial statements; and</td>
</tr>
<tr>
<td>• corporate finance services which involve promoting, dealing in, or underwriting shares.</td>
</tr>
</tbody>
</table>

In accordance with Bursa Securities Listing Requirements, disclosure should also be made on the nature and extent of non-audit services if the fees on such services are “significant”.

* Provisions 290.172 to 290.219 of By-Laws (on Professional Ethics, Conduct and Practice) by the MIA
Paragraph 18, Part A, Appendix 9C of Bursa Securities Listing Requirements

The content of an annual report must contain the following particulars in relation to the audit and non-audit services rendered to the listed issuer or its subsidiaries for the financial year:

(a) amount of audit fees paid or payable to the listed issuer’s auditors, stating the amount incurred by the listed issuer and the amount incurred on a group basis respectively; and

(b) amount of non-audit fees paid or payable to the listed issuer’s auditors, or a firm or corporation affiliated to the auditors’ firm, stating the amount incurred by the listed issuer and the amount incurred on a group basis respectively. If the non-audit fees incurred were significant, details on the nature of the services rendered. If no non-audit fees were incurred, a statement to that effect.

Note: Item 9.47A of the Questions and Answers in relation to Bursa Securities Listing Requirements clarifies that listed issuers should consider the amount of non-audit fees incurred compared to the amount of audit fees paid to determine if the non-audit fee is “significant”. Generally, if the non-audit fees constitute 50% of the total amount of audit fees paid to their external auditors, then such non-audit fees are regarded as significant.

Appointment of former key audit partners

The company should have in place a policy to govern the circumstances under which former key audit partners of the present and former external auditor(s) can be appointed to the board or be employed by the company. Such policies should include a procedure on a cooling-off period to govern the independence of such appointments.

Applicable provisions for cooling-off periods found in professional requirements are outlined below.

Provision 290.139 of the By-Laws (on Professional Ethics, Conduct and Practice) by the Malaysian Institute of Accountants

Familiarity or intimidation threats are created when a key audit partner joins the audit client that is a public interest entity as:

(a) A director or officer of the entity; or

(b) An employee in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the firm will express an opinion.

Independence would be deemed to be compromised unless, subsequent to the partner ceasing to be a key audit partner, the public interest entity had issued audited financial statements covering a period of not less than two years and the partner was not a member of the audit team with respect to the audit of those financial statements.
An illustrative disclosure highlighting the policy on appointing former employees of the external auditor (including former key audit partners of the external audit firm) as members of the company’s audit committee or the company’s employees is shown below with the following elements outlined:

- responsibility of the audit committee to oversee the policy;
- coverage of policy (i.e. applicable to former key audit partners and other audit team members); and
- length of cooling-off period established.

**Illustrative disclosure**

As part of its remit, the audit committee keeps under review the objectivity, independence and effectiveness of the external auditor. The committee has approved a policy on appointment of former key audit partners and former employees of the external auditor firm, to the company. Under this policy:

- On an ongoing basis, the audit committee agrees with the external auditors which members of the audit team are categorised as “key audit partners” and “other key team members”.

- Key audit partners will not be offered employment or be appointed as a member of the audit committee by the company or any of its related corporations within **two years** of undertaking any role on the audit.

- Other key team members will not be offered employment or be appointed as a member of the audit committee by the company or any of its related corporations within **six months** of undertaking any role on the audit.

- Other audit team members (excluding key audit partners or key audit team members) who accept employment or are appointed as a member of audit committee by the company or any of its related corporations must cease the audit activity immediately and tender their resignation to the audit firm.

Any offer of employment to a former employee of the audit firm in respect of a senior management position or appointment of the former employee as a member of the audit committee must be pre-approved by the audit committee. Between meetings, the audit committee chairman has the delegated authority to deal with such appointments at his or her discretion. Any such interim approval must be ratified at the next meeting of the committee.

*Adapted from KPMG’s Audit Committee Institute Handbook 2017*
Regional/international perspectives

As with Malaysia, audit committees in many jurisdictions including United Kingdom and Singapore are tasked to exercise robust oversight of the external audit process, including in evaluating the suitability and independence of the external auditor.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>A separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include:</td>
</tr>
<tr>
<td></td>
<td>• the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed;</td>
</tr>
<tr>
<td></td>
<td>• an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans; and</td>
</tr>
<tr>
<td></td>
<td>• if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence are safeguarded.</td>
</tr>
<tr>
<td></td>
<td><em>(Provision C.3.8)</em></td>
</tr>
<tr>
<td>Singapore</td>
<td>The duties of the audit committee should include:</td>
</tr>
<tr>
<td></td>
<td>d) reviewing the scope and results of the external audit, and the independence and objectivity of the external auditors; and</td>
</tr>
<tr>
<td></td>
<td>e) making recommendations to the Board on the proposals to the shareholders on the appointment, re-appointment and removal of the external auditors, and approving the remuneration and terms of engagement of the external auditors.</td>
</tr>
<tr>
<td></td>
<td><em>[Guideline 12.4(d) and (e)]</em></td>
</tr>
</tbody>
</table>
Independence of the audit committee

MCCG Intended Outcome 8.0

There is an effective and independent Audit Committee.

The board is able to objectively review the Audit Committee’s findings and recommendations. The company’s financial statement is a reliable source of information.

Step Up 8.4

The Audit Committee should comprise solely of Independent Directors.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why

The case for change

Independence is the cornerstone of a well-functioning audit committee. The ability of its members to exercise their judgment in an informed and impartial manner is important to the fulfilment of the audit committee’s mandate, especially in overseeing the areas of financial reporting, related party transactions and conflicts of interest, internal control environment, internal audit and external audit processes.

It should be noted that the core functions of audit committees set out in many, if not all, global authoritative governance documents, are expressed in terms of “evaluation”, “assessment” or “review” of the aforementioned areas. The undertaking of such responsibilities would naturally necessitate audit committee members to critically and objectively apply a probing view on pertinent matters, particularly in areas which involve a high degree of judgment. In many instances, audit committee members are expected to take tough, constructive or even unpopular stances, all of which call for independence in “thought and action”.

As a former Senator of the United States, Howard Metzenbaum puts it, “audit committees that lack independence frequently have a fealty to the management that an audit committee shouldn’t have”\(^1\). To coin it differently, audit committees should not be having a “debt” to the management which is then “repaid” when a tough issue (e.g. financial reporting issue) arises.

Recognising that objectivity is essential to the proper functioning of the audit committee, regulators have outlined provisions on the composition of the audit committee with due regard to the element of independence.

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\(^1\) Bostelman, JT et.al 2010, *Public Company Deskbook: Sarbanes-Oxley and Federal Governance Requirements*, Practising Law Institute
### Paragraph 15.09(1)(a) and (b) of Bursa Securities Listing Requirements

A listed issuer must appoint an audit committee from amongst its directors which fulfils the following requirements:

(a) the audit committee must be composed of not fewer than 3 members; and

(b) all the audit committee members must be non-executive directors, with a majority of them being independent directors.

Note: Only requirements pertaining to the composition of the audit committee are extracted from the said paragraph. Similar provisions are also applicable for financial institutions under Standard 12.3 of Bank Negara Malaysia’s Policy Document on Corporate Governance. The requirements in relation to the composition of audit committees for financial institutions are the same as that of other board committees.

Whilst it is not a recommendation prior to the issuance of MCCG, many companies are already having wholly independent audit committees, premised on the proposition that such a committee would be better positioned to perform the functions entrusted to it. A review of annual reports across the top 100 listed issuers (by market capitalisation) in Malaysia as at 31 December 2016 revealed that 54% of them have audit committees which are composed exclusively of independent directors.

Companies with wholly independent audit committees in the top 100 listed issuers (by market capitalisation) as at 31 December 2016.

### Point for reflection

Several research studies have shown that the value of having an audit committee comprising solely of independent directors can be particularly evident when a company is undergoing financial distress.

For example, a prominent research performed by Bronson et al highlighted that wholly independent audit committees are more likely to protect external auditors’ independence during a dispute with management of a financially distressed company. The research highlighted that given the negative consequences associated with a going concern report (an opinion by the auditors that the company may not be viable in the foreseeable future), management may try to pressure the external auditor into not issuing the said report when one is warranted. In such a scenario, having a fully independent audit committee would more likely lead to objective support for the external auditor and mitigate pressure from management relating to the going concern reporting decision. Conversely, audit committees with members who are affiliated with management were found to be more likely in replacing the external auditor in such a circumstance.

In the course of establishing a fully independent audit committee, boards are not expected to compromise on the skill sets and make unwieldy changes to the composition of the audit committee. In order to create a conducive environment for insightful deliberations of the audit committee, boards should ensure that the enlisted independent audit committee members are financially independent.

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2 Referring to audit committees comprising wholly of independent directors
3 Review undertaken by KPMG Management & Risk Consulting Sdn Bhd in 2017
4 Bronson, SN et al. 2009, “Are fully independent audit committee really necessary?”, Elsevier
literate and have a sufficient understanding of the company’s business (as highlighted in Guidance to Practice 8.5 of MCCG).

Independent audit committee members who possess the aforementioned attributes are able to exercise intelligent reviews of the processes, transactions and information on matters under its purview as well as continuously apply a critical view on the assertions made by management.

**The practice in substance**

It is therefore incumbent on the board to assess the independence of its audit committee and consider establishing a wholly independent audit committee with a view of going a step further in strengthening the company’s corporate governance practices and processes. Every member’s appointment is an occasion for careful deliberation and the board should have a strong understanding of how imperative is independence to the effective functioning of the audit committee.

Key considerations relating to the application of this Step Up are discussed below:

**How should the independence of the audit committee members be assessed?**

As with other independent directors, independent audit committee members should display a strong element of objectivity, both in appearance (“perceived independence”) as well as of mind (“independence in thought and action”).

In assessing “independence in thought and action”, the nominating committee or the board should, amongst others, evaluate if the audit committee members demonstrate vigilance, scepticism and more importantly, have the courage to stand up for an objective point of view.

Characteristics (non-exhaustive) that are commonly exhibited by audit committee members which demonstrate vigilance, scepticism and courage:

- clarifies objectives of the topics for deliberation to understand the issues and set expectations for possible solutions;
- drives for complete and accurate financial and non-financial information disclosures that reflect substance over form which can be issued on a timely basis;
- actively engages internal and external auditors and fosters candid two-way relationship;
- suspends prevailing assumptions and continues to ask questions until satisfactory responses are obtained;
- changes the angle of debate to probe for further information;
- raises any issues or “red flags” promptly with the audit committee chair; and
- leverages on internal and external audit findings to review the way management manages business risks as well as how the risks are managed to enhance shareholder value.

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**Dos**

- Putting in place mechanisms for independent directors to disclose changes in relationships or circumstances that may impact their independence.
- Ensuring all questions and remarks (including dissenting comments made by audit committee members) are minuted.
- Developing channels for audit committee members to enlist the services of third party experts, if needed.

**Don’ts**

- Conceding that the element of financial literacy overrides the aspect of independence.
- Maintaining that adherence to the audit committee’s independence requirements set out in paragraph 15.09(1)(b) of Bursa Securities Listing Requirements is the be-all and end-all.
The consideration of independence is often a matter of substance rather than mere compliance with specific rules. The board should also be cognisant and mindful of situations in which the regulatory definition of independence is met, yet impairment of objectivity or perceived conflicts of interest may still arise.

**How should audit committee members deal with conflict of interest situations?**

Audit committee members should declare any matter in which they have an interest. Normally, the process for recording declarations of conflicts of interest in the audit committee should mirror that used by the board. Each member of the committee should undertake to declare proactively, at the outset of each meeting, any potential conflict of interest relating to the affairs of the committee or from changes in the member’s personal circumstances.

Depending on the nature, extent and potential duration of the conflict of interest situation, the chairman of the audit committee should then determine an appropriate course of action with the said member. For example, the member might be asked to abstain from deliberation and decision-making, or in more extreme cases, the member could be asked to step down from the committee.

If it is the chairman of the audit committee that has a conflict of interest, the board should ask another member of the committee to lead in determining the appropriate course of action.

**Regional/international perspectives**

Alongside Malaysia, jurisdictions such as South Africa and Canada have incorporated enumerations for public listed companies to establish audit committees which comprise solely of independent directors.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
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<tbody>
<tr>
<td>South Africa</td>
<td>All members of the audit committee should be independent, non-executive members of the governing body <em>(Recommended Practice 56).</em></td>
</tr>
<tr>
<td>Canada</td>
<td>Every audit committee member must be independent <em>(Provision 3.1(3)).</em></td>
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Financial literacy of audit committee members

MCCG Intended Outcome 8.0
There is an effective and independent Audit Committee.
The board is able to objectively review the Audit Committee’s findings and recommendations. The company’s financial statement is a reliable source of information.

MCCG Practice 8.5
Collectively, the Audit Committee should possess a wide range of necessary skills to discharge its duties. All members should be financially literate and are able to understand matters under the purview of the Audit Committee including the financial reporting process.

All members of the Audit Committee should undertake continuous professional development to keep themselves abreast of relevant developments in accounting and auditing standards, practices and rules.

(The application of this Practice in its entirety entails the possession of a wide range of necessary skills and financial literacy of all members of the audit committee as well as their undertaking of continuous professional development.)

⚠️ The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why
The case for change
Financial literacy is a key cornerstone of a well-functioning audit committee. As a committee that is specialised and focused, the audit committee is relied upon by the board to, amongst others, provide advice in the areas of financial reporting, external audit, internal control environment and internal audit process, review of related party transactions as well as conflict of interest situations.

Point for reflection
As businesses become more complex, globalised, and increasingly face new risks, the breadth and complexity of the audit committee responsibilities similarly continue to increase. The need for audit committee members to possess sound financial understanding is now made more important than ever by the changes in business models and financial reporting requirements.

A recent KPMG Audit Committee Institute’s Global Pulse Survey in 2017 revealed that a lack of understanding of business drivers (e.g. changes in the industry) and poor oversight of the implementation of new accounting standards (e.g. revenue recognition and leasing) were amongst the main weak spots of audit committees.

What could go wrong:
- Financial statements do not serve as reliable sources of information.
- Transactions carried out are detrimental to the interests of the company.
The changing landscape of the financial reporting environment is exemplified by a review of the recent amendments to International Financial Reporting Standards (“IFRS”) which revealed that there were a total of 29 changes made between the years 2014 to 2016 (depicted in the chart below). The changes to IFRS, to a large extent, have resulted in more subjective judgments on accounting estimates and valuations. It is therefore now incumbent on the audit committee to be more informed and increasingly scrutinise the risk for management bias in the application of these judgments.

In order to ensure that the audit committee is well-equipped to carry out its mandate, regulators have emphasised the importance of having members with accounting or financial acumen.

**Paragraph 15.09(1)(c) of Bursa Securities Listing Requirements**

At least one member of the audit committee –

(i) must be a member of the Malaysian Institute of Accountants; or

(ii) if he is not a member of the Malaysian Institute of Accountants, he must have at least 3 years’ working experience and –

(aa) he must have passed the examinations specified in Part I of the First Schedule of the Accountants Act 1967; or

(bb) he must be a member of one of the associations of accountants specified in Part II of the First Schedule of the Accountants Act 1967; or

(iii) fulfils such other requirements as prescribed or approved by the Exchange.

It is important to note that financial literacy is a prerequisite for each member to deliver tangible value to the functions of the audit committee. Having only a single audit committee member with special knowledge or skills in accounting would place undue reliance on that one individual and render the deliberations of the audit committee ineffective. To this end, the audit committee as a whole should consist of financially literate members who would be able to challenge, encourage and support each other in a more meaningful manner.
The practice in substance

In considering the composition of the audit committee, the board should have regard to the range of skills, experience, knowledge and qualifications possessed by committee members. It is imperative for the audit committee to comprise members with a sound understanding of the language of accounting and finance in order to perform the duties that have been entrusted to it by the board.

Key considerations relating to the application of this Practice are discussed below.

What constitutes a financially literate audit committee member?

Financial literacy goes beyond basic familiarity with financial statements and would include the following:

Attributes of a financially literate audit committee member:

- ability to read and understand financial statements, including a company’s statement of financial position, statement of profit or loss and other comprehensive income, statement of changes in equity, cash flow statement, notes to the statements, cost accounting, budgets and management’s discussion and analysis ("MD&A");
- ability to understand and assess the general application of accounting principles and apply a critical view on the underlying assumptions;
- ability to analyse financial statements and challenge management’s assertions on financials;
- awareness of, and familiarity with, new financial reporting standards and how they impact the company’s financial performance to enable the member to ask pertinent questions;
- ability to assess the effectiveness of the audit process and the company’s finance functions in generating reliable and timely financial information; and
- ability to ask probing questions about the company’s operations against internal controls and risk factors.

Adapted from the Guidebook for Audit Committees in Singapore (2014) issued by the Audit Committee Guidance Committee

Note: A sample questionnaire is provided in the Appendix IV of this Pull-Out in order to further understand and assess who may qualify as a financially literate member.

What are the potential indicators which may signal that a lack of financial literacy is impeding the effective functioning of the audit committee?

Examples of indicators which may highlight a lack of financial literacy amongst audit committee members are as follows:

- inability of the audit committee to critically probe highly risky transactions as well as key accounting policies and judgments adopted by the company in its financial reporting;
- undue reliance by the audit committee on management, auditors and experts to ensure the reliability of the financial statements; and
- lack of strategic input from the audit committee to the board on the drivers of financial performance.

Dos

✓ Inducting directors with sector-specific financial literacy into the audit committee.
✓ Having in place a comprehensive induction programme for new audit committee members, covering the business and financial dynamics of the company.
✓ Establishing structured professional development programmes for members of the audit committee on an ongoing and timely basis.

Don’ts

× Maintaining that the collective expertise and experience of the audit committee serves as a substitute for not having individual members that are financially literate.
× Accepting that adherence to the Bursa Securities Listing Requirement (i.e. at least one member of the audit committee to be a member of the MIA or equivalent) is the be-all and end-all.
What are the other qualities that should be considered in selecting audit committee members?

An audit committee’s effectiveness is certainly enhanced by, and is often dependent upon the personal and professional attributes of individual members.

Personal and professional qualities that should be considered in selecting audit committee members:

- a strong understanding of the business and industry in which the company operates;
- ability to be proactive in advising the board of any concerns;
- ability to ask tough and incisive questions, evaluate the responses and continue to probe for information until completely satisfied with the feedback provided;
- ability to appreciate the company's values and have the determination to uphold these values coupled with a thoughtful approach to the ethical issues that may be faced;
- a professional approach to duties, including an appropriate commitment of time and effort;
- courage to take and stand by tough decisions and high ethical standards; and
- ability to accept mistakes and not ascribe blame.

As such, in addition to financial literacy, it would be desirable for members to have experience that is relevant to the business and the industry the company operates in. For example, given the complex nature of the banking industry, it would be highly value-adding for audit committee members to have previous experience in that particular sector with a granular understanding of the pertinent nuances such as financial instruments and credit models.

What is the nature of continuous professional development programmes that should be undertaken by audit committee members?

Given the ever changing financial reporting and corporate landscape, it is essential for members of the audit committee to undertake continuous professional development to keep themselves abreast of relevant developments, as outlined in the areas on the following page.
How can the deliberations of the audit committee be enriched?

Effective audit committee deliberations necessitate members to get to the root of the issues that is impacting the company’s financial reporting process. This includes an assessment of relevant non-financial information such as business model and other operational aspects that can have a significant bearing on the company’s value creation process. Audit committee members are required to apply an inquiring mind and make informed inquiries. Whilst audit committee members are entitled to avail themselves to external advisors, they should take a diligent and an informed interest in the information that is presented to them.

Applying an inquiring mind and making informed inquiries are key aspects of effective audit committee oversight. **One of the world’s distinguished investors, Warren Buffet is known for three key questions he developed for audit committees to consider, and he suggests the discussion of these matters be documented in the minutes of their meetings**.

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A list of indicators that the audit committee should be aware of in relation to financial reporting and examples of questions to be posed to management on financial reporting are outlined in Appendix I of this Pull-out.

**Case study: Centro Properties Group (Australia)**

**Background:**
- Section 295(A) of the Companies Act 2001 in Australia obligates directors to ensure the integrity of financial statements while Section 180(1) and 344(1) of the Corporations Act 2001 enumerate provisions on statutory duty of care and diligence pertaining to directors.

**Facts:**
- The Australian Securities and Investment Commission (“ASIC”) brought proceedings against the directors of certain companies in the Centro Properties Group on grounds that the directors failed to take all reasonable steps to ensure compliance with the financial reporting obligations of the Corporations Act 2001, and breaches of their statutory duty of care and diligence.
- The allegations were related to the disclosures in the 2007 annual financial statements of companies within Centro Properties Group. Those financial statements wrongly classified liabilities of about AUD $ 2.1 billion as non-current liabilities instead of current liabilities and failed to disclose certain post balance date related party guarantees.
- The court held that notwithstanding the fact that neither Centro management nor the auditors had detected the error, the erroneous disclosure could have been identified by the directors if they had carried out a careful and diligent review of the financial statements.

**Lessons Drawn:**
- Scepticism: Directors must question the information provided to them. There is no defence for wilful blindness.
- Accounting knowledge: Directors are expected to have financial literacy and accounting knowledge.
- Accountability and control: It is up to directors to ensure that management has put in place systems, protocols and controls to ensure sound corporate governance.
Regional/international perspectives

As in the case of Malaysia, selected jurisdictions including Canada have enumerated prescriptions for the audit committee as a whole to possess financial literacy in order to enhance the effectiveness of the committee.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
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<tbody>
<tr>
<td>Canada</td>
<td>Every audit committee member must be financially literate [Provision 3.1(4)].</td>
</tr>
</tbody>
</table>
Risk management and internal controls

MCCG Intended Outcome 9.0
Companies make informed decisions about the level of risk they want to take and implement necessary controls to pursue their objectives.

The board is provided with reasonable assurance that adverse impact arising from a foreseeable future event or situation on the company’s objectives is mitigated and managed.

MCCG Practice 9.1
The board should establish an effective risk management and internal control framework.

MCCG Practice 9.2
The board should disclose the features of its risk management and internal control framework, and the adequacy and effectiveness of this framework.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why The case for change
Risk management and internal controls are often repeated buzzwords of regulators and corporate governance commentators alike. Although there is widespread agreement that the practice of risk management and internal controls is beneficial, such concepts are often perceived as elements that are disrupting the spirit of entrepreneurship while advocates of risk management and internal controls are often viewed with suspicion by frontline staff, who view them as “wet blankets”.

The diagram on the following page is commonly used to illustrate the relationship between entrepreneurship and risk management, and how they are complementary and not mutually exclusive.

What could go wrong:
- Failure to detect unknown risk exposures or “blind spots”.
- Inability of the company to adapt to changing business circumstances.
- Inability of the company to contain high impact risks in a timely manner, resulting in adverse consequences to the company’s value-creation.
Therefore, running a business with an appropriate risk management and internal control framework can be equated to driving fast whilst equipped with brakes.

Some of the benefits of risk management and internal controls are as follows:

- sharpens corporate strategy and heightens strategic focus;
- frees up capital to be invested in activities with higher returns;
- reduces costs;
- improves the risk finance portfolio;
- improves regulatory and legal compliance; and
- enhances reputation and the company’s attractiveness to investors.

**Point for reflection**

**Is risk management necessary?**

The 9/11 attack caused significant and tragic loss of lives. Beyond that, damage to property and business was immense, with one estimate of US$3.2 billion alone for information technology infrastructure and assets (servers, workstations, storage, hubs and wiring) belonging to securities firms impacted by the attacks.

**Did it:**

American Express Bank: The Bank operated a network of servers on a “hot backup” basis. Although headquartered at the World Trade Centre, it lost neither a transaction nor was its customer service interrupted.

**Did not do it:**

The Pentagon: The Pentagon had a secure server and the back-up of this server was located just down the hall. Needless to say, neither survived the attack.

**Hot-button issue**

Management frequently agonises over the level of risk management oversight and the associated internal controls. On one hand, expediency and efficiency are highly valued in the business world. On the other hand, dispensing with controls exposes the company to an unacceptably high level of risk.

In a recent case involving a company in the aviation industry, having a doctor forcibly thrown off an overbooked plane was bad enough. What made the situation worse was that the company, led by its CEO, was clearly unprepared to handle the media storm that enveloped it in the days that followed the viral video of the doctor bloodied and injured being dragged out of the aeroplane.

In forcibly removing the passenger and failing to weather the media storm, the company created an unexpected and huge reputational risk. The exposure to nuanced risks such as reputational risks is often overlooked and not integrated as part of a company’s risk management framework, much to a company’s detriment.

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1 Estimate on the Impact of the World Trade Centre Disaster to the Securities Industry’s Technology Infrastructure 2001, TowerGroup
The practice in substance

As with the **MCCG**, the **Companies Act 2016** and **Bursa Securities Listing Requirements** outline prescriptions on internal controls and risk management.

### Section 246(1) of Companies Act 2016

The directors of a public company or a subsidiary of a public company shall have in place a system of internal control that will provide reasonable assurance that –

(a) the assets of the company are safeguarded against loss from unauthorized use or disposition and to give a proper account of the assets; and

(b) all transactions are properly authorized and that the transactions are recorded as necessary to enable the preparation of true and fair view of the financial statements of the company.

### Paragraph 15.12(1) of Bursa Securities Listing Requirements

Without limiting the generality of **paragraph 15.11** above, a listed issuer must ensure an audit committee, amongst others, discharges the following functions:

1. review the following and report the same to the board of directors of the listed issuer:
   1. with the external auditor, his evaluation of the system of internal controls;
   2. the adequacy of the scope, competency and resources of the internal audit function and that it has the necessary authority to carry out its work; and
   3. the internal audit plan, processes, the results of the internal audit assessments, investigation undertaken and whether or not appropriate action is taken on the recommendations.

**Note:** Only requirements pertaining to internal controls and internal audit function are extracted from the said Paragraph.

### Paragraph 15.23 of Bursa Securities Listing Requirements

A listed issuer must ensure that the external auditors review a statement made by the board of directors of a listed issuer pursuant to **subparagraph 15.26(b)** below, with regard to the state of risk management and internal control of the listed issuer and report the results thereof to the board of directors of the listed issuer.

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**Dos**

- Being aware of emerging risks that may threaten the business (e.g. cyber-security risk).
- Providing necessary support to the risk management and internal audit functions (e.g. giving access to information, physical properties, and personnel)
- According adequate attention to the recommendations raised on risk management and internal controls as well as implementing the recommendations where appropriate.
- Providing balanced disclosures in relation to risk management and internal controls (highlighting areas of strengths as well as improvement considerations).

**Don’ts**

- Paying lip service to concerns raised on risk and internal controls.
- Omitting mention of significant incidences or risk events in the annual report (e.g. the entity may have been involved in a large legal case during the year).
- Turning risk and internal control into static activities – a risk profile can even change from day to day.

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* Requirement for audit committee to have written terms of reference
Paragraph 15.26(b) of Bursa Securities Listing Requirements

A listed issuer must ensure that its board of directors makes the following additional statements in its annual report:

(b) a statement about the state of risk management and internal control of the listed issuer as a group.

Note: Only requirements pertaining to disclosure on risk management and internal control are extracted from the said Paragraph.

Enumerations in this regard for financial institutions are encapsulated in Bank Negara Malaysia’s Policy Document on Corporate Governance.

It is helpful to view risk management and internal controls in the context of governance and how each element relates to the other:

The company’s governance framework is always the starting point for its risk management and internal control processes. This is simply because the board will articulate the company’s strategy, set the values and shape its culture.

These elements will influence the company’s risk management appetite and in turn, the risk management appetite will dictate the kind of controls the entity will integrate into its business processes.

As such, risk management and internal controls should not be viewed as “wet blankets” but rather as important lines of defence, as follows:

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3 Paragraphs 3, 7 and 12 of Appendix 1, Bank Negara Malaysia’s Policy Document on Corporate Governance
A number of methodologies have been developed to help companies approach risk management and internal controls in a systematic manner. Some of these have been widely accepted and include the following:

- ISO 31000 on principles and guidelines for risk management;
- The internal control environment framework suggested by the Committee of Sponsoring Organisations of the Treadway Commission (the “COSO framework,” which is now known as “Internal Control – Integrated Framework”); and
- Other globally recognised internal control and risk management frameworks developed by professional organisations (e.g. Criteria of Control Framework developed by the Canadian Institute of Chartered Accountants or widely known as “CoCo Framework” and KPMG’s Risk Management Methodology).

Examples of key aspects contained in a frame of reference to drive the governance of risk management and internal controls in a systematic manner is outlined on the following page.
Risk governance
A structure through which the company directs, manages and reports its risk management activities. It encompasses clear roles and responsibilities, decision rights, the risk governance operating model, and reporting.

Risk assessment and measurement
Tools and techniques to identify, measure and quantify current and emerging risks. It allows companies to consider the extent to which potential events may have an impact on achievement of objectives.

Risk management and monitoring
Management’s risk strategies and responses to manage risks and improve risk and business performance. Continuous monitoring against established metrics permits proactive and timely response where warranted.

Risk reporting and insights
Reporting of risk information provides insights on significant risks and the strengths and weaknesses in managing them. Disclosure of risk management information to key stakeholders also supports timely decision-making.

Data and technology
Information and associated storage and delivery mechanisms which provide management with a real time view of the key risks and how these are being managed (including risk register).

Risk culture
Values and behaviours that shape risk decisions. Risk culture influences the decisions of management and employees. A strong risk culture helps to encourage strategic decisions and long term value for all stakeholders.

Adequacy and effectiveness review
Internal processes by which management and the Board derive assurance on the overall adequacy and effectiveness of the internal control and risk management systems.

Source: KPMG’s risk management framework
Point for reflection

How much is too much, how little is too little?
Not only are risk management and internal controls important, getting the right balance can be challenging. Examples of real case scenarios are highlighted below:

Example I (Trustee company)

At a trustee company, the board was so risk averse that practically every transaction carried out on behalf of a beneficial owner required the CEO’s signature. As the CEO was frequently away on business, this disrupted day-to-day efficiency and eventually, operational staff resorted to “breaking the law” and proceeding with transactions without the CEO’s authorisation.

Whilst it may seem innocuous, this could have unnecessarily exposed the company to claims by clients if transactions were erroneously carried out.

Example II (Financial institution)

At a major financial institution, the board exercised a high level of controls for investments in equities and debt by the bank’s dealing team, and this has been documented in the bank’s limits of authority matrix. Somewhat inexplicably, the same matrix grants the senior management team with unlimited authority on operational expenses.

Needless to say, the bank was soon caught in a fraud incident amounting to millions of ringgit, perpetrated through the loophole in the matrix.

Whilst the board remains responsible over risk management and internal controls, the task of scrutinising the framework (i.e. its design and effectiveness) is often taken up by a board committee, typically the risk management committee and the audit committee. In some entities, these committees are combined. It is pertinent for the committee members to have sound knowledge of risk management and internal control concepts, and to be able to assess risks in an objective manner – given the elements of self-interest and pressure to achieve returns, representations made by management may not represent the true picture.

Key considerations relating to the application of these Practices (Practices 9.1 and 9.2) are discussed below:

What are the practical ways to embed a risk aware and control optimised culture in companies?

Risk management is often an unwritten process particularly during a company’s start-up phase of its life. As the company progresses along its life cycle and the number of stakeholders increase, risk management and internal controls should receive appropriate consideration and be embedded as part of the company’s culture.
Some guidance are provided below:

- Establishing an effective and well-designed internal control system that takes into account the nature and circumstances of the company. This will support the objective of managing identified risks in the company;
- Designating a section on risk in board papers on proposals, investments, etc. This promotes a culture of risk awareness and can assist directors in identifying “blind spots”;
- Having a well-supported internal audit function. The internal audit function is regarded as a key line of defence after day-to-day management and bolsters the defence provided by the risk management function. Hence, it can greatly benefit the company by way of advising the board on where it can minimise avoidable losses; and
- Taking small steps can help to inculcate a risk aware culture over time. For example, it is customary for construction companies to hold a “toolbox talk” prior to commencement of work. Such talks focus on safe working practices and hazards to look out for.

Examples of questions to be posed to management on controls and compliance are outlined in Appendix V of this Pull-out.

**What are the key considerations that should be taken into account in establishing an adequate and effective internal control and risk management framework?**

An adequate and effective internal control and risk management framework provides companies with a structured approach to implement, monitor, review and improve internal control and risk management in tandem with the changing business circumstances.

Examples of overarching components and key considerations that should be taken into account in establishing an adequate and effective internal control and risk management framework are outlined on the following page.
Five components of an internal control and risk management framework

Note: The term “objectives” in the explanations below refers to the objectives relating to operations, reporting and compliance.

1. The company demonstrates commitment to integrity and ethical values.
2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The company demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The company holds individuals accountable for their internal control responsibilities in the pursuit of its objectives.
6. The company specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to its objectives.
7. The company identifies risks to the achievement of its objectives across the entity and analyses risks as a basis for determining how the risks should be managed.
8. The company considers the potential for fraud in assessing risks to the achievement of its objectives.
9. The company identifies and assesses changes that could significantly impact the system of internal control.
10. The company selects and develops control activities that mitigate risks to acceptable levels.
11. The company selects and develops general control activities over technology to support the achievement of its objectives.
12. The company deploys control activities through policies that establish what is expected and in procedures that put policies into action.
13. The company obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The company internally communicates information, including its objectives and responsibilities for internal control, necessary to support the functioning of internal control.
15. The company communicates with external parties about matters affecting the functioning of internal control.
16. The company selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
17. The company evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

Source: Adapted from the COSO Internal Control – Integrated Framework

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COSO is a framework that is developed by the International Committee of Sponsoring Organizations of the Treadway Commission to guide companies in designing, implementing and evaluating internal controls in response to the risks that are being faced by the company.
How can the board assess the adequacy and effectiveness of the risk management and internal control framework?

The board should define the processes to be adopted for its on-going monitoring and review, including specifying the requirements, scope and frequency for reporting and assurance. The board should form its own view on effectiveness and adequacy of the risk management and internal controls, based on the evidence it obtains.

The board's assessment should, in particular, consider:

- the company’s willingness to take on risks (its “risk appetite”), the desired culture within the company and whether this culture has been embedded;
- the operation of the risk management and internal control systems, covering the design, implementation, monitoring and review, and identification of risks and determination of those which are principal to the company;
- the integration of risk management and internal controls with considerations of strategy and business model, and with business planning processes;
- any changes since the last assessment in the nature and extent of significant risks, and the company’s ability to respond to changes in its business and the external environment;
- the work of its internal audit and risk management (where applicable) units and other assurance providers;
- the extent and frequency of the communication relating to the results of the monitoring, to the board [or board committee(s)];
- the incidence of significant control failings or weaknesses that were identified at any time during the period and their impact on the company’s performance or condition (financial or otherwise); and
- any events that impacted the achievement of objectives that were not anticipated by management.

---

What are the common pitfalls that should be avoided in the management of risks?

The following are some of the issues the board should be wary of:

**Common pitfalls in risk management:**

- box-ticking rather than business-led assessment of risk approach;
- failure and/or the inability to prioritise principal risks in relation to their mitigating measures leading to unidentified strategic risks turning into emerging risks without a preparedness to respond;
- risks are managed in silos and their impact is not considered across business units and functions;
- inadequate attention is given to the ever changing internal and external market environment;
- merely discussing risk issues without integrating them into the board’s own decision making process, since strategic risks can be difficult to identify;
- general failure to embed risk management in the culture and processes of the company and its workforce, leading to the lack of a sustainable risk identification system in place across business units and functions;
- there is no precise documented accountability for managing risks;
- level of investment is not always a reliable proxy for the level of enterprise risk;
- the board does not have a sense of assurance arising from risk management implementation; and
- bad news is not easily communicated to the top.

**Can internal controls be designed independently outside the risk management process?**

The design of internal controls in silos and without reference to their associated risks can lead to an imbalance and consequently, certain key risk areas may be left unaddressed. For example, too many controls (and thus, resources) are put in place over petty cash, which in the grand scheme of things is hardly material to a company’s survival.

**What are some of the more common ways in which a company’s appetite for risk can be articulated?**

Risk appetite must support a company’s risk management activities. Some companies prefer the distinction between risk tolerance (i.e. maximum risk that can be taken before financial distress) and risk appetite (amount of risk that is actually taken for risk reward benefits). Risk appetite is generally understood to be “how much risk a company is willing to take” as opposed to a maximum threshold before financial sufferings (i.e. risk tolerance). Risk appetite should be a sub-set of risk tolerance.
A company’s risk appetite can be articulated in the following ways:

Common ways to articulate risk appetite (non-exhaustive):

- **Setting a boundary on the “impact vs likelihood” grid**
  Established through the use of risk matrices where a risk appetite line is drawn to demarcate the boundary between those risks that are deemed to be “high” and those which are not. Typically identified through an “Enterprise Risk Management” process.

- **Economic capital measures/ balance sheet based expressions**
  Achieved by the ability to absorb losses by holding surplus capital against the desire to invest capital to generate a positive return. The higher the risk premium, the lower the appetite for risk.

- **Changes in credit ratings**
  Based on probability of default by a rating agency, companies with “AA” rating may not wish to take any risks that may cause a downgrade to an “A” rating.

- **Profit and loss measures**
  Profit and loss based expressions, e.g. companies that set maximum loss figures.

- **Value based measures**
  Accomplished by setting limits around the volatility of share price or against a target share price. This allows companies to direct their attention to investments, projects and activities that are likely to achieve these targets/ limits.

- **Develop effective targets or thresholds for key risk indicators**
  The simplest method where the company sets a range of key risk indicators (monitors changes in exposure to a specific risk event), key control indicators (monitors to determine whether specific controls are operating effectively) and key performance indicators (“KPIs”) (monitors to keep track on the financial performance or operational efficiency). Examples of common risk indicators are outlined in Appendix VI of this Pull-out.

- **Qualitative statements**
  Expressions of statements that cannot be articulated numerically. Also applied to areas of risk that are difficult to quantify effectively, such as reputation risks. Often easy to understand and communicate and integrate within the organisation’s culture or statement of values, e.g. “We have zero tolerance for fraud”.

An illustrative non-exhaustive list of risk appetite threshold (quantitative and qualitative) is provided below:

<table>
<thead>
<tr>
<th>Quantitative</th>
<th>Risk Appetite (Variance Range)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Measure</td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>1% - 2.5%</td>
</tr>
<tr>
<td>Earnings per share</td>
<td>3% - 5%</td>
</tr>
<tr>
<td>Cash flow</td>
<td>5% - 10%</td>
</tr>
<tr>
<td>Credit rating</td>
<td>To maintain grade of XX</td>
</tr>
</tbody>
</table>
What should be considered from a disclosure perspective?

The state of internal control system of the group (the listed issuer and its subsidiaries) is articulated primarily through the “Statement of Risk Management and Internal Control” within the listed issuer’s annual report. In essence, directors are to comment amongst others on the following:

- What are the features of the risk management process and internal control system – for example, how are risks identified? Were risks flagged during a workshop session or during a board session? How are risks, as they evolve, tracked and managed?
- Did the board assess the design of the risk management process and internal control system and test their effectiveness?
- If weaknesses surfaced during the process, how did the board treat such weaknesses? Were any deficiencies corrected?
- In summary, what does the board think of the risk management process and internal control system?

In making the Risk Management and Internal Control Statement, a listed issuer should be guided by the *Statement on Risk Management and Internal Control: Guidelines for Directors of Listed Issuers* which is issued by the Taskforce on Internal Control (“SORMIC Guidelines”) with the support and endorsement of Bursa Malaysia Securities Berhad.

**Paragraphs 41 and 42** of the said document which is reproduced on the following page outline the key elements that a listed issuer should provide in its narrative statement so as to enable stakeholders to make an informed assessment of the main features and adequacy of the listed issuer’s risk management and internal control system.
Paragraph 41 of SORMIC Guidelines

In its narrative statement, the board should disclose the following:

- The main features of the company’s risk management and internal control system;
- The ongoing process for identifying, evaluating and managing the significant risks faced by the company in its achievement of objectives and strategies;
- That such process has been in place for the year under review and up to the date of approval of this statement for inclusion in the annual report;
- The process it (or where applicable, through its committees) has applied in reviewing the risk management and internal control system and confirming that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review;
- That a review on the adequacy and effectiveness of the risk management and internal control system has been undertaken;
- Commentary on the adequacy and effectiveness of the risk management and internal control system;
- The process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and financial statements; and
- Where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these guidelines, this should be disclosed.

Paragraph 42 of SORMIC Guidelines

In its narrative statement, the board should also include whether it has received assurance from the chief executive officer and chief financial officer on whether the company’s risk management and internal control system is operating adequately and effectively, in all material aspects, based on the risk management and internal control system of the company.

It should be noted that Recommended Practice Guide 5 (Revised 2015) by the MIA provides guidance for auditors in applying Malaysian Approved Standard on Assurance Engagements, International Standard on Assurance Engagements 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information in the performance of a limited assurance engagement to report on the Statement on Risk Management and Internal Control.
Regional/international perspectives

Risk management and internal controls are well-established concepts and therefore, as in the case of Malaysia, many jurisdictions have long incorporated them into governance documents.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>The Board is responsible for the governance of risk. The Board should ensure that Management maintains a sound system of risk management and internal controls to safeguard shareholders’ interests and the company’s assets, and should determine the nature and extent of the significant risks which the Board is willing to take in achieving its strategic objectives (Principle 11). The Board should, at least annually, review the adequacy and effectiveness of the company’s risk management and internal control systems, including financial, operational, compliance and information technology controls. Such review can be carried out internally or with the assistance of any competent third parties. The Board should comment on the adequacy and effectiveness of the internal controls, including financial, operational, compliance and information technology controls, and risk management systems, in the company’s Annual Report (Guidelines 11.2 and 11.3).</td>
</tr>
<tr>
<td>Australia</td>
<td>A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework (Principle 7). The board or a committee of the board should: (a) review the entity’s risk management framework at least annually to satisfy itself that it continues to be sound; and (b) disclose, in relation to each reporting period, whether such a review has taken place. (Recommendation 7.2)</td>
</tr>
</tbody>
</table>
## Country | Provision(s)
--- | ---
A listed entity should disclose:

(a) if it has an internal audit function, how the function is structured and what role it performs; or

(b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.  
*(Recommendation 7.3)*

**United Kingdom**
The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems *(Principle C.2).*

**South Africa**
The governing body should exercise ongoing oversight of risk management and, in particular, oversee that it results in the following:

(a) An assessment of risks and opportunities emanating from the triple context in which the organisation operates and the capitals that the organisation uses and affects.

In addition, the following should be disclosed in relation to risk:

(a) An overview of the arrangements for governing and managing risk.

(b) Key areas of focus during the reporting period, including objectives, the key risks that the organisation faces, as well as undue, unexpected or unusual risks and risks taken outside of risk tolerance levels.

(c) Actions taken to monitor the effectiveness of risk management and how the outcomes were addressed.

(d) Planned areas of future focus.  
*(Recommended Practices 6 and 9 under Principle 1)*

The governing body should assume responsibility for assurance by setting the direction concerning the arrangements for assurance services and functions. The governing body should delegate to the audit committee, if in pace, the responsibility for overseeing that those arrangements are effective in achieving the following objectives:

(a) Enabling an effective internal control environment.  
*(Recommended Practice 40 under Principle 15)*

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*Triple context in the Report on Corporate Governance for South Africa 2016 refers to the economy, society and the environment.*
Establishment of risk management committee

MCCG Intended Outcome 9.0
Companies make informed decisions about the level of risk they want to take and implement necessary controls to pursue their objectives.

The board is provided with reasonable assurance that adverse impact arising from a foreseeable future event or situation on the company’s objectives is mitigated and managed.

MCCG Step Up 9.3
The board establishes a Risk Management Committee, which comprises a majority of independent directors, to oversee the company’s risk management framework and policies.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why
The case for change
The marketplace is becoming increasingly complex as new waves of change are reshaping numerous industries, as illustrated in the diagram below:

Key changes in the current business context:

- Advances in technology
- Business model disruption
- Global volatility
- Heightened expectation of investors and stakeholders
- Political shifts

Source: On the 2017 board agenda, KPMG

What could go wrong:
- Inadequate attention and focus on risk management issues.
- Risks that do not fall neatly into the scope of a particular board committee may be overlooked.
- Undue reliance placed by the board on management and external experts for input on risk management.
- Deliberations on risk management are isolated from strategy and corporate culture.
The greater sophistication and complexity of businesses have significantly affected the way in which management implements key decisions. Being able to challenge management on how the company is responding to these signals and exposures necessitates greater attention at the oversight level.

Given the ongoing developments, it may be value-adding to institute a board committee to deal with the unique, complex, and volatile risks the company faces. A dedicated company-wide risk oversight by the board committee could go a long way in heightening scrutiny on risk management matters and thus enabling a more effective anticipation of, and reaction to, events and trends that could lead to disruptive changes in the business model. It also provides an opportunity to coordinate and monitor all key risk discussions in a transparent manner at a central point.

Point for reflection

A key driver for the establishment of a dedicated board risk management committee is the need for comprehensive views as opposed to silo perspectives.

At present, most of the committees and other governance mechanisms are focused on one specific aspect of the company’s risks. For example, audit committees typically oversee financial reporting risks and certain compliance-related risks that can have financial reporting implications. Remuneration committees oversee risks related to how the remuneration structure drives behaviour within the company.

This oversight model commonly leaves other critical risks such as technological, litigation and environmental risks unattended, thus giving rise to the scenario dubbed as "orphan risks syndrome".

In the case of financial institutions, the need for a stand-alone risk management committee is even more compelling as the nature of risks inherent in their operating models are varied and nuanced. Exposures such as market, credit and liquidity risks are closely related to the fluctuating macroeconomic environment, thus rendering them volatile. These exposures elicit the deployment of complex risk infrastructures and call for greater scrutiny at the board level.

Recognising the significance of dedicated risk oversight in financial institutions, Standard 12.1(c) of Bank Negara Malaysia’s Policy Document on Corporate Governance mandated the establishment of a risk management committee.

1 Lipton et al 2017, Risk Management and the Board of Directors, Harvard Law School Forum on Corporate Governance and Financial Regulation
The practice in substance

It is clear that whilst ultimate responsibility for a company’s risk management framework rests with the board, having a risk management committee can be an efficient and effective mechanism to bring the transparency, focus and independent judgment needed to oversee the company’s risk management framework.

Key considerations relating to the application of this Step Up are discussed below:

**What are the key responsibilities of the risk management committee?**

A risk management committee should have a charter that clearly sets out its role and provides it with all the necessary powers to perform that role. Some of the suggested responsibility areas that can be considered when outlining the terms of reference of a risk management committee are set out below:

**Suggested risk oversight responsibilities (non-exhaustive):**

- Determine that there is a robust process in place for identifying, managing, and monitoring critical risks; oversee execution of that process; and ensure it is continuously improved as the business environment changes.
- Provide timely input to management on critical risk issues.
- Engage management in an ongoing risk appetite dialogue as conditions and circumstances change and new opportunities arise.
- Oversee the conduct, and review the results, of company-wide risk assessments, including the identification and reporting of critical risks.
- Oversee the management of certain risks, with regard to the complexity and significance of these risk exposures.
- Provide advice to the board on risk strategies and coordinate the activities of the various standing board committees for risk oversight.
- Promote a healthy risk culture and watch for dysfunctional behaviour that could undermine the effectiveness of the risk management process (e.g. excessive risk-taking due to misaligned key performance indicators and remuneration schemes).

Care should be exercised to minimise overlaps in relation to specific risks that the risk committee is assigned to oversee (e.g. oversight of compliance risk by both the audit committee and risk management committee).

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2 Board perspectives- risk oversight 2015, Protiviti
Can a combined board committee lead to focused or dedicated oversight of risk management as envisaged by Step Up 9.3 of MCCG?

In determining whether there is dedicated oversight by the committee, the test would be the balance of work performed by the committee and whether matters of risk are accorded with due attention.

Under normal circumstances, a combined committee (e.g. audit and risk management committee) would not be considered as an application of Step Up 9.3 of MCCG. Combined committees are commonly overwhelmed with their primary agenda and may not have the expertise to oversee risk management matters in an effective manner.

What are the factors that should be taken into account in establishing the composition of a risk management committee?

In order to be able to discharge the committee’s mandate effectively, a risk management committee should be of sufficient size and independence (majority independent directors) and its members between them should have a sufficient understanding of the industry in which the company operates. Having directors who have little knowledge of the industry or the business environment would not add value to the committee and its function, leading to substandard risk assessment.

Key factors in determining the committee’s composition are outlined below:

**Dos**

- Setting out the terms of reference which deals with the authority and duties and disclosing these terms on the company’s website.
- Developing focused agenda items for the risk management committee and its reporting to the board.
- Establishing platforms for periodic engagement sessions between the risk management committee and senior management.

**Don’ts**

- Having excessive overlaps in the responsibilities of a risk management committee and that of another board committee.

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**Size**

The risk management committee should be of an appropriate size (i.e. at least three members) so that members can deliberate in an effective manner and any changes to the composition can be managed without undue disruption.

**Independence**

The risk management committee should comprise a majority of independent directors to enable objective oversight of risk matters. Whilst executive directors have more in-depth knowledge on the exposures that the company is subjected to, it is widely held that executive directors have a greater propensity to take risks given that their evaluation and remuneration are usually linked to the company’s performance.

**Business/Industry knowledge**

Directors with risk management experience and strong industry or business knowledge can significantly add value to the deliberations of the risk committee, particularly on operational risks. Their knowledge on the subject matter relating to the industry and the external environment may help to provide a better understanding of business-specific issues or growing exposures.

**Time commitment**

The establishment of an additional committee demands the time of directors. As such, consideration should be given in appointing members who are able to devote the time and attention to the affairs of the risk management committee.
Regional/international perspectives

Alongside Malaysia, selected jurisdictions including Australia and Singapore have also placed emphasis on the establishment of risk management committees in public listed companies premised on the evolving nature of risks in the corporate landscape which necessitates more focused oversight on risks.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>The board of a listed entity should have a committee or committees to oversee risk, each of which:</td>
</tr>
<tr>
<td></td>
<td>(1) has at least three members, a majority of whom are independent directors; and</td>
</tr>
<tr>
<td></td>
<td>(2) is chaired by an independent director.</td>
</tr>
<tr>
<td></td>
<td>[Recommendation 7.1(a)(1) and (2)]</td>
</tr>
<tr>
<td>Singapore</td>
<td>The Board may establish a separate board risk committee or otherwise assess appropriate means to assist it in carrying out its responsibility of overseeing the company’s risk management framework and policies (Guideline 11.4).</td>
</tr>
</tbody>
</table>

Where
Effectiveness of an internal audit function

**MCCG Intended Outcome 10.0**
Companies have an effective governance, risk management and internal control framework and stakeholders are able to assess the effectiveness of such a framework.

**MCCG Practice 10.1**
The Audit Committee should ensure that the internal audit function is effective and able to function independently.

**MCCG Practice 10.2**
The board should disclose:

- whether internal audit personnel are free from any relationships or conflicts of interest, which could impair their objectivity and independence;
- the number of resources in the internal audit department;
- name and qualification of the person responsible for internal audit; and
- whether the internal audit function is carried out in accordance with a recognised framework.

(The application of Practice 10.2 of MCCG in its entirety entails the disclosure of the following four elements by the board:

- whether internal audit personnel are free from any relationships or conflicts of interest, which could impair their objectivity and independence;
- the number of resources in the internal audit department;
- name and qualification of the person responsible for internal audit; and
- whether the internal audit function is carried out in accordance with a recognised framework.)

⚠️ The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

The case for change

An internal audit function helps a company to accomplish its goals by bringing an objective and disciplined approach to evaluate and improve the effectiveness of risk management, internal control and governance processes. The internal audit function is essentially the “eyes and ears” of the audit committee, serving as a sounding board on deficiencies in the aforementioned areas and providing advice on the remedial measures to be meted out by the company.
Point for reflection

The internal audit function has changed considerably over time to meet the challenges of modern economy and the complexities of business. Stakeholders are increasingly looking to the internal audit function for insights regarding the future and to provide advisory services earlier in the life cycle of business initiatives.

A global survey titled “Evolution or irrelevance – internal audit at a crossroads” which was conducted by Deloitte in 2016 revealed that 55% of Chief Internal Auditors expect the proportion of advisory services rendered by internal auditors to expand over the next three to five years.

Internal auditors are now deploying enhanced methodologies such as predictive risk analysis and advice on risk mitigation in the planning stages of a business initiative. This is expected to deliver more value rather than noting what management could have done differently after the initiative has been launched or completed.

Given the significance of this function in safeguarding a company against weaknesses in risk management, internal control and governance, a facilitative environment should be created to enable the internal audit function to carry out its responsibilities in an effective manner.

To this end, the need for listed issuers to establish an internal audit function and the responsibilities of the audit committee in overseeing the effectiveness of this function are well-codified in Bursa Securities Listing Requirements.

Paragraph 15.27 of Bursa Securities Listing Requirements

Internal audit

(1) A listed issuer must establish an internal audit function which is independent of the activities it audits.

(2) A listed issuer must ensure its internal audit function reports directly to the audit committee.

Paragraph 15.12(1)(e) and (f) of Bursa Securities Listing Requirements

Without limiting the generality of paragraph 15.11 above, a listed issuer must ensure an audit committee, amongst others, discharges the following functions:

(1) review the following and report the same to the board of directors of the listed issuer:

   e) the adequacy of the scope, competency and resources of the internal audit function and that it has the necessary authority to carry out its work; and

   f) the internal audit plan, processes, the results of the internal audit assessments, investigation undertaken and whether or not appropriate action is taken on the recommendations.

Note: Only requirements pertaining to internal audit function are extracted from the said Paragraph.

1 Requirement for audit committee to have written terms of reference
Similar provisions are also encapsulated for financial institutions in Bank Negara Malaysia’s Policy Document on Corporate Governance. For example, Appendix 1 of the said document requires audit committees of financial institutions to oversee the effectiveness of the internal audit function in relation to its scope, procedures and frequency, key audit reports, disagreements between the chief internal auditor and the senior management team as well as the performance evaluation of the function. Note: Detailed supervisory expectations on an effective internal audit function are outlined in the Guidelines on Internal Audit Function for Licensed Institutions 2010 issued by Bank Negara Malaysia.

Recognising that the value of internal audit lies in the objectivity of its process and the trust that has been placed on this function by stakeholders, regulators have also enumerated prescriptions to enhance transparency in this regard. It is therefore important for companies to appreciate that the disclosed information serves as the basis for constructive dialogue with stakeholders.

**Paragraph 15.15(3)(e) of Bursa Securities Listing Requirements**

The audit committee report must include a summary of the work of the internal audit function.

**Paragraph 30, Part A, Appendix 9C of Bursa Securities Listing Requirements**

The contents of an annual report must include a statement relating to the internal audit function of the listed issuer, i.e. whether the internal audit function is performed in-house or is outsourced and the costs incurred for the internal audit function in respect of the financial year.

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**What could go wrong:**

- Key control failures and potential fraud issues are unsurfaced.
- Internal audit personnel succumb to pressure from management to reconsider audit issues and to make them more “user friendly”, thus, diminishing the actual level of risk that the company is exposed to.
- Limitation on the scope of internal audit (e.g. excluding the coverage of managing director or chief executive officer’s office from the scope of the audit).
- Lack of co-ordination between the internal auditors and external auditors which leads to gaps in the audit coverage.
- The internal audit work performed is not sufficiently responsive to changes in business strategies and risk profile of the company.
- Corrective actions recommended by the internal audit function are not acted upon and addressed in a timely manner by management.
In order for the internal audit function to provide objective assurance on the quality of a company’s risk management, internal control and governance processes, it is imperative to ensure that this function is well-equipped to deliver the depth and quality of the work that is expected of it.

Key considerations relating to the application of these Practices (Practices 10.1 and 10.2 of MCCG) are discussed below:

**What are the key activities undertaken by an internal audit function?**

It is the responsibility of the audit committee to decide on the remit of the internal audit function including its objectives and activities. The internal audit function is normally involved in carrying out the following:

- a review and objective evaluation of the governance, risk and control environment of the company and entities across the group;
- a systematic analysis of business processes to identify the associated controls in place;
- an assessment of how information on fraud and irregularities is reported including providing feedback on adherence to the company’s code of conduct and/or code of ethics;
- ad-hoc reviews of other areas where there is a concern that affects financial reporting or a threat on the safeguarding of the company’s assets;
- reviews of the compliance framework and specific compliance issues;
- follow-up visits to determine the status of management implementation of plans to address observations reported in preceding internal audit visits; and
- value-added recommendations for more effective and efficient use of resources within the company.

**Dos**

- Establishing an internal audit charter to set forth the purpose of the internal audit function, its responsibilities and the necessary authority that it has been conferred with to carry out its work.
- Formalising the qualifications and competencies that are expected of those carrying out the internal audit work.
- Establishing platforms for external auditors and internal auditors to communicate and co-ordinate.
- Keeping close tabs on the resignation of internal auditors so as to ascertain if it is indicative of broader issues.

**Don’ts**

The following would render the application of this practice ineffective:

- Disclosing adherence to a professionally recognised internal audit framework when the company only adopted a minimal number of standards or practices encapsulated in the said framework.
- Maintaining that an outsourced internal audit provider’s confirmation on independence and other regulatory requirements is the be-all and end-all.
What are the key attributes of an effective internal audit function?

The salient characteristics which are commonly exhibited by an effective internal audit function are outlined below:

<table>
<thead>
<tr>
<th>Objective and free from undue influence</th>
<th>Adequately resourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal audit personnel should be able to exercise objectivity by being free from conflicts of interest or the undue influence of others that will override professional and business judgment.</td>
<td>The internal audit function should be resourced with adequate manpower and supporting infrastructure, such as auditing tools and knowledge repositories. The resources and budget allocated should be proportionate with the envisaged extent and complexity of the audit work, in line with the company’s size and circumstances.</td>
</tr>
<tr>
<td>In order to preserve the independence of this function, the head of internal audit should report directly to the audit committee. The audit committee should also be responsible for deciding on the appointment and removal as well as the performance evaluation and remuneration of those in the internal audit function.</td>
<td>The audit committee should ensure that internal audit personnel, particularly the head of internal audit, is competent to carry out the work.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Appropriately positioned</th>
<th>Aligned with the strategies and risks of the company</th>
</tr>
</thead>
<tbody>
<tr>
<td>The internal audit function should be appropriately positioned within the company to be recognised as an authoritative voice. In this regard, as highlighted in Guidance to Practice 10.1 of MCCG, the audit committee should ensure that the head of internal audit has sufficient standing and authority to discharge his or her functions effectively.</td>
<td>The internal audit coverage should be tailored in response to changes in the company’s business, risks and operations.</td>
</tr>
<tr>
<td>The function should be accorded with unrestricted access to the necessary information, records, physical properties and personnel to perform its agreed-upon objectives and responsibilities.</td>
<td>The evaluation performed by the internal auditor should be contextualised to the business and industry, identify root-causes of issues and offer new insights with a consideration of the future impact.</td>
</tr>
</tbody>
</table>

**Hot-button issue**

At present, there are no minimum requirements for an individual to act as an internal audit practitioner.

It is therefore incumbent on the audit committee to ensure that internal auditors, particularly the head of internal audit, possess appropriate qualifications and expertise to carry out the work. In addition, the audit committee should reinforce the need for continuous professional development as a means for internal auditors to keep themselves abreast of the evolving developments.

The adoption of a professionally recognised framework such as the International Professional Practices Framework ("IPPF") by the Institute of Internal Auditors would also go a long way in fostering the need for proper adherence to independence and ethical standards as well as technical standards on execution of internal audits and quality assurance (discussed on the following page).
What are the key factors that should be taken into account in evaluating the capability and adequacy of resources of the internal audit function?

In evaluating the resources of the internal audit, due cognisance should be given (as a minimum) to the aspects of **people** and **process**.

As mentioned above, the quality of the **people** (i.e. internal audit personnel) should reflect the extent and complexity of internal audit coverage. This would, amongst others, entail:

- the relevant academic and professional accreditation;
- the experience that is crucial to enable them to carry out internal audit work;
- reasonably strong interpersonal skills in discussing with the auditee and writing reports, articulating issues in no uncertain terms;
- maturity of the personnel in engaging with management on contentious issues encountered when carrying out the internal audit projects; and
- the ability to provide recommendations that are not only practical for implementation but also take into consideration the “cost-benefit” aspects of the suggestions.

In terms of **process**, the evaluation should focus on how structured and robust is the approach deployed by internal audit personnel in achieving the internal audit objective. Internal audit plans should be clear and objective enough to enable the personnel to execute the work procedures and to obtain as well as evaluate the audit evidence for reliability and sufficiency.

*Note: A sample exhibit outlining a checklist to evaluate the internal audit function is provided in Appendix VII of this Pull-out.*

**Should an internal audit function be conducted in-house or outsourced?**

Companies may choose to have an in-house internal audit function or outsource it, depending on the circumstances of the company.

It is commonplace for audit committees to consider outsourcing the internal audit work when there is a **lack of specialised expertise** to carry out the audit. For example, an in-house internal audit function may not have the appropriate information technology skills to conduct an audit of information technology systems, thus necessitating the need to commission specialised information technology auditors to perform the necessary audit work.

In the event the audit committee decides to outsource the internal audit function, it is pertinent that the audit committee assesses the remit of the outsourced internal audit provider to ensure that relevant criteria, such as independence, qualification, skills and experience, adequacy of resources and remuneration have been considered for the work to be carried out effectively.
Key considerations in outsourcing the internal audit function:

- assessment of outsourcing risks (e.g., contracts and confidentiality agreements including any sub-contracting arrangements);
- scope of internal audit work to be outsourced;
- service provider selection process including the independence, qualification, skills and experience, as well as knowledge;
- adequacy of resources deployed and remuneration of the outsourced service provider;
- internal audit framework adopted by the outsourced service provider;
- roles and responsibilities of the outsourced service provider;
- access to information, records, physical properties, and personnel as well as the reporting workflow; and
- effectiveness of the internal audit service rendered by the outsourced service provider and continuity of such service (for subsequent outsourcing arrangements).

How do the disclosures in relation to “number of resources” and “person responsible for internal audit” (in Practice 10.2 of MCCG) vary for an outsourced function vis-à-vis an in-house function?

Disclosure on “number of resources” and “person responsible for internal audit” should be made in the manner set out below.

If the function is conducted in-house, disclosure shall include:

- name and qualification of the head of internal audit; and
- number of resources (number of personnel in the internal audit department).

or

If the function is outsourced, disclosure shall include:

- name of the outsourced service provider/external firm;
- name and qualification of the lead individual in charge of the engagement (from the outsourced service provider/external firm); and
- number of resources deployed by the outsourced service provider/external firm for the said engagement.

As for partially outsourced (co-sourced) internal audit engagements, a more prudent approach can be adopted by providing disclosure on both the name and qualification of the head of internal audit as well as that of the lead individual in charge of the engagement from the outsourced service provider/external firm. A statement should also be made on the nature of work that is outsourced.

The illustrative disclosure on the following page outlines an example with regards to the following (in-house internal audit function):

- name and qualification of the head of internal audit (note: experience of the said individual was also provided); and
- number of resources (note: general description of their qualifications was also provided).
Illustrative disclosure (in-house internal audit function)

Disclosure on the name and qualification of the head of internal audit:

Ms. Say Nee was appointed as the Acting Head of Internal Audit of Singapore Press Holdings Limited (“SPH”) in October 2014. She subsequently took over as Division Head in April 2015.

Ms. Say Nee has been with the Division for 10 years, having joined in October 2005. Say Nee’s 15 years of experience in the profession spanned across both public and commercial sectors. She began her career in the Auditor-General’s Office in 2000, where she was involved in the financial audit and system controls review at the Ministry of Manpower and Central Provident Fund Board, after graduating from Nanyang Technological University with a Bachelor of Accountancy degree. She was an Internal Auditor with United Engineers Ltd before joining SPH.

Disclosure on the number of resources:

IAD is staffed by nine audit executives, including the Head of Internal Audit. Most of the IAD staff have professional qualifications, and are members of the Institute of Internal Auditors, Inc. (“IIA”). Some are qualified IT auditors and/or Certified Fraud Examiners.

Source: Annual Report of Singapore Press Holdings Limited for the financial year end 31 December 2015

In addition to the number of resources in the internal audit department and the name and qualification of person responsible for internal audit, boards should also disclose the following elements as stated in Practice 10.2 of MCCG:

- whether the internal audit personnel are free from any relationships or conflicts of interest, which could impair their objectivity and independence (e.g. annual confirmation by the head of the internal audit to the audit committee on the objectivity and independence of the internal audit function); and

- whether the internal audit function is carried out in accordance with a recognised framework (e.g. IPPF).

Is there a distinction in disclosure requirement for the cost of internal audit [paragraph 30, Part A, Appendix 9C of Bursa Securities Listing Requirements] when the internal audit is outsourced as opposed to being conducted in-house?

The cost is to be disclosed regardless of whether the internal audit function is performed in-house or outsourced. Such cost should include all costs involved in performing the internal audit function, including but not limited to salary of personnel, overhead expenses (e.g. expenses on training and knowledge repositories) and other ancillary expenses incurred.

What should a disclosure on the summary of the work of the internal audit function [paragraph 15.15(3)(e) of Bursa Securities Listing Requirements] include?

In providing disclosures on the summary of activities performed by the internal audit function, companies should provide meaningful insights into the actual areas that were audited during the financial year and how internal audit performed its function. A mere statement that the “internal audit function has reviewed the state of internal control of various operating cycles within the company” would not be particularly useful for stakeholders.
The “Analysis of Corporate Governance Disclosures in Annual Reports” performed by Bursa Malaysia in 2016 across 280 listed issuers has identified the following elements (non-exhaustive) which were encapsulated in the annual reports of listed issuers that exhibited good disclosures in this regard:

- number of internal audit assignments completed during the year and a statement as to whether these were aligned to the audit plan;
- specific areas that were audited such as finance, sales, marketing and procurement, with details of the specific aspects audited;
- a statement or discussion that the scope of internal audit engagements were aligned with the companies’ risk management profile (i.e. the audited areas were identified as key risk areas);
- a statement or discussion that the internal audit’s reports were deliberated at the senior management level and that action plans were put in place to complete the necessary preventive and corrective actions;
- a statement or discussion that the internal audit’s findings and management’s responses were tabled to the audit committee to ensure that management undertakes the agreed remedial actions;
- detailed breakdown of data to show how many internal audit personnel were involved in specific areas audited; and
- analysis of the variations in the internal audit costs or fees with explanations.

**Regional/international perspectives**

Premised on the importance of a robust internal audit process, many jurisdictions have enumerated provisions for public listed companies to establish an internal audit function with the audit committee being responsible for immediate oversight of this function. As in the case of Malaysia, selected jurisdictions such as Singapore have also provided emphasis on the adoption of professional recognised standards in carrying out this function.

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<tr>
<th>Country</th>
<th>Provision(s)</th>
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<tbody>
<tr>
<td>Singapore</td>
<td>The Internal Auditor should carry out its function according to the standards set by nationally or internationally recognised professional bodies including the Standards for the Professional Practice of Internal Auditing set by the Institute of Internal Auditors (IIA) <strong>(Guideline 13.4)</strong>.</td>
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Appendices
Appendix I:
List of indicators to be aware of and questions to be posed to management - financial reporting

The following is a list of indicators that the audit committees should be aware of in relation to financial reporting:

- sharp fall in the company’s share price
- overly complex transactions and company structures
- deterioration in the collection of debts and/or quality of debtors
- increase in amounts owing to creditors
- ongoing or previous investigations by regulators
- unusual rapid growth
- regular deferral of capital expenditure
- unrealistic earning expectations by the financial community
- excessive or inappropriate performance-based compensation
- gearing or liquidity forecast to be a problem
- loan agreement covenants not being complied with
- results appear unrealistically high in the given industry and economic conditions
- key ratios deteriorating or differing greatly compared to its peers
- last minute transactions that resulted in significant revenue
- delay in the issuance of financial reports

Directors should consider what further actions or information they require on financial reporting and tailor the questionnaire accordingly. For example, all “No” answers may require further explanation. Also, directors may wish to organise a series of detailed presentations from relevant senior management on specific issues.

The questionnaire, which is not meant to be exhaustive, covers a broad range of issues, some of which may not be applicable or only relevant to certain types of companies. Accordingly, the scope and nature of the questions should be adapted to suit the circumstances of the company’s activities, relevant legislation (including overseas reporting requirements) and perceived contentious reporting issues. The questionnaire would typically be completed by the chief financial officer.
A. Overall

1. Do the company’s financial statements comply in all respects with applicable approved accounting standards and other relevant reporting requirements? □ Yes □ No

B. Accounting policies

2. Are there any new applicable approved accounting standards or other authoritative pronouncements in the current period? □ Yes □ No

3. Are there any changes to the company’s accounting policies this year? □ Yes □ No

C. Going concern

4. Does the company or any of its controlled entities have a liquidity or solvency problem? □ Yes □ No

5. Have cash flow forecasts been prepared to determine whether the company’s liabilities can be met as and when they fall due? □ Yes □ No

D. Cash

6. Have bank reconciliations been performed regularly and reviewed by an appropriate person? □ Yes □ No

7. Are any cash balances of controlled entities or those held in foreign countries subjected to any restrictions? If yes, please describe. □ Yes □ No

E. Investments

8. Is the company trading in shares? □ Yes □ No

9. Are there established authority limits covering investments? □ Yes □ No

10. Have there been incidences where the limits of authority were not adhered to? □ Yes □ No

F. Account receivable

11. Are there any new types of transactions giving rise to complex revenue recognition considerations? □ Yes □ No

12. Is the provision for doubtful receivables adequate? □ Yes □ No

13. Has adequate provision been raised for sales returns? □ Yes □ No

14. Has the company observed a correct cut-off for its sales transactions? □ Yes □ No

G. Inventories

15. Do the relationships between inventory movements, inventories at year-end, trade receivables and sales revenue appear reasonable? □ Yes □ No
16. Are there material adjustments made to the book inventory to reflect the physical inventory? □ Yes □ No

17. Is the company’s method of valuing inventories consistent with most companies in the industry and in line with applicable approved accounting standards? □ Yes □ No

18. Is the provision for obsolete and excess inventory adequate? □ Yes □ No

19. Have all anticipated variations and claims relating to construction contracts and other service contracts been considered in the determination of contract outcome? □ Yes □ No

20. Have expected losses on construction contracts and other service contracts been recognised immediately? □ Yes □ No

21. Have profits on construction contracts and other service contracts been properly determined in accordance with appropriate accounting standards? □ Yes □ No

H. Property, plant and equipment

22. Have all major acquisitions of property, plant and equipment been subjected to a duly authorised approval process? □ Yes □ No

23. Has there been any valuation conducted on the land and buildings in accordance with the applicable approved accounting standards and if so, is it appropriately disclosed in the financial statements, where required? □ Yes □ No

24. Are the useful lives and methods used to depreciate plant and equipment reasonable? □ Yes □ No

25. Has a review of idle plant and surplus premises, including leased assets and premises, been performed for possible impairment? □ Yes □ No

26. If borrowing costs have been capitalised in property, plant and equipment, has the capitalisation been carried out as allowed by applicable approved accounting standards? □ Yes □ No

27. If the company has capital commitments on the purchase of property, plant and equipment, have appropriate disclosures required by the Companies Act 2016 been made in terms of amounts approved but not contracted for, and amount contracted but not provided for in the financial statements? □ Yes □ No

28. Does the company periodically take a physical inventory of property, plant and equipment? □ Yes □ No

29. Were there any significant adjustments made to the carrying value of property, plant and equipment? □ Yes □ No

If yes, provide details of the adjustments:
I. **Intangible assets**

30. Have the intangible assets been impaired to reflect the useful life of the asset?  □ Yes □ No

31. Is the impairment policy clearly disclosed in the financial statements? □ Yes □ No

J. **Other non-current assets**

32. Do all other non-current assets satisfy the definition of “asset” as defined in the applicable approved accounting standards? □ Yes □ No

33. Is the impairment policy appropriate? □ Yes □ No

34. Does the company have contingent assets and have these been disclosed according to applicable approved accounting standards? □ Yes □ No

K. **Liabilities**

35. Have provisions only been raised when there is a legal, equitable or constructive obligation present as a result of past transactions or events? □ Yes □ No

36. Are any assets pledged to secure borrowings? □ Yes □ No

37. If yes, have they been properly disclosed in the financial statements? □ Yes □ No

38. Has the company entered into any significant sale and lease back transactions during the financial year and if so, is the transaction appropriately recorded in accordance with applicable approved accounting standards? □ Yes □ No

39. Has the company adequately disclosed any contingent liabilities and off-balance sheet items according to applicable approved accounting standards? □ Yes □ No

L. **Shareholders’ equity**

40. Have there been any share buybacks during the period? □ Yes □ No

41. Has the amount of any asset revaluation reserve attributable to assets disposed of been transferred to retained earnings or to a capital reserve, as appropriate? □ Yes □ No

42. Have issues of financial instruments, other than ordinary shares, been properly classified as equity or debt in accordance with applicable approved accounting standards? □ Yes □ No

M. **Revenue and expenses**

43. Are the methods of recognising major items of income/expense appropriate in the circumstances? □ Yes □ No
44. Are the company’s methods of recognising income/expense consistent with methods used in the industry? □ Yes □ No

45. Has the gross profit on sales percentage changed significantly during the year? □ Yes □ No

46. Are the financial results of the company in line with analysts’ expectations? □ Yes □ No

47. Have intra-group transactions been appropriately eliminated, including unrealised profits? □ Yes □ No

N. Taxation

48. Has the current tax liability in the financial report been calculated in accordance with current income tax laws and applicable approved accounting standards, including deferred tax? □ Yes □ No

49. Have the tax calculations been reviewed by a party independent of the preparer and who has appropriate knowledge of the tax requirements? □ Yes □ No

50. Are there any significant tax balances in dispute? □ Yes □ No

51. Has the effective tax rate been reconciled with the statutory tax rate? □ Yes □ No

O. Acquisitions/disposals

52. Have all acquisitions and disposals been subjected to due diligence procedures and board’s/shareholders’ approvals, where required? □ Yes □ No

53. Has the company carried out post acquisition reviews to assess the actual performance against the proposed business case? □ Yes □ No

54. Have all discontinuing operations been properly identified and disclosed only in accordance with applicable approved accounting standards? □ Yes □ No

P. Earnings per share

55. Have any changes in capital structure or accounting policies during the year significantly affected the earnings per share? □ Yes □ No

56. Have basic and diluted earnings per share been accurately computed and disclosed in accordance with applicable approved accounting standards? □ Yes □ No

Q. General

57. Are assumptions regarding the determination of carrying value of assets and liabilities subjected to significant risks? □ Yes □ No

58. Have all major suspense, clearing or inter-office general ledger accounts been reconciled and cleared at reporting date? □ Yes □ No
59. Are there any significant post reporting date events that have a bearing on the financial report?

☐ Yes  ☐ No

R. Bursa Securities Listing Requirements

60. Does the annual report comply with all of the disclosure requirements in the Bursa Securities Listing Requirements disclosures?

☐ Yes  ☐ No

61. Do the quarterly reports announcements contain the required disclosures as prescribed by the Bursa Securities Listing Requirements and applicable approved accounting standards?

☐ Yes  ☐ No

S. Directors’ Report

62. Have all disclosures required by the Companies Act 2016 been made in the directors’ report, including principal activities, review of operations, significant changes in the state of affairs, etc.?

☐ Yes  ☐ No
Appendix II:

External auditor evaluation form

This sample exhibit, which is not exhaustive in nature, illustrates key questions which may be used to assist the process for the evaluation of external auditor, prior to its appointment and/or re-appointment. The external auditor by definition includes its network member firms and companies based on the By Laws (on Professional Ethics, Conduct and Practice) by the Malaysian Institute of Accountants.

This sample evaluation form may be customised, depending on the peculiar circumstances of the companies concerned.

The Evaluation Form provides ratings from one (1) to four (4), or ‘yes’ and ‘no’, with the indicators illustrated below, to be responded in relation to the nature of the questions:

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<tr>
<td>Yes, always</td>
<td>Yes, most of the time</td>
<td>Yes, but seldom</td>
<td>No</td>
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<td>or</td>
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<td>Above average</td>
<td>Average</td>
<td>Below average</td>
<td>Poor</td>
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Where a particular criterion is deemed not applicable, it shall be indicated as ‘Not Applicable’ in the comment box.

Name of External Auditor:

______________________________________________

Section A: Calibre of external audit firm

1. Are there recent or current litigation cases against the firm?

   Yes □ [ ] [ ] [ ] [ ] No □

   Comment: ________________________________

2. Does the external audit firm have the size, resources and geographical coverage required to audit the company?

   Yes □ [ ] [ ] [ ] [ ] No □

   Comment: ________________________________
Section B: Quality processes/performance

3. How are the quality control processes maintained in the external audit firm? Factors to be considered include the level and nature of review procedures, the approach to audit judgments and issues, independent quality control reviews and the external audit firm’s approach to risk.

4. How have key risks, including fraud risk and financial misstatement risk, being discussed and factored into the audit plan?

5. How is the external audit firm’s process for internal review of accounting judgments, including an understanding of the key issues?

6. How are relevant specialists/experts being employed by the external audit firm and how are these linked to the audit process?

7. How multiple-location audits and/or overseas audits are controlled and are their audit effectiveness regarded as consistent internationally?

8. Are the reporting processes for subsidiary audit teams\(^1\) effective?

9. How is the external audit firm’s approach to seeking and assessing management representations?

---

\(^1\) Group engagement team (i.e. audit team from the parent company’s external auditor) or component external auditor (i.e. audit team from a different external audit firm) that performs the external audit on the subsidiaries of the parent company.
10. In cases where there are any differences in views between management and the external auditor, does the external auditor communicate its views clearly and accurately from an accounting perspective?

| Yes □ | ☐ | ☐ | ☐ | No □ |

Comment:

11. Does the audit committee agree with the bases and extent of reliance external auditors place on management and internal audit testing, if any? (Comment as 'Not Applicable' if none).

| Yes □ | ☐ | ☐ | ☐ | No □ |

Comment:

12. Comment on the external auditor’s working relationship with internal audit.

Comment:

13. Did the auditors meet the performance targets, i.e. audit scope, audit plan, timing, etc.?

| Yes □ | ☐ | ☐ | ☐ | No □ |

Comment:

14. Does the external audit function include detection and investigation of fraud? If it does not, please comment on its role in relation to investigation of fraud?

| Yes □ | ☐ | ☐ | ☐ | No □ |

Comment:

Section C: Audit team

15. Rate whether audit engagement partner and individuals assigned to the external audit team have the requisite skills and expertise, including industry knowledge, to effectively audit this company and meet its requirements.

| ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ |

4 □ 3 □ 2 □ 1 □

Comment:

16. Is the lead engagement partner able to provide a clear and understandable explanation on auditing and accounting issues faced by the company?

| Yes □ | ☐ | ☐ | ☐ | No □ |

Comment:
17. How is the audit engagement partner’s/other senior personnel’s involvement in the audit process and is this sufficient?

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Comment:

Section D: Independence and objectivity

18. Does the external audit firm communicate to the company on any matters which might reasonably be perceived as affecting the independence of the firm and/or of individuals assigned to the external audit team (e.g. provision of services to entities that are related to directors and controlling shareholders of the company)?

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Comment:

19. Does the external audit firm have adequate key member succession plans in place, which meet the relevant audit partner rotation requirements and facilitate the maintenance of objectivity?

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Comment:

20. Is the audit committee of the opinion that the external audit function is independent and objective?

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Comment:

21. Prior to approval by the audit committee on non-audit services to be rendered by the external audit firm, does the lead engagement partner explain and discuss safeguards in place to protect against impairment to independence and objectivity of the external audit firm?

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<th>Yes □</th>
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Comment:

22. Does the external auditor communicate to the audit committee about new and applicable accounting practices and auditing standards and its impact on the company’s financial statement?

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<th>Yes □</th>
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Comment:
### Section E: Audit scope and planning

23. Does the external audit firm, with the audit engagement partner present, agree to the audit scope and plan with the audit committee?

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**Comment:**

24. Is the external audit scope and plan adequate to address company/industry-specific areas of accounting risks, audit risks and financial reporting risks faced by the company?

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**Comment:**

25. In planning the audit, are adequate considerations given to geographical coverage, resource allocation, level of audit testing and nature of audit reports issued at each location?

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**Comment:**

26. Is specialist input to the audit in areas such as taxation, pensions and regulation at an appropriate level?

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**Comment:**

27. Are all key operations covered by the external audit?

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**Comment:**

28. Did the auditors maintain or update the audit plan to respond to changing risks and circumstances, in a manner agreeable and determined appropriate by the audit committee?

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**Comment:**

### Section F: Audit fees

29. How does the audit fee compare with other similarly sized companies in this industry? *(Note: In this context, a rating of “4” indicates a relatively high fee whilst a rating of “1” indicates a relatively low fee. A fee that is either too high or too low can be of concern).*

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**Comment:**
30. Rate how the differences between actual and estimated fees are handled.

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Comment:

31. Is an assessment conducted on the amount and relationship of audit and non-audit fees and services?

Yes □ ____________ ____________ ____________ No □

Comment:

32. Does the audit committee consider the fee for the external audit practical and sufficient for the scope, size, complexity and risks of the company?

Yes □ ____________ ____________ ____________ No □

Comment:

Section G: Audit communications

33. Does the external audit firm meet freely, regularly, and on a confidential basis with the audit committee, including being able to communicate to the audit committee if not being provided with sufficient cooperation during the audit?

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Comment:

34. Does the external audit engagement partner maintain professional and open dialogues with the audit committee and communicate findings and discussions in a frank and complete manner (including matters on management’s reporting process, internal control over financial reporting, etc.)?

Yes □ ____________ ____________ ____________ No □

Comment:

35. Does the external audit firm advise the audit committee about significant issues and new developments regarding risk management, corporate governance, financial accounting and related risks and control matters pertaining to the company on a timely basis?

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Comment:

36. Does the external auditor discuss the critical accounting policies and whether the accounting treatment is conservative or aggressive?

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Comment:
37. Does the external audit firm discuss with the audit committee the quality of the company’s financial reporting, including the reasonableness of accounting estimates and judgments?

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<td><strong>Comment:</strong></td>
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38. Does the external audit firm resolve accounting issues in a timely manner?

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39. Does the external audit firm seek feedback on the quality and effectiveness of the service they are providing?

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<th>Yes □</th>
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Evaluation carried out by: 

________________________________________

Name: 
Designation:

Checked and compiled by: 

________________________________________

Name: 
Designation:
Appendix III: Matters to be tabled to the audit committee on related party transactions

The following is an illustrative list. It is not exhaustive but is intended to stimulate thoughts as to the type of matters that should be tabled to the audit committee in relation to the related party transactions/recurrent related party transactions.

i. a description of the transaction;

ii. parties to the transaction, including who the related party is and the relationship involved;

iii. relevant details of the transaction, including value and percentage ratio, calculations based on the Listing Requirements. The percentage ratio should be calculated against all methods listed in Bursa Securities Listing Requirements and the calculations disclosed to the audit committee;

iv. the nature of the transaction, including an explanation of the related party’s interest and if it is a recurrent related party transaction, how the transaction meets the relevant criteria for being considered a recurrent related party transaction;

v. whether advisors and/or valuers are to be appointed;

vi. whether any other approvals are required;

vii. rationale for the transaction and cost and benefit to the company/group;

viii. comparative quotes, if available, including sources, methods and procedures through which transaction prices are determined;

ix. justification as to why the transaction must be undertaken with the related party, for example that the services provided by a related party cannot be obtained elsewhere or if need be, a current independent valuation report annexed for that purpose;

x. an explanation of how “arm’s length” was maintained during negotiations and in ensuring negotiations and terms to the related party transactions/recurrent related party transactions were carried out were on a commercial basis;

xi. an explanation of why the terms are considered fair and reasonable;

xii. an explanation of why the transaction is considered in the best interest of the company/group;

xiii. an explanation of why the terms are not detrimental to the minority shareholders;

xiv. if the transaction has gone through the usual tender process, to state so and the recommendations of the tender committee;

xv. management recommendations; and

xvi. revision/changes to the related party transactions/recurrent related party transactions policy and procedures relating to compliance with mandates arising from the nature and volume of transactions.
Appendix IV:
Financial literacy questionnaire

Financial literacy, which signifies the ability and competency to read, analyse and interpret financial statements, including a company’s statement of financial position, statement of comprehensive income, statement of changes in equity, cash flow statement, notes to the statements, cost accounting, budgets and management’s discussion and analysis can be acquired through education either formal or self-guided.

Below is a sample questionnaire to gauge the level of financial literacy of an audit committee member. If the answer is “No”, that does not mean that the member cannot serve but that training and education for the said audit committee member become imperative.

Name of director/candidate: ______________________________________

1. Ability to read, analyse and interpret the company’s financial statements. □ Yes □ No

2. General understanding of approved accounting standards relevant to the company’s business environment and related industry. □ Yes □ No

3. Competency to understand accounting principles, for example revenue recognition, valuation of assets, provisions, accruals, etc. □ Yes □ No

4. Ability to assess whether management’s judgments/estimates in financial statements are consistent with the industry. □ Yes □ No

5. Ability to assess clarity and completeness of disclosures in the financial statements (e.g. significant judgments have been explained in the notes to the financial statements). □ Yes □ No

6. Ability to analyse financial statements to quantify the overall financial condition of the company, i.e. use of profitability ratios, liquidity ratios, debt ratios, etc. □ Yes □ No

7. Ability to interpret the implications of significant or non-recurring transactions, events or adjustments made in the financial statements. □ Yes □ No

8. Ability to understand, analyse and enquire about potential manipulation of financial reporting i.e. did management make an estimate (or change an accounting treatment) to meet earnings target. □ Yes □ No

9. Ability to assess whether the external audit work plan focuses on the company’s key audit risks. □ Yes □ No
10. What seems to be the main cause for significant or non-recurring transactions or financial reporting adjustments? Please state below and the rationale thereof.

_________________________________________________________________

11. Please provide an example of a potential red flag that can adversely affect the quality of financial statements.

_________________________________________________________________

12. What are the purposes of holding private meetings between the audit committee and the auditors, both external and internal, without the presence of any other directors and employees?

_________________________________________________________________
Appendix V:
Questions to be posed to management - controls and compliance

This sample exhibit, which is not exhaustive in nature, illustrates key questions that the board may require senior management to complete or discuss.

Additional questions may need to be included, depending on the peculiar circumstances of the companies concerned.

Reference for additional questions can be made to the Appendix 2 of the Statement on Risk Management and Internal Control: Guidelines for Directors of Listed Issuers which is issued by the Taskforce on Internal Control with the support and endorsement of Bursa Malaysia Securities Berhad.

The Evaluation Questionnaire provides ratings of ‘yes’ and ‘no’, with the indicators illustrated below, to be responded in relation to the nature of the questions:

Yes □ No □

Where a particular criterion is deemed not applicable, it shall be indicated as ‘Not Applicable’ in the comment box.

Section A: Overall control environment

A.1 Identification and evaluation of business risks

1. Are the company’s business risks identified and assessed on an ongoing basis?

Yes □ No □

Comment:

2. Do the company’s accounting policies appropriately reflect the nature of its operational and business risks?

Yes □ No □

Comment:

3. Are employees informed of what is required of them to act in the best interest of the company so as to achieve its strategic objectives?

Yes □ No □

Comment:
A.2 Internal controls

4. Are delegations of authority and responsibility to individuals appropriately determined and notified?

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<tr>
<th>Yes □</th>
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Comment:

5. Are internal controls documented, approved and communicated to employees?

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Comment:

6. Does any one person initiate and approve significant transactions? If yes, does this represent an unacceptable level of risk?

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<th>Yes □</th>
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Comment:

7. Are there policies on competitive bidding for all significant purchases and contracts?

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<th>Yes □</th>
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Comment:

8. Is there a response plan for prompt and effective action when fraud or an illegal act is discovered?

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Comment:

A.3 Information systems

9. Are computers, programs and data adequately protected from improper use, loss or destruction?

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<th>Yes □</th>
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Comment:

10. Have employees been informed of their responsibilities and accountabilities relating to the secure and confidential use of information technology assets, including data?

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<tr>
<th>Yes □</th>
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Comment:
11. Have company officers assessed the business impact in the event of a computer breakdown resulting in a sustained loss of processing capability?

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<tr>
<th>Yes □</th>
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12. Is there a disaster recovery/contingency/business continuity plan, which is periodically tested?

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<tr>
<th>Yes □</th>
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</table>

### A.4 Insurance

13. Is there adequate insurance coverage over assets and potential liabilities, in terms of perils covered and sum insured?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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</table>

14. Have all known reportable incidents, circumstances or events that may give rise to an action against the company reported to the insurers and company lawyers?

<table>
<thead>
<tr>
<th>Yes □</th>
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### A.5 Communications

15. Is there a defined and approved media policy that includes discussions on performance, strategies and progress with market analysts, media rating agencies and similar bodies?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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16. Do procedures exist to ensure that all relevant matters are reported to Bursa Malaysia Securities Berhad, Securities Commission Malaysia, Companies Commission of Malaysia, Bank Negara Malaysia, etc.?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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</table>
A.6 Corporate code of conduct

17. Does the company have a policy on the establishment and maintenance of appropriate ethical standards?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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Comment:

18. Does the company have appropriate procedures to continuously inform and update its employees of the company’s ethical standards and monitor their performance?

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<tr>
<th>Yes □</th>
<th>No □</th>
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Comment:

Section B: Other regulatory areas

B.1 Tax & duties

19. Has the company complied with relevant tax legislations?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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Comment:

20. Have all tax payments been paid on time?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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Comment:

21. Have tax issues been considered in all due diligence procedures for acquisitions and divestments, including tax implications on dividends paid by the company?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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Comment:

22. Have all relevant employees been adequately trained on tax matters?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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</table>

Comment:
B.2 Corporate social responsibility

23. Is there a formal economic, environmental and social ("EES") policy endorsed by senior management and directors?

<table>
<thead>
<tr>
<th>Yes □</th>
<th>No □</th>
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Comment:

24. Have significant EES aspects or impacts been identified and processes put in place to address the aspects?

<table>
<thead>
<tr>
<th>Yes □</th>
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Comment:

25. Have EES provision and the company’s obligations under legislation been identified?

<table>
<thead>
<tr>
<th>Yes □</th>
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Comment:

26. Have the directors been made aware of all EES reporting requirements under legislation?

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<thead>
<tr>
<th>Yes □</th>
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Comment:

27. Does the annual report disclose the details of the company’s performance in relation to EES activities?

<table>
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<tr>
<th>Yes □</th>
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Comment:

Section C: Secretarial

28. Have all required documents, including annual returns been lodged with the Companies Commission of Malaysia?

<table>
<thead>
<tr>
<th>Yes □</th>
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Comment:

29. Have all relevant Bursa Securities Listing Requirements been complied with?

<table>
<thead>
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<th>Yes □</th>
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Comment:
30. Have certificates of title for all owned properties, trademarks, patents, intellectual property, etc., been verified and safely stored?

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<th>Yes □</th>
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Comment:

31. Have all property lease agreements, contracts, agreements, etc., been approved in accordance with delegated authorities and reviewed by legal experts?

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<thead>
<tr>
<th>Yes □</th>
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Comment:

32. Have all dividends been declared and paid only in accordance with Companies Act 2016 and the company’s constitution?

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<tr>
<th>Yes □</th>
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Comment:

33. Have all share issues, buybacks and cancellations been approved by the board/shareholders, entered in the registers and notifications provided to Bursa Malaysia Securities Berhad and Companies Commission of Malaysia?

<table>
<thead>
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<th>Yes □</th>
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Comment:

Checked and compiled by:

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Name:
Designation:
Appendix VI: Examples of risk indicators

The following is an illustrative list. It is not exhaustive but is intended to stimulate thoughts in relation to risk indicators.

- lack of oversight and inadequate attention on risk management matters by the board;
- high turnover of senior management and staff;
- autocratic management;
- untimely reporting and responses to audit committee inquiries;
- exposure to rapid technological changes;
- industry “softness” or downturns;
- interest rate and currency exposures;
- overly complex company structures or transactions;
- late surprises/high frequency of accounting adjustments;
- ongoing or prior investigations by regulators or others;
- bad news not escalated to the top;
- deteriorating employee morale;
- excessive or inappropriate performance-based compensation;
- lack of succession planning;
- inexperienced management;
- lack of management oversight;
- over-ambitious growth goals;
- unusually rapid growth;
- inappropriate focus on the importance of maintaining trends and achieving forecasts;
- unusual results or trends;
- lack of transparency in the business model and purposes of transactions;
- results appearing unrealistically high given the industry and economic conditions;
- key ratios deteriorating or differing greatly compared to its peers;
- regular deferral of capital expenditure;
- inadequate explanations for budget variances; and
- significant projects having a strategic objective or high market profile such as acquisitions or information technology system implementation.
Appendix VII:
Evaluation of internal audit function

This sample exhibit, which is not exhaustive, illustrates key questions which may be used to assist the process of evaluating the internal audit function. The internal audit function may be performed in-house or outsourced, as the company deems fit.

This sample Evaluation Questionnaire may be customised, depending on the circumstances of the company.

The Evaluation Questionnaire provides ratings of ‘yes’ and ‘no’, with the indicators illustrated below, to be responded in relation to the nature of the questions:

| Yes □ | No □ |

Where a particular criterion is deemed not applicable, it shall be indicated as ‘Not Applicable’ in the comment box.

**Name of Audit Committee member:**

1. Is the head of internal audit a member of:
   - IIAM\(^1\) □
   - MIA\(^2\) □
   - Any other professional body

2. Does the audit committee decide on the scope and functions of the internal audit as required in the Listing Requirements? If not, please comment on who makes that decision and why.

   | Yes □ | No □ |
   | Comment: |

3. Does the internal audit function understand the company’s business and the peculiarities of the industry(ies) in which the company operates?

   | Yes □ | No □ |
   | Comment: |

\(^1\) Institute of Internal Auditors Malaysia  
\(^2\) Malaysian Institute of Accountants
### 4. Do internal auditors meet with the audit committee without the presence of non-audit committee members whenever deemed necessary in relation to the operations of the company?

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### 5. Does internal audit function perform regular reviews to test the effectiveness of the financial, operational and compliance controls and processes of the company?

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### 6. Does the internal audit function test the effectiveness of risk management framework and policies?

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### 7. Does the internal audit function have sufficient resources and competency to carry out its work?

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### 8. Do the internal auditors undertake their functions according to the standards set by recognised professional bodies?

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### 9. Does the internal audit function provide input into developing action plans to monitor risks and internal controls based on the internal audit plan and processes undertaken?

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### 10. Is the scope of internal audit limited to certain areas only? If so, please state the reason for the limitation.

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11. Does the internal audit function include detection and investigation of fraud? If it does not, please comment its role in relation to investigation of fraud?

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12. Has the listed issuer carried out a Quality Assessment Review (QAR) of the internal audit function?

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13. Do the listed issuer’s external auditors rely on the internal audit assessment? If not, why?

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14. Does the internal audit function work in collaboration with external auditors, particularly in the area of evaluation of internal controls?

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Evaluation carried out by: 
Checked and compiled by:

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Name: 
Designation: 

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Name: 
Designation:
Corporate Governance: Moving from Aspiration to Actualisation

Corporate Governance Guide

Pull-out III

Guidance on Integrity in Corporate Reporting and Meaningful Relationship with Stakeholders

3rd Edition
www.bursamalaysia.com
This Corporate Governance Guide ("Guide") is issued by Bursa Malaysia Berhad for users to gain an understanding and appreciation on the application of corporate governance practices especially in relation to those set out in the Malaysian Code on Corporate Governance.

This Guide is provided for reference purposes only and is not exhaustive in its coverage. Users must exercise discernment and diligence in the use of this Guide. It is the boards’ and company officers’ responsibility to obtain independent, professional advice regarding any specific set of facts or issues before using or relying on it.

All applicable laws, regulations and existing Bursa Securities Listing Requirements should be referred to in conjunction with this Guide.

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Introduction

Background

This Introduction to Pull-out III ("Integrity in Corporate Reporting and Meaningful Relationship with Stakeholders") is designed to provide companies with broad guidance in making suitable arrangements to meaningfully engage and communicate with stakeholders. The Introduction also intends to provide companies with direction in implementing the Practices of Principle C in the Malaysian Code on Corporate Governance ("MCCG") and thus, should be read in conjunction with the write-ups on the individual Practices encapsulated in this Pull-out.

In an ever-changing business landscape, companies must understand the importance of maintaining and fostering good meaningful relationship with their stakeholders as they play a key role within the company’s ecosystem. Companies should recognise that their stakeholders are affected in one way or another by the companies’ actions. In this regard, directors, as stewards of the company should take responsibility to improve their communication and relationship with their stakeholders.

A company should ensure the following in fostering a good relationship with its stakeholders:

- set in place methodologies that would enable the company to identify its different set of stakeholders;
- identify the impact of different stakeholder groups towards the company’s activities and the output and outcomes of the company;
- examine the company’s business impact towards its stakeholders; and
- provide formal mechanisms for engagement and communication with stakeholders.

It is important to note that stakeholders not only receive comfort when they see the company’s leadership team present during key events such as general meetings, they also perceive the company in a positive light when there is quick and adequate response to events and crises.

In addition, companies should ensure timely, complete and accurate disclosures are made to their stakeholders and not just for the mere purpose of meeting minimum requirements. High quality disclosures allow stakeholders to form a clear understanding on the company’s state of affairs and make informed decisions.

This Introduction is set out over three sections. Section I addresses the boards’ responsibilities to stakeholders. Section II explores corporate reporting whilst Section III sheds light on the general meetings of shareholders.
Boards’ responsibilities to stakeholders

Identifying stakeholders

A company operates within a community or society where it has both internal and external stakeholders involved. The company is dependent upon the society for resources such as the operating environment, customer base as well as skilled workers that the company requires. Companies now need to consider the impact they have on their stakeholders based on the business decisions they make. This forms an unwritten social contract that reflects the relationship between companies and the communities in which they operate within typically referred to as the “social licence to operate”. It is imperative that the board first understands who the company’s stakeholders are.

The board must understand the different roles and contribution each group of stakeholder makes to the company and ensure it takes the appropriate measures to foster a good relationship with them. As owners of the company, shareholders delegate the responsibility of managing and guiding the company to the directors. Directors in turn are responsible to ensure they carry out their responsibilities based on the mandate given by the shareholders. The diagram below provides examples on the types of stakeholders usually involved in a company (external and internal):
Responsibilities towards shareholders and other stakeholders

**Shareholders**

Shareholders represent an important group of stakeholders of a company as they have a direct financial interest in the company and they delegate the responsibility of managing the company to the directors of the company. Shareholders perform a more reactive role in making decisions based on the actions taken by the board and management in governing and managing the company. The board must ensure that the needs and expectations of shareholders are properly understood. The relationship with shareholders should be included as part of the company’s board meeting agenda to ensure that the board is aware of the state of its relationship between the company and its shareholders.

In exercising their responsibilities towards shareholders, directors should take account of the following:

- shareholders’ rights stipulated under the **Companies Act 2016, Capital Markets and Services Act 2007, Bursa Securities Listing Requirements** and other relevant legislations as well as the company’s policies;
- fiduciary duties and oversight processes undertaken by the board to protect shareholders’ rights (e.g. process allowing effective participation of, and voting by, shareholders at general meetings);
- appropriate level of transparency and openness in shareholder communication;
- extent to which debate on contentious issues is embraced and prepared for (e.g. anticipating specific shareholder questions at general meetings and developing appropriate responses);
- implementation of shareholder proposals to be approved by a majority of votes;
- provide shareholders with opportunities to question and interact with board members; and
- ensure high standards of corporate reporting that provides clear and concise information to shareholders.

**Other stakeholders**

Companies should realise that the sustainable running of a company is not only achieved by maximisation of shareholders’ value but also by the value the company brings to all its other stakeholders (e.g. employees, customers, creditors, suppliers, business partners, regulators and policymakers and local communities).

A company that focuses on other stakeholders’ value will not undermine the importance of its shareholders’ value and in fact may provide long-term protection for shareholders’ value. In order to achieve an understanding of the varying needs of different stakeholder groups, the company has to constantly and effectively engage with its stakeholders. Effective measures to facilitate stakeholders’ communication include identifying and assessing important stakeholders, the establishment of an investor relations function to manage stakeholders’ communication and feedback, as well as practising transparent, timely and quality disclosure of information.

Apart from incorporating the welfare of various stakeholders in its business decision-making, a company should also embed stakeholder value in its long-term corporate strategies. This may be done by having a board which is diverse, not only in terms of gender, but more particularly, diverse in terms of the stakeholder group which they will represent or be concerned about. Having such an approach to corporate governance will also lead to better consideration and implementation of the sustainability strategies of the company, as the company’s objectives shall no longer be only to maximise shareholders’ value but also include all its other stakeholders’ welfare and sustainability considerations.
Communication

It is the board’s responsibility to develop and implement a communication policy which effectively articulates the operations of the company to its shareholders and other stakeholders whilst accommodating feedback from them. Considerations on such stakeholder communication are covered in detail in the write-up to Practice 11.1.

Feedback from stakeholders should be taken into account in business decision-making. The board should be responsible for setting the tone in the company and should manage stakeholders’ expectations. The communication policy may include the following contents:

- **purpose** – describes the purpose of the policy to promote effective communication and provide stakeholders with full and timely information about the company;
- **principles** – applies to the communication of information, including the level of clarity and reliability of information, as well as open, fair, timely and consistent disclosures;
- **point of accountability** – highlights the parties responsible for communication with stakeholders and whom stakeholders can contact, if necessary;
- **methods of communication** – sets out the types of communication by stakeholders such as telephone, mail, email, facsimile, corporate website, in person at the company’s office or via attendance at the annual general meeting (“AGM”)/extraordinary general meetings (“EGM”). Communication with stakeholders includes quarterly and annual reports, press releases and announcements; and
- **information** on where the policy or further information about the company can be accessed.

In this regard, companies may be guided by Bursa Malaysia Corporate Disclosure Guide that encourages prompt and timely dissemination of information to shareholders and investors. The Bursa Malaysia Corporate Disclosure Guide also recommends listed issuers to have in place written corporate disclosure policies and procedures (“CDPP”) and provides guidance for companies to establish its CDPP.

Other forms of communication policies include the insider trading policy, whistleblowing policy and company general meetings. The communication policy on general meetings may include matters such as purpose, notice of meeting, date and venue, conduct of meetings and shareholder participation, proxies and disclosure of proxy results, and minutes of the general meeting.

**Note:** In making arrangements to prepare, convene and conduct an AGM, listed issuers may be guided by “Best Practice Guide on AGMs for Listed Issuers” published by the Malaysian Institute of Charted Secretaries and Administrators with the support of Bursa Malaysia Berhad in 2016.
Corporate reporting has been an integral part of a company’s medium of communication to its stakeholders. Generally, corporate reports include information such as a company’s financial and operational results, governance, strategy and objectives.

In producing corporate reports such as annual reports, board and managements must take into consideration the expectations of stakeholders. Stakeholders, especially shareholders and regulators, expect an increased level of transparency from companies in terms of their reported information on financial, strategy, risk, sustainability and corporate governance.

In tandem with the demand from stakeholders for improved disclosures, there has been an increased focus on the way businesses are run, with greater attention given to how businesses impact the economy, environment and society. Bursa Securities Listing Requirements outline provisions in this regard:

Paragraph 29, Part A, Appendix 9C of Bursa Securities Listing Requirements

A narrative statement of the listed issuer’s management of material economic, environmental and social risks and opportunities ("Sustainability Statement"), in the manner as prescribed by the Exchange. [Cross reference: Practice Note 9]

Paragraph 6.1, Practice Note 9 of Bursa Securities Listing Requirements

All listed issuers should ensure that the Sustainability Statement contains information that is balanced, comparable and meaningful by referring to the Sustainability Reporting Guide issued by the Exchange. In identifying the material economic, environmental and social risks and opportunities, the listed issuer should consider the themes set out in the Sustainability Reporting Guide.

Paragraph 6.2, Practice Note 9 of Bursa Securities Listing Requirements

In making the Sustainability Statement, a listed issuer must include disclosures on the following:

(a) the governance structure in place to manage the economic, environmental and social risks and opportunities ("sustainability matters");
(b) the scope of the Sustainability Statement and basis for the scope;
(c) material sustainability matters and –
   (i) how they are identified;
   (ii) why they are important to the listed issuer; and
   (iii) how they are managed including details on –
      (aa) policies to manage these sustainability matters;
      (bb) measures or actions taken to deal with these sustainability matters; and
      (cc) indicators relevant to these sustainability matters which demonstrate how the listed issuer has performed in managing these sustainability matters.

Note: The above only represents an extract. Detailed provisions are contained in Practice Note 9.
The heightened expectations of stakeholders have resulted in corporate reporting becoming more complex and voluminous by the year. To this end, Practice 11.2 of MCCG encourages Large Companies\(^1\) to adopt integrated reporting based on a globally recognised framework. Integrated reporting provides an avenue for companies to create a clearer and concise report which would encompass details that can be tailored to meet the needs of different group of stakeholders associated with the company. The following diagram illustrates the different types of reporting that could be integrated into a single report by adopting the elements of integrated thinking in the form of integrated reporting.

<table>
<thead>
<tr>
<th>How to read an annual integrated report</th>
</tr>
</thead>
<tbody>
<tr>
<td>An annual integrated report provides extensive cross-references to other reporting publications as shown below.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Annual integrated report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary annual report to stakeholders contains succinct material information and conforms to local and other international reporting framework, as applicable.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Annual financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contains a full analysis of the company’s financial results, with detailed financial statements, prepared in accordance with Malaysian Financial Reporting Standards.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Specific regulatory report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reports issued in accordance with legal and regulatory requirements such as quarterly reports.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sustainability report</th>
</tr>
</thead>
<tbody>
<tr>
<td>A report covering economic, environmental and social matters.</td>
</tr>
</tbody>
</table>

Integrated reporting facilitates the connectivity of information by linking factors such as strategy, available resources and performance. Integrated reporting also helps management and the board to better understand the process involved in the business and issues they face more clearly, which allows them to better articulate their business strategy (short, medium and long-term) to their stakeholders. Considerations on integrated reporting are covered in detail in the write-up to Practice 11.2.

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\(^1\) Companies on the FTSE Bursa Malaysia Top 100 Index; or companies with market capitalisation of RM2 billion and above, at the start of the companies’ financial year (defined on page 3 of MCCG).
General meeting of shareholders

Enhancing shareholder participation

Regarded as an important platform for shareholders to interact and converse with the board, general meetings are evolving with the advancement of technology. During general meetings, companies are encouraged to embrace the use of technology to facilitate the presentation and communication of relevant information to shareholders, including the directors’ report, the audited financial statements, the company’s principal activities and its financial and operational performance.

In addition, the AGM should include communication of long-term corporate objectives, strategies and plans, as well as a dialogue on governance matters between the board and management and the shareholders. For many companies, the AGM is a major challenge in terms of shareholder communication and is a potential source of both positive and negative publicity. The outcome is determined by the information communicated and by the tone taken by the board towards shareholders, which, in turn, determines shareholders’ confidence in the company and the board. Considerations on shareholder participation in general meetings are covered in detail in the write-up to Practice 12.1.

Over the years, there has been increasing calls for greater inclusion of shareholders particularly to enable those who are unable to attend in person, to participate in the general meeting process. There has been a shift from traditional proxy voting to electronic voting with many companies, particularly in the United Kingdom and Taiwan, making significant progress in this regard to facilitate voting in absentia. Considerations on electronic voting in general meetings are covered in detail in the write-up to Practice 12.3.

It is important to note that shareholder attendance and the voting process only form a part of the overall general meeting process. Shareholders’ participation may be further encouraged at general meetings by:

- setting the timing and the location of the general meeting so that it is convenient for shareholders to attend;
- ensuring the participation and availability of the external auditor to answer questions from shareholders about the conduct of the external audit, including the preparation and content of the independent auditor’s report such as the key audit matters. Shareholders attending the general meeting should be made aware of the presence of the external auditor and their prerogative to ask questions to the external auditor concerning the conduct of the audit;
- providing information to shareholders in plain and simple language, both in English and other relevant languages to facilitate easy reading and understanding; and
- utilising available communication channels such as corporate website to keep shareholders updated on material matters.

Improving directors’ participation

General meetings are an important platform for shareholders to meet and engage the board. Interaction with the board allows shareholders to hear directly from the directors on how the board has been managing the company’s affairs. This also gives an opportunity for shareholders to directly pose questions on matters such as governance, remuneration and audit to the board committee members who are involved in the respective processes. Hence, it is important for directors to ensure their attendance at general meetings so as to enable more forthcoming communication with shareholders. Considerations on directors’ participation in general meetings are covered in detail in the write-up to Practice 12.2.
In order to avoid the possibility of a painful general meeting experience, the board in building meaningful shareholders’ relationship should at the very least take into account the following:

- the board and management should spend time attempting to anticipate specific shareholder questions and develop appropriate responses;
- the board and management should put in place consistent communication with shareholders, not just at the time of the AGM, as it allows for better anticipation of shareholders’ concerns and contentious issues;
- the chairman of the general meeting should explain the effects and purpose of the proposed resolution before it is tabled at the AGM;
- the board may avoid a confrontational atmosphere by addressing contentious issues in the annual report or in the chairman’s formal address to the meeting;
- the board should allow the respective board committee chairmen to address matters pertaining to a specific governance issue, e.g. matters relating to the assessment on the independence and performance of directors should likely be addressed by the chairman of the nominating committee;
- the chairman of the board is normally responsible for the conduct of the general meeting and should be thoroughly familiar with the general meeting agenda and meeting procedures. The chairman should develop an approach for dealing with difficult or hostile responses from the floor;
- the chairman of the general meeting should allow and facilitate discussions of matters that are relevant and practical to the business of the general meeting and important to shareholders. The chairman should not accumulate questions from the shareholders with a view to answer all the questions in one go as this practice will dilute the importance of the questions and generalise the answers;
- the chairman of the general meeting must provide reasonable opportunity to the shareholders as a whole to pose their questions on the management of the company; and
- shareholders could be invited to submit questions prior to the general meeting to facilitate discussions at the meeting. Such questions may be posted on the company’s website and addressed to the relevant email address dedicated for shareholder communication.

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2 *Best Practice Guide on AGMs for Listed Issuers*, 2016, Malaysian Institute of Chartered Secretaries and Administrators (“MAICSA”) with the support of Bursa Malaysia Berhad
Practices
Communication with stakeholders

**MCCG Intended Outcome 11.0**

There is continuous communication between the company and stakeholders to facilitate mutual understanding of each other’s objectives and expectations.

Stakeholders are able to make informed decisions with respect to the business of the company, its policies on governance, the environment and social responsibility.

**MCCG Practice 11.1**

The board ensures there is effective, transparent and regular communication with its stakeholders.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

The case for change

The directors of a company are accountable to their stakeholders for the operations and the performance of a company. Stakeholders refer to “any individual or entity who can get benefited or affected by, and/or can benefit or adversely affect, a company’s actions in pursuit of its primary objectives”. Apart from shareholders, stakeholders typically include employees, creditors and suppliers, to name a few. Although shareholders are regarded as stakeholders of a company, they differ in many aspects from the other groups as they are owners of the company and they delegate the responsibility of managing the company to the directors.

Each group of stakeholders expect a varying level of interaction from the board based on their differing levels of interest in the company. Stakeholders expect the board to, amongst others, undertake the following:

- communicate in a timely and open manner;
- adopt good corporate governance practices;
- ensure that the company’s performance is closely monitored and feedback is provided; and
- engage and interact with stakeholders when making decisions that are significant to the company’s direction.

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1. Effective Co-operation And Communication With Stakeholders, 2007, Organisation for Economic Co-operation and Development

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**What could go wrong:**

- Adverse impact on share price due to unsubstantiated rumours and negative press coverage or loss of trust in the company.
- Lack of timely disclosure of material and reliable information resulting in the inability of stakeholders to make informed decisions.
Stakeholders expect timely and accurate dissemination of information and demand greater transparency from the company on their disclosures for them to form an informed view on the company.

For stakeholders such as shareholders, the AGM has in many instances become the sole avenue to engage the board and gain insights on the company’s business activities and financial position. Now, stakeholders are increasingly attempting to engage the board beyond the scope of the general meetings. This has made communication between a company and its stakeholders an integral part of the corporate governance framework.

The need for proper communication between a company and its shareholders has become far more evident with increased shareholder activism. In Malaysia, institutional investors are demonstrating heightened stewardship efforts via engagement efforts with their investee companies. Given the significant stakes that they commonly hold in their investee companies, institutional investors are typically in a strong position to influence the corporate governance practices of their investee companies. The heightened efforts undertaken by domestic institutional investors in engaging their investee companies are well encapsulated in the “Report on Institutional Stewardship and Future Key Priorities” by Institutional Investor Council Malaysia (“IIC”) in 2016.

Apart from general meetings, other modes of engagement by institutional investors include written submission of concerns and queries to the boards of investee companies and meeting with the companies centred on the topics of financial performance, strategic direction and long-term sustainability of the business.

Ongoing communication and engagement with stakeholders are essential to provide stakeholders with a better appreciation of the company’s objectives and the quality of its management. Chapter 9 of Bursa Securities Listing Requirements requires a listed issuer to have in place good corporate disclosure policies and effective communication channels to ensure thorough and timely dissemination of material and reliable information from the listed issuer to the Exchange, its shareholders and other stakeholders.

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2 Investor Stewardship and Future Key Priorities, 2016, Institutional Investor Council Malaysia
From a company’s viewpoint, it is vital to understand that communication depends on the nature of stakeholders that the company is dealing with. In engaging with stakeholders, companies should consider leveraging on technology as it facilitates the dissemination of information in a more seamless and inclusive manner.

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Paragraph 9.01(4) of the Bursa Securities Listing Requirements

Continuing disclosure ensures a credible and responsible market in which participants conduct themselves with the highest standards of due diligence and investors have access to timely and accurate information to facilitate the evaluation of securities.

Paragraph 9.21(2)(a) and (b) of the Bursa Securities Listing Requirements

A listed issuer must publish the following information on its website:

(a) all announcements made to the Exchange pursuant to these Requirements, as soon as practicable after the same are released on the Exchange’s website; and

(b) a summary of the key matters discussed at the annual general meeting, as soon as practicable after the conclusion of the annual general meeting.

Paragraph 9.21(4) of the Bursa Securities Listing Requirements

A listed issuer should ensure that its website is current, informative and contains all information which may be relevant to the listed issuer’s shareholders including analyst’s briefings.

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Hot-button issue

In Malaysia, it is often noted that institutional investors due to their resources and clout are able to engage boards in private to discuss the strategic and financial status of the company. On the other hand, retail shareholders commonly gather information from the board only during general meetings or when announcements and media reports are made available.

This forms a divide between the different shareholder groups. It is therefore imperative that the board exercises equal treatment to all shareholders and ensures that selective disclosures are not made to any particular group of its stakeholders.

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3 Investor Stewardship and Future Key Priorities 2016, Institutional Investor Council Malaysia
Key considerations relating to the application of this Practice are discussed below:

**How does the board improve its communication with stakeholders?**

The board has to first identify its stakeholders and formalise a policy. The board then has to implement and disclose its policies on stakeholder communication to articulate the approaches towards different stakeholders. These policies must be assessed regularly by the board. A policy on communication with stakeholders should at the very least contain:

- **purpose of the policy;**
  
The policy should describe the purpose of the policy to promote effective communication and provide stakeholders with complete and timely information about the company.

- **principles used to formulate the policy;**
  
There should be an explanation on how the communication policy was formulated, including the level of clarity and reliability of information, as well as the application of open, fair, timely and consistent disclosures. The policy should outline measures to ensure compliance with the disclosure requirements as set out in **Bursa Securities Listing Requirements** and other relevant regulatory requirements such as nature of information that can be released so as to avoid instances of disseminating unpublished price-sensitive information. The nature of information that would be classified as price-sensitive should be clearly ascertained. A clear level of authority should be accorded to designated spokespersons or those handling the material information.

- **parties responsible for the communication;**
  
The policy should include details on the parties responsible for communication with stakeholders and whom stakeholders can contact, if necessary.

- **methods of communication; and**
  
The policy must define and provide details on avenues available to stakeholders to communicate with the company and the board such as telephone, mail, email, facsimile, corporate website, in person at the company’s office and for shareholders this also includes attendance at the AGMs/EGMs. Communication with stakeholders also includes quarterly and annual reports, press releases and announcements made by the company.

- **location where additional information can be found.**
  
Information on where the policy or further information about the company can be accessed such as the company website, must be provided to stakeholders.

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**Investors’ perspectives**

Institutional investors are increasingly staking a demand for greater transparency and accountability from their investee companies.

In June 2014, a market driven effort, led by the major institutional investors resulted in the formulation of the **Malaysian Code for Institutional Investors** ("MCII"), which is a set of guiding principles in relation to the stewardship responsibilities of institutional investors. Subsequent to that, the IIC was established to serve as a common platform for institutional investors to raise concerns or views, particularly on corporate governance issues.

It is worth noting that **Principle 3 of MCII calls upon institutional investors to engage investee companies and undertake proactive measures in this regard.**
What are the common channels of communications?

In order to communicate with stakeholders, the board must first ensure the proper channels of communication have been established. This would involve the following:

1. Establishing an investor relations function

Investor relations is the process by which a company organises and conducts itself in an effective two-way communication with its shareholders. Reference can be made to Bursa Malaysia’s publication – “Investor Relations – Put Into Practice” which acts as a resource for a company to plan an investor relations programme or review its existing programme. Generally, an investor relations programme includes the activities outlined below.

Scope or activities of an investor relations function:

- Communicate corporate developments, strategy and financial plans to investors/financial community;
- Analyse market and sell-side sentiment;
- Develop shareholder management strategy; and
- Obtain feedback from investors/financial community.

It is acknowledged that it may not be feasible for all companies to have a stand-alone investor relations department. Companies that are larger in size of operations and market capitalisation, would deal with a larger number of stakeholders compared to smaller companies. This would necessitate a higher number of personnel involved in their activities.

It would be advisable for companies that are relatively large in size of operations and market capitalisation as a minimum to consider:

- establishing a separate independent investor relations function;
- providing dedicated investor relations contact on its website and annual report; and
- designing and implementing an investor relations programme.

As for the rest of the companies, it would be advisable for them, as a minimum to consider:

- ensuring there are personnel to oversee the communication with stakeholders;
- heightening efforts in providing information via company website; and
- ensuring matters concerning stakeholder communication are deliberated during board meetings.

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*Investor Relations Put Into Practice, 2007, Bursa Malaysia*
2. Conducting engagement sessions with the different types of stakeholders, including analyst and media briefings

As mentioned above, every stakeholder group is distinct as each group has different interests. Institutional investors would have a different perspective on their investment as opposed to a retail investor. As such, different approaches would be required to communicate with the different groups.

For example, engagement sessions (e.g. briefing and dialogues) allow shareholders and other stakeholders to better understand the company and make informed decisions on exercising their votes. Concerns regarding the company’s performance, strategy, corporate governance practices and future prospects can be raised through briefing sessions, which will provide the company and its stakeholders (e.g. investors, analysts and employees) with a common platform to improve the flow of information.

Common questions asked by shareholders and stakeholders currently

- What is the company’s strategy going forward, given the current market conditions?
- Why has the company’s share price exceeded/lagged behind the others in the same industry? How has the company’s share price performed in comparison to competitors?
- Is the company looking for opportunities for acquisition and/or acquiring assets?
- Why have gross operating margins increased/decreased from prior years?
- Which division/subsidiary/products contributed the most and the least to this year’s earnings? Which division/subsidiary/product is expected to be stronger/weaker next year?
- Why is the chairman also the chief executive of the company? Has the company considered separating these roles?
- What events have led to company’s impairment charges?
- How does the company plan to increase its market share?
- What was done from funds received from disposals?
- To what extent is the company dependent on short-term financing to operate?
- Are materials used in production sourced in an environmentally efficient manner?
- Has the company given due consideration to the social impact of its supply chain?
- Would the company look into investing in green energy and spaces?
- What are the measures taken by the company to limit the carbon footprint?
### Point for reflection

Institutional investors are increasingly seen to be exerting their influence to bring changes in a company. Recently, many South African companies have proposed to amend their Memoranda of Incorporation ("MOI") to state that only non-executive directors will be subjected to regular re-election by shareholders. The executive directors are excluded.

In this regard, a major institutional investor, BlackRock has taken the position that the ability to elect or re-elect a director to the board is a fundamental right of the shareholders that cannot be compromised.

To this end, BlackRock held several engagement sessions with a financial services company on the proposed amendments to the MOI. BlackRock advised the company that they would not be supportive of the removal of this fundamental shareholders' right.

BlackRock’s feedback, and that of other shareholders, encouraged the board of the said company to require all directors, including executives, to retire by rotation and seek shareholders’ approval in re-electing them. A new MOI was submitted to reflect this.

*Adapted from the report on Corporate Governance & Responsible Investment Report: Europe, The Middle East and Africa by BlackRock (Q1, 2017)*

3. Ensuring proper and accurate disclosure using available technological means such as the company website and social media

   It is important to note that stakeholders are increasingly active in online forums where latest industry developments and stock performance are shared and discussed. Although they are becoming more informed, there is a risk in them being misled in these forums. By being proactive on the company’s website and social media, companies can act to ease the pertinent concerns of stakeholders.

   **Bursa Malaysia Corporate Disclosure Guide** states that a listed issuer should leverage on advances in information technology to broaden its channel for dissemination of information. In tandem with this, the **Bursa Securities Listing Requirements** allows the use of e-communication by the listed issuer to disseminate information to its stakeholders, as outlined on the following page.

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* Paragraph 3.26, Bursa Malaysia Corporate Disclosure Guide
Paragraph 2.19B of Bursa Securities Listing Requirements

Issuance of documents by electronic means by a listed issuer to its securities holder

A listed issuer may send any document required to be sent under these Requirements to its securities holders (“Documents”) by electronic means, if the following conditions are complied with:

(a) the constitution of the listed issuer –
   (i) provides for the use of electronic means to communicate with its securities holders;
   (ii) specifies the manner in which the electronic means is to be used; and
   (iii) states that the contact details of a securities holder as provided to the Depository shall be deemed as the last known address provided by the securities holder to the listed issuer for purposes of communication with the securities holder;

(b) if the listed issuer publishes the Documents on its website, the listed issuer must separately and immediately notify the securities holders of the following in writing:
   (i) the publication of the Document on the website; and
   (ii) the designated website link or address where a copy of the Document may be downloaded;

(c) if the listed issuer sends the Documents or notification through electronic mail, there must be proof of electronic mail delivery;

(d) where a securities holder requests for a hard copy of the Document, the listed issuer must forward a hard copy of the Document to the securities holder as soon as reasonably practicable after the receipt of the request, free of charge; and

(e) where it relates to Documents required to be completed by securities holders for a rights issue or offer for sale, the listed issuer must send these Documents through electronic mail, in hard copy or in any other manner as the Exchange may prescribe from time to time.

Note: Sections 319, 320 and 612 of Companies Act 2016 allow companies to deploy technology to engage and communicate with its shareholders.
What are symptoms of poor communication efforts by the company to reach out to stakeholders?

Examples of poor communication efforts in this regard are as follows:

- the board does not provide sufficient time and information to engage with its stakeholders;
- investor relations activities are not conducted in accordance with the directions of the board and management; and
- an improperly maintained company website (i.e. not updated regularly).

How can a company’s website (on communication with stakeholders) be enhanced and be made user-friendly?

Suggested measures to enhance the content of a company's website are outlined below:

- ensure the website contains a calendar which sets out the important dates for stakeholders such as general meetings, upcoming engagement sessions, release date of financial statements, entitlement dates and other business updates;
- ensure corporate governance documents and policies (e.g. company’s constitution, board charter, terms of reference of board committees, remuneration policies and procedures) are regularly updated and easily accessible to stakeholders;
- ensure announcements made to the Exchange are published on the company’s own website and such announcements should be maintained as long as reasonably practicable for stakeholders’ information;
- publish the presentation slides and announcements made to the media as well as analysts, on the company’s website; and
- provide an investor relations contact to facilitate quick response to stakeholders’ queries.
Regional/international perspectives

As in the case of Malaysia, countries such as Australia, Singapore and United Kingdom have enumerated provisions (through their respective codes of corporate governance) that aim to foster transparent communication between the board and stakeholders.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place <em>(Principle E.1).</em></td>
</tr>
<tr>
<td>Australia</td>
<td>A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors <em>(Recommendation 6.2).</em></td>
</tr>
<tr>
<td>Singapore</td>
<td>The chairman should ensure effective communication with shareholders <em>(Guideline 3.2(e)).</em></td>
</tr>
</tbody>
</table>
**Integrated reporting**

**MCCG Intended Outcome 11.0**

There is continuous communication between the company and stakeholders to facilitate mutual understanding of each other’s objectives and expectations.

Stakeholders are able to make informed decisions with respect to the business of the company, its policies on governance, the environment and social responsibility.

**MCCG Practice 11.2**

Large companies are encouraged to adopt integrated reporting based on a globally recognised framework.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

**The case for change**

Integrated reporting establishes the cycle of integrated thinking and reporting as a core requirement that is designed to support sustainable business and financial stability.

The South African Institute of Chartered Accountants (“SAICA”) in its 2015 survey found evidence of improvement in the quality of information presented as a result of integrated thinking (i.e. a process that underpins integrated reporting), as follows¹:

- improved risk identification and management process;
- improved decision-making, at both management and board level through the understanding of inputs and outputs in which the business relies upon;
- improved efficiency in optimising and allocating resources, including between remuneration and value creation; and
- improved governance processes, as companies managed to develop a more inclusive culture that makes employees feel empowered.

Traditionally, annual reports have been an essential medium to update stakeholders on the company's financial and strategic performance over the past financial years. However, the nature and pace of change in businesses today have evolved over time and stakeholders are now placing greater emphasis on the future performance and non-financial information of a company.

¹ *Creating value: The cyclical power of integrated thinking and reporting*, 2016, International Integrated Reporting Council
The awareness of the importance of non-financial information in determining long-term financial stability is growing amongst stakeholders. In tandem with the growing demand for changes in corporate reporting, a number of initiatives have emerged that are aimed at addressing disclosure needs and expectations of stakeholders. Some of these initiatives are as follows:

- In order to provide more insights on the audit process, the International Auditing and Assurance Standards Board introduced the reporting of Key Audit Matters (“KAM”) by the external auditors4; and
- In line with greater demand by shareholders and public at large for disclosure of comprehensive and relevant non-financial information to complement the information provided in the financial statements, Bursa Malaysia Securities Berhad mandated the disclosure of Management Discussion & Analysis (“MD&A”) in annual reports effective from 31 December 2016 onwards. Information to be contained in the MD&A in summary must include an overview of the group’s business and operations; discussion and analysis of the financial results and financial condition; review of operating activities; discussion on identified and anticipated or known risks; and forward looking statements comprising trends, outlooks, prospects, and distribution policy6.

The rising importance of non-financial reporting is also reflected in the Companies Act 2016 for which an extraction of the relevant section is shown below.

**Section 253(3) of Companies Act 2016 – Contents of directors’ report**

The directors’ report prepared under section 2526 may include a business review as set out in Part II of Fifth Schedule1 or any other reporting as prescribed.

In light with these ongoing developments coupled with the need to provide stakeholders with a complete and closely knitted picture of the business, integrated reporting has emerged as a timely response to bridge the existing divide and enable all the dimensions of a company’s values, strategy, risks and opportunities aligned to outputs and outcomes, to be articulated in a single and comprehensive report.

**Integrated reporting signals integrated thinking**

Integrated reporting is based on the process of integrated thinking. Integrated thinking requires a company to evaluate and consider its many different relationships that intertwine with its operations and functions along with the resources involved. The process of integrated thinking allows a company to

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2 Report on Investors’ Roundtable and Engagement Session with Public Listed Companies by the Integrated Reporting Steering Committee, 5 & 6 August 2015, Malaysian Institute of Accountants (MIA)
3 Insights into Integrated Reporting, 2017, ACCA
4 KAM are those matters that, in the external auditor’s judgment, were of most significance in the financial audit of the current-period financial statements.
5 Paragraph 7, Part A, Appendix 9C of Bursa Securities Listing Requirements
6 Relating to the provision for directors to prepare directors’ report
7 Information to be included in the business review may contain, a fair review of the company’s business; a description of the principal risks and uncertainties facing the company; a balance and comprehensive analysis of the development and position, performance and key indicators of the company.
integrate its decision-making processes and its actions that contribute to the creation of value for the company over the short, medium and long term.

It is paramount that any reporting done by a company be in compliance with legal and regulatory requirements including those relevant to the business. Whilst many companies have complied with legal and regulatory requirements by publishing a vast amount of information, the information presented is often isolated as they are prepared by different departments, such as:

- financial reports which are prepared by accounting and finance departments;
- disclosures on regulatory and legal compliance which are produced by general and legal counsels;
- sustainability reporting which is carried out by those involved in sustainability management;
- media releases and website contents which are overseen by communication and media departments; and
- risk issues which are reported by risk management team.

As such, integrated thinking enhances connectivity in a company resulting in the following benefits:

- helps to align internal and external messages by clearly articulating the business strategy and business model;
- facilitates better understanding of the company’s strategy and how value is created through breaking down silos;
- provides stronger focus on material issues and facilitates a long-term view of the business;
- provides better information from management that enhances accountability;
- improves quality of reporting thus building greater trust within the business and with stakeholders;
- imparts deeper understanding of resources and business activities to analyse and remediate gaps in the processes; and
- improves the understanding of the value of non-financial assets and renews emphasis on stakeholder engagement.

The Integrated Reporting <IR> Framework, issued by the International Integrated Reporting Council (“IIRC”) in December 2013 is a widely recognised integrated reporting framework. The <IR> Framework illustrates the fundamental concepts that underpin integrated reporting (i.e. the articulation of value creation and information on six capitals) together with seven Guiding Principles that underpin the preparation and presentation of an integrated report, and eight Content Elements which are key categories of information to be included in an integrated report. These form the structure of an integrated report. The <IR> Framework enables a company to bring these Content Elements together through the concept of “connectivity of information”, to explain how it creates value. The fundamental concepts, Guiding Principles and Content Elements within the <IR> Framework can be found in Appendix I of this Pull-out.
Integrated reporting is no longer viewed as nugatory or just “another reporting initiative”. It is not about more reporting but better and concise reporting. In short, assembling an integrated report promotes integrated thinking i.e. by breaking down silos of business entity and introducing new way of value creation.

Integrated thinking blends the strategy, resource allocation and relationship that a company is reliant upon and through qualitative and quantitative information, integrated report looks at how the activities and capabilities of the company transform the relevant capitals into outcomes for the company’s decision making and value creation over the short, medium and long term.

There are six types of capitals that represent a collection of values that are either increased, decreased, or transformed through its business activities, into outputs and outcomes. These six capitals are typically referred to as: financial; manufactured; intellectual; human, social & relationship; and natural capitals. It is important to understand that although most companies interact with most of these capitals to some extent, not all capitals are of equal importance to each company.

The following explains how the capitals apply to companies of all sizes with some non-exhaustive examples.

<table>
<thead>
<tr>
<th>Capitals</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>The pool of funds available to a company for use in the production of goods or the provision of services, which are obtained through financing, such as debt, loans, equity or grants, or generated through operations or investments.</td>
</tr>
<tr>
<td>Manufactured</td>
<td>Physical objects (as distinct from natural physical objects) that are available to a company for use in the production of goods or the provision of services, including buildings, equipment and infrastructure (such as roads, ports and bridges, etc.).</td>
</tr>
<tr>
<td>Intellectual</td>
<td>Knowledge-based intangibles, including intellectual properties of a company, such as patents, copyrights, software, rights and licences, systems, procedures and protocols.</td>
</tr>
<tr>
<td>Human</td>
<td>People competencies, capabilities and experience, and their motivations to innovate, including their alignment with and support for a company’s governance framework, risk management approach, and ethical values along with the ability to understand, develop and implement a company’s strategy and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate.</td>
</tr>
<tr>
<td>Social and relationship</td>
<td>The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individuals’ wellbeing and its licence to operate. Social and relationship capital includes brand and reputation, common values and behaviors, key stakeholder relationships, and the trust and willingness to engage with its external stakeholders.</td>
</tr>
<tr>
<td>Natural</td>
<td>All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of the company. It includes emissions, water, waste, land, minerals and forests, along with biodiversity and its ecosystem.</td>
</tr>
</tbody>
</table>

* Realizing the benefits: The impact of Integrated Reporting, 2014, Black Sun
The capacity of the business model to adapt towards changes such as the availability, quality and affordability of the capitals could impact the company’s long-term viability.

**HOW**

The practice in substance

In order to explain the company’s current state and future aspirations, **Practice 11.2 of MCCG** encourages Large Companies to adopt integrated reporting based on a globally recognised framework.

Note: *In implementing Practice 11.2 of MCCG, the focus should be on the substance of the reporting, regardless of how companies opt to brand their annual reports. In providing a statement on the application of this Practice, companies should reflect on the extent to which they have adopted integrated reporting based on a globally recognised framework premised on the objective of providing disclosures on the company’s value creation in a credible, systematic and comprehensive manner.*

Integrated reporting expands on the current financial reporting model to integrate non-financial information that will help shareholders and other stakeholders understand how a company takes into account the connectivity and interdependences that have a material effect on the company’s ability to create and sustain value over time.

**Guidance to Practice 11.2 of MCCG** defines the integrated report to be the main report in which information flows seamlessly and interconnects the company’s financial statements to other non-financial based statements such as, governance statements and sustainability reports. The integrated report provides information on how a company’s strategy, performance, governance and prospects lead to value creation. The integrated report enhances the value of information available to stakeholders and advocates higher standards of transparency and accountability from the company towards its stakeholders.

Key considerations relating to the application of this Practice are discussed below:

**How is integrated reporting put into practice?**

The first step that has to be taken by a company is to make a conscious decision to adopt integrated reporting. **The decision to adopt integrated reporting usually stems from the company’s motivation to gain the internal benefits of integrated thinking and to focus their reporting on matters that are considered as material to the company and its stakeholders.**

A company with experience in sustainability reporting is in a better position to adopt integrated reporting as it is more likely to have established the necessary systems, controls and assurance processes to assure the senior management that there is a clear presence of quality non-financial data to support the development of an integrated report.

Although the details may vary, the integrated reporting journey of any company usually involves **five** phases, as outlined on the following page.
Phase 1: Deciding to adopt integrated thinking and reporting

The decision to adopt integrated reporting and the resulting activities should be supported by the highest governing body as this form of reporting requires breaking down silos. In this regard, directors of a company are best suited to ensure the company’s overall adoption of the integrated thinking and reporting process. Integrated reporting does not only help directors and senior management communicate better with stakeholders but it also provides them with a view of how long-term strategies could be pursued and how the resources could be allocated in achieving their targets.

The integrated report should include a statement from those in charge of governance that consists of an acknowledgement of their responsibility to ensure integrity of the integrated report and that they have applied their collective minds in setting the direction of the company and taking accountability for the performance of the company.

Phase 2: Embedding the process

Integrated thinking requires the participation of many functions across the business. A company that has the process of integrated thinking embedded into its activities will be able to better synergise its connectivity of reporting from management, its business analysis, decision-making process and this will flow into the integrated report.

The IIRC and the Chartered Institute of Public Finance & Accountancy ("CIPFA") in their jointly issued 2016 report have outlined the following considerations in this regard.

<table>
<thead>
<tr>
<th>Who?</th>
<th>What?</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Who are the intended readers/external stakeholders?</td>
<td>• What reports should be produced in addition to the integrated report (annual, financial, etc.) and will they be printed, only published on the website or both?</td>
</tr>
<tr>
<td>• Who will develop and distribute the reporting system/documentation, and is training required for those involved?</td>
<td>• Will any current reports be discontinued/moved to the web only?</td>
</tr>
<tr>
<td>• Who will write the integrated report?</td>
<td>• What information will be included in the integrated report?</td>
</tr>
<tr>
<td>• Who, of the senior managers, will 'champion' &lt;IR&gt; and review the report before it is submitted to the executive team?</td>
<td>• What gap analysis will be undertaken (what information we produce versus what is needed for the integrated report)?</td>
</tr>
<tr>
<td>• Who will approve the final report (e.g. audit committee before it goes to the board)?</td>
<td>• What are the inputs from the relevant six capitals that need to be considered?</td>
</tr>
<tr>
<td>• Who will design, typeset and print the report (internal, external or a combination)?</td>
<td>• What information will be assured – internally and/or externally – when will this take place and what are the requirements?</td>
</tr>
<tr>
<td>• Who will provide the budget?</td>
<td>• What is the budget for the reports (consider any cost saving measures on design, printing, etc.)?</td>
</tr>
</tbody>
</table>
Phase 3: Identifying stakeholders

Identifying key stakeholders will be one of the key challenges of the process. Stakeholders are either groups or individuals that can be affected by a company’s business activities, outputs or outcomes, and where their actions could have an impact on the company’s ability to create value over time. Guidance on stakeholder engagement can be found in established benchmarks such as the AA1000 Stakeholder Engagement Standard (AA1000SES).9

The following diagram shows the typical stakeholders considered by a company when determining the boundary of an integrated report, i.e. the context of which the company needs to address in relation to risks, opportunities and outcomes.

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9The AA1000SES issued by AccountAbility is a generally applicable framework for the assessment, design, implementation and communication of quality stakeholder engagement. AccountAbility is a global consulting and standards firm that works with business, governments, and multilateral organisations to advance business practices and long term performance.
Good communication with key internal and external stakeholders is vital throughout all five phases. The information provided to the stakeholders must be determined by what is material for the specific stakeholder group.

**Phase 4: Gathering and consolidating the information**

In order to decide what information to gather for an integrated report, materiality needs to be considered by a company.

In integrated reporting, a matter is material if it could substantially affect the company’s ability to create value in the short, medium or long term. The process of gathering and consolidating the information however depends on each specific company based on industry and other factors as well as from multi-stakeholder perspectives. The materiality should also be taken into consideration in setting the company’s goals and strategy as this would allow the board to be prepared for any challenges or risks that they could encounter in their value creation process.

Embedding the materiality determination process into management process can enhance the effectiveness of decision making and reporting. The <IR> Framework provides guidance for shaping the materiality content of the integrated report. The following diagram provides a summary of the steps involved in shaping and setting the reporting boundary and determining the disclosures

![Diagram showing the steps in shaping and setting the reporting boundary and determining disclosures](image)

**Source:** Materiality in <IR> guidance for the preparation of integrated reports 2015, IIRC

It is also imperative that the company considers how the existing reports such as internal reports, sustainability reports and financial statements could fit into the integrated reporting process so as to ensure there is no duplication of information nor overburdening of resources. Quantitative and qualitative indicators, such as key performance indicators ("KPIs") and targets or indicative values, and the context in which they are provided, can help to explain how a company creates value and how it uses and affects various capitals (see page 23 of this Pull-out).

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10 Materiality is the principle of identifying and assessing a wide range of relevant matters, and refining them to what are most important to the company for value creation.

11 Materiality in <IR> Guidance for the preparation of integrated reports 2015, IIRC
Phase 5: Preparing the integrated report

The <IR> Framework provides guidance on the Content Element which identifies information to be included in an integrated report, as briefly explained in Appendix I of this Pull-out. Companies should consider and reflect the company’s business activities and processes in producing an integrated report.

How can companies prepare an integrated report, guided by the Content Elements as contained in the <IR> Framework?

In preparing an integrated report, companies may draw guidance from the following eight Content Elements:

Content Element 1: Company overview and external environment

The integrated report should provide an overview of what the company does and under which environment it operates. In providing the company overview, the company should first identify the following:

- the company’s:
  - culture, ethics and values;
  - ownership and operating structure;
  - principal activities and markets;
  - competitive landscape and market positioning (considering factors such as the threat of new competition and substitute products or services, the bargaining power of customers and suppliers, and the intensity of competitive rivalry); and
  - position within the value chain;
- quantitative and qualitative information that is key to the company (e.g. the number of employees, revenue and number of countries in which the company operates), highlighting, in particular, significant changes from prior periods; and
- factors that significantly affect the external environment and the company’s response.

Significant factors impacting the external environment of a company include legal, commercial, social, environmental and political issues that affect the company’s ability to create value in the short, medium or long term.

Stakeholder needs, macro and micro economic conditions, political and economic stability as well as market forces such as competition and demand from customers, for instance, are some factors that can impact the company either directly or indirectly (e.g. by influencing the availability, quality and affordability of a capital that the company uses or affects). These factors may vary based on each individual company’s business activities, industry and region which it operates in.
Content Element 2: Governance

The company should provide an explanation on how the current governance structure supports its ability to create value in the short, medium and long term.

The integrated report must provide details on the company’s leadership structure, the skillset of its board and executive management, the diversity of its members, (e.g. range of backgrounds, gender, competence and experience) the people responsible for the governance within the company and which regulatory requirements influenced the design of the governance structure.

The integrated report must highlight the processes used in implementing strategic decisions, creating and monitoring the company’s culture, including the company’s risk appetite and the mechanisms in place to address issues relating to integrity and ethics. Information on the steps and measures taken to influence and monitor the company’s strategic direction along with the risk management in place should be provided together with the explanation on the company’s relationship with its key stakeholders. The following illustrative disclosure provides an example on a governance framework of a South African conglomerate.

Source: Sasol Limited, Integrated Report, 2016 (South Africa)

12 The International <IR> Framework. 2013, IIRC
Content Element 3: Business model

A company’s business model is a setup of transforming inputs, through its business activities, into outputs and outcomes that aims to satisfy the company’s strategic need and create the desired value over the short, medium and long term.

Factors that could improve the quality and readability of the articulation on the business model include the following:

- recognising the specific elements of the business model;
- providing a diagram illustrating the key elements and providing relevant explanations to the elements;
- ensuring there is a logical flow to the writing; and
- identifying the crucial factors affecting the external environment of the company including but not limited to the needs of stakeholders.

The diagram below provides an example of how the reporting for a business model could be accomplished.

Source: Sasol Limited 2016, Integrated Report (South Africa)

This illustration shows how the various inputs were incorporated into the business and delivered through outputs and outcomes allowing the reader to fully understand the company’s business model in a clear and concise manner.

Content Element 4: Risk and opportunities

The company should articulate the risks and opportunities faced by the company and state how it would mitigate the risks and take advantage of the opportunities. It is important for a company to understand what factors have a material impact on its long-term value creation. Integrated reporting provides stakeholders with a better understanding of what the risks to the business are and how the company would respond to them. The illustrative disclosure on the following page provides an example of a risk management process and its residual risk rating disclosed by a South African company.
Linking the issues across the report will allow for the disclosure to focus on the most material issues. If an issue is identified as a key risk or opportunity, the strategy and performance in managing it should also be explained, together with future outlook and governance process. If management finds it difficult to explain this information, they should ask themselves whether they are reporting on issues that are of only peripheral relevance.
Content Element 5: Strategy and resource allocation

A company should identify its strategic direction and allocate resources (means) to ensure it gets there (ends). There should be a link between the operational and functional risks and the opportunities identified elsewhere in the report along with the strategy. The results should be a mix of information covering the company’s short-term operational strategy and long-term strategic vision for the business.

In setting the company’s goals, the board and management should consider the following:

- clearly identify the overall company’s short, medium and long-term goals and outline how to achieve the said goals;
- ensure discussion on strategy and resources includes consideration of internal and external factors that could impact the business including future market trends;
- identify the resources available to the company; and
- provide a roadmap on the actions or plans taken by the company to achieve its short, medium and long-term goals.

The integrated reporting framework allows companies to reflect upon their business model and implement changes as deemed necessary.

The table below and illustrative disclosure on the following page provide an example of how a global conglomerate explains its strategy by showcasing its objectives and initiatives undertaken to achieve the objectives:

<table>
<thead>
<tr>
<th>Strategic Pillars</th>
<th>We focus on our four strategic pillars – Community trust, Consumer relevance, Customer preference and Cost leadership - that encompass the key areas of our business. While these strategic pillars are fundamental to our vision and do not change, we have adapted our initiatives to take full advantage of the growth era that we believe the economy is entering. The KPI to measure our progress during the period 2016-2020 are our scorecard.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initiatives</td>
<td>All our operations in 28 countries work towards the same objectives: drive volume growth, focus on value, improve efficiency and invest in the business by implementing initiatives that are designed centrally. These initiatives are adjusted to respond to local demographics, economies and market characteristics in order to manage growth.</td>
</tr>
<tr>
<td>Scorecard</td>
<td>We have five KPIs that are chosen to measure our progress. We report on these every year.</td>
</tr>
</tbody>
</table>
Community trust
We help our communities thrive, impacting their lives positively by making economic, social and environmental contributions.

Consumer relevance
Consumer preference
We work hard to remain relevant for our consumers and be the preferred supplier to our customers.

Cost leadership
We aspire to be a cost leader and make the necessary investments to sustain this leadership.

Strategic pillars

Objectives

Initiatives
1. Expand and deepen route-to-market
2. Execute in-store with excellence
3. Create joint value with customers
4. Drive the water category, focusing on value
1. Capitalise on meals and socializing occasions for sparkling drinks
2. Increase share of single-serve packs, driving transactions
3. Improve performance in hotels, restaurants and cafes (HoReCa)
4. Grow in the energy category
5. Drive pricing strategies
1. Continue production infrastructure and logistics optimisation
2. Capitalise on contiguous territory and Emerging market opportunities
3. Utilise shared services to gain process efficiency
4. Drive packaging harmonisation and innovation (light-weighting)
1. Invest in revenue-generating assets and innovative technology
2. Acquire water and juice brands in existing territory
3. Maintain negative working capital balance sheet position

Scorecard
Average currency-neutral revenue growth
4-5% p.a
Comparable OpEx as % of revenue
26-27% by 2020
Comparable EBIT
11% by 2020
Capital expenditure
5.5-6.5% of revenue
Working capital less than
-€100m

Enablers and values

Our people
Our most important enablers to growth are our people: unparalleled talent and a high-performance mindset are what we strive for.

Our people make our Company what it is and create value by growing our business responsibly and sustainably. Strengthening the capabilities of our people as well as engaging them and rewarding them appropriately are priorities at every level of our Company, enabling us to continue to attract and retain the best talent.

Adapted from Coca-Cola Hellenic Bottling Company 2016, Annual integrated report (Switzerland)
Content Element 6: Performance

The integrated report should contain qualitative and quantitative information about the company’s performance and value creation. It should describe current levels of performance both as a basis for assessing progress in delivering management’s strategic targets and as a base for understanding the future outlook for the business.

The information that may be included in the report is outlined below:

- quantitative indicators in relation to targets, risks and opportunities, explaining their significance, their implications, and the methods and assumptions used in compiling them;
- the company’s effects (both positive and negative) on the capitals, including material effects on capitals up and down the value chain;
- the relationship between the company and its key stakeholders and how the company has responded to key stakeholders’ legitimate needs and interests; and
- the connection between past and current performance, and between current performance and the company’s outlook.

Besides providing an understanding of the underlying business returns, current performance information also helps readers understand the implications for future performance. The focus of the report must be on identifying and explaining performance variances – in particular the strategic objectives management has self-imposed.

The relevant measures will often be operational rather than financial in nature and this requires the report to maintain a balanced view, written from an operational perspective. The logic of integrated reporting means that any gaps in the reporting of strategically important performance will be immediately apparent to readers.

The example on the following page illustrates a clear and concise reporting of performance by a company in the United Kingdom.
## Group Financial Objectives

<table>
<thead>
<tr>
<th>Objective</th>
<th>KPIs</th>
<th>2016/17 Performance (23 weeks to 1 April 2017)</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grow Group revenue</td>
<td>GROUP REVENUE</td>
<td>Total Group revenue, including retail sales for owned businesses and wholesale sales to franchise partners.</td>
<td>Group revenues were up this year, mainly driven by the growth in our Food business as we opened new stores and an improvement in International revenues.</td>
</tr>
<tr>
<td>Increase earnings and returns</td>
<td>GROUP PROFIT BEFORE TAX (PBT) AND ADJUSTED ITEMS</td>
<td>Adjusted profit provides additional information on performance, adjusting for items considered to be significant in nature and/or value.</td>
<td>Group PBT before adjusted items was down on last year largely due to the reduction in Clothing &amp; Home gross profit and the increase in operating costs in the year.</td>
</tr>
<tr>
<td></td>
<td>RETURN ON CAPITAL EMPLOYED (ROCE)</td>
<td>Return on capital employed is a relative profit measure of the returns from net operating assets.</td>
<td>The decrease in ROCE primarily reflects the decrease in earnings before interest, tax and adjusted items.</td>
</tr>
<tr>
<td></td>
<td>ADJUSTED EARNINGS PER SHARE (EPS)</td>
<td>Adjusted earnings per share (EPS) is the profit before the impact of adjusted items divided by the weighted average number of ordinary shares in issue.</td>
<td>Basic adjusted EPS decreased primarily due to the lower profit generated in the year. The weighted average number of shares in issue during the period was 1,623.1m (last year 1,635.9m).</td>
</tr>
<tr>
<td></td>
<td>DIVIDEND PER SHARE</td>
<td>Dividend per share declared in respect of the year.</td>
<td>The Board is recommending a final dividend of 11.9p per share, resulting in a total dividend of 18.7p.</td>
</tr>
</tbody>
</table>

## Non-Financial Objectives

<table>
<thead>
<tr>
<th>Objective</th>
<th>KPIs</th>
<th>2016/17 Performance</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engage, serve and retain our customers</td>
<td>FOOD</td>
<td>Total number of UK Food customers per year and average number of shops per customer resulting in a purchase across all UK shopping channels.</td>
<td>Our convenient, special and different food and our continued Simply Food store opening programme continue to draw customers in.</td>
</tr>
<tr>
<td></td>
<td>CLOTHING &amp; HOME</td>
<td>Total number of UK Clothing &amp; Home customers per year and average number of shops per customer resulting in a purchase across all UK shopping channels.</td>
<td>We are still in the recovery phase of our plan for Clothing &amp; Home. We grew the number of customers shopping through M&amp;S.com but this was more than offset by a decline in customers in our stores.</td>
</tr>
<tr>
<td>Foster a skilled, motivated and engaged team</td>
<td>EMPLOYEE ENGAGEMENT</td>
<td>Engagement is a key driver of performance. Our You Say survey looks at the key drivers of employee engagement such as pride in M&amp;S and our products, feelings about M&amp;S as an employer and the role of the Board in the management of the company.</td>
<td>The annual survey was completed by 80% of employees. Employee engagement results were positive and up on last year.</td>
</tr>
<tr>
<td>Source products with integrity</td>
<td>PRODUCTS WITH A PLAN A QUALITY</td>
<td>This is a quality or feature regarded as a characteristic or inherent part of a product which has a demonstrable positive or significantly lower environmental and/or social impact during its sourcing, production, supply, use and/or disposal.</td>
<td>This represents an improvement of 6%. Our target is to have at least one Plan A quality in all M&amp;S products by 2020.</td>
</tr>
</tbody>
</table>

Source: Marks and Spencer Group PLC Annual Report 2017 (United Kingdom)
Content Element 7: Outlook

Integrated report highlights the anticipated changes over time and provides information based on sound and transparent analysis on the company’s expectations about the external environment and how well equipped is the company to meet the challenges that lie ahead.

The outlook should help the reader form their own views on the future of the company. The illustrative disclosure below provides an example on how the company could provide an outlook for the next financial year.

Illustrative disclosure

Strategic priorities and future outlook for next financial period

- Organic growth is expected to be boosted by new product launches and possible bolt-on product acquisitions in targeted therapeutic areas. Following the success of current second brands/clones launches, additional co-marketing arrangements will be explored.
- In the quest to reduce complexity within the business, the Pharmaceutical and Consumer divisions of this business will be streamlined into a single structure to drive synergies. Focus on infant nutritionals continues with plans to achieve further growth through the various stages of infancy as well as ensuring reliable availability of products through all channels.
- The recent divestment of a product portfolio to Litha Pharma (Pty) Limited and acquisition of the Norgine business form part of Aspen’s ongoing strategic intent to focus attention on areas where most value can be added and to lessen complexity.

Source: Aspen Holdings 2015 Integrated Report (South Africa)

Content Element 8: Basis of preparation and presentation

The integrated report should provide clarity on how the company determines what matters would be included in the report and how they are evaluated and qualified.

The integrated report should contain a clear explanation on the process and application undertaken by the board and management in identifying material matters. The following steps should be taken to identify the material matters:

- establish parameters for the materiality determination process;
- ensure all matters are filtered to identify and evaluate their relevance, importance and prioritised accordingly;
- set the reporting boundaries; and
- determine the disclosures to be included in the integrated report.

Point for reflection

Integrated reporting was not created to replace the existing reporting frameworks. The <IR> framework provides a seamless integration of other standards and frameworks to help provide a complete and coherent view of the value creation process of a company. Further information on the <IR> Framework can be found at https://integratedreporting.org/.
**Regional/international perspectives**

Alongside Malaysia, countries such as South Africa and Philippines have enumerated provisions on integrated reporting premised on the need to provide stakeholders with a clear articulation of a company’s value creation.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>The governing body should oversee that the organisation issues an integrated report at least annually, which is either:</td>
</tr>
<tr>
<td></td>
<td>a. A standalone report which connects the more detailed information in other reports, and addresses at a high level and in a complete, concise way, the matters that could significantly affect the organisation’s ability to create value; or</td>
</tr>
<tr>
<td></td>
<td>b. A distinguishable, prominent and accessible part of another report which also includes the annual financial statements and other reports that must be issued in compliance with legal provisions. (<strong>Principle 5, Recommended Practice 12</strong>)</td>
</tr>
<tr>
<td>Philippines</td>
<td>The company should ensure that the material and reportable non-financial and sustainability issues are disclosed. (<strong>Principle 10</strong>).</td>
</tr>
<tr>
<td></td>
<td>The Board should have a clear and focused policy on the disclosure of non-financial information, with emphasis on the management of economic, environmental, social and governance (EESG) issues of its business, which underpin sustainability. Companies should adopt a globally recognized standard/framework in reporting sustainability and non-financial issues (<strong>Recommendation 10.1</strong>).</td>
</tr>
</tbody>
</table>

**Explanation**

As external pressures including resource scarcity, globalization, and access to information continue to increase, the way corporations respond to sustainability challenges, in addition to financial challenges, determines their long-term viability and competitiveness. One way to respond to sustainability...
challenges is disclosure to all shareholders and other stakeholders of the company’s strategic (long-term goals) and operational objectives (short-term goals), as well as the impact of a wide range of sustainability issues.

Disclosures can be made using standards/frameworks, such as the G4 Framework by the Global Reporting Initiative (GRI), the Integrated Reporting Framework by the IIRC and/or the Sustainability Accounting Standards Board (SASB)’s Conceptual Framework *(Principle 10, Recommendation 10.1).*
Notice of general meeting

MCCG Intended Outcome 12.0
Shareholders are able to participate, engage the board and senior management effectively and make informed voting decisions at General Meetings.

MCCG Practice 12.1
Notice for an Annual General Meeting should be given to the shareholders at least 28 days prior to the meeting.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why
The case for change

The importance of general meetings cannot be understated as they have a far-reaching impact on a company’s strategic direction. The two commonly held general meetings that allow shareholders to exercise their rights, are the AGM and EGM.

The AGM is an annual gathering of shareholders and the board of directors of a company, whereby resolutions such as election or re-election of directors, remuneration of directors and appointment of external auditors are tabled. The EGM meanwhile is a meeting that is called by the directors or any member holding at least 10% of the issued share capital of the company to pass a resolution that requires the immediate attention of shareholders.

These meetings provide an avenue for shareholders to communicate directly with the board of directors and are often viewed by shareholders, especially the minority shareholders, as one of the few occasions whereby they can engage in a meaningful discussion with the board.

Given the significance of general meetings, it is essential for the notice of these meetings to be provided to shareholders in a timely manner to accord them with sufficient time to consider the resolutions that will be discussed and decided at the general meeting. Practice 12.1 of MCCG calls upon companies to provide at least 28 days’ notice period for AGMs on the premise of empowering shareholders with sufficient preparation time to make informed voting decisions at general meetings. The need for a longer notice period also reflects the ongoing changes in the capital market which is characterised, amongst others, by globalisation (greater participation of foreign investors in the domestic market), increasing volume of information reported and rising complexity of transactions – all of which necessitates greater preparation time by shareholders.

The pertinent regulatory requirements on the requisitioning of general meetings including the prescribed duration for the notice of general meetings are outlined on the following page.
Section 310 of Companies Act 2016

A meeting of members may be convened by –

(a) the Board; or

(b) any member holding at least ten per centum of the issued share capital of a company or a lower percentage as specified in the constitution or if the company has no share capital, by at least five per centum in the number of the members.

Section 311(3) of Companies Act 2016

The directors shall call for a meeting of members once the company has received requisition to do so from –

(a) members representing at least ten per centum of the paid up capital of the company carrying the right of voting at meetings of members of the company, excluding any paid up capital held as treasury shares; or

(b) in the case of a company not having a share capital, members who represent at least five per centum of the total voting rights of all members having a right of voting at meetings of members.

Section 316(2) of Companies Act 2016

A meeting of members of a public company, other than a meeting for the passing of a special resolution, shall be called by notice –

(a) in the case of an annual general meeting, at least twenty-one days or any longer period specified in its constitution; and

(b) in any other case, at least fourteen days or any longer period specified in its constitution.

Section 319(1) of Companies Act 2016

Notice of a meeting of members shall be in writing and shall be given to the members either –

(a) in hard copy;

(b) in electronic form; or

(c) partly in hard copy and partly in electronic form.

Paragraph 7.15 of Bursa Securities Listing Requirements

The notices convening meetings shall specify the place, day and hour of the meeting, and shall be given to all shareholders at least 14 days before the meeting or at least 21 days before the meeting where any special resolution is to be proposed or where it is an annual general meeting. Any notice of a meeting called to consider special business shall be accompanied by a statement regarding the effect of any proposed resolution in respect of such special business. At least 14 days’ notice or 21 days’ notice in the case where any special resolution is proposed or where it is the annual general meeting, of every such meeting must be given by advertisement in at least 1 nationally circulated Bahasa Malaysia or English daily newspaper and in writing to each stock exchange upon which the company is listed.
Even before Practice 12.1 of MCCG was introduced, it should be noted that several listed issuers have already voluntarily provided a longer duration of AGM notice period as opposed to the minimum mandated period of 21 days [as stated in Section 316(2) of Companies Act 2016], to their shareholders. As stated in the publication by the Minority Shareholder Watchdog Group (“MSWG”), the average notice period for AGMs by listed issuers stood at 24 days in 2015¹.

**Point for reflection**

It is common for listed issuers in Malaysia to include the notice of AGM in their annual report with cross-referencing of the relevant content in the notice, to the annual report. The increasingly voluminous and complex content of annual reports has resulted in the need for additional lead time for shareholders to extract and comprehend the relevant information so as to formulate an informed voting decision².

**The practice in substance**

It is therefore clear that an extended notice period with detailed information in the notice and accompanying materials could go a long way in encouraging greater shareholder participation at general meetings.

Key considerations relating to the application of this Practice are discussed below:

**How should the notice of general meetings be disseminated?**

As stated in Section 319(1) of Companies Act 2016, notice of general meetings should be given to shareholders in writing via hardcopy or electronic format or a combination of both. In addition, for listed issuers, the notice must be given by advertisement in at least 1 nationally circulated Bahasa Malaysia or English daily newspaper and in writing to the stock exchange (paragraph 7.15 of Bursa Securities Listing Requirements).

In deciding how to disseminate the notice, the company should take into consideration the time taken for the notice to reach its shareholders. Circulation via electronic means (e.g. e-mail, company website) typically expedites the delivery of the notice. In the event the company decides to make the notice available on the website, the company should be cognisant of Section 320(3) of Companies Act 2016 which requires such notice to be made available from the date of notification until the conclusion of the general meeting, as well as paragraph 2.19B of Bursa Securities Listing Requirements relating to issuance of documents by electronic means for listed issuers.

**What should be encapsulated in the notice of general meetings?**

Guidance on the notice of a general meeting can be found in the regulatory requirements, as outlined on the following page.

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¹ Rita, B & Salleh, H, 2015, Report on AGM Practices by Malaysian Companies, MSWG
² Bin the clutter, 2015, Association of Chartered Certified Accountants (“ACCA”)
Section 317(1) of Companies Act 2016

Notice of a meeting of members of a company shall state –

(a) the place, date and time of the meeting; and
(b) the general nature of the business of the meeting.

Paragraph 8.27 of Bursa Securities Listing Requirements

(1) A listed issuer must ensure that all notices convening general meetings contain sufficient information to enable a member to decide whether to attend the meeting.

(2) Without limiting the generality of subparagraph (1) above, a listed issuer must ensure that a notice convening an annual general meeting, where applicable, is accompanied by a statement which includes the information set out in Appendix 8A.

(3) Any notice of a general meeting called to consider special business must be accompanied by an explanatory note which contains the necessary information to enable a member to make an informed decision. Such explanatory note must include the effect of any proposed resolution in respect of such special business.

Appendix 8A of Bursa Securities Listing Requirements

Contents of statement accompanying notices of annual general meetings (paragraph 8.27(2))

1. Further details of individuals who are standing for election as directors (excluding directors standing for a re-election), namely the following:

   (a) the name, age, gender, nationality, qualification, and whether the position is an executive or non-executive one and whether such director is an independent director;
   (b) the working experience and occupation;
   (c) any other directorships in public companies and listed issuers;
   (d) the details of any interest in the securities of the listed issuer and its subsidiaries;
   (e) the family relationship with any director and/or major shareholder of the listed issuer;
   (f) any conflict of interests that they have with the listed issuer; and
   (g) other than traffic offences, the list of convictions for offences within the past 5 years and particulars of any public sanction or penalty imposed by the relevant regulatory bodies during the financial year, if any.

2. A statement relating to general mandate for issue of securities in accordance with paragraph 6.03(3)\(^3\) of these Requirements.

Note: In the case of specific matters tabled for approval at general meetings which require the issuance of a circular to shareholders under Bursa Securities Listing Requirements (e.g. corporate proposals undertaken, or transactions entered into, by listed issuers), the notice of meetings must be accompanied by such circulars which contain information as prescribed in Bursa Securities Listing Requirements.

\(^3\) This paragraph stipulates the information that must be included in a statement accompanying the proposed resolution on a general mandate for issue of securities.
As stated in Guidance to Practice 12.1 of MCCG, “The notice should provide further explanation beyond the minimum content stipulated in the listing requirements for the resolution proposed to enable shareholders to make an informed decision in exercising their voting rights. The notice should include details of the resolutions proposed along with any background information and reports or recommendations that are relevant.”

A typical AGM notice would contain the following:

1. Time, date and location of the meeting
   
   It is important for companies to ensure that the aforementioned information is clearly provided in the notice. Once decided, any changes made to the location, date or the time of the meeting should be communicated to all shareholders.

2. Resolutions that are tabled for approval
   
   A resolution is a motion tabled by the board or the shareholders (also known as members) of the company to be voted for at the general meeting. There are typically two types of resolutions tabled during general meetings:

   - ordinary resolution: where a simple majority of more than half of the members who are entitled to vote is required (as outlined in Section 291 of Companies Act 2016); and
   - special resolution: to be passed by majority of not less than 75% of the members entitled to vote at the meeting (as outlined in Section 292 of Companies Act 2016).

   The company should explain and justify to shareholders on why the resolutions were proposed and how the board has evaluated the proposals. In this regard, the current state of disclosure warrants considerable improvement. According to a publication by MSWG (2015), only 19% of listed issuers in Malaysia provided detailed explanation to shareholders on each agenda item that was sought to be approved at the general meeting⁴.

An illustrative disclosure providing explanation for a resolution to approve the payment of a director’s remuneration is outlined on the following page (note: Singtel Ltd of Singapore, in its Notice of AGM for the year 2017 has provided explanation on the bases for arriving at the proposed amount of the chairman’s remuneration).

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⁴ Rita, B & Salleh, H, 2015, Report on AGM Practices by Malaysian Companies, MSWG
Illustrative disclosure

In arriving at the proposed Chairman’s fees of S$960,000, the Company took into account:

a) The significant leadership role played by the Chairman on the Board, and in providing clear oversight and guidance to management;

b) The amount of time the Chairman spends on Singtel matters, including providing input and guidance on strategy and supporting management in engaging with a wide range of other stakeholders such as partners, governments and regulators, as well as travelling to visit the Group’s key associates in the region. In this regard, the Board has agreed with the Chairman that he will commit a significant proportion of his time to his role as Chairman of the Singtel Board and will manage his other time commitments accordingly; and

c) Comparable benchmarks from other large listed companies in Singapore that have chairmen with similar roles and responsibilities, as well as benchmarks from large listed companies in Australia, where Singtel has sizeable operations.

Additional information on the role of the Chairman can be found under ‘Corporate Governance’ in the Company’s Annual Report 2016.

Source: Notice of Annual General Meeting Singtel Ltd (Singapore) for the AGM in 2017

3. Voting procedures at the meeting

Shareholders should be notified of their rights and the mechanisms that can be deployed in exercising their rights. Paragraph 8.29A(1) of Bursa Securities Listing Requirements requires any resolution set out in the notice of a general meeting by a listed issuer to be voted by poll. In line with international developments, many listed issuers have adopted electronic voting as means of carrying out poll voting (covered in the write-up to Practice 12.3). In accordance with paragraph 8.29A(2) of Bursa Securities Listing Requirements, the listed issuer is also required to appoint at least 1 scrutineer to validate the votes cast at the general meeting.

To this end, shareholders should be furnished with relevant information on the voting procedures to facilitate a seamless proceeding during the general meeting.

It is also important for shareholders to be informed of their legal right to appoint a proxy to attend the meeting on their behalf, including to ask questions and vote on behalf of the shareholders (note: Section 334 of Companies Act 2016 provides detailed explanation on the rights of a shareholder in appointing a proxy for general meetings). In this regard, a copy of the proxy form should be provided alongside the notice for the ease of shareholders.
Regional/international perspectives

As in the case of Malaysia, countries such as United Kingdom and Australia call for a longer notice period in recognition of the need to ensure that shareholders are given sufficient notice and time to consider the resolutions that will be discussed and decided at the general meetings.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting. For other general meetings this should be at least 14 working days in advance (Provision E.2.4).</td>
</tr>
<tr>
<td>Australia</td>
<td>Amount of notice of meetings of listed company:</td>
</tr>
<tr>
<td></td>
<td>1) Despite section 249H, at least 28 days’ notice must be given of a meeting of a company’s members.</td>
</tr>
<tr>
<td></td>
<td>2) This section only applies to a company that is listed.</td>
</tr>
<tr>
<td></td>
<td>3) This section applies despite anything in the company’s constitution.</td>
</tr>
<tr>
<td></td>
<td>(Section 249HA)</td>
</tr>
</tbody>
</table>

5 Amount of notice of meetings for a non-listed company
Attendance of directors at general meetings

MCCG Intended Outcome 12.0
Shareholders are able to participate, engage the board and senior management effectively and make informed voting decisions at General Meetings.

MCCG Practice 12.2
All directors attend General Meetings. The Chair of the Audit, Nominating, Risk Management and other committees provide meaningful response to questions addressed to them.

(The application of this Practice in its entirety entails the attendance of all directors at General Meetings and the provision of meaningful response by the Chair of the Audit, Nominating, Risk Management and other committees to the questions addressed to them.)

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

Why
The case for change
Good corporate governance to a large extent depends on the role played by directors as stewards of the company. Directors are expected to maintain a high level of professionalism and integrity in steering management to achieve long-term business sustainability whilst reinforcing its accountability to shareholders.

Observations over the recent years have shown that shareholders are becoming increasingly unrelenting in their push for better disclosure and transparency from directors. General meetings are typically regarded as one of the few available avenues for shareholders to communicate directly with the board, and hence, it is paramount for directors to be present during these meetings to attend to shareholders’ questions and concerns.

The participation of all board members in general meetings will serve to distribute the responsibility of engaging with shareholders, to all directors of the company and not just the chairman of the meeting. This would enable the board to communicate with shareholders in a more holistic manner. In a similar vein, it also provides shareholders with an opportunity to seek pertinent clarifications from directors who are acting as custodians of their investments.

What could go wrong:
- Shareholders could perceive that a director is not committed in performing his or her responsibilities to the company if the said director is not in attendance during the general meetings.
- Communication between the board and its shareholders is ineffective which leads to unhealthy relationship between both parties.
- A director may not be re-elected during the general meetings although he or she may have contributed effectively to the board during the preceding year(s).
The practice in substance

It is therefore clear that all directors should attend the company’s general meetings with the chairmen of board committees being present to facilitate discussion on matters such as audit, nomination, remuneration and risk management.

Key considerations relating to the application of this Practice are discussed below:

**How can communication between board committees and shareholders be enriched during general meetings?**

Issues such as board composition, directors’ remuneration and financial performance are key areas which shareholders typically have a keen interest in. To this end, shareholders expect the directors who are directly involved in those committees to be present at general meetings and provide meaningful explanation or responses to questions addressed to them.

For example, the chairman of the nominating committee should provide an explanation on the review undertaken in recommending the appointment of new directors to the board. In this regard, the chairman of the nominating committee should disclose during the general meeting on how the nominating committee assessed the candidate and why the board finds him or her suitable for the said role. This in turn would allow shareholders to make informed decisions in casting their votes.

The aforementioned scenario also applies to the other board committees. Although the depth of communication may vary between companies, there should be a conscious effort made by companies during the general meeting to keep shareholders apprised of the activities of the various board committees.

**Dos**

- Carrying out advance planning and avoiding overlaps with the AGM dates of other companies that the directors serve on.
- Taking the opportunity of the occasion by interacting with shareholders before and after the general meetings, not just during the said meetings. This will help companies to gather insights from shareholders that would not normally be raised via formal channels.
- Providing explanation on why a director was unable to attend the AGM if he or she is not in attendance.

**Don’ts**

The following would render the application of this practice ineffective:

- Reading out statements from the annual report to shareholders as a form of presentation without providing any additional information to shareholders.
- Having multiple general meetings of various subsidiary companies on the same day. This could lead to expedited meetings without thorough consideration of issues.
How can interaction during general meetings be improved?

It is commonly observed that questions posed by shareholders are predominantly answered by the chairman of the board (who also presides the general meeting) or the chief executive officer. In this context, as mentioned in the preceding page, the active participation of the chairmen of the various board committees would go a long way in making these meetings more interactive and informative to shareholders. Shareholders would be able to gather first hand views from the board committee members who have a deeper understanding of the relevant subject matters.

It is also essential for the board (including the board committees) to prepare adequate responses to any questions that have been submitted by shareholders in advance of the general meetings. This would allow “question and answer” sessions during the general meeting to be more productive with insights from both the directors as well as the shareholders.

In addition, in line with better practices such as that in Australia\(^2\), the board should ensure that the external auditor attends the AGM and is available to answer questions that are relevant to the audit process. It is important for companies to ensure that the partner signing the audit report or a representative of the external audit firm has sufficient information and experience to provide an adequate response to any question raised on audit matters.

Apart from the above, companies should also be guided by the recommendations set out in the section on “Improving directors’ participation” in the Introduction to this Pull-out III. Additionally, companies should refer to the guidance set out in Section 3.7 and Section 3.8 of the Best Practice Guide on AGMs for Listed Issuers, 2016\(^3\) in dealing with shareholders at the AGM and the role of external auditors during the AGM, respectively.

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2. Australian Stock Exchange Corporate Governance Council’s Corporate Governance Principles and Recommendations, Recommendation 4.1
3. Best Practice Guide on AGMs for Listed Issuers, 2016, was issued by the Malaysian Institute of Chartered Secretaries and Administrators (“MAICSA”) with the support of Bursa Malaysia Berhad
Regional/international perspectives

As with Malaysia, selected jurisdictions including United Kingdom and Singapore have enumerated provisions for directors to be present at general meetings in order to engage with shareholders.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend (Provision E.2.3).</td>
</tr>
<tr>
<td>Singapore</td>
<td>All directors should attend general meetings of shareholders. In particular, the chairman of the board and the respective chairmen of the audit committee, nominating committee and remuneration committee should be present and available to address shareholders' queries at these meetings. The external auditors should also be present to address shareholders' queries about the conduct of audit and the preparation and content of the auditors’ report (Guideline 16.3).</td>
</tr>
</tbody>
</table>
Electronic voting

MCCG Intended Outcome 12.0
Shareholders are able to participate, engage the board and senior management effectively and make informed voting decisions at General Meetings.

MCCG Practice 12.3
Listed companies with a large number of shareholders or which have meetings in remote locations should leverage technology to facilitate –

- voting including voting in absentia; and
- remote shareholders’ participation at General Meetings.

(The application of this Practice in its entirety entails the following two actions by listed companies with a large number of shareholders:

- **leveraging on technology to facilitate voting including voting in absentia;** and
- **leveraging on technology to facilitate remote shareholders’ participation at General Meetings.**

⚠️ The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why** The case for change

General meetings serve as a key platform for shareholders to exercise their rights and hold directors accountable for their actions. It is an avenue for shareholders to challenge the board on issues of concern, discuss strategies for achieving the companies’ goals and objectives and have their “voices” heard through the votes cast by them.

Traditionally, voting during general meetings has been carried out either by a show of hands, which represents “one person, one vote” or by poll, which is reflective of an individual or entity’s shareholding of the company (“one share, one vote”).

A transition to full-fledged poll voting in Malaysia took place in the year 2016 whereby Bursa Securities Listing Requirements were amended to require resolutions in a general meeting, to be voted by way of poll.

**What could go wrong:**

- Lack of communication between the board and shareholders which results in an unhealthy relationship (caused by poor participation of shareholders at general meetings).
- Inability of the company to gather meaningful feedback of shareholders, thus, representing a missed opportunity for the company to leverage on insights of shareholders.

**Paragraph 8.29A(1) of Bursa Securities Listing Requirements**

A listed issuer must ensure that any resolution set out in the notice of any general meeting, or in any notice of resolution which may properly be moved and is intended to be moved at any general meeting, is voted by poll.
Whilst the rights of shareholders to attend, speak and vote at general meetings are well-defined in the law, there are many constraints that pose a challenge in the exercise of their rights. These include the common practice of voting at general meetings which has to be cast through the physical attendance of shareholders or proxies. In certain instances, the location of the meeting itself can be a hindrance. Some companies have held their meetings without giving due consideration to shareholder demographics and accessibility. This may deter shareholders from attending or they may appoint a proxy to attend on their behalf instead.

It is therefore incumbent on companies to undertake measures, including facilitating voting in absentia to encourage greater shareholder participation during general meetings. Voting and participating in absentia would be particularly helpful for foreign shareholders or shareholders who are relatively distanced from the venue of general meeting, to exercise their rights.

In addition, companies, particularly those with a large shareholding base should consider adopting electronic voting (explained in detail in the ensuing pages of this write-up) as this would enable the proceedings to be managed in a more seamless manner when there is a high turnout of shareholders for the general meeting.

**Point for reflection**

Whilst the adoption of electronic voting will result in an outlay of initial costs, it is envisaged that companies may benefit from long term savings as electronic voting would substantially reduce administrative procedures and paper work as well as save time.

Additional benefits of electronic voting are outlined below:

- the electronic voting platform provides more reliable, transparent and faster results as compared to the manual counting of ballot papers;
- results are often tabulated and released at a faster pace (often within minutes after the voting process is completed); and
- the electronic voting process helps companies to reduce their carbon footprint by minimising the usage of paper.

It should be noted that the use of technology to facilitate the conduct of general meetings is permitted by **Companies Act 2016** subject to the company’s constitution.

**Section 327(1) of Companies Act 2016**

Subject to the constitution, a company may convene a meeting of members at more than one venue using any technology or method that enables the members of the company to participate and to exercise the members’ rights to speak and vote at the meeting.
How The practice in substance

As stated in Guidance to Practice 12.3 of MCCG, the board should take proactive measures to ensure that shareholders are able to participate in general meetings. In facilitating greater shareholder participation, it is important for the company to consider leveraging on technology such as webcast and/or electronic voting that could enhance the quality of engagement with shareholders.

Key considerations relating to the application of this Practice are discussed below:

What are the commonly used electronic voting methods?

The traditional poll voting involves a manual process of collecting and tabulating votes that are exercised via printed papers. This process typically takes a longer period of time and could lead to an extended general meeting session.

To this end, the electronic voting system serves as an alternative platform to expedite the voting and tabulation process. Whilst the manner in which the electronic voting process is carried out may vary from company to company, it may be useful to highlight the following electronic voting methods which are commonly deployed by companies:

- Voting via mobile application

  This method requires shareholders to download the e-voting application onto a mobile device, either via a mobile phone or tablet, and connect to a prescribed Wi-Fi network. A slip containing the code for shareholders will be issued upon registration. The shareholder will have to scan the slip to register for the voting process. When the chairman of the general meeting makes an announcement for the votes to be cast, the application allows shareholders to cast their votes from their mobile devices. The results are usually announced within 10-15 minutes upon conclusion of the voting.

- Voting via handheld device

  This process involves shareholders using a specific device provided upon registering for the meeting. The device would contain a card that carries the shareholder’s identity and number of shares registered. Similar to the mobile application, the device allows users to key in their voting options (for/against) for each resolution when the chairman makes an announcement for the votes to be cast. The results are shown at the end of voting for each resolution before moving on to the next resolution. Upon conclusion of the meeting, the devices are returned and the process is completed.

- Voting via polling stations

  This is a common platform for companies with a smaller shareholder base as it necessitates shareholders to line up and cast their votes via an electronic screen or a computer. Each shareholder would be provided with a wristband upon registration which would be scanned during the voting process. The scanned code allows the shareholder to access the voting page and register his or her vote. The process would then be completed and the results would be announced later.

Dos

- Investing in electronic voting platforms to enable greater participation of shareholders during general meetings.
- Enabling shareholders to participate in general meetings without being present at the meeting in person or by proxy.

Don’ts

- No proper consideration given to the location of the general meeting.
- Deliberately changing the location of general meetings year-on-year with the intention to discourage shareholder participation.
What are the challenges faced by shareholders in attending general meetings?

The following are common factors that contribute to shareholders’ inability to attend a general meeting:

- venue or location of the meeting is unable to cater to the crowd in attendance. Companies where attendance of shareholders are usually in large numbers should consider the comfort and welfare of their shareholders;
- insufficient parking or public transport access;
- competing general meetings of other companies that are scheduled on the same day;
- meeting is scheduled at remote location. According to a publication by MSWG in 2015, 5 listed issuers held their AGMs in “hard to reach” locations. In addition, 9 listed issuers held their AGMs at locations that were inaccessible by public transport⁵; and
- high cost of attending the meeting (especially when meeting requires shareholders to travel long distances).

How can a company leverage on technology to facilitate greater shareholders’ participation in general meetings?

The world took notice in 2016 when Jimmy Choo PLC (United Kingdom) attempted and successfully executed the first electronic AGM. The company was motivated to provide an opportunity for all of its shareholders to attend and participate in its AGM. The company worked together with Equiniti, the first registrar in United Kingdom to oversee a fully electronic AGM. The company also engaged with the regulatory authorities on how they could make the transition from a physical AGM to a full-fledged electronic AGM.

In order to cater to the needs of the general meeting, an application was developed to be used on a mobile, tablet or desktop. The application was integrated with the AGM registration system, allowing shareholders to submit questions and vote on the resolutions tabled during the meeting. A unique meeting code, known as the “meeting ID” was provided to each shareholder in order to access the system. A shareholder will not be permitted to enter the “virtual meeting” if his or her credentials could not be verified⁶. This allowed shareholders to be “present” during the meeting without actually having to be physically present at a venue. Shareholders were also free to raise questions prior to the meeting and receive responses in real time through the online platform.

Another country that has strived for greater participation by shareholders in general meetings is Taiwan. The Financial Supervisory Commission (“FSC”) has mandated all listed companies on the local main board and the over-the-counter market to adopt electronic-voting by the year 2018. This move was to allow shareholders who are unable to attend AGMs in person to participate in the voting process, especially when they have shareholdings in multiple listed companies that have competing AGMs on a particular day.

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¹ Rita, B & Salleh, H, 2015, Report on AGM Practices by Malaysian Companies, MSWG
² Annual General Meeting Practices 2016, Equiniti & Prism
³ Provision E.2.2 of United Kingdom’s Corporate Governance Code
The first introduction of the electronic voting platform in Taiwan was in 2009, whereby the Taiwan Depository & Clearing Corporation (“TDCC”), established an electronic voting platform called “StockVote”. This system allowed shareholders to cast their votes ahead of the general meetings.

The diagram below illustrates the process of electronic voting in Taiwan using the “StockVote” platform:

**Operations of “StockVote” platform:**

1. Companies would have to sign an agreement with “StockVote” and make an application each time they wish to use the electronic voting service provided by “StockVote”. Companies would also need to provide details of shareholders that are relevant to the voting process.

2. When shareholders receive their notice of the general meeting, they will be informed that the company deploys electronic voting and a certificate outlining the identification number will be provided to them.

3. Shareholders would then have to log-in to the “StockVote” platform and enter the identification number provided. Once the platform verifies their identification, shareholders are allowed to view the agenda of the general meeting and vote on the resolutions tabled.

4. Shareholders are allowed to verify the votes cast through the platform for up to 30-days after the general meeting.
Regional/international perspectives

As in the case of Malaysia, selected jurisdictions, such as United Kingdom, have recognised technology as a potential enabler of general meetings.

<table>
<thead>
<tr>
<th>Country</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>(1) Nothing in this Part is to be taken to preclude the holding and conducting of a meeting in such a way that persons who are not present together at the same place may by electronic means attend and speak and vote at it.</td>
</tr>
<tr>
<td></td>
<td>(2) In the case of a traded company the use of electronic means for the purpose of enabling members to participate in a general meeting may be made subject only to such requirements and restrictions as are —</td>
</tr>
<tr>
<td></td>
<td>(a) necessary to ensure the identification of those taking part and the security of the electronic communication; and</td>
</tr>
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<td></td>
<td>(b) proportionate to the achievement of those objectives.</td>
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<td>(3) Nothing in subsection (2) affects any power of a company to require reasonable evidence of the entitlement of any person who is not a member to participate in the meeting. (Section 360A)</td>
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Appendix
Appendix I:
Fundamental concepts, Guiding Principles and Content Elements of the <IR> Framework

**Fundamental concepts**

- Value creation for the company and for others: Overall, does the report explain how the company creates values for itself and others?
- The capitals: Overall, does the report provide information on the capitals (e.g. financial, manufactured, intellectual, human, social and relationship, natural) that the company uses or affects and which underpin its ability to create value?

**Guiding Principles**

- **Strategic focus and future orientation:** An integrated report should provide insight into the company’s strategy, and how it relates to the company’s ability to create value in the short, medium and long term, and to its use of and effects on the capitals.
- **Connectivity of information:** An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the company’s ability to create value over time.
- **Stakeholder relationships:** An integrated report should provide insight into the nature and quality of the company’s relationships with its key stakeholders, including how and to what extent the company understands, takes into account and responds to their legitimate needs and interests.
- **Materiality:** An integrated report should disclose information about matters that substantively affect the company’s ability to create value over the short, medium and long term.
- **Conciseness:** An integrated report should be concise.
- **Reliability and completeness:** An integrated report should include all material matters, both positive and negative, in a balanced way and without material error.
- **Consistency and comparability:** The information in an integrated report should be presented: (a) on a basis that is consistent over time, and (b) in a way that enables comparison with other companies to the extent it is material to the company’s own ability to create value over time.

**Content Elements**

- **Company’s overview and external environment:** What does the company do and what are the circumstances under which it operates?
- **Governance:** How does the company’s governance structure support its ability to create value in the short, medium and long term?
- **Business model:** What is the company’s business model?
- **Risks and opportunities:** What are the specific risks and opportunities that affect the company’s ability to create value over the short, medium and long term, and how is the company dealing with them?
- **Strategy and resource allocation:** Where does the company want to go and how does it intend to get there?
• **Performance**: To what extent has the company achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?

• **Outlook**: What challenges and uncertainties is the company likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?

• **Basis of preparation and presentation**: How does the company determine what matters to include in the integrated report and how are such matters quantified or evaluated?

Source: IIRC 2016