



Unusual resignation at KTC

Resignation of independent director sparks corporate governance debate

Shareholders should pay attention to external auditor's audited reports

The resignation of Kim Teck Cheong Consolidated Bhd's (KTC) independent director Wee Hock Kee has sparked a debate over the role and responsibilities of independent directors on the boards of listed entities.

It is rare for a listed company's independent director, who is also the chairman of the Audit and Risk Management Committee (ARMC), to resign and make his reasons public.

On Sept 4, Wee submitted his resignation due to what he termed as a "breakdown of trust and confidence" in a filing to Bursa Malaysia.

Based in Sabah, KTC is mainly involved in the distribution and manufacture of consumer packaged goods.

Wee is a past president of the Institute of Internal Auditors Malaysia and a past chairman of the Malaysian Institute of Auditors Internal Audit Working Group.

Aside from KTC, he holds two other board positions, at MIMOS Bhd and Malvern Internal PLC listed in the United Kingdom - he remains the chair of these two companies' audit committee and/or risk committee.

He tells **FocusM** that the issue began in mid-August when KTC's external auditors informed the ARMC about a "significant audit finding" relating to an impairment issue in the fourth quarter unaudited results.

KTC's external auditor is accounting firm Baker Tilly Monteiro Heng.

The committee asked the external auditors to investigate the matter further and consult management to try and resolve the issue.

Towards the end of August and with the filing deadline for the unaudited fourth quarter results fast approaching, the Baker Tilly team informed the committee that it had not received adequate evidence to reverse its original findings on the impairment matter.

The committee then recommended that an impairment be made, Wee says, but management was not in favour.

"The ARMC then informed the board that it could not recommend approving the fourth quarter results unless an impairment was added in," explains Wee. "However, the board decided to approve the results without the impairment."

It is important to note that all ARMC committee members were in agreement to not recommend the approval of its fourth quarter results. The other two independent directors on the committee are

Tengku Datin Paduka Setia Zatashah Sultan Sharafuddin Idris Shah and Tan Jwee Peng. They remain on KTC's board and on the ARMC committee.

Wee believes he had no choice but to resign his post because he feels the board and management should have acted on the ARMC recommendations with regards to audit and accounting matters.

He points out that this is in line with the Bursa Malaysia Main Market listing rules subsection 15.12 (1) (g) which states that for the quarterly results and year-end financial statements, before the approval by the board of directors, the audit committee must review and report to the board, focusing particularly on i) changes in or implementation of major accounting policy changes; ii) significant and unusual events; and iii) compliance with accounting standards and other legal requirements.

Given the expectations on the audit committee as laid out in the Malaysian Code of Corporate Governance and Bursa Malaysia's listing requirements, Wee says he saw no other option but to leave his post.

"I feel that I have no other choice but to submit my resignation and put on record my reasons for doing so to ensure the interest of all shareholders is protected," he says.

Depending on the circumstances and financial health of a corporate entity, some impairments can lead a company to sail into the red. However, in KTC's case, it is not clear if indeed KTC will remain in the red. KTC fell into the red in third quarter FY18. For its fourth quarter ended June 30, KTC posted an unaudited profit after tax of RM4.38 mil. The release of the fourth quarter results is the main point of contention between ARMC and KTC's board.

In response to Wee's resignation, Bursa issued a query to KTC on two matters. Firstly, it asked for the rationale for the board's rejection of the ARMC's advice.

The company responded that the majority of the board decided not to impair the trade receivables as they are confident they are recoverable, and were convinced by management's plans to secure the remaining balances.

This appears contrary to Baker Tilly's view as at end August, where it told the ARMC that management had not presented sufficient supporting documentation to change its view.

The regulator also asked for details of the impairment reported by the external auditors in the Audit Review Memorandum and its impact on the fourth quarter results should the impairment be made.

The company responded that the amount was about RM4.9 mil of which it had recovered just over RM1 mil. It opines the rest is recoverable though personal guarantees from customers and through legal action.

It is unclear what the regulator's next step will be in light of the company's responses.

Must the board listen?

The issue has raised some important questions over how the board should treat the advice and recommendations of its independent directors.

The Minority Shareholders Watchdog Group says that as the ARMC is a sub-committee of the larger board, the latter "is at liberty to reject the findings or recommendations of the committee."

However, it emphasises that to do so raises eyebrows particularly since this was the view of the whole ARMC and not just its chairman.

"If the board rejects the findings or recommendations of the Chairman of the ARMC, it is of concern. If it rejects the finding or recommendations of the ARMC, it is of greater concern," MSWG tells FocusM.

In those instances, the board must have a sound basis to reject the recommendations of the committee.

Retired KPMG Malaysia Partner (risk consulting division) Lee Min On offers a similar take, that the board is not mandated to accept the views of the committee.

However, given that it is the committee's role to scrutinise audit and accounting issues, its views are key to the board's decision making.

"It is highly unlikely for the board to reject the findings/recommendation of the committee. After all, the committee is formed by the board to assist the latter on financial reporting oversight," he points out.

Lee says in cases where the external auditor has highlighted a significant audit issue, such as this, the independent directors are forced into making a tough call. The board not accepting the recommendation of the ARMC puts its committee members in an even tighter spot, he adds.

Should the ARMC recommend the board hold off on releasing the results and the company misses the filing deadline, the company and directors could be reprimanded by the regulators. However, if they recommend for the results to be released and there is a deviation of more than 10%, between the audited and unaudited profit before tax and minority interest (PATAMI), the audit committee risks being hauled up to explain why it recommended it in the first place.

"While both come with consequences, the better option is for the audit committee to tell the board of its reservations and if the board chooses to release, it does so at its own peril.

"This is what happened in this case and in the event that there is a deviation, those who recommended against releasing it - in this case the ARMC - should be exempted or mitigated somewhat," opines Lee.

Ball in external auditors' court

He believes that the ball is now in the court of Baker Tilly and it will be interesting to see the audited financial statements and the opinion they issue accompanying it.

"Even though they have informed the board of their reservations in mid-August, that was the situation at that point of time and it does not mean they cannot move from that position if they receive sufficient and credible information in the interim period," notes Lee.

The external auditors will likely spend the next weeks leading up to the release of the audited reports tracking management's claims that it is capable of recovering the receivables. If they are convinced by management's progress, then Baker Tilly will likely issue an unqualified opinion and that will be the end of the issue, says Lee.

However, if it remains unconvinced over management's progress and plans to recover the debt, the external auditor has the option of issuing a qualified opinion of the accounts.

"If they should decide to qualify the accounts then the ball will switch back to the board, and specifically the executive directors who are running the show (will need to be able to answer).

"Furthermore, if the auditors do this, then I think Bursa Malaysia will not take it quietly and they will definitely take the management to task," says Lee.

Shareholders role

At the end of the day, it is the shareholders that are at the most risk of mismanagement and poor corporate governance. Regardless of the outcome, Wee's decision to make his resignation reasons public has raised a red flag for shareholders which they should pay attention to.

MSWG recommends that aside from asking questions and raising concerns at the annual general meeting, which may be some months away, shareholders can take more immediate steps.

"Both institutional and minority shareholders can write to the company and seek an explanation," suggests MSWG. "In addition, institutional shareholders can request for a special meeting with the board and management to discuss the issue." **FocusM**

STEPHANIE JACOB



Wee believes he has no choice but to resign