Listed corporations ignore good governance to their detriment

LETTERS

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Over the past week, much attention has been focused on independent directors.

There should be no misperception or misreading of the role these directors are expected to play. It involves a fiduciary duty that must be executed or else one falls foul of the law. In a 2011 High Court ruling, the presiding judge was crystal clear, stating in no uncertain terms that "An independent director is not a decorative ornament ... and has a role in governance".

There are no two ways about it. According to Bursa Malaysia Listing Rules, an independent non-executive director is defined as a director who is independent of management and free from any business or other relationship that could interfere with the exercise of independent judgement or the ability to act in the best interests of a listed issuer.

In the current climate of the continuing evolution of shareholder activism, a company's board of directors carries the heavy burden of governance that ensures a duty of care is observed. This reflects the depth of expectations in relation to governance that is placed on directors, more so on the shoulders of independent directors.

Being independent of management, serving in the best interest of the listed issuer is of paramount importance. This includes, among others, attestation to the veracity of published financials and oversight of non-financial issues relating to the environment, governance and corporate social responsibility.

They are not acting in the "best interests" of the corporation they serve if they are silent about non-adherence to regulations and/or questionable management practices.

This is where the integrity and character of independent directors are thrust into the forefront, as not all issues affecting the efficacy of a company's operations can be legislated.

It is not uncommon to hear of cutting corners to report higher profits. If this means compromising on ethical issues, independent directors are expected to speak up. This notwithstanding that they may be beholden to the corporation's owners for being selected as an independent director, not to mention the emoluments package that goes with the position.

Best practices recommend that independent directors should at least constitute a majority in the audit committee of the board, if not wholly. It is also incumbent on the committee to have an effective internal audit function which reports directly to it.

The internal audit function would be the conduit to ensure that corners have not been cut, be it in financial reporting or other operational efficiencies, which could include staff welfare, among others. Hence the criticality and importance of the function.

Independent directors cannot feign ignorance of the company's operational aspects as that is what they are there for in the first place – to sound alarm bells when necessary.

It is against this background that a major institutional investor made a symbolic gesture by not voting for the re-election of independent directors. It had no appreciable effect as the other shareholders collectively voted to have these independents retained, hence nullifying the showboating of the institutional investor.

The question that begs asking is how would retail or institutional investors be able to gauge if independent directors, and even the entire board for that matter, are effectively discharging their duties?

For example, how one remains independent after, on average, say a six-year period is beyond the comprehension of some. Is this a reasonable inference? The answer lies in an independent assessment as recommended in the Malaysian Code on Corporate Governance 2017.

It is critical that independent parties are engaged to conduct board effectiveness evaluations. Professional interest groups like the Institute of Corporate Directors Malaysia and accounting firms provide this service. The entire board is evaluated on eight to 10 parameters, which include board leadership, board composition, board dynamics and board management relationships, among others. It includes the examination of the supporting board sub-committees.

As for the audit committee of the board, periodic quality assurance reviews are a must to attest to the quality of the internal audit function, which by default is the committee's "eyes and ears", charged with highlighting issues of importance.

The responsibility to ensure that directors are up to the mark falls on investors, professional groupings and entities like the Minority Shareholders Watchdog Group. These must play an active role in promoting good governance within the broader spectrum of social issues.

Given the rising levels of shareholder activism and the rapidly changing economic environment due to the Covid-19 pandemic, listed corporations ignore good governance to their detriment.

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