

CORPORATE GOVERNANCE GUIDE

TOWARDS BOARDROOM EXCELLENCE

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DISCLAIMER

This Corporate Governance Guide (“Guide”) is issued by Bursa Malaysia Berhad to assist boards in applying the principles and best practices of corporate governance.

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STRONG BUSINESS ETHICS, SOUND POLICY AND PROCEDURES AND EFFECTIVE AND EFFICIENT MONITORING SYSTEMS WITH PROPER CHECKS AND BALANCES ARE THE INGREDIENTS OF GOOD CORPORATE GOVERNANCE

CORPORATE GOVERNANCE GUIDE: TOWARDS BOARDROOM EXCELLENCE

**YANG AMAT BERBAHAGIA TUN MOHAMED DZAIDDIN HJ ABDULLAH
CHAIRMAN, BURSA MALAYSIA BERHAD**

Good corporate governance is globally accepted as being fundamental to an organisation's competitiveness, growth and sustainability. There is great attention and onus on boards of directors to discharge their duties with high ethical values and accountability in their commitment to good governance practices. As such, good corporate governance should be widely practised to demonstrate the highest quality and integrity of the leaders in the organisation.

The production of this Corporate Governance Guide is intended for boards of directors of public listed companies (PLCs) to gain a clear and constructive direction on corporate governance best practices. This Guide focuses on bringing clarity to the roles and requirements needed by PLCs to enhance corporate governance practices among their boards and committees, which will go far in contributing towards the achievement of their strategic goals and values in their businesses.

In this Guide, we emphasise the integral ways the boards of directors and their core committees can exercise their authorities and discharge their oversight duties effectively, bound by their accountability to the company and shareholders.

I certainly hope that as key players in the Malaysian capital market, you will find this Guide useful in understanding your role in building sustainable business growth underlined by a strong case for corporate governance.

In an increasingly globalised corporate environment, investors expect us to be more transparent and perform over and above the recommended best practices to attract them to our side. Let us work together to build a market of quality leaders, a market of informed investors and a market of integrity.

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ACKNOWLEDGEMENTS

Bursa Malaysia would like to acknowledge the invaluable input and expertise lent towards the development of this Guide, in particular to Mr. Lee Min On and Ms. Kasturi Paramanathan of KPMG Business Advisory Sdn Bhd, as well as Mr. Philip Koh of Mah-Kamariyah & Philip Koh (Advocates & Solicitors).

We would also like to accord a very special word of thanks to the Securities Commission of Malaysia, Malaysian Institute of Accountants (MIA), Minority Shareholder Watchdog Group (MSWG), Malaysian Institute of Chartered Secretaries and Administrators (MAICSA), Institute of Internal Auditors Malaysia (IIAM), Malaysian Institute of Corporate Governance (MICG) and directors of public listed companies for their contribution in the compilation of this Guide.

ABOUT THIS GUIDE

This Corporate Governance Guide (“Guide”) is designed to help directors understand their role and duties to the company and its stakeholders. Its primary objective is to enhance professionalism in boards and their committees by providing:

- Suggestions on how to fulfil the governance obligations of companies listed on Bursa Malaysia Securities Berhad (“the Exchange”); and
- Practical examples of how the principles and best practices of corporate governance can be implemented.

This Guide has made reference to the Principles and Best Practices of the Revised 2007 Malaysian Code on Corporate Governance (“CG Code”), the Listing Requirements of Bursa Malaysia Securities Berhad (“Listing Requirements”) and primary legislative and regulatory provisions.

Whilst the CG Code’s Principles and Best Practices are included in the margins throughout this Guide, companies should refer to the relevant source documents for greater detail.

This Guide contains examples, checklists and questionnaires. They are meant to provide guidance only, are not meant to be exhaustive and should not be rigidly adopted by companies in isolation of the law and circumstances.

Companies are advised to adapt the materials contained in this Guide to suit the circumstances of their particular industry, company and business. This is consistent with the approach encouraged by the CG Code that –

“ Companies must be encouraged to consciously address their governance needs. In this respect, companies must avoid compliance with form or “box ticking” and instead, should focus their efforts on exercising their judgment on the corporate governance practices best suited for their companies. ”

This Guide aims to raise the level of corporate governance through the structuring and implementation of sound practices and processes which engender an effective board. It strives to provide practical insights into best practices, including how such practices can be adhered to in substance rather than in form, so as to help boards achieve their strategic objectives and build sustainable value in their businesses.

Companies should create an ethical environment that encourages management to do the right thing and to understand that this is vital to the company’s sustainable financial performance.

Data analysis¹ indicates that corporations with active and independent boards generated higher economic profits. This supports the reasonable assumption that corporate governance matters to corporate performance.

¹ Ira M. Millstein and Paul MacAvoy, “The Active Board of Directors and Performance of the Large Publicly Traded Corporations” *Columbia Law Review* 98.

This Guide is developed and structured into nine chapters with each chapter addressing the determinants of effective governance whilst exploring the underpinnings of the CG Code.

Chapter 1 explains the mechanics of a vigilant and effective board. This chapter addresses the “tone from the top” that sets the ethos of the entire business enterprise. An effective board essentially consists of directors who are engaged, committed and well-informed and who possess diverse skills and experience relevant to the business.

Boards should develop the right balance between their advisory role of engaging in the company’s strategic decisions and allowing management sufficient latitude to run the company’s operations. The board fulfils its fiduciary role by scrutinising management’s performance and the quality, reliability and transparency of both financial and non-financial information provided by management.

Chapter 2 looks at the foundation for an independent, objective and effective audit committee. This chapter focuses on the four fundamental responsibilities that must be assumed by an audit committee:

- assessing the processes related to the company’s risks and control environment (unless delegated to other committees by the board);
- overseeing financial reporting;
- evaluating the internal and external audit processes; and
- reviewing related party transactions and conflict of interest situations.

Chapter 3 addresses the board’s assessment of the processes relating to the company’s risks and the control environment. A robust risk management process which systematically identifies, assesses and mitigates the spectrum of risks facing a company can help boards effectively identify and manage principal risks.

This chapter also discusses that in order for the audit committee to obtain reasonable assurance of the integrity of the financial reporting process, the committee needs to have a clear understanding of the control environment and framework to effectively challenge and test the control environment as established by management.

Chapter 4 examines the role of the audit committee as overseer of a company’s financial reporting process. The board cannot by itself monitor financial transactions and maintain accounting records. Given its major role in, and accountability for, the financial performance of the business enterprise, the board may place reasonable reliance on the audit committee’s oversight, monitoring and reporting roles.

A company’s audit process is executed by the internal and external auditors. **Chapter 5** looks into the audit committee’s responsibility to ensure that audit efforts are coordinated and that there is effective communication between both the auditors. This chapter also discusses the selection, role and scope of the internal and external auditors.

Internal audit is well placed to provide the audit committee with insights into the operations and results of a robust risk management programme, together with an effective framework of internal control. The external auditor and audit committee should have a strong and candid relationship. It must be made clear that external auditors work with management but for the audit committee and report to shareholders.

Chapter 6 discusses the importance of the audit committee's responsibility to guard against related party transactions and conflict of interest situations. This chapter focuses on the need for the audit committee to ensure that a proper and comprehensive framework for the identification, monitoring, evaluating, approving and reporting of such transactions is established.

Chapter 7 looks at the governance role of the nominating committee. This committee is normally entrusted with identifying qualified individuals to serve as board members and recommending such candidates for appointment to the board and board committees. The nominating committee also conducts periodic evaluations to assess the effectiveness of the board as a whole, board committees and contribution of individual directors.

Chapter 8 focuses on how the remuneration committee should deal with and recommend the remuneration framework to attract and retain the directors, chief executive officer and senior management needed to run the company successfully for the board's approval. Growing shareholder activism and concomitant pressures for the disclosure of directors' remuneration have also placed remuneration policies and processes under scrutiny. Remuneration packages of executive directors should be structured to link rewards to corporate and individual performance. In the case of non-executive directors, the level of remuneration should reflect the experience and level of responsibilities involved.

And finally, **Chapter 9** looks at the various aspects of shareholder relations. The responsiveness of senior management and boards to investors is a key component of a company that embraces ongoing accountability.

References

The CG Code, regulatory requirements and other authoritative guidance referred to in this Guide can be accessed via the following websites:

- The Revised 2007 Malaysian Code of Corporate Governance;
The Securities Commission of Malaysia's website: www.sc.com.my
- Relevant chapters of the Listing Requirements
http://www.bursamalaysia.com/website/bm/rules_and_regulations/listing_requirements/
- Practice Notes released by Bursa Malaysia
http://www.bursamalaysia.com/website/bm/rules_and_regulations/listing_requirements/practice-notes.html
- Bursa Malaysia's Statement on Internal Controls – Guidance for Directors of Public Listed Companies
http://www.bursamalaysia.com/website/bm/rules_and_regulations/listing_requirements/guidelines_best_practices_practices_.html
- Bursa Malaysia's Corporate Social Responsibility Framework
http://www.bursamalaysia.com/website/bm/about_us/the_organisation/csr/resources.html
- Bursa Malaysia's Investor Relations – Put into Practice manual
http://www.bursamalaysia.com.my/website/bm/about_us/downloads/IR_Manual.html

CHAPTER 1
THE BOARD
STRUCTURE, DUTIES
AND EFFECTIVENESS

THE BOARD STRUCTURE, DUTIES AND EFFECTIVENESS

The Companies Act, 1965 (“CA”) states that “the business and affairs of a company must be managed by, or under the direction of, the board of directors.²”

Boards are obligated to play an active role in directing management. While this does not mean they should be involved in operational matters, it certainly implies that boards cannot passively endorse decisions of the management.

The CA also declares “the board of directors has all the powers necessary for managing and directing and supervising the management of the business and affairs of the company [...]”.³ ”

The company’s governance framework should be designed to:

- enable the board to provide strategic guidance and effective oversight of management;
- clarify the roles and responsibilities of board members and management to facilitate board’s and management’s accountability to the company and shareholders; and
- ensure a balance of authority so that no single individual has unfettered powers.

The function of governance is not an end by itself, but conformance is, in a dynamic relationship with performance leadership:

“ The board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.

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’s performance. The board should set the company’s values and standards and ensure that its obligations to its shareholders and others are understood and met⁴. ”

Directors are also expected to have a firm grip on the company’s internal controls processes and to heighten their vigilance in identifying, addressing and managing risks that may have material impact on the financial statements and operations of the company. A board should be structured to protect the interests of shareholders and relevant stakeholders whilst enabling the company to compete in a challenging market environment.

² Section 131B(1) of the CA

³ Section 131B(2) of the CA

⁴ Corporate Governance - A Practical Guide, London Stock Exchange plc & RSM Robson Rhodes LLP, July 2004

1.1 ESTABLISHING THE BOARD

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.

Principle A1 - Every listed company should be headed by an effective board which should lead and control the company.

In establishing an effective board, a company may take the key steps as illustrated in **Figure 1**.

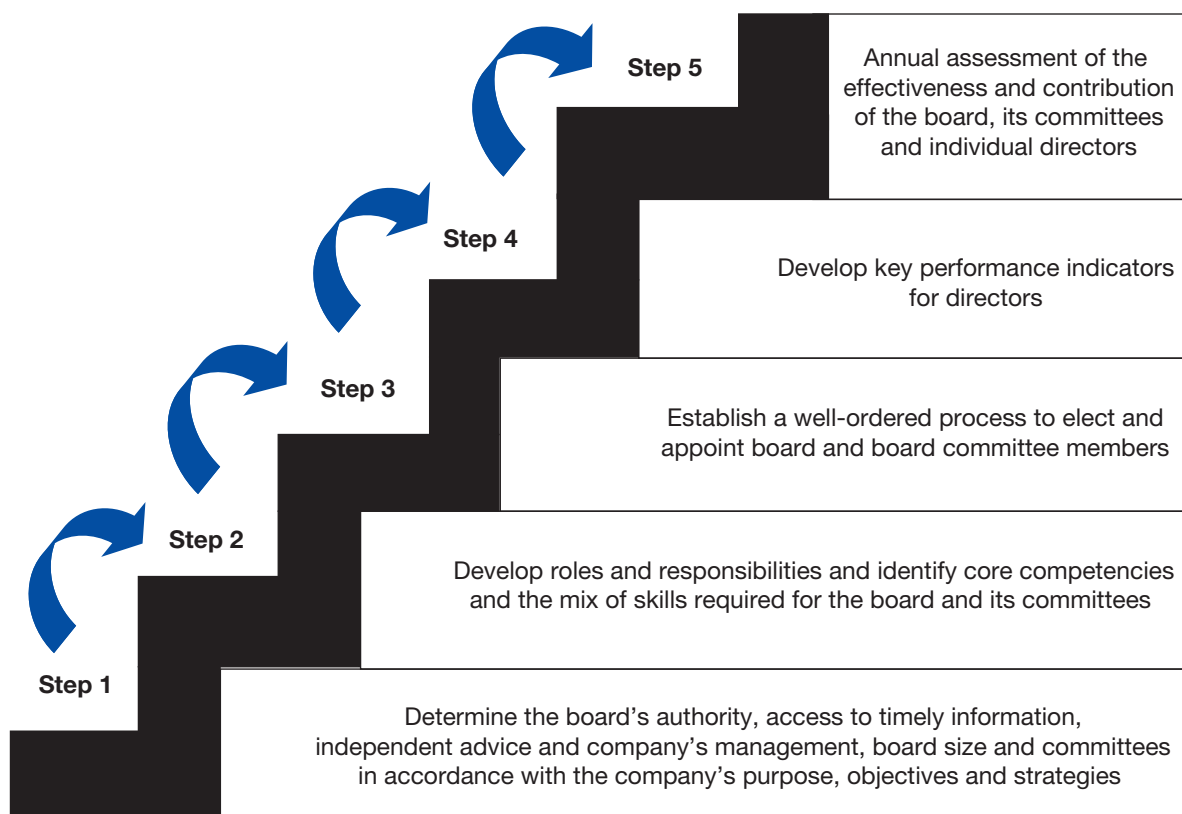


Figure 1: Five key steps in establishing an effective board

1.2 PRINCIPAL RESPONSIBILITIES OF THE BOARD

Best Practice AAI of the CG Code states that a board is required to explicitly assume the following six specific responsibilities in discharging its stewardship role:

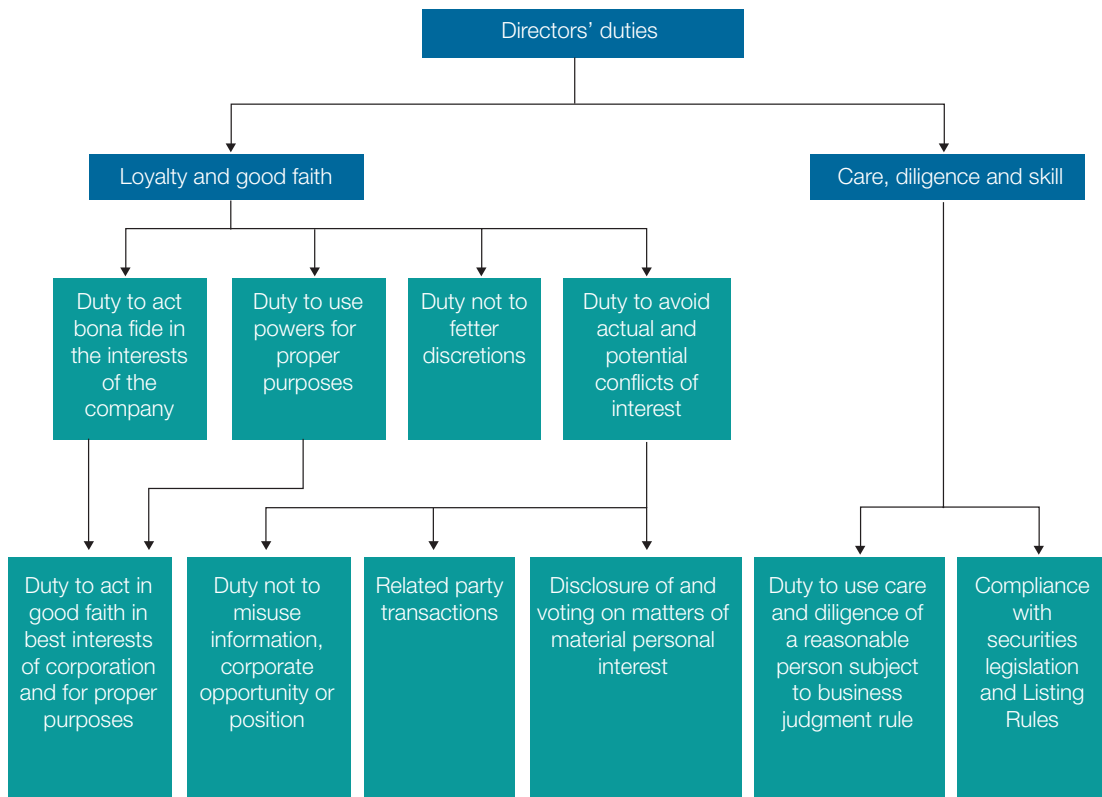
- Reviewing and adopting a strategic plan for the company - *the board should adopt a strategic and business plan aligned to ensure obligations to shareholders and stakeholders are met;*
- Overseeing the conduct of the company's business to evaluate whether the business is being properly managed - *the board should therefore provide entrepreneurial leadership;*
- Identifying principal risks and ensuring the implementation of appropriate systems to manage these risks - *the board should appraise the company's major risks and oversee that appropriate risk management and internal control procedures are in place;*
- Succession planning, including appointing, training, fixing the compensation of and, where appropriate, replacing senior management - *the board should oversee the human capital development process, monitoring and compensation against pre-determined evaluation criteria;*
- Developing and implementing an investor relations programme or shareholder communications policy for the company; and
- Reviewing the adequacy and the integrity of the company's internal control systems and management information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines – *the board should determine that procedures in place are designed to ensure the assets of the company are safeguarded against loss from unauthorised use/disposition and all transactions of the company are properly authorised and that they are recorded as necessary to enable the preparation of true and fair financial statements and their related disclosures as required of the company.*

1.3 DIRECTORS' CORE DUTIES

A director must be aware of the legal parameters that define his duties in law. A director owes fiduciary duties similar in some respects to those of a trustee. The law recognises that directors must be allowed to make business judgments and business decisions in the spirit of enterprise⁵. There are two major aspects of directors' duties:

- (i) Fiduciary duty; and
- (ii) Duty to use reasonable care, skill and diligence.

⁵ Section 132(1B) of the CA



A diagrammatic overview of directors' duties under the CA

(i) FIDUCIARY DUTY

Though boards act collectively, fiduciary duties are owed individually by each director. There are four major facets of a director's fiduciary duties:

- The duty to act in good faith;
- The duty to exercise power for a proper purpose;
- The duty to exercise discretion properly; and
- The duty to avoid conflict and self-dealing.

The duty to act in good faith

It has been repeatedly emphasised that directors must act honestly in line with what they believe to be the company's interests.



The duty to exercise powers for proper purpose

A director must at all times exercise his powers for a proper purpose and in good faith, in the best interests of the company⁶. The interests of the company have been judicially defined to mean the shareholders' interests as a whole, and not the interests of any other third party.

The duty to exercise discretion properly

A director has wide latitude in exercising the powers vested in him under the company's Articles of Association and he must exercise them properly. A director cannot fetter these powers by abdicating an independent exercise of such discretion and merely doing what is wanted by another person.

The duty to avoid conflict and self dealing

The improper use of a company's property, position, corporate opportunity or competing with the company by a director or an officer of a company is prohibited unless with the consent or ratification of a general meeting⁷.

- ***Making improper use of information***

Improper use of information refers to conduct which is inconsistent with the proper discharge of the duties, obligations and responsibilities of a director. Examples include insider trading and securities market misconduct that are prescribed in the Capital Markets and Services Act, 2007 ("CMSA"), which prohibits trading in corporate securities where there is price sensitive information that has not been made available in the public domain.

Directors are also subject to prohibitions against false trading and market rigging transactions, manipulations, making false or misleading statements, fraudulent inducement of persons dealing in securities and the use of manipulative and deceptive devices⁸.

⁶ Section 132(1) of the CA

⁷ Section 132(2) of the CA

⁸ Sections 175, 176, 177, 178 and 179 of the CMSA

Use of Corporate Insider and Proprietary Information and Handling of Confidential Information

Directors have access to a variety of information. This may include financial information and other price sensitive information which are not or have not been made available to the public. The law is paramount. The board must ensure adherence to the insider trading law which includes, amongst others, tipping third parties or procuring another to trade in securities where information has not yet been disclosed to the public. In addition, directors must comply with the Listing Requirements when dealing in securities during and/or outside closed periods.

Directors also have a duty to ensure that information that belongs to the company which has proprietary value cannot be exploited. Directors must ensure that there are systems and proper registers that record and manage the intellectual property of the company so that the company will be able to effectively enforce protection against any abuse or contravention of such assets.

In addition, directors must ensure that there are proper procedures put in place to ensure that confidential information is handled properly by the company's directors, employees and relevant parties to avoid leakages and improper use of such information.

- **Secret profits**

A director who makes a 'secret profit' is liable to account for it to the company. No one in a role that requires him to act in good faith may enter into an arrangement or have a personal interest which conflicts with the interests of those he is bound to protect.

- **Contracts with the company**

Directors are permitted to deal with the company on the condition that full disclosure is made to the company and shareholder approval is procured where required under the CA or the Listing Requirements. The CA and the Listing Requirements also provide specific criteria and thresholds which, when triggered, will require the consent of shareholders at a general meeting.

- **Duty of disclosure**

A director's obligation to disclose an interest related to a contract or proposed contract now includes the interest of the spouse and child (including adopted or step child) of the director⁹.

A company is required to keep a register showing the particulars of each director's shareholdings and any other interests¹⁰.

⁹ Section 131(7A) of the CA

¹⁰ Section 134 of the CA



– ***Duty to refrain from participation and voting***

A director who is directly or indirectly interested in a contract or proposed contract shall not participate in any discussion of consideration of the contract, or vote at the board meeting on the contract or proposed contract¹¹.

It should be noted that, although the interested director is required to abstain from participating in the discussion or voting on the contract or proposed contract, the director is counted to make quorum at the board meeting¹².

– ***Some related party transaction provisions under the CA¹³***

• ***Disposal by directors of company's undertaking or property***

Directors are prohibited from carrying into effect any arrangement or transaction for:

- (a) acquiring an undertaking or property of a substantial value; or
- (b) the disposal of a substantial portion of the company's undertaking or property, unless the arrangement or transaction has been approved by the company in a general meeting¹⁴.

• ***Acquisition or disposal of shares or non-cash assets***

A company is not permitted to enter into an arrangement or transaction with certain prohibited persons to acquire from, or dispose to, such prohibited persons 'non-cash assets' (which include shares) of a requisite value¹⁵, subject to prior approval in a general meeting and other exceptions¹⁶.

Duty To Ensure Integrity Of Financial Information

Every company and director have the legal responsibility to keep such accounting and other records as will sufficiently explain the transactions and financial position of the company and enable true and fair profit and loss accounts and balance sheets and any documents required to be attached thereto to be prepared from time to time, and shall cause those records to be kept in such manner as to enable them to be conveniently and properly audited¹⁷.

In addition, under the Listing Requirements, companies are required to issue accurate financial statements within the prescribed timeframes.

¹¹ Section 131A(1) of the CA

¹² Section 131A(1) of the CA

¹³ See Chapter 6 for related party transaction under this Guide

¹⁴ Section 132C(1) of the CA

¹⁵ Section 132E of the CA

¹⁶ Section 132F of the CA

¹⁷ Section 167 of the CA



Duty to Ensure Compliance with the Listing Requirements by Directors and Its Listed Issuer

Directors of companies listed on the Official List of Bursa Malaysia Securities Berhad are required to comply with the Listing Requirements¹⁸. A listed company's failure to comply with the Listing Requirements will amount to a breach in respect of which actions may be taken and/or penalties may be imposed not only against the listed company but also the directors, officers and advisers of the company who are found to be culpable pursuant to **Paragraph 16.11** of the Listing Requirements.

(ii) DUTY TO USE REASONABLE CARE, SKILL AND DILIGENCE

A director is required to exercise 'reasonable care, skill and diligence' according to the knowledge, skill and experience which may reasonably be expected of a director having the same responsibilities; and based on the facts, any additional knowledge, skill and experience which the director in fact has¹⁹.

Therefore, the standard in deciding whether a director has exercised 'reasonable care, skill and diligence' is an objective one, although a court will consider the particular characteristics of the director in question.

The CA does not draw a distinction between the standard of care required of executive and non-executive directors.

To ascertain the specific duties of any director, it is necessary to consider the nature of the company's business and the way in which the work is distributed between directors and officers.

Nominee Directors:

Malaysian law sets out a priority of duty which a nominee director must comply with when discharging his duty²⁰, which is to act in the best interests of the company.

¹⁸ Paragraph 3.10 of the Listing Requirements

¹⁹ Section 132(1A) of the CA

²⁰ Section 132(1E) of the CA

Business Judgment: Safe Haven for Directors?

There is a 'Business Judgment Rule' which deems that a director has fulfilled his duty to exercise reasonable care, skill and diligence, if he:

- i) makes the business judgment in good faith for a proper purpose;
- ii) does not have a material personal interest in the subject matter of the business judgment;
- iii) is informed about the subject matter of the business judgment to the extent the director reasonably believes to be appropriate under the circumstances; and
- iv) reasonably believes that the business judgment is in the best interest of the company²¹.

Reasonable Reliance Defence:

The 'Reasonable Reliance' defence is now incorporated in the CA²².

The protection afforded by this defence can be divided into two parts:

- i) Reasonable reliance on information, professional or expert advice, opinions, reports or statements²³; and
- ii) Reasonable reliance on delegated actions²⁴.

Guidelines For Discharging Duty Of Care, Skill And Diligence

Directors ought to discharge their duty of care, skill and diligence in a conscientious manner and may be guided as follows:

- i) Ensure that the company has established an effective governance system and process;
- ii) Refrain from rushing into decision-making. Provide adequate time for deliberations and evaluations of transactional and financial matters;
- iii) Require sufficient notice and distribution of board papers and explanatory appendices in advance of meetings;
- iv) Convene supplemental meetings in response to requests for further information before the final decision;
- v) Make informed decisions based on the information provided and analysis and recommendations of the company's independent professional advisers.

²¹ Section 132(1B) of the CA

²² Sections 132(1C), (1D), (1F) and (1G) of the CA

²³ Sections 132(1C) and (1D) of the CA

²⁴ Sections 132(1F) and (1G) of the CA

- vi) Ensure that there is no undue pressure from dominant personalities or nominees of significant shareholders;
- vii) Ensure proper record of key decision-making deliberations;
- viii) Base reliance on others where there is a sound basis for doing so; and
- ix) Periodically test internal control and risk assessment systems set up for integrity and soundness.

1.4 BOARD LEADERSHIP AND COMPETENCIES

Principle All - The board should include a balance of executive directors and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision making.

Corporations need strong leadership from boards that possess market and industry knowledge.

A dynamic mix of competent and diverse skill sets coupled with an appropriate tone at the top of practising and promoting legal-ethical compliance and professional conduct are necessary ingredients for an effectively governed board.

FOCUS:

A balanced board avoids the risk of being dominated by an individual or a small group within management.

Wider skill sets will promote broad-based competencies with a plurality of viewpoints that facilitate sound and constructive decision-making. Collegiality must not result in blind conformity.

The critical exercise of deliberative decision-making is to be encouraged.

1.5 BOARD SIZE

Best Practice AAXII - Every board should examine its size, with a view to determining the impact of the number upon its effectiveness.

There is no prescriptive rule for a board's optimum size.

Whilst the CA specifies a minimum number of directors, it does not set a maximum number of directors although companies normally specify a maximum in their Articles of Association.

The following factors should be considered in determining the number of seats in a board:

- The evolving circumstances and needs of the company in terms of its size, scope or geography;
- The need to achieve an appropriate balance of executive and non-executive directors and the independent elements of non-executive directors. A board with a balanced composition will ensure that no individual or small group of individuals will dominate decision-making;
- The establishment of board committees becomes impracticable with very small boards; and

- Quorum requirements for board meetings.

The CG Code highlights the need for a board to determine the appropriate size required for the effective discharge of its roles and responsibilities for the benefit of the company and its business.

In establishing the size and structure of a board, the following questions should also be asked and considered:

- Does any director represent the interests of certain shareholders or groups of shareholders (e.g. state agencies, pension funds, employees and financiers)?
- Does any director have the technical know-how or experience in the relevant industry/sector?
- Does the board reflect a diversity of professional experience, race and gender?

1.5.1 Appointment of Directors

Principle AIV - There should be a formal and transparent procedure for the appointment of new directors to the board.

Companies are increasingly adopting a more proactive and systematic approach to their board appointments.

Nominating committees are established with the responsibility of identifying suitable candidates, working ahead of anticipated board vacancies.

This practice is consistent with the CG Code, which recommends the establishment of a formal and transparent procedure for the appointment of new directors. This is further discussed in **Chapter 7: The Nominating Committee**.

Best Practice AAIV – In circumstances where a company has a significant shareholder, in addition to the requirement that one-third of the board should comprise independent non-executive directors, the board should include a number of directors that fairly reflects the investment in the company by shareholders other than the significant shareholder.



1.5.2 Core Competencies

Best Practice AAV – In circumstances where a shareholder holds less than the majority but is still the largest shareholder, the board will have to exercise judgment in determining the appropriate number of directors which will fairly reflect the interest of the remaining shareholders.

A committed and knowledgeable board is a cornerstone to an effective corporate governance system. Such a board would normally comprise directors who possess the necessary skills and experience towards achieving the company's goals.

Figure 2 below illustrates the recommended personal qualities and competencies required from a director.



Figure 2: Recommended attributes of directors

1.5.3 Independent Directors

A board is strengthened significantly by a group of non-executive directors who have no connection with the company. These individuals bring dispassionate objectivity that a director with a relationship with the company cannot provide.

Independent directors are essential for protecting the interests of minority shareholders and can make significant contributions to a company's decision making by bringing in the quality of detached impartiality. Since an independent director has no conflict of interests in the discharge of his duties, he ought to approach any approval that is being sought at board level for a transaction or any matter with a watchful eye and with an inquiring mind.

An independent director is especially important in areas where the interests of management, the company and the shareholders diverge, such as executive performance and remuneration, related party transactions and audit.



Best Practice AAVI - The board should disclose on an annual basis whether one third of the board is independent, and in circumstances where the company has a significant shareholder, whether it satisfies the requirement to fairly reflect, through board representation, the investment of the minority shareholders in the company.

The board should disclose its analysis of the application of the best practices set out above to the circumstances of the board.

“ Non-executive directors need to be sound in judgement and to have an inquiring mind. They should question intelligently, debate constructively, challenge rigorously and decide dispassionately. And they should listen sensitively to the views of others, inside and outside the board ²⁵ ”

A listed company must ensure at least two directors or one-third of its board (whichever is the higher) are independent directors²⁶.

Paragraph 15.02(3) of the Listing Requirements provides that if a vacancy in the board results in a non-compliance with the required composition, the vacancy must be filled within 3 months. The CG Code requires the board to disclose on an annual basis whether one third of the board is independent.

Paragraph 1.01 of the Listing Requirements provides that an independent director is one 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 company.

The assessment should be made taking into account the following criteria, to ensure that the director:

- Is not an executive director of the listed company or any related corporation of the listed company (hereinafter, each corporation shall be referred to as “the said Corporation”);
- Has not been within the last 2 years and is not an officer (except as a non-executive director) of the said Corporation;
- Is not a major shareholder of the said Corporation;
- Is not a relative of any executive director, officer or major shareholder of the said Corporation;

²⁵ Higgs Report, January 2003

²⁶ Paragraph 15.02 of the Listing Requirements

- Is not acting as a nominee or representative of any executive director or major shareholder of the said Corporation;
- Has not been engaged as a professional 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 a 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
- 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 a major shareholder, as the case may be, of a firm or corporation (other than subsidiaries of the listed company) which has been engaged in any transaction with the said Corporation under such circumstances as prescribed by the Exchange.

It is important to bear in mind the Listing Requirements emphasise that even if a person does not fall within any of the disqualifying indicia stated above, both the director concerned and the board must give effect to the spirit, intention and purpose of the definition. There must be a conscious application of the test of whether the said director is able to exercise independent judgment and act in the best interests of the company.

A company can meet in form all the regulatory indicia or criteria for independent directorship and yet fail in the substance and processes at work when a board sits for deliberation and decision.

The attributes of collegial yet independent decision-making that must be vested in an independent director would be determined in part by the character of the individual and that of the whole ethos of the board.

FOCUS:

A meaningful proportion of non-executive directors should have the key attribute of independence, and be known to act independently.

Such directors should ensure that the varied competing interests of all stakeholders are respected without sacrificing financial performance and accountability.

1.5.4 Senior Independent Non-Executive Director

The CG Code recommends that a board identifies an independent non-executive director to be the senior independent director to whom concerns may be conveyed, and to disclose this in the annual report.

Although the CG Code does not mention the specific responsibilities of the senior independent non-executive director, the duties would typically include the following:

- Ensure all independent directors have an opportunity to provide input on the agenda, and advise the chairman on the quality, quantity and timeliness of the information submitted by management that is necessary or appropriate for the independent directors to perform their duties effectively;
- Consult the chairman regarding board meeting schedules to ensure the independent directors can perform their duties responsibly and with sufficient time for discussion of all agenda items;
- Serve as the principal conduit between the independent directors and the chairman on sensitive issues, for example issues that arise from ‘whistle-blowing’; and
- Serve as a designated contact for consultation and direct communication with shareholders on areas that cannot be resolved through the normal channels of contact with the chairman or CEO.

1.6 TERMS OF REFERENCE

1.6.1 A Recommended Analytical Profile of an Effective Board

Best Practice AAXV - The board should have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the company is firmly in its hands.

A formal schedule of matters should be reserved for the board’s deliberation and decision-making exercise to ensure that the direction and control of the company is firmly vested in the board.

A formal schedule of matters should clearly define, inter-alia, the following:

- The types and nature of issues;
- Transactions and thresholds;
- The process for deliberation; and
- All relevant information that has been circulated to existing and newly appointed board members.

A formal schedule of matters would typically include, amongst others, the following:

Delegation to Management

Distinctions must be maintained between executive operational day-to-day functions and the overall responsibility of the board.

The board may delegate power to any committee, director or officer, employee, expert or any other person. However, the directors are still charged with the responsibility “for the exercise of such power by the delegatee as if such power had been exercised by the directors themselves²⁷”.

This responsibility cannot be negated, and is only circumscribed by the proviso that the board will not be responsible if:

²⁷ Section 132(1F) of the CA



- i) the board believed on reasonable grounds that the delegatee would exercise the delegated powers in conformity with the CA and the company's Memorandum and Articles of Association; and
- ii) the board believed on reasonable grounds, in good faith and after making a proper inquiry that the delegatee (where necessary) was reliable and competent in relation to the power delegated²⁸.

Setting of Management limits

The board should specify the parameters within which management decisions are to be made.

The board should ensure clearly articulated legal-ethical boundaries. The conduct of employees should be aligned to such considerations.

Strategy Setting, Implementation and Supervisory

The board should review the group's (comprising the company and its subsidiaries, including associates where relevant) strategic direction, including the approval of corporate exercises or restructuring plans.

Board Meetings and Agenda Setting

Board and committee papers with accompanying notes and explanations for agenda items, should be received at least 7 days before the meeting.

The frequency of meetings must be dictated by the requirements of the company. A listed company would typically have a minimum of 6 to 8 board meetings (i.e. meetings to approve the quarterly financial statements for announcement to the Exchange and to approve the annual financial statements of the company, etc.) annually. In certain circumstances (e.g. major transactions or take-over bids) and for regulated industries, e.g. banking, insurance, etc, the board has to meet more frequently.

Board resolutions passed by way of circular resolutions should be practised sparingly, and individual board members must exercise prudence in consenting to a circular resolution that involves company assets.

The board should ensure that the minutes of the board meetings are prepared on time and review the minutes to ensure completeness and accuracy.

Board Processes in Meetings

There should be a meaningful review of outstanding major action items from previous meetings.

A candid discussion of current issues, which may significantly affect the business of the company, should be encouraged. These issues include:

- Risk management matters;
- Major economic and industry trends;

²⁸ Section 132(1G) of the CA



- Competitors' actions;
- Adverse publicity/rumours concerning the company and/or its subsidiaries;
- Changes in regulatory requirements in the industry/business that the company operates in;
- Fluctuations in major raw material prices and supplies of the same; and
- Monitoring of management's performance

The board should conduct a review of the company's performance, i.e. financial results and operations of the current quarter, year-to-date and forecast, including budget variance reporting.

Monitoring of Financial Performance

There should be a discussion and approval of capital expenditure and/or disposal of capital items sanctioned over and above delegated levels, i.e. where the amount involved exceeds a predetermined threshold given to management.

The board should conduct a review of the company's funding requirements on a continuing basis, including significant treasury matters, approval of financing arrangements, cheques and other signatories.

The board should ensure proper procedures are put in place and that the financial statements (including quarterly/year-end announcements) of the group (comprising the company and its subsidiaries) are reviewed for integrity and approved for timely lodgement with, and/or release to, the various authorities and market.

Risk Management

The board must actively identify, assess and monitor key business risks to safeguard shareholders' investments and company's assets, including the relevant measures deployed by management to address the said risks.

The board must understand the principal risks of all aspects of the business that the company is engaged in and recognise that business decisions require the incurrence of risk. Board of directors must ensure that there is in place systems that effectively monitor and manage these risks with a view to the long term viability of the company.

An annual review of the risk management process, including the procedures thereof, should be carried out.

Effectiveness in Monitoring the System of Internal Controls

The board must have an unequivocal and demonstrable commitment to articulating, implementing and reviewing the company's internal control systems.

Appropriate resources should be made available to set up and manage information systems to ensure that both the board and management receive relevant and reliable information on a timely basis and that the company is not exposed to unmanaged financial and operational risks.

Periodic testing of the integrity of the internal control procedures and processes must be conducted to ensure the system set-up is viable and robust enough to assist management in realising company objectives.

Succession Planning, Self-Evaluation and Appointments

The board must review and ensure that the appointment, resignation/ termination of directors, company secretaries, auditors and key company officers are duly executed and documented.

There should be a request for, and proper consideration of, reports from the nominating committee on the performance of the board, board committee and individual directors.

Remuneration Review

The board should review for approval recommendations from the remuneration committee on remuneration packages of executive directors and recommend fees of directors for shareholders' approval at the Annual General Meeting of the company.

FOCUS:

The board has the overall accountability and responsibility for oversight and control of the company's performance and conformance capabilities.

1.6.2 Position Description

Best Practice AAXVI -The board, together with the CEO, should develop position descriptions for the board and for the CEO, involving definition of the limits to management's responsibilities.

In addition, the board should approve or develop, with the CEO, the corporate objectives for which the CEO is responsible to meet.

Position descriptions should be developed for the board and CEO, including a definition of the limits to management's responsibilities. Such information can be incorporated in a board charter (see **Section 1.6.3** of this Guide).

The board and the CEO should jointly develop the corporate objectives for which the CEO is held accountable.

Role of Chairman

Every board should be headed by a chairman who is able to discharge his duties effectively.

The chairman should undertake, amongst others, the following responsibilities:

- Monitor the workings of the board, especially the conduct of board meetings;
- Ensure that all relevant issues for the effective running of the company's business are on the agenda;
- Ensure that quality information to facilitate decision-making is delivered to board members on a timely basis;
- Encourage all directors to play an active role in board activities;
- Chair general meetings of shareholders; and
- Liaise with the CEO and the company secretary on the agenda for board meetings.

A chairman who is an independent non-executive director would provide a balance to the influence of the CEO.

Role of CEO

The CG Code states that “there should be a clearly accepted division of responsibilities at the head of the company which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision”.

In the event the roles are combined, the CG Code recommends that “there should be a strong independent element on the board” to strive for independent decision-making. A decision to combine the roles of chairman and CEO should be publicly explained in the annual report.

The role of a CEO is seen as critical to the performance of a company. A CEO is expected to provide:

- Leadership;
- Strategic vision;
- High-level business judgment and wisdom; and
- The ability to meet immediate performance targets without neglecting longer-term growth opportunities of the company.

Clearly, a CEO's responsibilities extend beyond the day-to-day running of the business and executing the board's instructions.

Major decisions are often made by the board following consideration of the CEO's ideas, vision and/or suggestions.

It is important that a person with great calibre and vision fills this role.

Best Practice AAIL - There should be a clearly accepted division of responsibilities at the head of the company which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.

Where the roles are combined, there should be a strong independent element on the board. A decision to combine the roles of chairman and CEO should be publicly explained.

Best Practice AAllI - Non-executive directors should be persons of calibre, credibility and have the necessary skill and experience to bring an independent judgment to bear on the issues of strategy, performance and resources, including key appointments and standards of conduct.

To be effective, independent non-executive directors should make up at least one-third of the board membership.

FOCUS:

The board must:

- Give its CEO room to perform, but be prepared to intervene when the need arises;
- Clearly define the respective functions and responsibilities of the board and the CEO;
- Develop standards and processes for evaluating CEO performance;
- Negotiate appropriate CEO compensation, with input and recommendation from the remuneration committee (if there is one); and
- Review and appraise the CEO's performance.

Role of Executive and Non-Executive Director(s)

Executive directors are, as employees, involved in the day-to-day management of the company.

Non-executive directors (NEDs) can be further classified as:

- Those who have no direct or indirect pecuniary interest in the company other than their directors' emoluments and their "permitted" shareholdings in the company;
- Those who are not employees of the company or affiliated with it in any other way and are not involved in the day-to-day running of business but may have pecuniary interest in the company, whether direct or indirect; or
- Those who are not employees of the company but are standing as nominees for substantial shareholders.

The CA makes no distinction between executive and non-executive directors in terms of the legal duties that are imposed on directors.

Non-executive directors may act as a bridge between management and stakeholders, particularly shareholders. They could provide the relevant checks and balances, focusing on shareholders' and other stakeholders' interests and ensuring that high standards of corporate governance are applied.

In relation to the selection and appointment of NEDs, a company should adopt a transparent policy based on time availability, quality and contribution that the NED can bring to the board. Objective evidence should be presented to illustrate that these criteria have been met when an NED is appointed.

The key to effective governance would be for the board to create an environment that allows the expression of disagreement when discussing strategic issues. This helps in avoiding situations where a dominant chairman or CEO who represents the significant shareholder presents the board with a fait accompli where even independent NEDs may shrink from expressing their disagreement unless a substantial principle is at stake.



1.6.3 Board Charter

Every board is encouraged to have a board charter outlining the roles and responsibilities of directors. The following are some of the matters that should be considered when developing a board charter:

- A general outline of the board's purpose;
- An overview of the board's monitoring role;
- Structure and membership, including a requirement that one-third of members or 2 directors, whichever is higher, be independent non-executive directors;
- A formal schedule of matters reserved for the board (see **Section 1.6.1** of this Guide), including authority levels;
- A position description of the role of the chairman, CEO and executive directors as well as NEDs;
- Appointment of board committees;
- Director's orientation and education programme; and
- 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).

The charter should be periodically reviewed and updated in accordance with the needs of the company and any new regulations that may have an impact on the discharge of the board's responsibilities.

1.7 CONDUCT OF BOARD MEETINGS

Best Practice AAXIV - The board should meet regularly, with due notice of issues to be discussed. The board should record its deliberations, in terms of the issues discussed, and the conclusions in discharging its duties and responsibilities.

The board should disclose the number of board meetings held in a year and the details of attendance of each individual director in respect of meetings held.

Board meetings should be conducted in a business-like manner where all directors feel encouraged to share their views and partake in discussions. A fair judgment should be given when an opinion, particularly a defiant one, is voiced.

No one person should dominate the discussions. The chairman should play a mediator's role to maintain the order of the proceedings in a constructive, productive and effective manner.

A thorough examination of the key issues and resolution of the same is to be achieved with the support of both the board and management. In relation to this, the CG Code specifically states that the board should record its deliberations and the resolutions carried in the discharge of its duties and responsibilities.

The chairman, assisted by the company secretary, should monitor technical matters which include:

- (a) Timely circulation of proper notice of meetings together with the agenda;

- (b) Punctuality of directors for board meetings;
- (c) Presence of a quorum;
- (d) Accuracy of the agenda content;
- (e) Reasonable time for directors to consider board papers prior to the board meeting;
- (f) Adherence to the company's Memorandum and Articles of Association; and
- (g) Applicable provisions of the CA, the Listing Requirements and other regulatory requirements.

The keeping of proper records of minutes is prescribed by law²⁹. Minutes of a directors' meeting shall be entered in books kept for that purpose within fourteen days of the relevant meeting date.

Proper record keeping is evidence of a well-governed company.

1.7.1 Frequency of Meetings

A typical board holds a minimum of 6 to 8 board meetings annually.

Some boards may meet more frequently depending on the nature of the company's operations, e.g. financial institutions and other institutions that are regulated by statutory bodies.

The CG Code calls for disclosure of the number of board meetings held in a year and details of each director's attendance of those meetings in the company's annual report. Disclosure of the total number of board meetings held and attendance of directors during the financial year is mandated under the Listing Requirements³⁰.

1.7.2 Board Agenda

Carefully prepared board agenda will enhance the board's productivity and strengthen its strategic and supervisory role. Boards should be in control of their meeting agenda.

The agenda should be prepared by taking into account the formal schedule of matters reserved for the board's decision.

²⁹ Section 156(1)(a) of the CA

³⁰ Chapter 9, Appendix 9C Part A (paragraphs 3 & 12)

Best Practice AAXVIII - The chairman of the board should undertake primary responsibility for organising information necessary for the board to deal with the agenda and for providing this information to directors on a timely basis. If the chairman is also the chief executive officer, the board should also have in place a procedure to ensure that its agenda items are placed on the agenda and for providing this information to directors.

As stipulated in the CG Code, the chairman should undertake the primary responsibility for organising the information necessary for a board to deal with in the agenda and for providing this information to directors on a timely basis.

Matters for the information or consideration of the board should be documented in board papers, with discussion focusing on strategic points of particular interest and concern.

FOCUS:

The following is a range of matters that should be periodically included on a board agenda:

- Business planning;
- Direction and strategy formulation, including review;
- Risk management issues and resolution;
- Budget, approval and monitoring against actual performance, including variance reporting;
- Funding requirements;
- Formulation and monitoring of key company policies;
- Evaluation of management's performance;
- Corporate exercises, e.g. acquisitions, mergers, divestments and takeovers;
- Regulatory changes that impact upon the company's business;
- Emerging business issues;
- Corporate disclosures and announcements;
- Investor and stakeholder relations; and
- Litigation matters against the company.

Principle AIII - The board should be supplied in a timely fashion with information in a form and of a quality appropriate to enable it to discharge its duties.

The CG Code emphasises that information provided to the board must be complete, adequate and timely. Generally, directors should receive board papers at least 7 days prior to board meetings.

Significant matters submitted to the board for decision-making should contain executive summaries, highlighting the major issues to be resolved as well as the background and explanatory information.

Time should be allocated for directors to raise matters not covered by the formal agenda.

1.8 ACCESS TO INFORMATION AND INDEPENDENT ADVICE

Best Practice AAXIX - Directors should have access to all information within a company whether as a full board or in their individual capacity, in furtherance of their duties.

The CG Code specifies that directors should have access to all information within a company whether as a board or in their individual capacity.

It is essential for directors, particularly NEDs, who are not involved in the day-to-day operations of the company, to have access to the information that enables them to better understand and assess the company's performance. This includes management's complete and accurate responses to directors' enquiries. Further enquiries should be made, as reliance on what is purely volunteered by management may be inadequate.

In addition, the CG Code mentions that each director should be entitled to seek independent professional advice at the company's expense through an agreed procedure laid down formally. The board charter, if developed, is an avenue to formalise such a procedure for directors to seek independent professional advice as they consider necessary (refer to **Section 1.6.3** of this Guide).

All directors should also have access to the advice and services of the company secretary.

Best Practice AA XX - There should be an agreed procedure for directors, whether as a full board or in their individual capacity, in furtherance of their duties, to take independent professional advice at the company's expense, if necessary.

Paragraph 15.04 of the Listing Requirements stipulates that a listed company 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 company and in accordance with a procedure to be determined by the board, including but not limited to obtaining:

- Full and unrestricted access to any information pertaining to the listed company;
- Full and unrestricted access to the advice and services of the company secretary; and
- Independent professional or other advice.

1.9 INDUCTION OF NEW BOARD MEMBERS

Best Practice AAXIII - As an integral element of the process of appointing new directors, each company should provide an orientation and education programme for new recruits to the board.

As specified in the CG Code, 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.

FOCUS:

How Pfizer makes directors effective?

When Robert Burt took over as Chairman of the Pfizer Audit Committee, the retired CEO and Chairman headed back to school as the only student in his class. For 4 hours following each of his next 3 Pfizer board meetings, he was tutored by senior managers from the divisions of internal audit, investor relations, tax planning, treasury operations, budgeting, corporate communications, etc. A lead partner from KPMG LLP, Pfizer's external audit, sat in on every session.

Not only did Mr. Burt learn a lot about his new role, he built relationships with the people reporting to him. The real making of a Pfizer director begins when he or she first joins the board. All new directors undergo an intensive orientation that immediately welcomes them into the fold of senior management. An internal group is charged with forwarding directors' information from third-party sources. All directors are encouraged to make facility visits.

Source: Bill Birchard, Management 2007

1.10 CONTINUING EDUCATION

It is important for directors to keep abreast of regulatory changes and developments in corporate governance through reading and attendance at relevant training programmes. Directors should also keep up with broad business trends through the reading of relevant industry and business publications, attending relevant conferences and expositions, and meeting up with authorities, financiers, overseas businessmen and others who may be a source of useful information.

Directors who are well informed would be in a better position to evaluate proposals made by management, to ask the right questions of management and thus to be more effective as directors.

The board must evaluate the training needs of its directors and ensure that their training needs are met. One good practice is for the board to regularly request each director to identify appropriate training that he believes will enhance his contribution to the board. Competencies of members need to be refreshed by participation in:

- Seminars and workshops that highlight techniques of enhancement of shareholder value and methods of evaluating business performance and capital proposals;
- Updating of regulatory and legislative reforms that impact board and committee work;
- Understanding of financial statements and investment products which the company may be exposed to;

- Industry conferences and trade shows which strengthen professional networking and enable the gaining of insights of customers and competitors; and
- Field trips to company operations to gain actual knowledge of staff, factory, department or plantation (as the case may be).

In relation to directors' training, **Paragraph 15.09** of the Listing Requirements requires directors to comply with the following:

- (1) A director of a listed company 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 companies as important to enable the directors to effectively discharge their duties. In this respect, the board of a listed company 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. The board must disclose in the listed company's annual report whether its directors have attended training for the financial year. Where any of its directors have not attended any training during the financial year, the board must state the reasons thereof in the annual report for each director.

Chapter 9 Appendix 9C (Part A, Paragraph 28) mandates a statement by the board of directors containing a brief description of the type of training directors have attended for the financial year. Where any of the directors have not attended any training during the financial year, the reasons thereof for each director must be stated.

1.11 DIRECTOR'S ROLE IN REVIEWING AND ADOPTING A STRATEGIC PLAN

The 1st limb of the CG Code's Best Practice AA1 states that it is a specific responsibility of the board to review and adopt a strategic plan for the company.

This simply means that the board has an overall responsibility related to the formalisation and implementation of the company's mission, values and strategy.

The effectiveness of the board in shaping a company's strategic direction and providing advice to management and performing this function would largely depend on the collective competency of its members.

Directors should have sufficient understanding and knowledge of the company's competitive environment, social, regulatory and technological issues affecting the company's business and operations.

1.11.1 The Dynamics of Strategy Development

Boards should avoid becoming captives of management's strategy agenda.

FOCUS:

Strategy Development – A Board Priority

Boards must insist for adequate time to be provided to the directors for review and approval of the strategic plan. Management should not make the assumption of automatic board approval of its plans, and should make provision for the possibility that these plans could be rejected or delayed or further deliberated.

Boards should cooperate with management in a climate of mutual respect and understanding. Such aims notwithstanding, boards cannot abdicate their ultimate responsibility for the formulation of sound business strategy and the successful implementation of the same.

1.11.2 Understanding Strategic Direction



One possible starting point is for the board and management to jointly formulate a corporate strategic vision even at the formative stage. The vision should not be so general that it becomes meaningless in practical terms, or so prescriptive that it shuns potentially valuable options.

The board should focus on shareholder value, taking into consideration relevant stakeholders' interests. Strategic directions should take a medium to long-term view of the company (depending on the type and volatility of the industry/market in which it operates) – 3 to 5 years is a good rule of thumb.

Risk can be viewed from either a strategic or operational perspective. Operational risk is considered in **Chapter 3** of this Guide.

Strategic risk concerns the future of the markets in which the company operates, and its evolving competitive position in those markets. It also entails the ability of the company to successfully implement its business strategies.

A strategic plan should incorporate 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)

1.11.3 Performing Strategy Review

Boards must 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 conducted by the board and separate from any management review of strategy.

The criteria used to measure strategic progress should be chosen by the board and not management. These will focus amongst others on financial performance and measure of shareholder value.

Board strategy reviews should be undertaken at least annually and in the midst of rapidly changing environment and market conditions, at even shorter intervals. The primary purpose of board strategy reviews is to force both the board and management to periodically step back from day-to-day operational concerns and re-examine underlying strategic issues. A self-initiated assessment process will enable a board to assert its ultimate responsibility for the strategy implemented.

1.12 QUALITY OF INFORMATION

The board is responsible for timely and balanced disclosure of the company's operational and financial performance.

In order to monitor and review the company's performance against its strategic objectives, the CG Code recommends that the board receives both financial and non-financial information that takes into account the company's own performance and prospects and how the company is being benchmarked against its key competitors and market leaders.

In this respect, the board should specify the amount, type and presentation of the information it requires and work with management to refine the board information package and modify it accordingly.

Non-financial information may include:

- Market positioning of key brands;
- Customer satisfaction and retention;
- Employee satisfaction and turnover;
- Research and development and innovation measures; and
- Social and environmental performance.

FOCUS:

Information overload should be avoided, whilst timely, concise, focused and relevant presentations must be prized.

- Graphical presentations may be utilised but care must be taken that they are not overwhelming in terms of superfluous information.
- Long management presentations which leave little time for thoughtful, reflective deliberations should be avoided.

1.12.1 Overseeing and Monitoring Company Performance

The 2nd limb of the CG Code's Best Practices AA1 provides that the board should explicitly assume the responsibility of overseeing the conduct of the company's business to evaluate whether the business is being properly managed.

Typically, boards concern themselves more with financial measures. Boards track performance against budget and are concerned whether their companies are able to meet forecast for the quarter, half or full-year. Traditional financial measures are essential but do not always depict the prevailing situation in view of the following inherent limitations:

- The measures portray events of the past (i.e. lagging indicators);
- They reveal little or nothing about the factors that drive performance;
- The true operational performance may have been affected by transactions or events outside the normal course of business; and
- Strategic considerations are obscured.

Boards cannot rely on intuition alone in their supervision of management and their stewardship of the company's assets. Information provided to the board must be focused and succinct, to the point that it facilitates effective decision-making. Directors must have access to accurate, timely and relevant information about their companies. Boards should spend time considering their real information needs by asking:

- What do they need to know to do their job properly?
- What should be put in place to ensure the need could be achieved satisfactorily?
- When do they need to know it? and
- In what form should it be presented?

1.12.2 Presenting Information to the Board

Best Practice AAXVII -The board should receive information that is not just historical or bottom line and financial-oriented but information that goes beyond assessing the quantitative performance of the enterprise, and looks at other performance factors such as customer satisfaction, product and service quality, market share, market reaction, environmental performance and so on, when dealing with any item on the agenda.

Boards should concern themselves with how performance data is presented to them. Information that is excessively detailed or presented in a convoluted and unsystematic manner will be poorly absorbed and not understood.

Board reports should be clear, concise and meaningful. A typical report can be set out under the following headings:

- Emerging issues that may affect business in the future;
- Strategic issues for discussion;
- Market and competitor news;
- Financial and non-financial performance;
- Value drivers' performances;
- Business unit performance; and
- Company performance in relation to strategic initiatives.

1.13 ROLE OF THE COMPANY SECRETARY

Best Practice AAXXI - All directors should have access to the advice and services of the company secretary.

Best Practice AAXI – Boards should be entitled to the services of a company secretary who must ensure that all appointments are properly made, that all necessary information is obtained from directors, both for the company's own records and for the purpose of meeting statutory obligations, as well as obligations arising from the Listing Requirements of Bursa Malaysia or other regulatory requirements.

Best Practice AAXXII - Directors should appoint as secretary, someone who is capable of carrying out the duties to which the post entails and his removal should be a matter for the board as a whole. The board should recognise that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board.

The CG Code emphasises the importance of the company secretary's role in ensuring effective functioning of the board.

The company secretary, as an adviser to directors and senior executives on regulatory requirements, Listing Requirements and legislations, should identify and highlight to the board the relevant requirements and ensure compliance of the same.

In view of the company secretary's pivotal role in the context of board management, the CG Code highlights that directors should have access to his advice and services.

In relation to the appointment of new directors, the CG Code particularly specifies that the company secretary must ensure all appointments are properly effected and all necessary information is obtained from the directors, for both the company's own records and for meeting statutory and regulatory requirements.

The qualification and experience of the person who fills the role of a company secretary will vary from company to company but the appointed person must be someone who is capable of carrying out the duties attached to the post.

The CG Code stipulates that the appointment and removal of a company secretary should be a matter for the board to consider as a whole. Though the company secretary plays a major role in compliance, a board should take cognisance that, in areas of doubt or complexities, relevant professional advice should be sought.

The CG Code also states the board should recognise that the chairman is entitled to the strong and positive support of the company secretary.

The company secretary should undertake, inter-alia, the functions as depicted in **Figure 3** below:

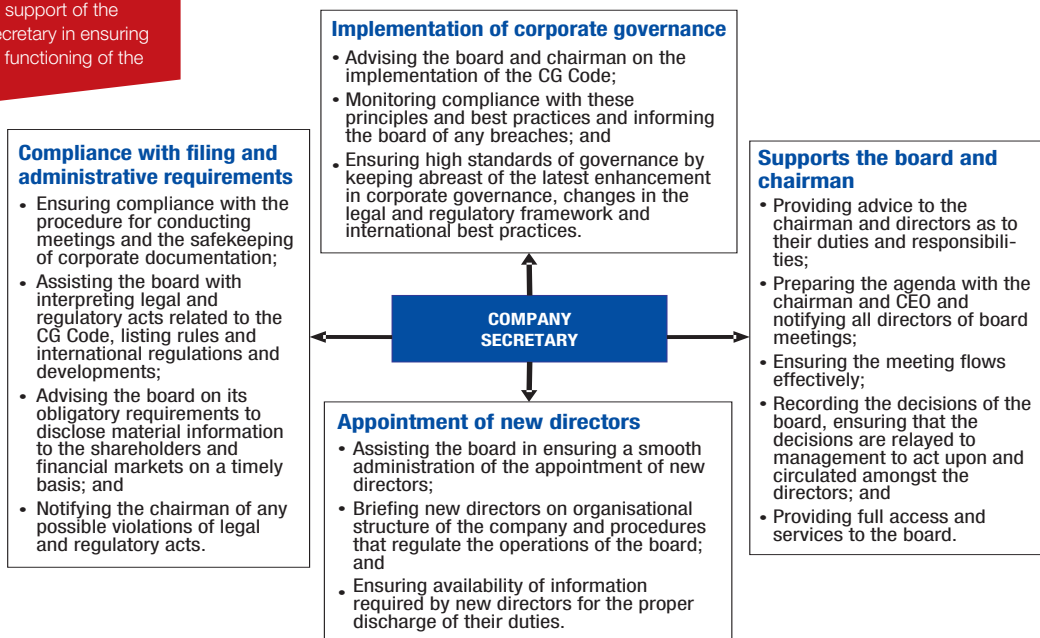


Figure 3: Functions of the company secretary

1.14 BOARD COMMITTEES

Best Practice AAXXIII -

Where the board appoints a committee, it should spell out the authority of the committee and, in particular, whether the committee has the authority to act on behalf of the board or just the authority to examine a particular issue and report back to the board with a recommendation.

As managing and controlling companies have become more complex and demanding, boards are resorting to committees to assist them in the discharge of their duties and responsibilities. Board committees:

- Allow directors to make better use of their limited time;
- Allow more focus to be given to complex issues and recommending courses of action; and
- Reinforce the role of independent directors in monitoring company activities.

However, the existence of board committees does not diminish the board's responsibility for the affairs of a company. Boards can delegate powers to committees but such delegation should be subject to the following:

- Delegated authority in accordance with the company's Articles of Association;
- Clearly established terms of reference, defining their responsibilities and authority, which are approved by the board;
- The board must supervise its delegation; and
- The board must not merely adopt or rely on the committee's recommendations without proper assessment and testing or challenging the same.

In addition to the audit committee, which is mandated by the Listing Requirements, the CG Code recommends companies to establish nominating and remuneration committees.

Each committee's role should be spelt out in written terms of reference approved by the board. Each year, the board, through the nominating committee, should review the board committees' effectiveness. The chairman of each board committee should assess the performance of individual committee members on an annual basis. These assessments can be used to facilitate the nominating committee's evaluation of board committees' performance.

FOCUS:

Effective board committees are not only critically aware of their responsibilities but also recognise what is necessary to effectively fulfill them.

The skills and experience possessed by committee members are an important aspect to consider in ensuring objective views are brought to the deliberation of the committee.

Directors need to have a thorough understanding of their company, be responsive to changes in the business environment and leading practices to make informed judgment and sound decisions. This is a pertinent factor considering the board will approve recommendations made by the committee, barring extenuating circumstances.

Therefore, recommendations and decisions made by the committee must correlate to the company's business direction and enhance the confidence of shareholders that the company's best interests are being served.

1.14.1 Audit Committee



The audit committee is fundamental to the concept of corporate accountability and sound governance.

It has become an integral part of the corporate framework to help fulfill board's stewardship accountability to its shareholders and financial stakeholders. Its work is dynamic and evolving, as accounting and auditing standards and processes are subject to rapid changes.

An audit committee is required in listed companies in Malaysia under **Paragraph 15.10** of the Listing Requirements.

An audit committee provides the board with assurance of the quality and reliability of financial information used by the board and of the financial information issued publicly by the company.

The board as a whole is responsible for the accuracy and integrity of the company's financial reporting. It can be difficult for all directors to keep up with the complexities of financial reporting. The audit committee provides an additional and more specialised oversight of the financial reporting process by facilitating the discharge of the board's responsibility in respect of the timely preparation and issuance of financial statements.

Generally, audit committees:

- Underscore the board's commitment to ensuring integrity of financial information and reporting;
- Increase the emphasis on risk and control, including the levels of authority delegated to management by the board;
- Give directors more insight into the company's accounting and control systems;
- Increase directors' understanding of both the external and internal audit processes;
- Improve communication between the board and the external auditor;
- Help improve the quality of financial reporting;
- Create a forum for the chief financial officer or finance director to raise issues of concern;
- Provide a mechanism for the external auditor to assert his independence in the event of a dispute with management; and
- Strengthen the internal audit function by giving it greater independence from management.

This topic on audit committee and its challenges is covered in detail in **Chapter 2** of this Guide.

1.14.2 Nominating Committee

Best Practice AAIX and AAX of the CG Code emphasise the importance of establishing a nominating committee to undertake, inter-alia, the following functions:

- Annually review the board's required mix of skills and experience and other qualities, including core competencies, which NEDs should bring to the board; and
- Annually assess the effectiveness of the board as a whole, the committees of the board and the contribution of each individual director.

Best Practice AAI of the CG Code states that the board is required to explicitly assume the responsibility of ensuring a succession plan is in place including appointing, training, fixing the compensation of and, where appropriate, replacing senior management. The board should work with the nominating committee on succession planning.

This topic on nominating committee is covered in detail in **Chapter 7** of this Guide.

1.14.3 Remuneration Committee

Best Practice AAXXIV of the CG Code recommends the establishment of a remuneration committee, consisting wholly or mainly of NEDs, to recommend to the board the remuneration of executive directors in all its forms. NEDs' remuneration should be a matter for the board. The challenge to the remuneration committee is to develop a policy on the remuneration of executive directors and propose balanced packages to these directors so as to attract, retain and motivate executive directors of the quality required, yet avoid paying more than is necessary for this purpose.

The key to this is to provide packages that:

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

This topic on remuneration committee is covered in detail in **Chapter 8** of this Guide.

1.15 BUSINESS ETHICS

The board should have knowledge of potentially unethical and legal issues that adversely impact the company. To monitor the ethical and compliance obligations of the company effectively, the board should have access to the information and have knowledge of the company's structure and business process.

Many companies now adopt formal codes of ethics as a way of articulating the company's business ethos. A code of ethics usually sits alongside a code of conduct. Together, they provide the ground rules for management behaviour, as well as guide the board on the manner in which it should act when deciding unanticipated situations.

Typically, a code of ethics:

- Spells out the company's values and principles;
- Reflects and shapes the company's culture; and
- Makes transparent the value framework within which the company pursues its business objectives.

A code of conduct defines behaviour that is acceptable or unacceptable in the workplace. It is about compliance, outlining the rules and the measurements by which employees will be held accountable in observing stated values and principles.

If a code of ethics is to be more than a "feel good" exercise, it must be developed and implemented with integrity, an element that refers to the level of commitment and support directors and managers place on the code.

1.15.1 Directors' Code of Ethics in Malaysia

Boards should approve the company's code of ethics. Boards should also satisfy themselves that ethical codes are taken seriously throughout the company, and make it known that they will take serious actions against any conscious and recurring breaches. Needless to add, if boards are to avoid accusations of hypocrisy, boards must demonstrate that the agreed codes and standards are equally applicable to them - they need to lead by example.

In Malaysia, the Companies Commission of Malaysia (CCM) has introduced the Code of Ethics for directors in formulating standards of corporate behaviour to create an ethical corporate climate. The principles on which the Code of Ethics relies are those that concern transparency, integrity, accountability and corporate social responsibility³¹.

The Code of Ethics has been drafted based on existing legislation such as the CA and includes social obligations that directors ought to fulfil.

John Sullivan³² has rightly emphasized

" A company setting out to build an ethical framework would need to answer to four basic but critical questions "

- Does our company adhere in practice to a code of ethics ?
- What type of code of ethics should we adopt ?
- What process will generate wide buy-in for our company's code of ethics?
- What systems lead to a tangible and constant reinforcement of the values and principles espoused by our code of ethics?

³¹ Company Directors' Code of Ethics extracted from the website of the Companies Commission of Malaysia, www.ssm.com.my

³² Global Corporate Governance Forum Focus No 7 John Sullivan, "The Moral Compass of Companies : Business Ethics and Corporate Governance as Anti-Corruption Tools (2009) IFC at page 38"

1.15.2 Ethics Audit ³³



One way to ensure the integrity of a Code of Ethics is to conduct a periodic ethics audit. Again, it is a case of “what gets measured gets done”. The kind of questions to be covered in an ethics audit includes the following:

- Are there clear rules about how employees of the company should behave towards each other and towards external stakeholders?
- Is there a shared understanding of the types of behaviour that support the company’s stated values?
- Do employees understand how decisions are taken within the company, especially those that affect them directly?
- Is the company’s performance in relation to its stated values measured and reviewed at least annually?
- Does the behaviour of senior managers reflect the company’s stated values? (Do they “walk the talk”?)
- Have employees been introduced to the company’s values and have they been instructed on how to approach possible ethical dilemmas?
- Is there management agreement on how the company should treat its people? Is compliance being measured?
- What is the state of employees’ morale?
- Are there processes and systems in place allowing employees to raise ethical concerns without fear of reprisals? Are there formal grievance procedures, and are these known and used?
- Are there clear, unequivocal sanctions applied to those who behave in breach of the company’s values and ethics?
- Does the company’s code of ethics adequately define matters pertaining to conflict of interest and directors’ obligations on confidentiality of information?

1.16 CORPORATE SOCIAL RESPONSIBILITY

Pursuant to **Chapter 9, Appendix 9C (Part A, Paragraph 29)** of the Listing Requirements, a listed company is required to provide a description in its annual report of the corporate social responsibility activities or practices undertaken by the listed company and its subsidiaries or if there are none, a statement to that effect.

³³ Material in this subsection has been extracted from Lagan, *Attracta, Why Ethics Matter: Business Ethics for Business People*.

1.16.1 Environmental Issues

The effect of business activities on the physical environment, health and safety consequences is an issue of public concern. It is expected to gain momentum in the foreseeable future.

The reporting of environmental performance to stakeholders has become such a substantial issue that it warrants specific mention. How companies manage their environmental responsibilities can have important consequences on their business performance and reputation.

Thus, more companies are viewing their environmental responsibilities seriously, and are prepared to be held accountable for their environmental performance.

Reporting can be seen as part of a due diligence process in environmental management. In fact, many companies are now operating Environmental Management Systems (EMS).

In 1996, the International Standards Organisation adopted the 14000 series of Standards for EMS and their audits. These are voluntary standards and take into account companies' differing circumstances.

The following issues, inter-alia, should be considered by companies in addressing and reporting environmental performance:

- Companies can be fined and their operations temporarily closed for environmental offences;
- Companies that purchase assets may find they are also buying environmental liabilities. Environmental due diligence is essential in such situations. However, it also appears possible, in some circumstances, for companies to retain environmental liability for assets they have sold;
- Pollution is a specific exclusion from most insurance policies, including directors' and officers' liability policies;
- Companies (and their directors) can be sued under common law for failing to protect the environment, including actions for negligence, trespass and nuisance;
- Claims about the "environmentally friendly" nature of products could give rise to actions for misleading and deceptive conduct;
- Investors, lenders and insurers are taking a harder line on environmental risks. Banks and other lenders, for example, may "inherit" environmental liabilities as a result of enforcing the securities they hold over certain assets. In turn, where lenders are financing the purchase of these assets, they are requiring sellers to retain environmental liability;
- A company's branding or trademark is becoming more of a "trust mark"; this trust can be damaged as a result of an environmental incident or disaster;

- Businesses are pressuring their suppliers to demonstrate superior environmental performance, for example, by demanding that suppliers' EMS are ISO 14001 certified;
- Companies that improve their environmental performance – say by reducing pollution, cutting waste, and reducing their energy use – often reap benefits in terms of increased efficiency and lower costs; and
- Companies failing to include environmental considerations in their business strategies could miss market opportunities.

1.16.2 Social Accountability



Companies are constantly making trade-offs between strictly commercial objectives and broader ethical and social considerations, just as they make trade-offs between profits now and the promise of higher returns in the foreseeable future.

Companies do not operate in an ethical, moral and social vacuum in that:

- Few boards are totally indifferent to the welfare of their employees;
- Most companies are acutely conscious of the fact that their customers will walk away if they are dissatisfied with prices, product quality, service, or other aspects of corporate behaviour;
- Companies are finding that neglect of the environment comes at a price - fines and other penalties, litigation, damaged reputations, public protests, consumer boycotts;
- Many companies are recognising that if they fail to take heed of important stakeholder concerns, they will still be required to adhere to such requirements through governmental legislations, by-laws and international treaties which may be imposing, e.g. fines, penalties and reprimands;
- Shareholders become nervous about companies that earn a reputation for 'serious misconduct'; and
- Companies that act in an ethical, socially responsible and environmentally friendly manner will reap commensurate commercial rewards. This can be described as the "doing well by doing good" approach to stakeholder concerns.

Boards can take the following steps to help their companies better manage some of these dilemmas:

- Boards can review their companies' visions, values, mission statements, and Codes of Conduct. One approach to the problem is to conduct a periodic corporate responsibility audit. Such an audit will assess a company's overall performance against its core values, ethics policy, internal operating practices, management systems and, most importantly, the expectations of key stakeholders;

- Examine a concept called Triple Bottom Line (TBL) reporting. TBL reporting means expanding the traditional reporting framework to take into account environmental and social performance in addition to financial performance reporting; and
- Formulate an approach to business integrity.

1.16.3 Sustainability and Special Interest Report

Sustainability and special interest reports such as environmental reports have largely arisen due to stakeholders' demands for transparency and for companies to be held accountable for the impact of their activities on the physical environment, workforce and the communities in which they operate.

There is great diversity in the types of reports issued. The majority of reports currently issued are health, safety and environmental reports. However, there is an increasing focus on social issues such as community involvement, equal opportunity, workforce diversity, human rights, supplier relations, child labour, freedom of association, and fair trade.

An increasing number of companies are producing sustainability reports. In essence, a sustainability report seeks to provide shareholders and other stakeholders with an insight into the company's long-term sustainability in terms of:

- Economic vitality;
- Social relationships with stakeholders; and
- Environmental compliance and integrity, by measuring and reporting financial, environmental and social performances.

Reference should be made to Bursa Malaysia's "Corporate Social Responsibility Framework for Malaysian PLCs", which is available on Bursa Malaysia's website.

1.17 FRAUD RISK AND WHISTLE-BLOWING

Proper policies and procedures vigilantly established within the company send a clear signal to the public, stakeholders and regulators about the attitude of management (i.e. "tone at the top") towards fraud and illegal acts.

All levels of personnel throughout the company have the responsibility for dealing with fraud risk. The board and management are collectively responsible for the prevention and detection of fraud. Based on its size and circumstances, the board should review the existing internal controls established by management so that anti-fraud programmes are adequately implemented within the company.

This will provide reasonable assurance that frameworks are in place to identify fraud risk. Some of the key considerations for assessment are as follows:

- How does the company identify fraud risk?
- What form of fraud risk management programme does the company have in place?
- What is being done within the company to better prevent fraud or at least discover it sooner?
- What process is in place to investigate fraud and take corrective action?

An example of an anti-fraud programme is a whistle-blowing policy. Whistle-blowing occurs when an employee raises a concern about a dangerous or illegal activity that he is aware of through his work.

It is the duty of every employee to speak up about genuine concerns in relation to criminal activity, breach of a legal obligation (including negligence, breach of contract, 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. It applies whether or not the information is confidential.

Where an officer, in the course of performing his duties, has a reasonable belief of any matter which may or will constitute a breach or non-observance of any CA requirement or that a serious offence involving fraud or dishonesty is being or is likely to be committed he *may* report the matter to the Registrar of CCM³⁴. Take note that this legislative provision imposing the whistle-blowing obligation is framed in discretionary terms.

Auditors, however, have a mandatory obligation, as he “*shall*” forthwith report the matter to the Registrar³⁵.

Pursuant to Section 320(1) of the CMSA, if an auditor, in the course of the performance of his duties 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 Listing Requirements 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 Securities Commission;
- b) in the case of a breach or non-performance of any of the Listing Requirements, to the Exchange and the Securities Commission; or
- c) in any other case which adversely affects to a material extent the financial position of the listed corporation, to the Exchange and the Securities Commission.

³⁴ Section 368B(1) of the CA

³⁵ Section 174(BA) of the CA

The CA and the CMSA require companies to ensure that employees are not discriminated against and the lawful employment or livelihood of such employees will not be interfered with by reason of the submission of a report regarding non-observance of regulations.

The board should ensure appropriate whistle-blowing policies are in place by which employees may, in confidence, raise concerns about possible misdemeanours.

Further, **Paragraph 15.17** of the Listing Requirements provides that where an audit committee is of the view that a matter reported by it to the board of directors of a listed company has not been satisfactorily resolved, resulting in a breach of the Listing Requirements, the audit committee in such a situation must promptly report such matter to the Exchange.

A sample of a whistle-blowing policy is set out in **Exhibit 1** of this Guide. This policy should be subject to an annual review. The whistle-blowing report should be addressed to an independent individual who is not subject to undue influence or pressure by management. Individuals who may be considered appropriate include the audit committee chairman; the senior independent non-executive director; parties such as the company secretary; head of internal audit department; or a dedicated department that handles investigations of misconduct or any other related matters and has a direct reporting line to independent directors.

Recipients of whistle-blowing reports are responsible for ensuring that all concerns received are appropriately accounted for, secured and reported to the right channel of authorities as deemed fit.



CHAPTER 2
THE AUDIT COMMITTEE
AND ITS CHALLENGES

THE AUDIT COMMITTEE AND ITS CHALLENGES

“THE MERE EXISTENCE OF AN AUDIT COMMITTEE IS NOT ENOUGH. THE AUDIT COMMITTEE MUST BE VIGILANT, INFORMED, DILIGENT AND PROBING IN FULFILLING ITS OVERSIGHT RESPONSIBILITIES”

A STATEMENT BY THE TREADWAY COMMISSION

2.1 ESTABLISHING AN AUDIT COMMITTEE

An audit committee formed by a company’s board of directors plays a crucial role in the corporate governance process, a process that is one of the cornerstones of shareholder protection. Board may delegate, but not abdicate its responsibilities to the audit committee.

An audit committee must be mindful of what is happening within a company now and, at the same time, what may happen in the future. Five “Guiding Principles”³⁶ for best practices applicable to every audit committee are as follows:

- Interaction with other participants of the audit process;
- Internal auditor communications;
- External auditor communications;
- Candid discussions with management, internal auditors and external auditors; and
- Audit committee membership.

2.2 KEY 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. As seen in Figure 4, every audit committee should assume four fundamental responsibilities:

- Assessing the risks and control environment;
- Overseeing financial reporting;
- Evaluating the internal and external audit process; and
- Reviewing conflict of interest situations and related party transactions.

³⁶ Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committee, February 1999.

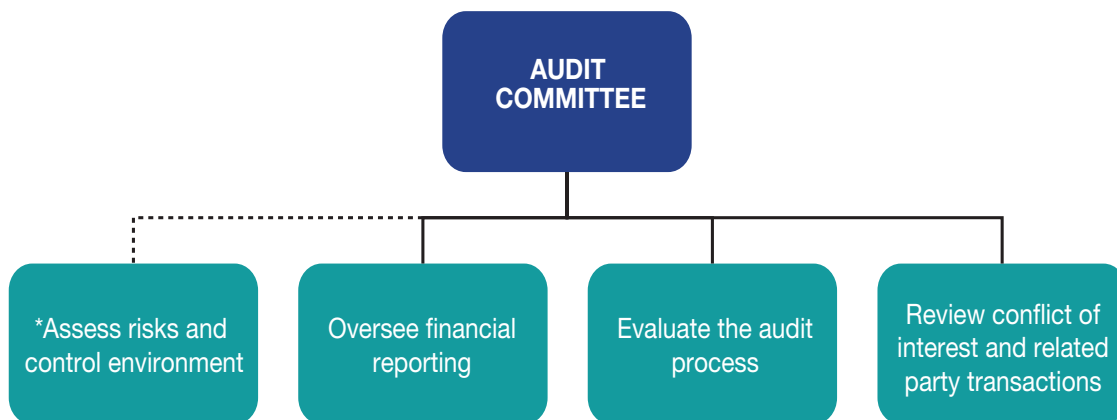


Figure 4: Key responsibilities of the audit committee

* The board may choose to delegate this responsibility to the audit committee or another specific committee

2.2.1 Assessing the Risk and Control Environment

Principle DII - The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

Where the board has delegated the audit committee to oversee the assessment of processes relating to the company's risk and controls, the audit committee must determine that management has implemented policies ensuring that the company's risks are identified and evaluated and that controls in place are adequate and functioning properly to address the risks.

The internal control framework should address the following inter-related components:

- *Control environment*: this sets the tone of the company. It is the foundation of all aspects of internal control, 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;
- *Information*: must be identified, captured and communicated in a form and timeframe that enables personnel to carry out their responsibilities; and
- *Monitoring*: assesses the performance of the control system on a continuing basis.

2.2.2 Overseeing Financial Reporting

Principle DI - The board should present a balanced and understandable assessment of the company's position and prospects.

The audit committee's financial reporting responsibilities include:

- Reviewing earnings releases and financial reports;
- Assessing the appropriateness of management's selection of accounting policies and disclosures in compliance with approved accounting standards;

- Ensuring timely submission of financial statements by management;
- Reviewing significant or unusual transactions and accounting estimates, including related party transactions;
- Reviewing and understanding management's representations; and
- Assessing whether the financial report presents a true and fair view of the company's financial position and performance and complies with regulatory requirements.

2.2.3 Evaluating the Internal and External Audit Process

Principle DIII - The board should establish formal and transparent arrangements for maintaining an appropriate relationship with the company's auditors.

A company's audit process is executed by external and internal auditors. The audit committee should ensure that these auditors maintain an effective relationship with each other and that their efforts are coordinated. The external auditor is responsible for auditing the financial statements whilst the internal auditor's responsibility is evaluating the risk management, control and governance processes.

The audit committee should determine if the internal audit is conducted in accordance with acceptable professional standards and consider whether an external review of the internal audit's performance should be undertaken. **Paragraph 15.13 (1)(e)** of the Listing Requirements stipulates that the audit committee must, amongst others, review the competency of the internal audit function.

In evaluating the external auditor, the committee should consider the auditor's competence and independence, the scope of the audit and whether the fee is sufficient to enable a quality audit to be conducted.

2.2.4 Reviewing Conflict of Interest Situations and Related Party Transactions

Best Practices BBII (vii) - Audit committee should consider any related party transactions that may arise within the company or group.

Related party transactions can present potential or actual conflict of interest and create the appearance that company decisions are based on considerations other than the best interest of the company and its shareholders.

The audit committee should determine whether and how the company addresses conflict of interest situations and monitors compliance with related party transactions policy and/or mandate including transactions or situations that warrant timely internal and regulatory disclosures and appropriate review and reporting.

The four fundamental responsibilities of the audit committee as described above are explained in detail in **Chapters 3, 4, 5 and 6** of this Guide.

2.3 COMPOSITION

Best Practice BBI - The board should establish an audit committee comprising at least 3 members, a majority of whom are independent. All members of the audit committee should be non-executive directors. The board should provide the audit committee with written terms of reference which deal clearly with its authority and duties.

All members of the audit committee should be financially literate and at least one should be a member of an accounting association or body.

The size of the audit committee will vary depending on the needs of the company, the board and the extent of responsibilities delegated. **Paragraph 15.10** of the Listing Requirements mandates the listed company to appoint an audit committee composed of no fewer than 3 members.

All members of the committee must be non-executive directors with a majority independent. At least one member of the audit committee must fulfill the financial expertise requisite of the Listing Requirements.

The audit committee should be appointed by the board based on recommendation from the nominating committee. In the absence of a nominating committee, the board appoints the audit committee members from amongst its number.

The committee members must have the required skills to engage with management and the auditors and be prepared to ask key and probing questions about the company's financial and operational risks, compliance with approved accounting standards and other requirements.

When new directors are appointed to the audit committee, the board should ensure effective orientation is given to the new committee members and that there are adequate experienced directors on the committee.

2.3.1 Independence of Members

An audit committee's independence is the cornerstone of the committee's effectiveness.

The audit committee should comprise a majority of independent directors. As prescribed by **Paragraph 15.11** of the Listing Requirements, the chairman of the audit committee should be an independent non-executive director.

Audit committee meetings should be effective contributing sessions. Competent independent directors on audit committees provide one of the best ways of reinforcing both internal and annual statutory audits.

2.3.2 Qualifications of Members

The audit committee's effectiveness is dependent on its members' broad business experience, knowledge and competence in business matters, financial reporting, internal controls and auditing.

The committee should have candidates with the ability to understand and to effectively challenge management's assertions in respect of the following:

- Risk identification and evaluation;
- Internal control systems;
- Major accounting and reporting issues;
- Interpretation and implementation of the approved accounting standards; and
- Roles of the internal and external auditors.

2.3.3 Financial Literacy of Members

The CG Code requires all members to be financially literate with at least 1 member fulfilling the financial expertise requisite under the Listing Requirements. A short illustration of financial literacy is as follows:

- The ability to read and understand financial statements, including a company's balance sheet, income statement and cash flow statement;
- The ability to analyse financial statements and ask pertinent questions about the company's operations against internal controls and risk factors; and
- The ability to understand and interpret the application of approved accounting standards.

In order to understand further and assess as to who may qualify as a financially literate member, a sample questionnaire is provided in **Exhibit 2** of this Guide.

The board, through the nominating committee, should appraise the financial literacy of the audit committee members and consider implications of the findings thereof.

2.3.4 Personal Qualities of Members

The audit committee should comprise individuals with a wide range of skills that go beyond mere familiarity with financial statements. In selecting audit committee members, personal and professional characteristics should be assessed to ensure the effectiveness of the audit committee in providing independent, objective and effective oversight.

The board may consider the following personal qualities when selecting committee members:

- The ability to act independently and be pro-active in advising the board of any concerns;
- The ability to ask relevant questions, evaluate the responses and continue to probe for information until completely satisfied with the feedback provided;
- An ability and desire to constantly engage in self-development programs;
- Receptiveness to new ideas and tolerance for unconventional views;
- Ability to appreciate the company's culture and values and a determination to uphold these company's 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;
- The courage to take and stand by tough decisions; and
- Encouragement of openness and transparency which is demonstrated by the ability to accept mistakes and not ascribe blame.



2.4 TERMS OF REFERENCE

Best Practice AAXXIII -
Where the board appoints a committee, it should spell out the authority of the committee and, in particular, whether the committee has the authority to act on behalf of the board or just the authority to examine a particular issue and report back to the board with a recommendation.

The board's responsibilities delegated to the audit committee should be clearly conveyed and explicitly defined. Both the CG Code and **Paragraphs 15.12 and 15.13** of the Listing Requirements set out the need for written terms of reference and minimum functions of the audit committee.

Terms of reference will not only help committee members focus on their roles and responsibilities but the disclosure of such will also enable shareholders to be apprised of the roles and responsibilities of the audit committee.

Terms of reference should be tailored to the company's specific needs and circumstances. Once established, the terms of reference should be assessed, reviewed and updated at least annually by the committee or as and when there are changes to the CG Code and Listing Requirements.

The committee should recommend any change to the terms of reference to the board for the latter's approval. The assessment of the committee's terms of reference should be a vigorous process taking into consideration the company's circumstances and any new regulations that may have an effect on the audit committee's responsibilities.

2.5 ROLE OF THE AUDIT COMMITTEE CHAIRMAN

Best Practice BBV -
The chairman of the audit committee should engage on a continuous basis with senior management, such as the chairman, the chief executive officer, the finance director, the head of internal audit and the external auditors in order to be kept informed of matters affecting the company.

A strong chair demonstrating depth of skills and capabilities is a key element for a successful committee, and so its selection should be undertaken with due care and consideration.

The audit committee chairman should assume, amongst others, the following responsibilities:

- Planning and conducting meetings;
- Overseeing reporting to the board;
- Encouraging open discussion during meetings; and
- Developing and maintaining an active on-going dialogue with senior management and both the internal and external auditors.

2.6 MEETINGS AND AGENDA

Best Practice BBVI -The board should disclose in an informative way, details of the activities of the audit committee, the number of audit meetings held in a year and details of attendance of each director in respect of meetings, and details of relevant training attended by each director.

Best Practice BBII (ix) – The duties of the audit committee should include considering other topics as defined by the board.

Paragraph 15.19 of the Listing Requirements states that in order to form a quorum in respect of an audit committee meeting, the majority of members present must be independent directors.

The CG Code requires details of the audit committee's activities, number of audit meetings held in a year and attendance of each individual director in respect of the meetings to be disclosed in the annual report. This enables shareholders to evaluate the commitment of a particular director.

A comprehensive agenda helps committee members to stay focused on their objective. Where necessary, the agenda should include input from the CEO, finance director, the internal and/or external auditors.

The audit committee chairman is accountable for the agenda and should not delegate it to management.

Considering the complexity of the issues to be discussed, it is imperative that committee members be provided with the meeting agenda and relevant papers at least a week in advance of each meeting. This will allow the committee members to give full consideration to the issues and, where necessary, obtain supplementary facts before the meeting.

2.6.1 Participants

Best Practice BBIII -The finance director, the head of internal audit and a representative of the external auditors should normally attend meetings. Other board members may attend meetings upon the invitation of the audit committee.

However, the committee should meet with the external auditors without executive board members present at least twice a year.

The finance director, the head of internal audit and the external auditor may be invited to attend audit committee meetings. The chairman of the board or CEO, who often has vital insight of the company's operations, may also be invited to attend as and when required by the audit committee. Management or external professionals may also be called to attend meetings when the agenda calls for their expertise.

Paragraph 15.14 of the Listing Requirements stipulates that a listed company 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.



2.6.2 Frequency of Meetings

Best Practice BBV – The audit committee should meet regularly, with due notice of issues to be discussed, and should record its conclusions in discharging its duties and responsibilities.

The audit committee chairman, in consultation with the committee secretary, should determine the frequency of committee meetings. The schedule of meetings should be discussed with all the participants concerned, including the finance director, internal auditors and external auditors to ensure that key tasks, such as approval of financial statements for timely issuance, can be accommodated.

Paragraph 15.15 of the Listing Requirements states that the audit committee may regulate its own procedure, in particular, on the calling of meetings, notice to be given of such meetings, the voting and proceedings of such meetings, the keeping of minutes and the custody, production and inspection of such minutes.

At a minimum, the committee should meet at least four times a year, i.e. on a quarterly basis, to properly carry out its duties and ensure effective discharge of its responsibilities.

2.6.3 Duration of Meetings

The duration of meetings will vary depending on the range and complexity of the issues under consideration. 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.

There should be sufficient interval in between the audit committee and board meetings to allow sufficient notice and consideration of matters for the purposes of deliberation by the board.

2.7 ACCESS TO INFORMATION AND INDEPENDENT ADVICE

Best Practice BBIV – The audit committee should have explicit authority to investigate any matter within its terms of reference, the resources to do so and full access to information.

The committee should be able to obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary.

Each audit committee member has full and unrestricted access to information and is entitled to ask for further information required to make informed decisions.

This is enforced through **Paragraph 15.18 (c) and (d)** of the Listing Requirements that provides the audit committee authority to have full and unrestricted access to any information pertaining to the listed company and to be able to obtain independent professional or other advice for the performance of its duties.

Audit committees may use the services of outside expertise or advisors such as valuers, engineers or tax consultants at the cost of the company in accordance to a procedure determined by the board towards performance of its duties.

2.8 RIGHT OF ACCESS TO EMPLOYEES

Best Practice BBll(viii) - The duties of the audit committee should include considering the major findings of internal investigations and management's response.

There may be exceptional situations that require a special investigation to be carried out, for example fraud, violation of code of conduct or an illegal act. The audit committee is entrusted with the duty to consider the major findings of internal investigations and management's response.

With this, the audit committee should have the right of direct access to anyone in the company to conduct such investigation and this should be stipulated in the audit committee's terms of reference.

Paragraph 15.18 of the Listing Requirements states that a listed company must provide the audit committee with the authority to investigate any matter within its terms of reference and for the committee to have the resources which are required to perform its duties.

2.9 INDUCTION OF NEW MEMBERS

Formalised orientation training should be provided to new members of the audit committee to ensure they understand their roles, nature of the company's business, operations and current issues, objectives of the audit processes and the board's expectations of the performance of audit committee members.

A meeting should be held with the finance director and members of management who are responsible for the financial control system and internal audit.

A board member should consider the following areas when freshly appointed to the audit committee:

- **Audit committee terms of reference:** outline the committee's key responsibilities and limits of authorities;
- **Meeting schedules, agenda and minutes:** planned meetings for the year and minutes of meetings of the audit committee and board held for the past two years;
- **Risk management system:** policies and procedures for risk assessment and management of both the business and the financial reporting process;
- **Internal control system:** policies and procedures in relation to financial reporting, operations and compliance controls;
- **Financial reporting:** types of information provided and timeline for submission of reports;
- **Financial reports:** quarterly unaudited financial results and annual reports for the past two years;
- **Internal auditors:** internal audit charter, internal audit plan for the year, recent and past internal audit reports and reporting process;

- **External auditors:** engagement letter, audit scope, recent and past management letters and reporting process; and
- **Major operational areas:** details of controlling and/or major shareholders, how the company operates including key customers, suppliers and parties to major contracts.

2.10 CONTINUING EDUCATION

Best Practice BBVI – The board should disclose in an informative way, details of the activities of audit committees, the number of audit meetings held in a year, details of attendance of each director in respect of meetings, and the details of relevant training attended by each director.

Audit committee members, including experienced ones, should seek continuing professional education to keep abreast of developments not only in the area of financial reporting but in regulatory compliance, technology, business risk and the implications of significant changes that may affect the company/industry.

Audit committee members' skills and experience should be assessed and training given where gaps are identified.

Training is essential, particularly when specific roles are assigned to the audit committee, for example, if the committee assumes oversight of enterprise risk management, legal and regulatory compliance or fraud management.

Additionally, ongoing development and education sessions for audit committee members are likely to be provided by management during regular briefings and via reports and presentations that cover both operational and financial issues specific to the company and the industry.

Briefings on new accounting and auditing standards by internal and external auditors, particularly on those impacting the company should be given periodically to keep the members updated.

In addition, management should update the audit committee of changes in substantial shareholding that result in changes of persons connected and related parties and the way the company operates, including changes in key customers, suppliers and parties to major contracts.

2.11 COMMITTEE SECRETARY

Generally, the company secretary is the audit committee secretary. The secretary plays an important role in organising and providing assistance at audit committee meetings and has the following key responsibilities:

- Ensure meetings are arranged and held accordingly;
- Assist the chairman in planning the audit committee's activities;
- Draw up meeting agendas in consultation with the audit committee chairman, maintain the minutes, and draft its scheduled activities for the financial year;

- Ensure structured communication channels between the board and the audit committee;
- Ensure proceedings of meetings are recorded and the minutes circulated to and confirmed by the audit committee chairman before disseminating them to the board; and
- Ensure audit committee recommendations presented to the board are supported by papers, including minutes that explain the rationale for the committee's recommendations.

2.12 AUDIT COMMITTEE RELATIONSHIPS AND COMMUNICATION

The increased responsibilities, complexity of accounting issues, and demand of shareholders and regulators call for audit committees to be more focused than ever in enhancing their efficiency and effectiveness.

Vital to achieving this is the strength and openness of the audit committee's working relationship with the board of directors, management, internal and external auditors.

The CG Code places emphasis on continuous engagement between the chairman of the audit committee and senior management (including executive members of the board) of the company, as well as the internal and external auditors. Through these engagements, relevant issues affecting the company can be brought to the attention of the audit committee in a timely manner.

2.12.1 Relationship with the Board

As the board is ultimately responsible for the financial reporting of the company, it needs to be consistently kept informed by the audit committee of its activities. This includes the extent to which the committee's duties are effectively discharged on key issues relating to financial reporting and internal control systems and the committee's conclusions and recommendations thereof on an ongoing basis.

Any irregularities or violations by the company's employees and significant findings or matters of concerns raised by management, internal auditor or external auditor should be communicated to the board immediately.

Audit committee minutes are normally circulated with the papers of the next board meeting and the audit committee chairman would provide an update to the board on their contents.

Any proposal requiring substantive action by the board should be submitted promptly in writing, providing board members ample time to review and consider the proposals. If a proposal made by the audit committee is accepted by the board, the deliberation and resolution should be clearly stated in the minutes of the board meeting.

2.12.2 Relationship with Management

It is the role of the board and management to maintain a sound system of internal controls. The role of the internal and external auditors is to assess the strength and quality of those controls and the overall control environment.

The CEO needs to foster a culture of co-operation and understanding within management to facilitate the discharge of the role of the internal and external auditors. As part of its assessment of the processes relating to the company's risks and control environment, the audit committee should receive from management an overview of the risks, policies, procedures and controls surrounding the integrity of financial reporting.

The CEO should highlight and provide justifications to the audit committee on behalf of management where there is a difference of opinion between management and either the internal or external auditors.

The CEO and chief financial officer are invited to attend audit committee meetings as required. Successful discharge of the audit committee's duties and responsibilities requires significant interaction with management.

It is common for management to take the lead in presenting to the committee reports on matters such as reviews of operating results and financial statements, significant estimates inherent in the financial statements, financial reporting risk analysis, adequacy of controls, impact of changes in accounting policies and standards, etc.

2.12.3 Relationship with the Internal and External Auditors

Both internal and external auditors provide integral support for the audit committee in carrying out its duties and meeting its responsibilities. The audit committee should have direct and unrestricted access to the internal and external auditors, i.e. meetings with the auditors without the presence of any employees.

2.13 PERFORMANCE EVALUATION

The board of directors is responsible for evaluating the performance and effectiveness of the audit committee and ensuring the discharge of such function is properly documented.

The board, through the nominating committee, should assess the effectiveness of the audit committee and the contribution of each individual director on an annual basis.

The audit committee, in conjunction with the board, should develop a formal and rigorous assessment process. This may include interviews with the member being assessed, self-assessment and/or peer assessment of members against pre-set criteria.

Paragraph 15.21 of the Listing Requirements states that the board of directors of a listed company must review the term of office and performance of the audit committee and each of its members at least once every three years. This is to assess whether the audit committee and its members have carried out their duties in accordance with their terms of reference.

When evaluating the effectiveness of the audit committee, the board on its own or through the nominating committee, as the case may be, should consider, amongst others, the following:

- The audit committee's compliance with the Listing Requirements and adherence to the CG Code; and
- The level of financial literacy among the audit committee members.

2.13.1 Committee Performance Evaluation

Self-assessment of the audit committee's effectiveness helps to ensure the committee members' expectations are continuously met. There are several ways to assess performance:

- *Consultation with the board about its satisfaction with the committee's performance and with internal and external auditors on ways to improve the audit committee's performance* – an effective approach to enhance the committee's performance;
- *Comparing the committee's activities to the recommendations of the CG Code and international best practices* – this allows the committee to identify any gaps and to make the necessary changes; and
- *Comparing the committee's activities to the terms of reference and any other objectives the board has set for the committee* – this helps to ensure the committee has effectively carried out the full scope of its duties.

While comparison against terms of reference and the CG Code should be performed annually, comparison against international best practices can be performed every two to three years. It is important to note that assessments should not only focus on what the committee has done, but also on how effectively the committee conducted its activities.

Some key questions that the audit committee could consider when undertaking the self-assessment exercise is provided in **Exhibit 3** of this Guide.

The board should discuss the findings and recommendations and ensure that appropriate action is taken to ensure the committee discharges its responsibilities effectively.

2.13.2 Evaluation of Committee Members

A formal evaluation of the performance of all committee members should be undertaken. The nominating committee should evaluate the performance of committee members as recommended by the CG Code. In the absence of a nominating committee, the board can conduct the evaluation based on agreed upon criteria.

The evaluation should consider several aspects, including:

- Expertise of member;
- Inquiring attitude, objectivity and independence;
- Exercise of sound judgment;



- Ability to take tough, constructive stands at meetings, when and where necessary;
- Understanding of the company's business;
- Understanding of, and commitment to, the committee's duties and responsibilities;
- Willingness to devote the time needed to prepare for, and participate in, committee deliberations;
- Responsiveness (timeliness and quality);
- Approach to conflicts and whether the member helps the committee manage conflicts constructively and productively; and
- Attendance at meetings.

Upon completion of the evaluation, the board should deliberate the outcome to undertake appropriate remedial actions (if any), for example relevant training to be recommended for the committee members, etc, to effectively discharge their responsibilities.

2.14 AUDIT COMMITTEE REPORT

Pursuant to **Paragraph 15.16** of the Listing Requirements, a listed company must ensure that its board of directors prepares an audit committee report at the end of each financial year which must be clearly set out in the annual report.

The audit committee report should include the following:

- Composition of the audit committee, including the names and designations of the chairman and members, indicating whether the directors are independent or otherwise;
- The terms of reference of the audit committee;
- The number of audit committee meetings held during the financial year and details of attendance of each audit committee member;
- A summary of the activities of the audit committee carried out in the discharge of its functions and duties for that financial year; and
- A summary of the activities of the internal audit function or activity.

2.15 CHARACTERISTICS OF AN EFFECTIVE AUDIT COMMITTEE

The characteristics of an audit committee include the following:

- Conducts its own affairs efficiently and responsibly and reviews its own performance annually;
- Ensures effective communication among those involved with the audit committee;
- Understands the company's risks and the control systems aimed at addressing those risks;
- Drives for complete and accurate financial and non-financial information disclosures that reflect substance over form which can be issued on a timely basis;
- Conducts meetings independently and separately from time to time with internal and external auditors;
- Varies the duration of time spent for meetings, as needed, in order to meet changing and often increasing demands;
- Actively engages in the appointment, replacement or re-appointment of the external auditor;
- Has a strong and candid relationship with the external auditors;
- Evaluates and assesses the performance of external auditors, including the latter's independence;
- Determines the scope and fee of the external audit and ensures that the audit is comprehensive;
- Determines the internal audit plan and adequacy of the internal audit scope, functions and resources and that the internal audit function has the necessary authority to carry out its work;
- Uses internal audit to review the way management manages business risks as well as how the risks are managed to enhance shareholder value;
- Evaluates the performance of the internal audit function, including having an external review periodically to assess the competency of the function; and
- Ensures management is responsive to internal and external audit recommendations.

CHAPTER 3
ASSESSING THE RISK AND
CONTROL ENVIRONMENT

ASSESSING THE RISK AND CONTROL ENVIRONMENT

Risk management and the internal control framework are essential facets of effective corporate governance.

The 3rd and 6th limbs of the CG Code's Best Practice AA1 provide that the board should explicitly assume the responsibility of identifying principal risks and ensuring implementation of a risk management system, and reviewing the adequacy and integrity of the company's internal control and management information systems.

To fulfil its oversight responsibility, the board as a whole or through delegation to the audit committee or another specific committee, e.g. risk management committee, should review the adequacy, integrity and implementation of appropriate systems for risk management and internal controls.

If a board committee is utilised to fulfil this role, the board should ensure that such responsibility is clearly reflected in the committee's terms of reference. However, the board remains responsible for all the actions of the committee with regard to the execution of the delegated responsibility.

3.1 THE BOARD'S ROLE IN RISK MANAGEMENT AND CONTROL

Best Practice AAI – The board should explicitly assume the following which facilitate the discharge of the board's stewardship responsibilities:

- Identifying principal risks and ensuring the implementation of appropriate systems to manage these risks; and
- Reviewing the adequacy and the integrity of the company's internal control systems and management information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines.

Management is responsible for implementing the processes for identifying, evaluating, monitoring and reporting of risks and internal controls and for providing assurance to the board that the processes have been carried out. The board's role in the oversight of risk management and review of the adequacy and integrity of the company's control environment includes:

- (a) Upholding a culture that emphasises integrity;
- (b) Embedding a holistic risk management framework in all aspects of the group's activities;
- (c) Approving the board's acceptable "risk appetite", i.e. the extent of risk the board is prepared to accept in achieving the company's objectives;
- (d) Evaluating the principal risks and ensuring these risks are appropriately communicated to management;
- (e) Establishing in general, the risk management and control policies for the business;
- (f) Conceiving and adopting a befitting scheme of delegation of board responsibilities to committees;

- (g) Ensuring timely and regular receipt of reports from management of principal risks and that appropriate follow-up measures are implemented on a timely basis; and
- (h) Adopting risk management as part of the board's own decision-making culture.

3.2 PRINCIPAL RISKS ³⁷

The board should remain focused on the company's principal risks and ensure the implementation of appropriate systems to identify and manage these risks that threaten the business. Whilst these risks may be strategic in nature, the board should ensure appropriate controls, encompassing those that are financial, operational and compliance in nature, are in place and working as intended.

Care should be exercised in the implementation of control measures, as it should not require the board's meddling but rather the board should be the 'navigator' while the implementation process is left to management.

3.2.1 Risk Indicators and Appetite

Every company is different and invariably subjected to various types of risks that threaten the attainment of the company's objectives and goals. The severity of risk is generally driven by a number of basic factors such as:

- The company's control environment;
- Management's competency in the industry;
- Market conditions and expectations;
- The company's operating and financial stability; and
- The nature of the company's operations, its location and assets.

A board, upon identification of a list of risks with proper instructions given to management, can determine its risk appetite. The board needs to clearly articulate the company's risk appetite, relative to business goals and objectives and then actively monitor compliance with relevant policies adopted.

³⁷ Corporate Governance – A Practical Guide: London Stock Exchange plc & RSM Robson Rhodes LLP, July 2004

A non-exhaustive list of risk indicators is provided below:

Examples of Risk Indicators:

- Inappropriate “tone at the top”
- High turnover of senior management
- 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 organisational structures or transactions
- Late surprises/high frequency of accounting adjustments
- Ongoing or prior investigations by regulators or others
- Bad news not floating to the top
- Deteriorating employee morale
- Excessive or inappropriate performance-based compensation
- Lack of succession planning
- Inexperienced management
- Lack of management oversight
- Interest rate and currency exposures
- 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
- Regular deferral of capital expenditure
- Inadequate explanations for budget variances
- Significant projects having a strategic objective or high market profile such as acquisitions or information technology system implementations

3.3 INTERNAL CONTROL

Having identified and analysed the risks threatening the company's ability to achieve its objectives, the company is in a position to determine how those risks should best be managed, mitigated and optimised. Managing those risks effectively means using internal control as one of the mechanisms which can help reduce the likelihood of the risks materialising or the impact of the risks when they materialise.

Internal control is an integral part of the objectives, risks and control continuum. If objectives are not clearly stated, understood and communicated, the risks which may prevent the achievement of those objectives cannot be identified, evaluated and thus, the controls appropriate to the level and magnitude of those risks cannot be established.

Management is responsible for designing and implementing internal controls. The board should assess whether management has implemented policies that ensure controls which are in place are adequate and functioning effectively.

Exhibit 4 of this Guide provides a sample questionnaire that the board may ask management to complete in order to provide the board with information on the risk and control environment. The questionnaire should be tailored to the company's specific circumstances as appropriate.



Where the board has delegated its oversight responsibility on risk management to a committee such as the audit committee, the committee should determine the scope and frequency of reports on internal control during the year. During the risk assessment process, the following should be considered:

- The principal risks and the process of identification, evaluation and management of the principal risks;
- The effectiveness of internal control systems deployed by management to address those risks;
- Corrective measures undertaken to remedy failings and/or weaknesses;
- Further requirement for extensive monitoring;
- 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 the work of internal audit and other assurance providers on the robustness of the risk management process;
- Communication and monitoring of risk assessment results to the board; and
- Actual and potential impact of any failing/weakness, particularly those related to financial performance/conditions affecting the company.

Paragraph 15.13 of the Listing Requirements states that the audit committee must review the report by the external auditor on the evaluation of the internal control system and report the same to the board.

Further, **Paragraph 15.27 (b)** of the Listing Requirements requires the board of the listed company to provide a statement about the company's state of internal control as a group.

Reference should be made to Bursa Malaysia's "Statement On Internal Control - Guidance for Directors of Public Listed Companies". This document is available on Bursa Malaysia's website. It provides guidance for directors in making disclosures in their company's annual report on the state of internal control in accordance with the Listing Requirements.

3.4 EMBEDDING RISK MANAGEMENT AND CONTROL FRAMEWORKS

The board must ensure that risk management and control frameworks are embedded into the company's culture, processes and structures to enable effective management of potential opportunities and adverse effects. This can be achieved through the following:

- Adoption of a code of ethics that must be seen to be implemented when difficult choices are to be made;
- Establishment and implementation of whistle-blowing processes;
- Incorporation of management's self-assessment processes;
- Management's assertions on acknowledging its accountability and responsibility for managing risk under the respective areas;
- Training for all employees on the importance of risk management and ensuring that structures are in place to allow employees to participate in the on-going management of risks;
- Establishing a culture of continuous learning from own failures, competitors' challenges or near misses; and
- Constantly being aware of emerging concerns.

The board should also be wary of pitfalls to avoid in the management of risks. The following are some of the issues the board should consider:

- 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;
- Seeing risks as those related solely to finance;
- Inadequate attention 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; and
- General failure to embed risk management in the culture and processes of the company and its workforce.

3.4.1 Managing Risks and Opportunities

Some key questions that the board should consider in its evaluation of the company's risk profile and management's risk management efforts are as follows:

- Whether there is a robust process in place to identify, assess, manage, monitor and report the principal risks faced by the company to the board;
- Whether there is adequate monitoring of principal risks, and that responsibility for risk is assigned to designated personnel or department via the use of key risk indicators, key performance indicators or other equivalent mechanisms;
- Whether consensus is achieved amongst board members and management on acceptable risk levels (in terms of risk likelihood and its impact);
- Whether management is accountable for risk management processes and compliance with the risk policies. The board should assess if management has the relevant expertise to manage risk exposures effectively;
- Whether management and auditors are sufficiently engaged in helping to facilitate information sharing and promoting the establishment of a "risk-aware" culture; and
- Whether significant changes in business strategies or operating environment have taken place and if management has considered and explained the impact of such changes on the company's risk profile.

A forward thinking board would be able to effectively manage its risks whilst maintaining the flexibility to tap the market and lead the business of the company through the ever-changing internal and external environments.



CHAPTER 4
EFFECTIVE OVERSIGHT OF
FINANCIAL REPORTING

EFFECTIVE OVERSIGHT OF FINANCIAL REPORTING

The board is required by law to ensure that the financial statements of the company represent a true and fair view of the state of affairs of the company and that they are prepared in accordance with the applicable approved accounting standards.

To assist in discharging the board's fiduciary duties, the responsibility for overseeing the financial reporting process is often delegated to the audit committee. The board may delegate but not abdicate its responsibility to the audit committee. The audit committee must review and report the company's financial statements to the board for the board's assessment and approval. The board in approving the financial statements cannot expect total assurance on the recommendations by the audit committee without proper assessment and consideration of the financial statements. The board must deliberate on the audit committee's recommendations and approve the financial statements before the statements are announced in accordance with the Listing Requirements.

The audit committee's review and evaluation of financial statements is one of the most important functions, with the culmination of the audit committee's work in any given reporting cycle being the acceptance of the financial statements by the board.

4.1 FINANCIAL REPORTING INTEGRITY

Paragraph 15.13 (1)(g) of the Listing Requirements requires the audit committee to review the quarterly results and year-end financial statements prior to approval by the board, focusing particularly on:

- Changes in or implementation of major accounting policy changes;
- Significant and unusual events; and
- Compliance with accounting standards and other legal requirements.

Best Practice BBII of the CG Code further requires the audit committee to focus on significant adjustments arising from the external audit and the appropriateness of the going concern assumption used in preparation of the financial statements.

Understanding the company's financial statements is crucial for audit committee members. They should be prudent in assessing the impact of current and emerging issues and be able to formulate the relevant responses.



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, particularly by reviewing the relevance and consistency of the accounting principles used (including criteria and principles used for consolidation) and understand 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 transaction where its 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 state 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 reality of such transactions and whether they have been entered into according to terms as stipulated in the shareholders' mandate or in the best interest of the company;
- Requesting the 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.

Where there are group financial statements involved, a common appreciation of the control frameworks and cultures of the entities and substantial sharing of information should be coordinated and communicated between the audit committees of the parent and subsidiaries.

A thorough understanding of all these factors is integral to the audit committee's ability to meet its responsibilities.

4.2 THE AUDIT COMMITTEE AND FINANCIAL REPORTING

Shareholder and investor communications normally start with statutory disclosure. For listed companies in Malaysia, statutory disclosure is principally based on:

- The Companies Act, 1965;
- The Financial Reporting Act, 1997;

- Capital Markets and Services Act, 2007;
- Applicable approved accounting standards and mandatory professional reporting requirements;
- The Listing Requirements of Bursa Malaysia Securities Berhad;
- Various guidelines issued by the Securities Commission that apply to the company; and
- The Banking & Financial Institutions Act, 1989 and the Garisan Panduan directives of Bank Negara Malaysia (as appropriate).

The changes in standards and legislation from time to time invariably pose a challenge to the audit committee in its oversight role of the company's financial reporting process. In such a dynamic reporting environment, it is vital for the audit committee to be made up of members who are ready and prepared to engage in dialogue on equal terms with the external and internal auditors and with senior management on matters of financial reporting.

4.2.1 Reporting Practices

The recent years have been marked by rapid and widespread expansion in the scope of financial reporting, both in depth and extent. This widening of scope is necessary to cater to the increasingly complex and innovative transactions in today's market besides responding to the growing information demands from users of financial statements. In addition, changes in financial reporting have also been necessitated by the international harmonisation and convergence of accounting standards as a result of globalisation for better comparability of financial reporting.

Paragraph 15.18 of the Listing Requirements provides the rights of the audit committee include, amongst others, having full and unrestricted access to any information pertaining to the company; having direct communication channels with the external and internal auditors; and being able to convene meetings with the external auditors or internal auditors or both, excluding the attendance of other directors and employees of the company, whenever deemed necessary. Such rights or powers rightly empower the audit committee to carry out its work unhindered.

It is essential that the audit committee continues to keep abreast of latest developments in financial reporting and regulatory changes. The audit committee should understand and evaluate the complexities of new financial reporting requirements in the context of the company's business and business transactions.

Audit committee members must educate themselves appropriately through ongoing training, augmented by inputs from management and external auditors on the recent developments in financial reporting.

Equipped with this knowledge, the audit committee should probe management on how new accounting standards have an effect on the financial reporting of the company and how significant transactions are accounted for and disclosed in the company's financial statements and announcements.

Mergers, acquisitions and restructuring often involve the merging of companies entailing, amongst others, the following matters:

- Distinct corporate cultures which may require a change management process amongst the operating personnel and local management;
- Varying industries with different challenges and business risks; and
- Different geographical locations that may have onerous regulations and laws to be complied with.

Today, it is common for companies to cross borders in every aspect of their businesses. This environment poses the management and the audit committee with unique oversight challenges.

While governance practices in such environments are slowly evolving, the influence of global business needs to be carefully considered. A number of questions may need answering:

- How are management's reporting, controls and compliance responsibilities integrated?
- Is there effective oversight of local management?
- How does the committee evaluate domestic and international audit results, both internal and independent?
- How does management ensure compliance with various countries' rules and regulations?

Management reporting of operations must be clear and responsible. The company must be able to satisfactorily respond to a regulator's inquiry into the earnings of the company.

The pressure to achieve earnings targets can place a heavy burden on senior management in terms of job security and remuneration. This can inadvertently lead to the consideration of aggressive and/or inappropriate financial reporting through earnings management, involving, amongst others, revenue recognition anomalies, inappropriate deferral of expenses, inconsistent recognition of controlled entities' results and understated reserves.

The audit committee should be alert to risk factors and recognise circumstances which may affect the integrity of financial reporting, such as:

- Difficult economic times;
- Pressure to perform
 - market/analyst expectations;
 - management incentives or remuneration tied to short term performance measures;



– debt or other covenants;

- Rapid or innovative business expansion;
- Use of complex financial instruments and/or structured financial transactions via special purpose vehicles;
- The intricacies of financial reporting standards, regulations, abstract interpretations, exacerbated by the volume and types of transactions and pace of change in such requirements;
- Cash flow constraints; and
- Changes in the internal control system, especially in the area of segregation of conflicting functions and management override.

Some examples of specific areas of accounting irregularities that can adversely affect the quality of reported earnings are:

- *Revenue recognition* – recognising turnover before a sale is completed, or at a time when the customer still has the option to terminate, void or delay the sale resulting in it distorting the actual revenue for the reporting period;
- *Recording of fictitious assets/revenue* – fictitious assets/revenue being recorded to enhance the performance and balance sheet, e.g. by inflating income and the corresponding receivables;
- *Provisioning of bad/doubtful debts* – inordinate changes in the provisioning policy in terms of quantum and/or criteria with the aim of reducing the level of doubtful debts in order to maximise reported profit in the income statement;
- *Impairment of assets* – postponing write-downs for impairment or under-reporting reserves on reversal of impairment. In industries with rapid changes in product lines or technology, insignificant or no write-downs in carrying value of assets may indicate red flags;
- *Intra-group transactions* – these involve transactions amongst companies in the group where the unrealised profit element thereof is not eliminated on consolidation;
- *Sale and leaseback arrangements* – such arrangements can result in erroneous recognition of profit that enhances financial performance, especially when the sale of an asset is carried out by a company in the group whilst the leaseback arrangement for the same asset is entered into by another company in the group;

Best Practice BBII (vii) – The duties of the audit committee include considering any related-party transactions that may arise within the company or group.

- *Classification of financial instruments* – intentionally reclassifying securities or transferring securities to trigger the recognition of gain or deferment of loss. For example, reclassifying a debt security as held to maturity to avoid recognising a loss in the current period or transferring a security from held to maturity to either trading or available for sale to allow recognition of gain;
- *Abuse of the materiality concept* – this involves the intentional recording of errors under the “materiality threshold” and to conclude that the impact on the bottom line is not significant;
- *Capitalisation and deferral of expenses* – capitalising and deferring costs that should be accounted for as a cost for the period, for example, ambiguously defined capitalisation criteria for property, plant and equipment and intangible assets, unreasonable amortisation periods or through the capitalisation of costs for which future economic benefits are not reasonably assured;
- *Transactions with related parties* – this involves misleading the audit committee and the board concerning related party transactions through misrepresentation and omission to state the material facts regarding these transactions. Further reference should be made to **Chapter 6** of this Guide on related party transactions; and
- *Transactions involving off-balance sheet arrangements* – improper deconsolidation through off-balance sheet vehicles to understate liabilities or overstate income.

Exhibit 5 of this Guide provides a list of warning signals or “red flags” that the audit committee should consider prior to discussions with management or in its review of financial statements.

It is therefore imperative that the audit committee fully understands the company’s accounting policies and procedures that may compromise the quality and integrity of the financial reporting process.

In case of doubt or a need to clarify pertinent issues affecting financial reporting, it is vital for the audit committee to consult with the external auditors or other relevant parties for the required insights.

4.2.2 Representations by Management

It is management’s responsibility to prepare complete and accurate financial statements and disclosures in accordance with applicable approved accounting standards in Malaysia and in compliance with the relevant rules and regulations for board’s approval.

Nonetheless, the audit committee needs to be satisfied with the use of accounting estimates and judgments by management, and that the latter’s selection of accounting policies are in line with applicable approved accounting standards in Malaysia. Once the assessment has been made by the audit committee, the board needs to satisfy itself as to the reasonableness and appropriateness of the report and recommendations.

Exhibit 6 of this Guide provides a sample questionnaire that can be tailored to seek management's representations on a range of financial reporting matters. The audit committee is encouraged to consult the external auditors on the appropriateness of matters and application of approach if a need arises.

It is important that management is available for the audit committee meetings and prepared to answer questions on financial reporting issues. Such questions include:

- What is your assessment of the overall control environment?
- 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 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?
- 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 to the company's financial report?
- What are the financial statement captions where significant differences exist between the current and prior period? Why have these variances occurred?
- Is the financial result significantly different from 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?

CHAPTER 5

INTERNAL AND EXTERNAL AUDIT: “EYES AND EARS” OF AUDIT COMMITTEE

INTERNAL AND EXTERNAL AUDIT: “EYES AND EARS” OF AUDIT COMMITTEE

5.1 INTERNAL AUDIT



The internal audit function is essentially the “eyes and ears” of the audit committee, providing the committee primarily with the much needed assurance pertaining to the risk management, governance and control processes within the company. Its key role is to assess management’s adherence to established policies and procedures, ethical standards and requirements and is largely instrumental in acting as an independent sounding board to the audit committee concerning areas of weaknesses or deficiencies in the risk management, governance and control processes for appropriate remedial measures to be meted out by the company.

The above is in line with the definition of internal auditing promulgated by the Institute of Internal Auditors Inc (“the IIA”) which states:

“ Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes ”.

The CG Code clearly specifies that an internal audit function should be established with the head of internal audit reporting directly to the audit committee. **Paragraph 15.28** of the Listing Requirements states that a listed company must establish an internal audit function that is independent of the activities it audits and reports directly to the audit committee.

Chapter 9 Appendix 9C Part A (Paragraph 30) of the Listing Requirements mandates the disclosure of whether the internal audit function is performed in-house or out-sourced and the costs incurred for the internal audit function in respect of the financial year.

Exhibit 11 shows a sample “Statement on Internal Audit Function” that PLCs may consider for disclosure in the annual report.

5.1.1 Role, Scope and Resources of Internal Audit

Best Practice BBVIII - The internal audit function should be independent of the activities it audits and should be performed with impartiality, proficiency and due professional care. The board or the audit committee should determine the remit of the internal audit function.

Role

In assisting the audit committee to discharge its governance responsibilities, the head of internal audit is normally involved in carrying out:

- A review of the “tone at the top”, i.e. the control environment of the company;
- An objective evaluation of the risk and internal control framework;
- A systematic analysis of business processes and associated controls;
- An assessment of how information on fraud and irregularities is reported;
- 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;
- Reviews and providing recommendations for more effective and efficient use of resources;
- Follow-up visits to determine the status of management implementation of plans to address observations reported in preceding internal audit visits; and
- Reviews and providing feedback on adherence to the company’s code of conduct and/or code of ethics.

To position and formalise the internal auditor’s role in the oversight function, a mandate in writing (e.g. an internal audit charter or terms of reference), setting forth its purpose, responsibilities and the necessary authority to carry out its work, should be established and approved by the audit committee. To benchmark against better practices, the audit committee should consider establishing the internal audit function’s purpose, authority and responsibility by taking into consideration the definition of internal auditing, the company’s Code of Ethics and the International Standards for the Professional Practice of Internal Auditing (the “Standards”) which form part of the International Professional Practices Framework of the IIA, being the globally recognised standards for the internal audit profession. The board or audit committee on behalf of the board should be involved in developing and approving the mandate, goals and mission.

This often helps ensure a proper balance between the assessment of internal controls related to financial reporting and other special projects involving operational efficiency and risk management.

Best Practice BBII (vi) – The duties of the audit committee should include the following, in relation to the internal audit function:

- Review the adequacy of the scope, functions and resources of the internal audit function, and that it has the necessary authority to carry out its work;
- Review the internal audit programme and results of the internal audit process and, where necessary, ensure that appropriate actions are taken on the recommendations of the internal audit function;
- Review any appraisal or assessment of members of the internal audit function;
- Approve any appointment or termination of senior staff members of the internal audit function; and
- Take cognisance of resignations of internal audit staff members and provide the resigning staff member an opportunity to submit his reasons for resigning.

Scope

The CG Code requires the audit committee to review the planned scope of internal auditing activities for the year.

Paragraph 15.13(1)(f) of the Listing Requirements states that the audit committee must review the internal audit programme, processes, the results of the internal audit programme, processes or investigation undertaken and whether or not appropriate action is taken on the recommendations of the internal audit function.

The proposed breadth and depth of the plan and, particularly, any restrictions placed on its scope need to be fully discussed and debated by the audit committee before the plan is approved.

Once the internal audit plan has been rolled out, the audit committee, in reviewing the audit programmes, must ensure that the internal audit coverage is responsive and robust enough to vary in tandem with the changing level of risk and emerging areas of concern, for example where there is a sudden exodus of operating personnel in certain companies within the group, changes in regulatory requirements that need close adherence by the company, etc.

Audit committee members need to be aware of the need for internal auditors to undertake special investigative reviews from time to time in addition to the agreed internal audit plan, such as in the area of fraud, conflicts of interest and related party transactions.

In relation to reviewing internal audit reports, practices may differ amongst companies, but the key is to ensure that the audit committee receives adequate information to fulfil its role.

The audit committee therefore should ensure that the internal and external auditors complement each other as appropriate, the audit efforts are coordinated and there is effective communication between them. Audit committee members need to fully understand the internal audit plan and the implications. They must ensure that when it is read in conjunction with the external audit plan, there are no significant exposures with respect to the review of financial and non-financial reporting risks that may have financial reporting implications.



Resources and Appointments

Paragraph 15.13(1)(e) of the Listing Requirements requires the audit committee to review the adequacy of the scope, functions, competency and resources of the internal audit function and that it has the necessary authority to carry out its work.

Thus, the audit committee must ensure that the internal audit function, be it in-house or outsourced, has adequate resources, consisting of people who are adequately skilled.

Whilst the IIA provides guidance on assessing the competency of the internal audit function (vide the Competency Framework of Internal Auditors (CFIA), 2008), audit committees should, as a minimum, evaluate the capability and adequacy of resources of the said function in the following two aspects, regardless of whether the function is in-house or outsourced:

- The people – whether internal audit personnel are qualified and adequate in number vis-à-vis the extent and complexity of internal audit coverage, e.g. the relevant academic or professional accreditation such as degree in the relevant field; the experience that is crucial to enable them to carry out internal audit work; reasonably strong interpersonal skills in discussing with auditee personnel and writing reports, articulating the 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; and
- The process – the robustness of the internal audit process, including how structured the approach used by internal audit personnel is in achieving the internal audit objective. Internal audit programmes should be clear and objective enough to enable the personnel to execute the test steps, methods of adducing and evaluating audit evidence for reliability and sufficiency vis-à-vis the objectives served.

The decision as to appropriate sourcing of internal audit man-power for the company will usually be driven by the availability of appropriate skills and the breadth and depth of personnel’s ability to adequately cover the group’s business operations. The team should be capable of providing services across the spectrum from basic compliance audit work to consulting work.

The audit committee should review the appointment, transfers, promotion or dismissal of the internal audit staff.

The CG Code further emphasises the need for the audit committee to take cognisance of resignations of the internal audit staff and provide a resigning staff member an opportunity to submit his or her reasons for resigning. This is important to ensure there is no attempt by management to restrict inquiries or findings of internal audit. Close involvement in the resignations of internal audit staff may also provide an opportunity for the audit committee to be kept informed of systemic issues faced by outgoing staff.

5.1.2 The Audit Committee and Internal Audit

Best Practice BBVII –The board should establish an internal audit function and identify a head of internal audit who reports directly to the audit committee.

The head of internal audit will be responsible for the regular review and/or appraisal of the effectiveness of the risk management, internal control and governance processes within the company.

In order to ensure the internal audit function retains independence from management so that it may carry out its function impartially, the CG Code requires the head of internal audit to report directly to the audit committee.

The CG Code calls for the audit committee chairman to continuously engage with the head of internal audit. A good practice for such an engagement is that it should be carried out without the presence of management or any employees, or even the external auditors towards the end of each audit committee meeting.

As the internal audit function's focus is clearly wider than purely looking into financial risks and controls, it is natural for the function to provide input on a range of issues and matters. In inquiring from the internal auditor on financial reporting, the audit committee should pose, amongst others, the following questions:

- What is your assessment of the overall control environment?
- What is your assessment of the company's financial reporting processes, both internal and external?
- Have you performed the audit on the strategic and operational risks faced by the company?
- What processes are in place to assure that material errors in the financial report, if any, can be reasonably detected? Do you consider these to be robust and effective?
- Have you had sufficient access to all areas of the company and appropriate resources to facilitate your reviews and assessments?
- What is your assessment of the company's compliance with regulations?
- Has there been any attempt to limit the scope of your work in any way?
- Has there been any modification to the original audit plan due to deficiencies in internal control or accounting records?
- Have there been any disagreements between you and management and/or the external auditors? If so, what were they and how were they resolved?
- Have there been any circumstances where you were placed under undue pressure?
- Are there any other concerns that should be considered by the audit committee?

5.1.3 Evaluation of Internal Audit

In evaluating the internal audit, the audit committee needs to assess its effectiveness against agreed performance criteria such as:

- The overall comprehensiveness of the internal audit plan and its relationship to the strategic objectives of the company;
- Timely delivery of internal audit services in accordance with the plan; and
- The competency of internal audit staff and adequacy of resources to achieve the scope as outlined in the plan.

The CG Code requires the audit committee to review any appraisal or assessment of the performance of members of the internal audit function.

In addition, the audit committee may request for a periodic internal and external quality assessment review of the internal audit function for any apparent gaps that need to be fixed so that the capability of the internal audit function can be honed over time to provide the necessary assurance to the audit committee on the effectiveness of the company's risk management, governance and control processes.

5.2 EXTERNAL AUDIT

External auditors play a vital role in the process of accountability for shareholders. Their primary role is to form an opinion on the accounts of the group and the company, including accounting and other records relating to those accounts and thereafter report to the shareholders in general meeting³⁸. In their course of work, they may identify and, where appropriate, quantify the financial risk that may result in adjustments to the accounts.

The external auditor's independent attestation is also viewed as contributing to the effective functioning of the capital markets which value consistent and reliable financial reporting.



³⁸ Section 174(1) and (2) of the CA

5.2.1 Role, Scope and Resources

Best Practice BBII (i)-(ii), (iv) & (v) - The duties of the audit committee should include the following:

- To consider the appointment of the external auditor, the audit fee and any question of resignation or dismissal;
- To discuss with the external auditor before the audit commences, the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved ;
- To discuss problems and reservations arising from the interim and final audits, and any matter the auditor may wish to discuss (in the absence of management where necessary); and
- To review the external auditor's management letter and management's response.

Role and Scope

Paragraph 15.13(1)(a)-(d) of the Listing Requirements states that the audit committee must carry out the following and report the same to the board:

- Review with the external auditor, the audit plan;
- Review with the external auditor, his evaluation of the system of internal controls;
- Review with the external auditor, his audit report; and
- Review the assistance given by the employees of the listed company to the external auditor.

The audit committee needs to be aware of the scope and approach of the external audit. While the audit plan is the external auditor's responsibility, it is important that the audit committee fully understands it. To accomplish this in an effective way, the audit committee's role in relation to audit scope is as follows:

- 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 help clarify the responsibilities of the company and the external auditor and other logistical matters;
- Study and evaluate the audit plan, especially the approach to be deployed by the external auditor. A typical audit plan would normally set out the following:
 - Scope of the audit;
 - Timing of the audit and reporting, including the 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;
 - 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 accounts;
- 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.

Resources and Appointments

Paragraph 15.22 of the Listing Requirements stipulates that the listed company must appoint a suitable firm to act as its external auditors, and amongst others, the factors to be considered for the appointment are the adequacy of the experience and resources of the firm and the persons assigned to the audit.

The audit committee plays a key role in reviewing the scope and results of the external audit and the independence and objectivity of the auditors. The audit committee is responsible for recommending to the board on the appointment, reappointment and removal of the company's external auditors, although the shareholders are essentially the party appointing the external auditors. Some of the matters for consideration regarding appointment, reappointment and removal of the company's external auditors include:

- The independence of the firm and the individuals identified to form the team, including the processes deployed by the firm to ensure on-going independence;
- The firm's reputation and qualifications of its professionals, including the breadth and depth of resources, expertise and experience of the team members;
- The networking ability and competency to address overseas subsidiaries not audited by the firm, i.e. its liaison capability with the secondary auditors;
- The audit methodology employed by the firm such as the underlying methodology and materiality used to determine the nature, extent and timing of testing required is a key ingredient for an effective audit;
- How the firm delivers value other than through the provision of the statutory audit report; and
- The proposed fee arrangements.

Following the appointment of an external auditor, the audit committee should review the terms of engagement, ensuring that they have been updated to reflect changes in circumstances arising since the previous year (or previous auditor).

The audit committee should be satisfied that the level of fee payable to the external auditor in respect of the scope of the external audit to be performed is appropriate and that an effective audit can be conducted for such a fee.

The performance of the external auditors should be periodically reviewed by the audit committee. In evaluating this, the audit committee should assess the effectiveness of the external audit based on feedback from management and against agreed performance criteria such as:

- The overall comprehensiveness of the external audit plan vis-à-vis the objective of the engagement;
- The timeliness and quality of communication as contemplated under the plan; and
- The competency of external audit staff (i.e. whether there is an appropriate mix of experienced and junior audit staff) and adequacy of resources to cover the scope as outlined in the plan.

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 impasse in the resolution of contentious matters that affect financial reporting.

Paragraph 15.23 of the Listing Requirements stipulates where external auditors are removed from office or give notice to the listed company of their desire to resign as external auditors of the listed company, the listed company must forward to the Exchange a copy of any written representations or written explanations of the resignation made by the external auditors at the same time as copies of such representations or explanations are submitted to the Registrar of Companies Commission of Malaysia pursuant to Section 172A of the Companies Act, 1965.

5.2.2 Audit Committee and External Audit

Audit Independence

On an annual basis, the audit committee should ensure the independence and impartiality of the external auditor, taking into consideration relevant regulatory requirements. The audit committee could consider seeking information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners, the level of fees that the company pays and other related regulatory requirements.

In relation to non-audit services provided by the external auditors, the audit committee should establish and recommend to the board a policy to ensure such services provided by the auditors do not impair, or appear to impair, the auditor's independence or objectivity.

Prior to the provision of any engagement of non-audit services by the external auditor, the audit committee should review and approve the acceptance of such engagements. The By-Laws of the Malaysian Institute of Accountants (“MIA”) prohibit the external auditor of a listed company from providing internal audit services to the same company or its subsidiaries.

The audit committee should consider the following when determining the policy:

- If the skills and experience of the audit firm make it a suitable service provider;
- If there are mitigating controls in place to avoid the threat against objectivity and independence; and
- The nature of the non-audit services, including the related fee levels.

Private Sessions with the External Auditors

A formal mechanism should be established by the audit committee to ensure there is frank and candid dialogue with the external auditors.

The CG Code emphasises the frequency of meetings between the audit committee and the external auditor without the executive board members present. This encourages a greater exchange of free and honest views and opinions between both parties.

Paragraph 15.18 (f) of the Listing Requirements mentions that the audit committee shall be able to convene meetings with the external auditors, the internal auditors or both, excluding the attendance of other directors and employees of the listed company, whenever deemed necessary.

Exhibit 7 includes a list of questions that can be raised with the external auditor during such meetings.

Audit Report, Management Representation Letter and Management Letter

The external auditor, in carrying out his work, would normally assess the system of internal control, especially on the processes deployed by management to ensure all transactions are properly authorised, monitored and recorded to enable the preparation of true and fair profit and loss account and balance sheet and to give a proper account of the assets of the company. Arising from such review, the external auditor may well have observed certain weaknesses or deficiencies in the system that need improvement.

Such observations are normally included in a management letter setting out the issues and recommended action plans for management’s consideration with a view of rectifying the gaps noted. Following the audit and before signing off 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;

Best Practice BBIII – The audit committee should meet the external auditors without executive board members present at least twice a year.

- The draft external auditor's report of his opinion on the financial statements; and
- A management letter concerning improvement measures that management should consider pertaining to weaknesses or deficiencies in the internal control system.

FOCUS:

Responsibility Over Financial Reporting

It is important to note that the directors, and not the external auditors, are primarily responsible for preparation of the financial statements in accordance with the provisions of the Companies Act 1965 and must sign a directors' declaration before the audit report can be signed.

The audit committee cannot rely solely on the work of the external auditor to enable it to form its view on the truth and fairness of the financial statements, including compliance with applicable laws and regulations. There are other avenues that the audit committee can draw assurance from, e.g. the internal audit function, the compliance unit, robustness of the internal control system and triggering mechanisms for breach of controls like exception reports generated by system, etc.

Once the directors' declaration has been signed, a management's representation letter is to be signed by an executive representative of the management which covers inter-alia, the following matters before the external auditor issues an audit report:

- Confirmation that all accounting records had been made available, all transactions properly recorded in the accounting records, and all other records and related information had been made available; and
- Management's expectations regarding future events that affect critical accounting judgments, for example, the recoverability of debt.

A management representation letter includes a written summary of representations made to the audit team during the course of the audit. It must be finalised before the audit report can be signed.

In making enquiries of external auditors in relation to financial reporting, the audit committee needs to ask a range of questions including, but not limited to, the following:

- Which aspects of our financial report cause you the most concern?
- If you had prepared the financial statements, what would have been different?
- Do you feel management's approach to accounting is conservative, moderate or aggressive from the perspective of income, asset and liability recognition?
- Are the policies which have been applied, usual or unusual for a company in our industry?
- Are any of the changes in accounting policy or disclosure likely to be challenged by regulators or questioned by stakeholders?
- What are the nature and extent of adjusted and unadjusted audit errors/ differences? If unadjusted differences had been recorded, would they have impacted the company's position with respect to compliance with debt covenants or regulations, or affected bonus entitlements tied to performance or be likely to change the decision making of readers of the financial statements?
- Can the going concern assumption in the preparation of the financial statements be supported?
- Have you received complete co-operation from management? Have there been any disagreements in respect of financial reporting? If so, what were they and how were they resolved?
- What are the greatest financial risks to the company? Is the company effectively managing these risks? What related audit procedures have the external auditors performed in relation to these risks?
- How would you evaluate the internal audit function with respect to its approach to identifying, assessing, monitoring and reporting on financial risks and controls?
- What financial, regulatory, industry, operational and technology trends have you noticed within the company and the industry over the last year? What impact have they had on the company?
- How would you compare such impact on our company with others in the industry?

Best Practice BBII (v) – The duties of the audit committee should include reviewing the external auditor's management letter and management's response.

The “Management Letter” is a reporting tool used by the external auditors to report to the company any material weaknesses identified in the accounting or internal control systems and recommendations for improvements.

The audit committee should request the external auditors to present their findings on internal control weaknesses noted during their 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.

Hence, 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.



CHAPTER 6
CONFLICT OF INTEREST
AND RELATED PARTY
TRANSACTIONS

CONFLICT OF INTEREST AND RELATED PARTY TRANSACTIONS ³⁹

It is an important function of the audit committee to guard against conflict of interest situations and questionable related party transactions for purposes of facilitating the discharge of board's responsibility. The audit committee should review these areas to ensure that companies have clear lines drawn with respect to the use of company assets and related party transactions.

Paragraph 1.01 of the Listing Requirements defines a related party as a director, major shareholder or person connected with such director or major shareholder.

Chapter 10 of the Listing Requirements sets out the requirements on transactions, with Part E thereof focusing on related party transactions.

A related party transaction is a transaction entered into by the listed issuer or its subsidiaries which involves the interest, direct or indirect, of a related party. 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 company or its subsidiaries⁴⁰.

In addition, the CA which prescribes the obligation in respect of substantial property transactions involving directors or substantial shareholders or persons connected with directors or substantial shareholders must also be read and complied with⁴¹.

³⁹ See Chapter 1 in this Guide for related party transaction under the CA.

⁴⁰ Paragraph 10.02 of the Listing Requirements

⁴¹ Section 132E of the CA

6.1 CONFLICT OF INTEREST

Conflict of interest may arise when a director and/or shareholder 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.

When a company transacts with directors, major shareholders or connected persons who have significant influence over the decision-making process in the company, there is a risk that the interest of the company or its shareholders may be compromised.

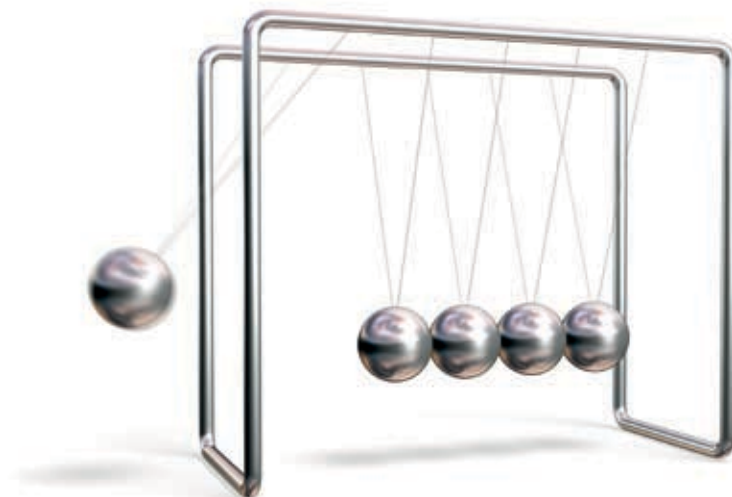
A company must ensure there are policies, guidelines and procedures in place pertaining to the identification, treatment and reporting of situations constituting conflicts of interest within it and its group of companies. This is to ensure that:

- There will be standard treatment of conflicts of interest;
- All conflicts of interest are dealt with and addressed expeditiously; and
- The role, responsibilities and accountability of relevant parties in dealing with and resolving conflicts of interest are outlined clearly.

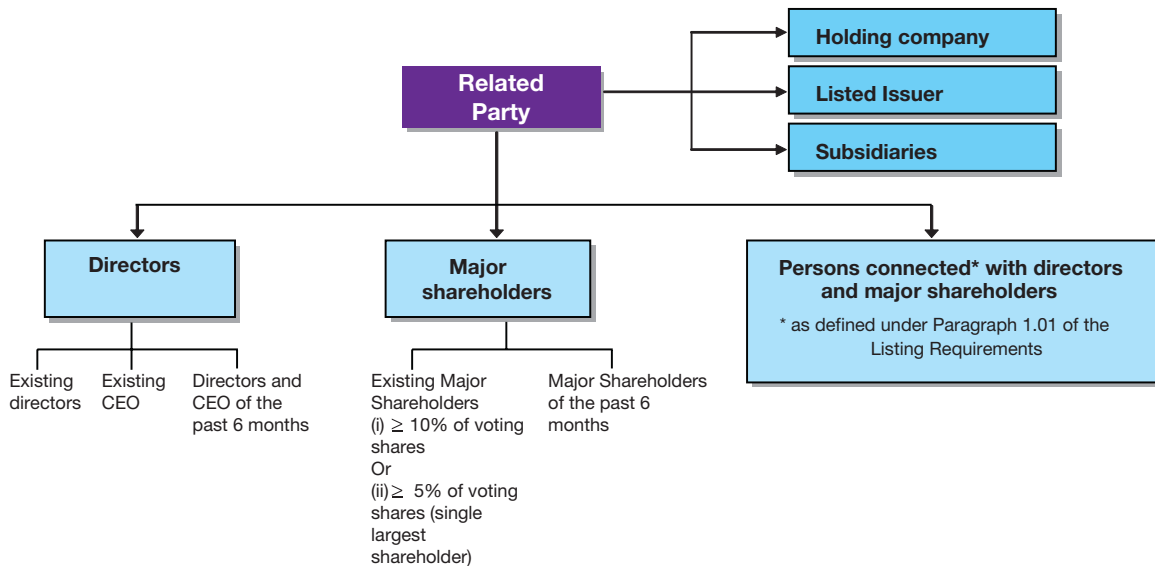
Situations likely to give rise to conflicts of interest include the following:

- Where the interested party has 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");
- Where the interested party conducts or has interest in business transactions involving goods or services, either directly or indirectly, with the group;
- Where the interested persons provide or receive financial assistance from the group; and
- Where the interested persons lease property to or from the group.

Generally, conflict of interest situations should be controlled or managed to ensure that they would not be detrimental to the company.



6.2 RELATED PARTIES AND DISCLOSURE OF INTERESTS



The above diagram shows the various persons who are included in the definition of a related party under **Chapter 10** of the Listing Requirements.

In order to identify individuals who may have influence over decisions made by the company, the audit committee should regularly review submission of disclosures on the directorships and shareholdings held by directors of the company and persons connected with them.

If possible, similar disclosure from the controlling shareholder who is not a director, officer or employee of the company should be procured. However, the controlling shareholder must be willing to volunteer such information. In this regard, directors who are nominees or representatives of the controlling shareholder may assist by engaging the controlling shareholder to volunteer such information to the company.

6.3 AUDIT COMMITTEE'S OVERSIGHT RESPONSIBILITY IN REVIEWING CONFLICT OF INTEREST SITUATIONS AND RELATED PARTY TRANSACTIONS

Best Practice BB11 (vii) - Audit committee should consider any related party transactions that may arise within the company or group.

The audit committee is tasked under **Paragraph 15.13(h)** of the Listing Requirements to review and report to the board any related party transactions and conflict of interest situations that may arise within the company or group including any transaction, procedure or course of conduct that raises questions of management integrity.

The audit committee is entrusted to review related party transactions and conflict of interest situations and ensure that the transactions are carried out on normal commercial terms and are not prejudicial to the interests of the company or its minority shareholders.

6.3.1 Establishment of Proper Framework for Conflict of Interest Situations and Related Party Transactions Reporting

The audit committee should ensure that management establishes a comprehensive framework for the purposes of identifying, monitoring, evaluating, reporting and approving such situations and transactions.

Such a framework should be able to provide sufficient assurance that related party transactions and conflict of interest situations, including recurrent related party transactions, are identified, evaluated, presented for review and approval and reported, where required.

The audit committee may request the internal auditor or other external consultants to review the effectiveness, adherence to and relevance of the framework.

Additionally, there could be transactions that may not fall within the definition of a related party transaction as per the Listing Requirements strictly but may still involve certain level of conflicts of interest due to the close proximity of the transacting parties or where the director or major shareholder may derive personal gain or advantage from the transaction or arrangement.

To facilitate the discharge of its oversight role, the audit committee must also ensure a proper framework is put in place to bring such related party transactions and conflict of interest situations to its attention by directing management to establish appropriate controls and by way of regular reporting to the audit committee.

6.3.2 Scope of Audit Committee's Responsibility

The audit committee's role vis-à-vis the board is as follows:

- Oversight over the controls of the following:
 - Identification of the interested parties; and
 - Identification of the related party transactions and possible conflict of interest situation.
- Upon receiving a report on conflict of interest situations and/or a related party transactions report, the audit committee should review and determine whether the conflict of interest situations or related party transactions are fair, reasonable, on normal commercial terms and in the best interests of the company. Factors to be taken into account and questions the audit committee may ask in making this assessment include:
 - Whether the basis for arriving at the transaction price is on arm's length basis or terms fair to the company. This is addressed under **Section 6.4** of this Guide;
 - Whether there are business reasons for the company to enter into the transaction with the related party and not a third party;
 - Whether the business reasons are in line with the overall strategy and objective of the company;
 - What benefits the interested party will derive from the transaction;

- What impact the transaction will have on the financial statements; and
- Whether there is economic substance in entering into the transaction.

The board on the other hand should consider and decide whether to approve (or otherwise) the proposed transaction. The board must ensure that the company conducts its affairs in the best interest of the company and its shareholders.

The audit committee should review conflict of interest situations or related party transactions prior to the company entering into such transactions. The audit committee shall then report its views to the board on the following:

- (i) whether the transaction is in the best interest of the company;
- (ii) whether the transaction is fair, reasonable and on commercial terms and not detrimental to the interest of minority shareholders; and
- (iii) the basis for its views.

The audit committee's views should also be included as part of the public announcement that would be made in respect of the transaction.

A list of matters to be tabled to the audit committee and samples of “memory jogging” information that can assist the audit committee to arrive at its views to properly discharge its oversight role over related party transactions and possible conflict of interest situations is set out in **Exhibit 8** of this Guide.

The audit committee should also be aware that, apart from the review of related party transactions and conflicts of interest, transactions entered into may also be required to be disclosed in the company's financial statements under the applicable approved accounting standard. For reference on the review of related party transactions relating to financial reporting, please refer to **Chapter 4** of this Guide.

FOCUS:

What happens if the audit committee finds that the conflict of interest situation or related party transaction is to the detriment of the company (not at fair value or not at arm's length) and will have an impact on the financial position of the company?

It is the responsibility of the audit committee to report such transactions to the board together with its recommendations. The board should make a decision collectively on whether the transactions in question are in line with the company's objectives and in its best interest and follow up with appropriate action to the best interest of the company.

6.3.3 Undisclosed Conflict of Interest Situations and Related Party Transactions

The possibility of undisclosed conflict of interest situations or related party transactions being entered into with the objective of managing earnings is an issue which may be faced by the audit committee.

In order for the audit committee to identify a potential or a questionable situation or to satisfy itself if the transaction might be a related party transaction, the audit committee should request management to provide the following information:

- Background information on the company's trading partner;
- Information on the trading partner's substantial shareholders;
- Identity of the transacting parties;
- Identity of related parties; and
- Information of the key business partners, major customers, major suppliers and parties to key contracts.

Considerations should also be made to further assess the potential influence the parties may have and that may be exercised over the company. In determining if conflicts of interest exist in transactions, the audit committee should make further enquiries on the influence the parties may have over the company by considering the economic and commercial substance of the transaction. Factors to be taken into account and questions that the audit committee may ask in making this assessment include:

- Whether such a transaction would raise any potential conflict of interest taking into account:
 - the size of transaction;
 - the overall financial position of the interested party;
 - the interested party's interest in the transaction and the importance and nature of the interest;
 - the benefits to the company and to the relevant interested party; and
 - other terms of the transaction.
- Whether the interested parties have personal pecuniary interests which are in conflict with those of the company;
- Whether the relationship between a major shareholder and the company could result in a conflict between the company's obligations towards that major shareholder and its duties to the general body of shareholders;
- Whether the interested party's objective professional judgment to act in the best interest of the company is compromised; and
- Whether the interested person is otherwise engaged in an activity which detracts time and commitment from managing the company.

6.4 EVALUATION OF PRICING AND OTHER TERMS AND CONDITIONS OF TRANSACTIONS

The audit committee should assess and address the reasonableness of the conflict of interest situations or the related party transactions to ensure that interested parties do not abuse their powers to gain unfair advantage.

FOCUS:

How does the audit committee satisfy itself on reasonableness of the related party transaction pricing?

Some suggestions:

- Ensure that the board is conversant on the merits of the transaction;
- Be aware of the basis and assumptions behind management's valuation and projection;
- Assess and challenge the rationale, basis and assumptions in arriving at the pricing;
- Review the valuation report and consider valuer's qualification, independence and experience;
- Consider getting a second opinion on valuation if there is merit for one;
- Obtain independent third party comparative quotes; and
- Be aware of issues impacting the financial statements and company's tax obligations.

FOCUS:

How does the audit committee ensure that the terms and conditions of transaction are fair to the company?

Some suggestions:

- Request management to furnish an analysis or comparison of the terms of transaction done with a typical third party and the related party, including the credit or repayment terms, interest rates (comparable to market rate), security (market and fair value), credit worthiness of the related party, etc.;
- Obtain confirmation from management that the terms of transaction are reasonable, fair and done at arm's length;
- Review the terms and conditions together with the analysis of costs and benefits of the transaction to the company; and
- Where appropriate, consider seeking independent advice before forming an opinion.

CHAPTER 7

THE NOMINATING COMMITTEE

THE NOMINATING COMMITTEE

The CG Code recommends the board establish a committee responsible for identifying, nominating and orientating new directors.

Delegation of this responsibility to a committee helps ensure that board level recruitment matters are discussed in depth, allowing the board to instead spend time on strategic and operational matters.

The key task of the nominating committee is to ensure that the company recruits and retains the best available executive and non-executive directors.

7.1 TERMS OF REFERENCE

Best Practice AAVIII -The board of every company should appoint a committee of directors composed exclusively of non-executive directors, a majority of whom are independent, with the responsibility for proposing new nominees to the board and for assessing directors on an on-going basis.

The actual decision as to who should be nominated should be the responsibility of the full board after considering the recommendations of such a committee.

(abbreviated from the CG Code)

Written terms of reference outlining the nominating committee's duties and responsibilities, including structure, process and membership requirements, should be developed. The board remains responsible for considering and approving recommendations from the nominating committee.

The CG Code prescribes that the nominating committee should:

- Recommend to the board candidates for all directorships to be filled by the shareholders or the board, taking into consideration the candidates':
 - skills, knowledge, expertise and experience;
 - professionalism;
 - integrity; and
 - in the case of candidates for the position of independent non-executive directors, the nominating committee should also evaluate the candidates' ability to discharge such responsibilities/functions as expected from independent non-executive directors.
- Consider, in making its recommendation, candidates proposed by the CEO and within the bounds of practicality, by any senior management or any director or shareholder;
- Recommend to the board, candidates to fill the seats on board committees;
- Assist the board in an annual review of the required mix of skills and experience and other qualities including core competencies which non-executive directors should bring to the board; and

- Annually assess the effectiveness of the board as a whole, the board committees and the contribution of each individual director, including independent non-executive directors and CEO. All assessments and evaluations carried out by the nominating committee in the discharge of all its functions should be properly documented.

The board could also authorise the nominating committee to carry out the following:

- Assess the desirable balance in board membership, considering the structure and development of excessive number of directorships⁴²;
- Assess desirable number of independent directors; and
- Consider the possible representation of interest groups.

The nominating committee should also:

- Recommend individuals for nomination as members of the board by assessing the desirability of renewing existing directorships. Due consideration should be given to the extent to which the interplay of the director's expertise, skills, knowledge and experience was demonstrated with those of other board members;
- Facilitate the annual board effectiveness assessment, through the board and directors' self-evaluation forms⁴³. This process should be coordinated by the nominating committee and thus, reporting to the board at the end of each fiscal year with an assessment of the board's performance and areas in which the board, board committees or individual director could improve on; and
- Periodically reporting to the board on succession planning for the board chairman and CEO. The board should work with the nominating committee to evaluate potential successors.

7.2 APPOINTMENT OF DIRECTORS

Appointment of directors is a vital process as it determines the composition and quality of the board's capacity and competencies. The CG Code requires a formal and transparent procedure to be established for the appointment of new directors to the board.

The nominating committee should establish and recommend to the board clear and appropriate selection criteria for directorship and assess the suitability of potential candidates against the criteria set.

⁴² A director of a listed issuer must not hold more than 25 directorships in companies, of which:

- (a) the number of directorships in listed issuers shall not be more than 10; and
- (b) the number of directorships in companies other than listed issuers shall not be more than 15.

⁴³ Evaluations should be based on pertinent key performance indicators ("KPIs") and other performance indicators of the company. The nominating committee should ensure that the employment terms, KPIs, targets and corresponding compensation (including any variable performance-linked compensation) are included in the evaluation forms.



This recommendation should be based on an annual review of the board's required mix of skills and experiences, taking into account the current and future needs of the company. This review should be matched against the current composition of directors to identify any gaps.

The existing board's strengths and weaknesses, its skill and experience gaps, its current age range and gender composition, and its aspirations for the future of the company should also be considered throughout the appointment process. The nominating committee should make comprehensive and independent assessment. In exercising objectivity in the assessment process, the committee should not be influenced by major controlling shareholders or the CEO / executive directors.

FOCUS:

Appointment of 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 and with all such activities carried out without being beholden to executive directors or major/controlling shareholders.

The nominating committee and the board should devote sufficient time to review, deliberate and finalise the selection of directors.

7.3 COMPOSITION AND SIZE

The CG Code prescribes that the nominating committee, established by the board, should comprise wholly non-executive directors and a majority of whom are independent.

The board should ensure the nominating committee is composed of directors who are frank, outspoken and collegial in establishing an effective committee.

Many companies have no set policies for rotating committee members but depend on weighing a member's experience against the risk of complacency. Companies should consider the appointment of nominating committee members on three-year terms, with staggered expiration dates to ensure continuity. In the absence of such a rotation policy, the board should evaluate a nominating committee member's performance to see that it meets both the board and committee's expectations.

The performance assessment of the nominating committee should be carried out by the board, benchmarking the activities it carried out against its terms of reference as approved by the board. Alternatively, the assessment of the nominating committee's performance can be carried out by individual members of the nominating committee on a peer assessment basis, with the results forwarded to the board for consideration, as appropriate.

7.4 MEETINGS

The CG Guide specifies that where a nominating committee is formed by the board, it should meet at least once a year to carry out the activities as enshrined in its terms of reference, or more frequently when the need arises.

The nominating committee should be provided with sufficient resources to undertake its duties. It should have access to the services of the company secretary on all nominating committee matters including, assisting the chairman in planning the nominating committee's work, drawing up meeting agendas, maintenance of minutes and collection and distribution of information and provision of any necessary practical support.

The meetings of the nominating committee should be transparent, with all proceedings recorded and actions documented. The board should be kept aware of the committee's activities by way of the committee minutes being circulated together with the board meeting papers.

7.5 PERFORMANCE EVALUATION

Best Practice AAX - The board should implement a process, to be carried out by the nominating committee annually, for assessing the effectiveness of the board as a whole, the committees of the board, and for assessing the contribution of each individual director, including independent non-executive directors, as well as the CEO.

All assessments and evaluations carried out by the nominating committee in the discharge of all its functions should be properly documented.

The CG Code stipulates that an evaluation should be carried out by the nominating committee annually on the effectiveness of the board as a whole, the board committees and the contribution of each individual director.

Additionally, the CG Code specifically calls for the evaluation of independent non-executive directors and CEO, and that all assessments and evaluations by the nominating committee should be properly documented.

There are intangible or soft elements concerning board performance that are difficult to measure, but will certainly affect the quality and effectiveness of the company's governance.

If these elements do not get measured, there is a good chance that potential improvement will not get managed. Amongst the most important criteria for evaluating board performances are:

- Individual board member's understanding of the company's mission and strategic plan;
- Board members' understanding and knowledge of the company's business;
- Readiness to ask management probing questions or interrogate management when required; and
- Particular knowledge that board members bring to add value to the company.

7.5.1 The Evaluation Process

Performance evaluation provides the board with valuable insights into the training and development needs of the board and its individual directors.

A performance evaluation process of the board, its committees and individual directors with clear evaluation criteria should be established and communicated to all directors.

The following are suggested steps to be taken in carrying out the evaluation process. The suggestions are merely useful guidance and are by no means exhaustive. The board will need to consider appropriate customisation to suit its own peculiar requirements and circumstances:

- Determine the key functions and responsibilities of the board, the various committees and individual directors. Identify the key performance indicators for directors in order for effective and meaningful evaluations to take place;
- Agree on the criteria to be used for evaluations and ensure all directors are informed that they will be evaluated. These criteria should reflect the company's current and expected position in the market. Each director should be evaluated on the right mix of skills, experience and knowledge relevant to the company;
- Perform evaluation based on the criteria as provided in **Exhibits 9 and 10** of this Guide. The results thereof should be explained to the directors and CEO, allowing them to know their standing;
- Take action on the outcome of evaluation by recommending remedial measures pertaining to areas of governance where the board has not done well. The board members should also be informed on the consequences for continuous poor performance, such as curtailment of benefits (as long as the benefits are non-contractual in nature), non-recommendation by the board for re-election upon retirement by rotation of the directors concerned and, in the worst case scenario, the directors concerned may be counselled out from the board;
- Recommend to restructure the board and its committees, including their functions, where they have been deemed ineffective;
- Implement a training and development plan to enhance each director's performance; and
- Summarise the performance evaluation process and report to the board.

Exhibit 9 of this Guide provides a sample performance evaluation sheet for the assessment of the board and board committee's performance.

Exhibit 10 of this Guide provides a sample performance self-evaluation sheet for individual directors.

7.5.2 Post-Evaluation Process

All reports should be gathered and assessed by the nominating committee for the board's review and approval.

Subsequently, an action plan with a set timeframe should be established by the board to ensure actions are taken on the weaknesses identified as part of a continual improvement process in the boardroom. The progress of the action plan should then be reviewed and regularly followed up against the plan established.

In relation to an individual director's evaluation, some factors that may be considered are attendance, preparedness, participation and candour.



Where a director sits on various boards, the nominating committee should consider whether the director is able to and has been effective in carrying out his duties.

Some boards may find it useful to involve an external facilitator in the evaluation process. The facilitator can manage the information-gathering process and speak to individual board members to identify key issues for discussion. The external input could help raise issues that may not emerge if it was purely an internal process. Other boards may, however, feel more comfortable having a private discussion on their collective performances.

7.6 EVALUATION OF THE BOARD'S MIX OF SKILLS, EXPERIENCE AND QUALITIES

Best Practice AAX - The board, through the nominating committee, should annually review its required mix of skills and experience and other qualities, including core competencies which non-executive directors should bring to the board.

This should be disclosed in the annual report.

The board should ensure each director brings a right mix of skills and knowledge relevant to the company. These could come from a combination of the director's commercial experience in running or leading operations or specific functional skills such as marketing that could lead to meaningful conversations and debates amongst board members.

Where practicable, the board collectively should possess adequate knowledge and skills to fulfil the company's needs, taking into account prevailing requirements, stage of development and goals. Thus, it is imperative that the mix of skills, experience and qualities of the directors be evaluated. Reference should be made to **Section 7.5.1** of this Guide on the evaluation process. Such evaluation allows the board to identify areas for improvement.

Knowing areas for improvement in the board (e.g. lack of certain expertise or skill set) will assist the company in a more focused search for candidates with the required skills and experience. This will also assist the nominating committee in developing selection criteria for new or additional directors.

The CG Code calls for the board to disclose in the annual report if the nominating committee has performed an assessment to evaluate the board's mix of skills, experience and other qualities. Disclosure of such evaluation in the annual report provides insight into how the board has discharged its stewardship duties towards the company, with such disclosure being particularly useful for shareholders and other stakeholders.

7.7 RE-ELECTION OF DIRECTORS

Principle AV - All directors should be required to submit themselves for re-election at regular intervals and at least every three years.

The CG Code and **Paragraph 7.28(2)** of the Listing Requirements require directors of listed companies to submit themselves for re-election at regular intervals and at least once in every three years.

The requirement allows shareholders to assess the directors' performances and contributions and, if required, to replace them. The nominating committee should highlight to the board, through performance evaluations, the directors who do not meet established performance evaluation criteria.

7.8 SUCCESSION PLANNING

Best Practice AA1 – The board should explicitly assume, amongst others, the specific responsibility of succession planning, including appointing, training, fixing the compensation of and where appropriate, replacing senior management.

As stipulated in the 4th limb of the CG Code's Best Practice AA1, the board is responsible for establishing a clear succession plan, including appointing, training, fixing the compensation of and where appropriate, replacing senior management.

The board should work with the nominating committee in ensuring that a clear succession plan is established.

In a competitive global environment, where securing talents of the requisite skills is a challenge, boards have to dedicate more attention to the matter of human capital development and management.

The sudden loss of a key officer without a suitable replacement may disrupt the operations of a company and hinder its future growth in the event of a widening gap in the experience of the remaining personnel.

Hence, the board needs to understand the current performance, competencies and potential of those in key positions in order to identify and develop plans for those key talents.

Identified successors should be exposed to the real task and undertake the job function of the incumbents, with appropriate supervision by the latter. This is to help fast-track the successors' familiarisation with the job requirements and ensure the transfer and retention of knowledge amongst identified second liners within a company in the eventual retirement, resignation or prolonged absence of a key employee.

The absence of succession planning can result in hasty promotion of individuals who may be unsuitable or not ready for the position.

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, i.e. company strategic direction;
- Identifying expected critical position vacancies;
- Determining critical positions, identifying current and future competencies;
- Identifying gaps in current employees and candidate competency levels which increase the company's chances of finding high calibre internal candidates;
- Developing individual development plans for employees;
- Developing and implementing coaching and mentoring programs; and
- Assisting with leadership transition and development, i.e. the right leader at the right time.

CHAPTER 8
THE REMUNERATION
COMMITTEE

THE REMUNERATION COMMITTEE

Best Practice AAXXIV- Boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors, to recommend to the board the remuneration of the executive directors in all its forms, drawing from outside advice as necessary. Executive directors should play no part in decisions on their own remuneration.

Membership of the remuneration committee should appear in the directors' report.

The determination of remuneration packages of non-executive directors, including non-executive chairman, should be a matter for the board as a whole. The individuals concerned should abstain from discussing their own remuneration.

An effective remuneration committee, if properly established and manned by appropriate personnel, can bring significant benefits to the company. The main purpose of the remuneration committee is to achieve a balance between setting the level and structure of the remuneration package of executive directors so as to be able to attract and retain the best against its interest in not paying excessive remuneration.

The remuneration committee should ensure that all the executive directors, CEO (where the CEO is not a director of the company) and senior management are fairly rewarded for their individual contributions to the company's overall performance.

The remuneration committee is responsible for ensuring that the compensation and other benefits encourage executive directors to act in ways that enhance the company's long-term profitability and value.

It should also be responsible for ensuring that the remuneration offered to the CEO (where the CEO is not a director of the company) and senior management is commensurate with the level of executive responsibilities and is appropriate in light of the company's performance.



8.1 TERMS OF REFERENCE

In essence, the remuneration committee's terms of reference should define the scope of its responsibilities and how these are to be discharged. The committee members should be familiar with the terms of reference which explain the role of the committee and the authority delegated to it by the board.

The terms of reference, which should be reviewed by the board annually and updated as appropriate, should clearly outline the committee's duties and responsibilities, including structure, process and membership requirements with such information taken into consideration when the committee prepares its meeting agenda.

The annual review of the committee's terms of reference should be a robust process, reflecting changes to the company's circumstances and any new regulations that may impact upon the remuneration committee's responsibilities.

8.2 COMPOSITION AND SIZE

The CG Code recommends the establishment of a remuneration committee, consisting wholly or mainly of non-executive directors. The CG Code calls for the board to disclose the membership of the remuneration committee in the directors' report.

The committee should be appointed by the board and comprise board members who will not benefit personally from their decisions and who will give due regard to the interest of shareholders and other stakeholders.

The size of the remuneration committee will vary depending upon the needs and culture of the company and the extent of responsibilities delegated to the committee by the board. The objective is to allow the committee to function efficiently and for all members to participate with appropriate levels of experience and knowledge.

Many companies have no set policies for rotating committee members but depend on weighing a member's experience against the risk of complacency. Companies should consider the appointment of remuneration committee members on three-year terms, with staggered expiration dates to ensure continuity. In the absence of such a rotation policy, the board should evaluate a remuneration committee member's performance to see that it meets both the board and committee's expectations.

The board, or via its delegation to the nominating committee, should assess the integrity and objectivity of a remuneration committee candidate. As such, every member's appointment is an occasion for careful deliberation. The board, through the nominating committee, should assess the effectiveness of the remuneration committee on an annual basis. Reference should be made to **Chapter 7** of this Guide.

8.3 COMMITTEE MEETINGS

Whilst the CG Code does not specify the frequency of meetings to be conducted annually, it is obvious that the committee needs to meet at least once a year to discharge its responsibilities as spelt out in its terms of reference. More frequent meetings may be called as the need arises, especially when there are major changes to executive directors and corporate structure within the group.

The frequency with which the committee needs to meet will vary from company to company and may change from time to time. However, committee meetings should be held at times when attendance is maximised and quorum for meetings established is met.

The remuneration committee should be provided with sufficient resources to undertake its duties. It should have access to the services of the company secretary on all remuneration committee matters including assisting the chairman in planning the remuneration committee's work, drawing up meeting agendas, maintenance of minutes and collection and distribution of information and provision of any necessary practical support.

8.4 SETTING REMUNERATION FOR DIRECTORS, CEO AND SENIOR MANAGEMENT

8.4.1 The Remuneration Framework

Principle B11 - Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.

The remuneration committee's objectivity is a cornerstone of its effectiveness, particularly when determining the appropriate compensation and benefits packages and on any issue where judgments and decisions are significant.

Remuneration committee members should be adept at communicating with management and ready to ask key probing questions about the company's position and strategy, thus enabling them to determine the right level of stretch within the performance targets.

One of the remuneration committee's key tasks is to develop and agree with the board a framework on the fee structure and level of remuneration for executive directors of the board, CEO (where the CEO is not a director of the company) and senior management. The board should determine who its senior management are and they may include the chief operating officer, director of subsidiaries within the group, etc., as is appropriate, in the opinion of the board.

The company should ensure that its remuneration framework is robust and effective enough in the following areas:

- Attracting and retaining key personnel of requisite quality that increases productivity and profitability in the long run;
- Motivating and creating incentives for directors to perform at their best; and
- Focusing attention on the achievement of desired goals and objectives.

8.4.2 Developing the Framework for Remuneration

Principle B1 – Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully.

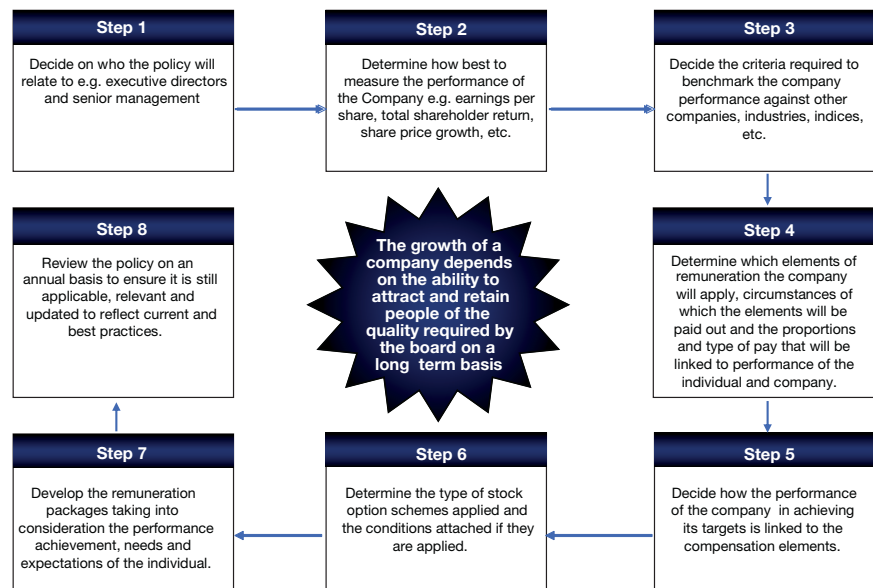
The component parts of remuneration should be structured so as to link rewards to corporate and individual performance in the case of executive directors.

In the case of non-executive directors, the level of remuneration should reflect the experience and level of responsibilities undertaken by the particular non-executive concerned.

A remuneration framework should be designed in such a way that it supports the strategies and long-term vision of the company as well as provides adequate motivational incentive for directors to pursue the long-term growth and success of the company.

The main challenge faced by most remuneration committees is the process to develop a remuneration framework taking into consideration the best practices, views of industry experts, stakeholders and the market at large.

The following steps could be considered by the remuneration committee in developing the framework:



8.5 EXECUTIVE DIRECTORS' REMUNERATION

Remuneration packages for executive directors should involve a balance between fixed and performance-linked (variable) elements. The relative weighing of fixed and variable remuneration for target 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 senior executives. Individual pay levels should reflect the performance of the director, skills and experience as well as responsibility undertaken.



The main provision in the CG Code on performance related elements of remuneration indicates that they should link executive directors' rewards to corporate and individual performance.

In this case, the remuneration committee should demonstrate that performance-based remuneration arrangements are clearly aligned to business strategy and objectives, regularly reviewed and consistent with industry practices.

It is the committee's duty when recommending incentive schemes to ensure that the linkage between pay and performance is robust. The committee should check that the comparatives chosen and the performance criteria set are genuinely challenging and that they are more suitable than possible alternatives.

The remuneration committee should also review the underlying performance of the company in light of the business plans and consider competitors' results, analyst reports and views of the chairman of other board committees, when assessing results.

8.6 NON-EXECUTIVE DIRECTORS' REMUNERATION

The CG Code stipulates that the determination of remuneration packages for non-executive directors, including the non-executive chairman, should be a matter for the board as a whole.

The individuals concerned should abstain from discussion of their own remuneration.

A review of the fees for non executive directors should take into account fee levels and trends for similar positions in the market, time commitment required from the director (estimated number of days per year). Such review should take into consideration any additional responsibilities undertaken such as a director acting as chairman of a board committee or as the senior independent non-executive director.

A basic fee should be paid to non-executive directors and an additional fee should be established for lead role positions such as board chairman, board committee chairman or senior independent non-executive director.

Non-executive directors are normally remunerated by way of fees (in the form of cash) that are approved by shareholders on an annual basis.

However, non-executive directors should not receive share options or bonus payments, participate in schemes designed for the remuneration of executives or be provided with retirement benefits since this could lead to a situation of impaired independence.

If, however, a company is absolutely intent on granting share options to its non-executives then it should seek shareholders' approval prior to going ahead with the plan. A minimum time frame should be established (e.g. at least a year) for any option to be vested in the non-executive director.

8.7 CEO AND SENIOR MANAGEMENT REMUNERATION

Apart from recommending the remuneration package of executive directors to the board, the remuneration of the CEO (where the CEO is not a director of the company) and the senior management should also be recommended by the remuneration committee.

In determining the remuneration for the CEO and senior management, the committee should ensure that the rewards are in line with the following key objectives:

- The offer is sufficient to attract and retain the best candidate in the short term;
- The incentives offered are appropriate to motivate the CEO and senior management to perform at their maximum on a continuous basis; and
- The CEO's and senior management's remuneration are aligned with shareholder value whilst creating an effective "golden handcuff" in the long term.

8.8 DISCLOSURE OF EACH DIRECTOR'S REMUNERATION

Principle B111 – The company's annual report should contain details of each director's remuneration.

Chapter 9 Appendix 9C, Part A of the Listing Requirements specifies all listed companies are to disclose the remuneration of directors for the financial year in the company's annual report in the following manner:

- The aggregate remuneration of directors with categorisation into appropriate components (e.g. directors' fees, salaries, percentages, bonuses, commission, compensation for loss of office, benefits in kind based on an estimated money value) distinguishing between executive and non-executive directors; and
- The number of directors whose remuneration falls in each successive band of RM50,000 distinguishing between executive and non-executive directors.



CHAPTER 9

SHAREHOLDER RELATIONS

SHAREHOLDER RELATIONS

Best Practice AA1 – The board should explicitly assume, amongst others, the specific responsibility for developing and implementing an investor relations programme or shareholder communications policy for the company.

The 5th limb of the CG Code's Best Practice AA1 states that the board should explicitly assume the responsibility to develop and implement an investor relations programme or shareholder communications policy for the company. Communication to shareholders should have the following characteristics:

- Transparency
- Objectivity
- Simplicity
- Promptness
- Substance over form
- Relevance
- Reliability

The board should be responsible for setting the tone and culture of the company and overseeing compliance with the policy, including the management of shareholders' requirements.



9.1 DIALOGUE WITH SHAREHOLDERS

Principle C1 – Companies and institutional shareholders should each be ready, where practicable, to enter into a dialogue based on the mutual understanding of objectives.

The CG Code recommends that companies enter into dialogue with shareholders based on the mutual understanding of objectives. The company must be prepared to discuss economic, social and environmental issues with all shareholders.

A critical aspect of this dialogue will involve listening carefully to messages being relayed back to the board.

A high quality, ongoing dialogue and communication with shareholders helps to build trust and understanding in the relationship between the company and its shareholders.

Dialogues with shareholders can be done through various forums, such as through focus group interviews, meeting with selected representatives of groups, written communication, open discussions on internet, etc.

9.2 SHAREHOLDER COMMUNICATIONS POLICY

Best Practice CCI – The board should maintain an effective communications policy that enables both the board and management to communicate effectively with its shareholders, stakeholders and the public.

This policy must effectively interpret the operations of the company to shareholders and accommodate feedback from shareholders, which should be factored into the company's business decisions.

A practical way to manage shareholder relations is to establish a shareholder communications policy which guides the company towards engaging in a continuous dialogue with shareholders and to meet shareholder obligations.

The communications policy could include the following contents:

- **Purpose** – describes the purpose of the policy to promote effective communication and provide shareholders with full and timely information about the company;
- **Responsibility** – parties responsible for communication with shareholders;
- **Access** – identified personnel that the shareholders can access and where the policy can be accessed;
- **Review** – who is to review the policy and the frequency of review;
- **Access to information** – describes access to information through the various means, for example, Bursa Malaysia's website, annual reports, company website, share registry and company contact details; and

Principle CII – The Companies should use the Annual General Meeting to communicate with private investors and encourage their participation.

- **Methods of communication** – communication by shareholders such as telephone, mail, email, facsimile, corporate website, in person at the company's office or via attendance at the annual general meeting/ extraordinary general meetings. Communication with shareholders includes quarterly and annual reports either mailed or published on the company's website, press releases and announcements.

Continuous dialogue with shareholders includes the company's update during the annual general meeting. The communications policy on the annual general meeting may include the following matters such as purpose, notice of meeting, date and venue, directors seeking election or re-election, conduct of meetings and shareholder participation, proxies and disclosure of proxy results and minutes of the annual general meeting.

Reference should be made to Bursa Malaysia's publication – **"INVESTOR RELATIONS – PUT INTO PRACTICE"**. This manual was developed to encourage listed companies to have pro-active investor relations programmes with the objective of consistently informing companies' shareholders, the financial community and other stakeholders of companies' developments.



EXHIBITS

EXHIBITS

Exhibit 1 Whistle-Blowing Policy

The following is a sample whistle-blowing policy. As it is only a sample, it needs to be customised as appropriate to suit the circumstances of the company.

Introduction

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:

- Support the company's values;
- Ensure employees can raise concerns without fear of reprisals; and
- Provide a transparent and confidential process for dealing with concerns.

This policy not only covers possible improprieties in matters of financial reporting, but also:

- 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:

- All concerns raised will be treated fairly and properly;
- The company will not tolerate harassment or victimisation of anyone raising a genuine concern;
- Any individual making a disclosure will retain anonymity unless the individual agrees otherwise;
- The company will ensure that any individual raising a concern is aware of who is handling the matter; and
- The company will ensure no one will be at risk of suffering some form of 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/she knows is untrue.

Grievance Procedure

If any employee believes reasonably and in good faith that malpractice exists in the work place, 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:

- Group Company Secretary; or
- Audit Committee Chairman.

Employees concerned about speaking to another member of staff can speak, in confidence, to an independent third party by calling the **whistle-blowing hotline** [hotline number]. The independent party will provide the employee counselling advice. Your concerns will be reported to the company without revealing your identity.

If these channels have been followed and employees still have concerns, or if employees feel the matter is so serious that it cannot be discussed with any of the above, they should contact the Senior Independent Non-Executive Director at [telephone number], 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 be proceeded.

Exhibit 2

Financial Literacy Questionnaire

Financial literacy, which signifies the ability and some competency to read, analyse and interpret financial statements, including a company's balance sheet, income statement and cash flow statement, 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 becomes imperative.

Name of candidate: _____

1. Ability to read, analyse and interpret the company's balance sheet, income statement and cash flow statement
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 analyse financial statements to quantify the overall financial condition i.e. use of profitability ratios, liquidity ratios, debt ratios, etc.
Yes No
6. Ability to interpret the implications of significant or non-recurring transactions, events or adjustments effected in the financial statements
Yes No

What seems to be the main cause for significant or non-recurring transaction or financial reporting adjustments? Please state below and the rationale thereof:

7. Ability to understand, analyse and enquire for potential manipulation of financial reporting i.e. did management make an estimate (or change an accounting treatment) to meet earnings target
Yes No

Please provide an example of a potential manipulation that could adversely affect the quality of reported earnings:

8. What is the purpose of private meetings between the audit committee and the auditors, both external and internal, without the presence of any other directors and employees?

Exhibit 3

Self-Assessment of the Audit Committee

The following are some of the key questions that the audit committee can consider when undertaking the self-assessment exercise.

A. Committee and Governance Structure

Terms of Reference

Evaluate the clarity and comprehensiveness of the committee's terms of reference and responsibilities.

Strong Adequate Needs improvement

During the past 12 months, did the committee address all responsibilities, as detailed in the terms of reference?

Yes No

Do you believe the committee is addressing areas that should be directly dealt with by the board or other committees?

Yes No

Skills and Competencies

How would you assess the committee's commitment to competence, integrity and the fostering of a climate of trust and a "no-surprises" environment?

Strong Adequate Needs improvement

Are you aware of any relationships or dealings that may impair, or may be perceived to impair, your or another committee member's independence?

Yes No

How would you assess the committee's overall independence?

Strong Adequate Needs improvement

Does the mix of skills on the committee allow the committee to effectively perform its assigned responsibilities?

Yes No

Given the company's business and risk environment, assess your skills and experience to analyse and critically evaluate information presented to the committee.

Strong Adequate Needs improvement

Evaluate the quality of training/briefing you receive (internal and external) on developments in regulations, audit, accounting, financial reporting and the industry.

Strong Adequate Needs improvement

How would you assess the committee's overall financial literacy?

Strong Adequate Needs improvement

Evaluate the committee's understanding of the company's significant financial risks and financial reporting risk.

Strong Adequate Needs improvement

How would you assess the committee's understanding of the company's significant non-financial risks that may have implications on the financial reporting risk?

Strong Adequate Needs improvement

How well does the committee understand the company's compliance processes?

Strong Adequate Needs improvement

Evaluate the committee's understanding of statutory reporting requirements.

Strong Adequate Needs improvement

Evaluate the committee's understanding of the company's significant accounting policies, accounting estimates and financial reporting practices.

Strong Adequate Needs improvement

Assess the committee's confidence in dealing with any complex and difficult matters brought before it.

Strong Adequate Needs improvement

Does the committee have access to appropriate internal and/or external resources to assist the committee in understanding and dealing with complex and difficult matters on a timely basis?

Yes No

Assess the consistency and appropriateness of how the committee probes and challenges on what is presented to it.

Strong Adequate Needs improvement

Are dissenting views of committee members appropriately addressed?

Yes No

Meeting Administration

Has the committee had the appropriate number of meetings to properly discharge its duties during the year?

Yes No

Does the agenda-setting process allow for all the necessary matters to be included?

Yes No

Can and do management, internal and external auditors influence the content of the agenda?

Yes No

Is the agenda structured to allow sufficient time to discuss the most complex and critical issues?

Yes No

Does the committee receive agenda items and supporting papers in sufficient time prior to meetings?

Yes No

Are the agenda, supporting papers and recommendations of sufficient clarity and quality to make informed decisions?

Yes No

Meeting Conduct

Evaluate the processes in place to facilitate review by the committee of urgent issues or significant transactions.

Strong Adequate Needs improvement

Does the committee spend sufficient time discussing issues of importance?

Yes No

Board Communication

Assess the quality of the committee's communications to the board about the committee's deliberations.

Strong Adequate Needs improvement

Is the board well informed on a sufficiently timely basis regarding the committee's deliberations?

Yes No

How would you assess the committee's overall performance?

Strong Adequate Needs improvement

B. Areas of Focus

Management

Were there significant gaps between what was presented to the committee by management (nature, clarity, quality and timeliness) and what the committee expected to receive from management in respect of:

- Risk identification and assessment, including the process to identify company risks that may have financial reporting implications?
Yes No
- The internal control framework designed by management to identify and mitigate risk, including fraud?
Yes No
- The internal control framework designed by management for ensuring compliance with regulations and internal policies?
Yes No
- Significant regulatory findings or notifications of regulatory non-compliance/violation?
Yes No
- Complaints received by the company regarding financial reporting, internal controls and audit?
Yes No

How would you assess the quality and openness of the committee's discussions with management?

Strong Adequate Needs improvement

Evaluate the adequacy of the time spent by the committee in discussing issues with management?

Strong Adequate Needs improvement

Internal Audit

Did the committee assess internal audit's independence and objectivity?

Yes No

Evaluate the committee's assessment process of internal audit's independence.

Strong Adequate Needs improvement

Did the committee assess the performance of the internal audit function?

Yes No

Evaluate the committee's assessment process of internal auditors' competency.

Strong Adequate Needs improvement

Did the committee review and approve the internal audit plan?

Yes No

Did the committee receive appropriate information to assess internal audit's progress against plan, to track progress against significant issues and findings and to understand significant findings and examination trends?

Yes No

Did the committee have direct communication channels with the person(s) carrying out the internal audit function or activity?

Yes No

Was the committee able to convene meetings with the internal auditors without the attendance of other directors and employees of the company whenever deemed necessary?

Yes No

How would you assess the committee's confidence in internal audit?

Strong Adequate Needs improvement

External Audit

Did the committee consider the re-appointment, or dismissal and selection, of the external auditor, especially when there are grounds to believe that the company's external auditor is not suitable for re-appointment?

Yes No

Did the committee approve the current year's external audit fee and terms of engagement?

Yes No

Did the committee assess the external auditor's independence?

Yes No

Evaluate the committee's assessment process of the external auditors' audit plan.

Strong Adequate Needs improvement

Did the committee comprehensively review the performance of the external auditors and reach a consensus view on performance?

Yes No

Evaluate the adequacy of the time spent by the committee in discussing issues with external auditors?

Strong Adequate Needs improvement

Did the committee meet with the external auditors in the absence of management at least twice a year?

Yes No

Did the committee have direct communication channels with the external auditors?

Yes No

Was the committee able to convene meetings with the external auditors without the attendance of other directors and employees of the company whenever deemed necessary?

Yes No

How would you assess the committee's confidence in the external auditors?

Strong Adequate Needs improvement

Exhibit 4

Controls and Regulation – Questionnaire to be posed to Senior Management

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.

Section A: Overall Control Environment

A.1 Identification and Evaluation of Business Risks

Are the company's business risks identified and assessed on an ongoing basis?

Yes No

Do the company's accounting policies appropriately reflect the nature of operational and business risks?

Yes No

Are employees informed of what is required of them to act in the best interests of the company so as to achieve its strategic objectives?

Yes No

A.2 Internal Controls

Are delegations of authority and responsibility to individuals appropriately determined and notified?

Yes No

Are internal controls documented, approved and communicated to employees?

Yes No

Does any one person initiate and approve significant transactions? If yes, does this represent an unacceptable level of risk?

Yes No

Are there policies on competitive bidding for all significant purchases and contracts?

Yes No

Is there a response plan for prompt and effective action when fraud or an illegal act is discovered?

Yes No

A.3 Information Systems

Are computers, programs and data adequately protected from improper use, loss or destruction?

Yes No

Have employees been informed of their responsibilities and accountabilities relating to the secure and confidential use of information technology assets, including data?

Yes No

Have company officers assessed the business impact in the event of a computer breakdown resulting in a sustained loss of processing capability?

Yes No

Is there a disaster recovery/contingency/business continuity plan, which is tested?

Yes No

A.4 Insurance

Is there adequate insurance coverage over assets and potential liabilities, in terms of perils covered and sum insured?

Yes No

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?

Yes No

A.5 Communications

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?

Yes No

Do procedures exist to ensure that all relevant matters are reported to Bursa Malaysia Securities Berhad, Securities Commission, Companies Commission of Malaysia, Bank Negara Malaysia, etc, under the continuous disclosure requirements?

Yes No

A.6 Corporate Code of Conduct

Does the company have a policy on the establishment and maintenance of appropriate ethical standards?

Yes No

Do we have appropriate procedures to inform our employees of our ethical standards and monitor performance?

Yes No

Section B: Other Regulatory Areas

B.1 Tax & Duties

Have we complied with relevant tax legislations?

Yes No

Have all tax payments been paid on time?

Yes No

Have tax issues been considered in all due diligence procedures for acquisitions and divestments, including tax implications on dividends paid by the company?

Yes No

Have all relevant employees been adequately trained on tax matters?

Yes No

B.2 Corporate Social Responsibility

Is there a formal corporate social responsibility (CSR) policy endorsed by senior management and directors?

Yes No

Have significant CSR aspects or impacts been identified?

Yes No

Have CSR legislation and the company's obligations under legislation been identified?

Yes No

Have the directors been made aware of all CSR reporting requirements under legislation?

Yes No

Does the annual report disclose the details of the company's performance in relation to CSR activities?

Yes No

Section C: Secretarial

Have all required documents, including annual returns been lodged with the Companies Commission of Malaysia?

Yes No

Have all relevant Listing Requirements been complied with?

Yes No

Have certificates of title for all owned properties, trademarks, patents, intellectual property, etc, been verified and safely stored?

Yes No

Have all property lease agreements, contracts, agreements, etc, been approved in accordance with delegated authorities and reviewed by legal experts?

Yes No

Have all dividends been declared and paid only in accordance with the Companies Act 1965 and the company's Articles of Association?

Yes No

Have all share issues, buybacks and cancellations been approved by the board/shareholders, entered in the registers and advice provided to the Exchange and Companies Commission of Malaysia?

Yes No

Exhibit 5

Warning Signals

Every company is different and each board should develop and maintain its own list of warning signals or “red” flags.

Some will relate specifically to the individual circumstances of the company and its environment, while others will be more general in nature. The following are some of the signals directors should be aware of:

1. Financial Considerations

- Company’s share price has fallen sharply recently
- 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
- Unusually 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 given industry and economic conditions
- Key ratios deteriorating
- Last minute transactions that result in significant revenues
- Delay in the issuance of financial reports

2. Board of Directors and Management

- Chairman and CEO dominate meetings and make decisions without first consulting the board on matters reserved for the board
- Autocratic management
- Flow of information delayed, especially concerning problematic areas
- Inexperienced management
- Insufficient questioning and enquiry by board members
- Lack of understanding about technology
- CEO is a dominant individual
- Managerial and board self-indulgence
- Lack of management oversight
- Resignation of key management or directors
- Failure to comply with company’s code of ethics/conduct

3. Audit Considerations

- Auditor's report and management letters show an increasing number of control problems and areas of disagreement with management
- External auditors changed due to accounting or financial reporting disagreements
- Company's accounting principles and practices are aggressive or vary from the industry norm
- Audit committee not meeting with external and internal auditors without management present

4. Other Warning Signs

- Abnormally high level of related party transactions:
 - Large amount of related party transactions not in the ordinary course of business;
 - Large, unusual, or highly complex transactions, particularly near to year-end that pose difficult 'substance over form' questions;
 - Advancing the company's funds for transactions which are not in the ordinary course or to a party that does not have an ability to repay and later written off as bad debts;
 - Borrowing or lending on an interest-free basis or at an interest rate that is significantly above or below current market rates;
 - Assets purchased at prices in excess or below fair market value;
 - Engagement in sales or business deals excessively below the market rates to an unnecessary related party, who in turn sells to the ultimate customer at a higher price and retains the difference
- Frequent customer complaints about the quality of goods or services provided
- Increasing stock levels compared to turnover
- Insufficient review of compliance with legislative requirements
- Media commenting adversely on the company's performance and products
- Significant drop in sales order activity, especially with forward sales
- Trend of losses appears continuing
- Major new projects 'out of control' – behind time, significantly over budget and not delivering benefits
- Deteriorating relationship with the company's bankers
- Lack of or inadequate succession planning

Exhibit 6

Financial Reporting - Questionnaire to be posed to Senior Management

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.

1. Overall

Do the company’s financial statements comply in all respects with applicable approved accounting standards and other relevant reporting requirements?

Yes No

2. Accounting policies

Are there any new applicable approved accounting standards or other authoritative pronouncements in the current period?

Yes No

Are there any changes to the company’s accounting policies this year?

Yes No

3. Going concern

Does the company or any of its controlled entities have a liquidity or solvency problem?

Yes No

Have cash flow forecasts been prepared to determine whether the company’s liabilities can be met as and when they fall due?

Yes No

4. Cash

Have bank reconciliations been performed regularly and reviewed by an appropriate person?

Yes No

Are any cash balances of controlled entities or those held in foreign countries subject to any restrictions?

Yes No

5. Investments

Is the company trading in shares?

Yes No

Are there established authority limits covering investments?

Yes No

6. Accounts receivable

Are there any new types of transactions giving rise to complex revenue recognition considerations?

Yes No

Is the provision for doubtful accounts adequate?

Yes No

Has adequate provision been raised for sales returns?

Yes No

Has the company observed a correct cut-off for its sales transactions?

Yes No

7. Inventories

Do the relationships between inventory movements, inventories at year-end, trade debtors and sales revenue appear reasonable?

Yes No

Are adjustments made to the book inventory to reflect the physical inventory?

Yes No

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

Is the provision for obsolete and excess inventory adequate?

Yes No

Have all anticipated variations and claims relating to construction contracts and other service contracts been considered in the determination of contract outcome?

Yes No

Have expected losses on construction contracts and other service contracts been recognised immediately?

Yes No

Have profits on construction contracts and other service contracts been properly determined in accordance with the stages of completion?

Yes No

8. Property, plant and equipment

Have all major acquisitions of property, plant and equipment been subject to a duly authorised approval process?

Yes No

Has the latest valuation of land and buildings been obtained within the last three years and is it appropriately disclosed in the financial statements?

Yes No

Are the useful lives and methods used to depreciate plant and equipment reasonable?

Yes No

Has a review of idle plant and surplus premises, including leased assets and premises, been performed?

Yes No

Has the cost of property, plant and equipment included the costs of its dismantlement and removal and site restoration obligation incurred at the time of acquisition, installation and during the period of use?

Yes No

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

If the company has capital commitments on the purchase of property, plant and equipment, have appropriate disclosures required by the CA been made in terms of amount approved but not contracted for; and amount contracted but not provided for in the financial statements?

Yes No

Does the company periodically take a physical inventory of property, plant and equipment?

Yes No

Were there any significant adjustments made to the carrying value of property, plant and equipment?

Yes No

If yes, provide details of the adjustment:

9. Intangible assets

Does the amortisation period for intangible assets reflect the asset's estimated useful life?

Yes No

Is the amortisation period adequately disclosed in the financial statements?

Yes No

10. Other non-current assets

Do all other non-current assets satisfy the definition of "asset" in accounting standards?

Yes No

Is the amortisation policy appropriate?

Yes No

Does the company have contingent assets and have these been disclosed according to applicable approved accounting standards?

Yes No

11. Liabilities

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

Are any assets pledged to secure borrowings?

Yes No

If yes, have they been properly disclosed in the financial statements?

Yes No

Has the company entered into any significant sale and lease back transactions during the year?

Yes No

Does the company have any contingent liabilities which have been adequately disclosed according to applicable approved accounting standards?

Yes No

12. Shareholders' equity

Are there any restrictions on the distribution of retained earnings of either the company or controlled entities?

Yes No

Have there been any share buybacks during the period?

Yes No

Has the amount of any asset revaluation reserve attributable to assets now disposed of been transferred to retained earnings or to a capital reserve, as appropriate?

Yes No

Have issues of financial instruments, other than ordinary shares, been properly classified as equity or debt in accordance with accounting standards?

Yes No

13. Revenue and expenses

Are the methods of recognising major items of income/expense appropriate in the circumstances?

Yes No

Are the company's methods of recognising income/expense consistent with methods used in the industry?

Yes No

Has the gross profit on sales percentage changed significantly during the year?

Yes No

Are the financial results of the company in line with analysts' expectations?

Yes No

Have intra-group transactions been appropriately eliminated, including unrealised profits?

Yes No

14. Taxation

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

Have the tax calculations been reviewed by someone independent of the preparer who has appropriate knowledge of the tax requirements?

Yes No

Are there any significant tax balances in dispute?

Yes No

Has the effective tax rate been reconciled with the statutory tax rate?

Yes No

15. Acquisitions/disposals

Have all acquisitions and disposals been subject to due diligence procedures and board's/ shareholders' approvals, where required?

Yes No

Has the company carried out post acquisition reviews to assess the actual performance against the proposed business case?

Yes No

Have all discontinuing operations been properly identified and disclosed only in accordance with applicable approved accounting standards?

Yes No

16. Earnings per share

Have any changes in capital structure or accounting policies during the year had a significant impact on earnings per share?

Yes No

Have basic and diluted earnings per share been properly calculated and disclosed in accordance with applicable approved accounting standards?

Yes No

17. General

Are assumptions regarding the determination of carrying value of assets and liabilities subject to significant risks?

Yes No

Have all major suspense, clearing or inter-office general ledger accounts been reconciled and cleared at reporting date?

Yes No

Does the statement of financial position comply with applicable approved accounting standards?

Yes No

Are there any significant post reporting date events that have a bearing on the financial report?

Yes No

18. Listing Requirements

Does the annual financial report contain the required Listing Requirements disclosures?

Yes No

19. Directors' Report

Have all disclosures required by the CA been made in the directors' report, including principal activities, review of operations, significant changes in the state of affairs, etc?

Yes No

Exhibit 7

Private Sessions with the External Auditors

The private sessions should focus on areas where the external auditors can provide additional, candid, and often confidential, comments to the audit committee. The private sessions give the audit committee an opportunity to explore such matters in a frank and open forum.

In addition, the audit committee may have more knowledge than the external auditors on other matters, and these sessions allow the audit committee an opportunity to talk to the external auditors about them. The following are some questions the audit committee can pose to the external auditors during the private sessions.

Attitudes

- What is your assessment of the “tone from the top”?
- What is your assessment of the ethics, values and integrity of management?
- What do you believe are the reasons management did not adjust for the uncorrected audit differences?
- Does management have plans to correct these “audit “differences in the future?
- Was management fully supportive of the corrected “audit” differences?
- What is your assessment of the quality of the company’s financial reporting, business reviews, and press releases?
- How does this company’s attitude towards financial reporting compare to other companies?
- Is there excessive pressure on management or operating personnel to meet financial targets, including sales or profitability incentive goals?
- Is there excessive pressure to meet unrealistic or aggressive profitability expectations by investment analysts or others?
- What is your assessment of management’s attitude towards:
 - disclosure controls and procedures; and
 - internal control systems and procedures?

Resources

- Do the company’s accounting staff and internal audit function have the appropriate number of people?
- Do they have a sufficiently broad range of knowledge and experience to be able to deal with the types of transactions faced by the company?
- Are these people competent for their positions? Do you have any concerns?
- Has management adequately responded to your prior management letter recommendations?
- Are there other areas where internal audit should focus its activities?

Relationships

- Did you receive full co-operation during the audit and did you get full, honest answers to all questions that were asked?
- Was any information withheld from you?
- Was management forthcoming, open and candid in discussions with you?
- How is your relationship with financial management personnel? Internal audit? CEO? Chief Financial Officer? Chief Information Officer? Information Technology Head? Chief Risk Officer? etc.

Other issues

- Did you receive everything you requested on a timely basis?
- Did you have adequate time to carry out all your audit procedures?
- Is the audit fee at an appropriate level?
- On what area was the most amount of audit time spent?
- What is the most complex issue encountered during the audit that has not been discussed at the audit committee meeting?
- What were the two or three issues that you spent the most amount of time discussing with management?

Exhibit 8

Matters to be tabled to the Audit Committee on Related Party Transactions

The following is only an illustrative list. It is not an exhaustive list but is intended to stimulate thought as to the type of matters that should be tabled to the audit committee.

1. A description of the transaction;
2. Parties to the transaction, including who the related party is and the relationship involved;
3. Relevant details of the transaction, including value and percentage ratio;
4. 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;
5. Whether advisors are to be appointed;
6. Whether any other approvals are required;
7. Rationale for the transaction and cost and benefit to the company/ group;
8. Comparative quotes, if available, including sources, methods and procedures through which transaction prices are determined;
9. 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, an independent valuation report annexed for that purpose;
10. An explanation of how "arm's length" basis was maintained during negotiations and in ensuring terms were on a commercial basis;
11. An explanation of why the terms are considered fair and reasonable;
12. An explanation of why the transaction is considered in the best interests of the company/group;
13. An explanation of why the terms are not detrimental to the minority shareholders;
14. If the transaction has gone through the usual tender process, to state so and the recommendation of the tender committee; and
15. Management recommendation.

Exhibit 9

Performance Evaluation Sheet – Board and Board Committees

This sample performance evaluation sheet is designed to assist the evaluation process and may be customised to meet the requirements of the board and board committees. Where reference is made to the company, the subsidiaries of the company are also included.

This sheet is to be completed by the nominating committee on a confidential basis based on the following ratings:

1 = Weak 3 = Adequate 5 = Strong
 2 = Needs improvement 4 = Consistently good

I. The Board

A. Board structure		Rating					Action plan
1.	Does the board have the appropriate composition (i.e. size) and committees corresponding to its oversight duties and the development of the company's strategy?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
2.	Does it have the right mix of skills and experience to optimise performance and strategy?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
3.	Are roles and responsibilities of the board and individual directors clearly defined in the board charter?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
4.	Are matters reserved for the board clearly defined?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
5.	Does the board work constructively as a team through collegial, productive working relationships that foster trust and respect?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
6.	Do the board discussions enhance the quality of management decision-making? Does the board engage constructively with management to stimulate its thinking and performance?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
7.	Is the company's orientation program effective in supplying useful information to new directors about the board and company (i.e. briefings and plant visits)?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
8.	Is the board given continuing programmes to keep all directors up to date with the latest developments in the market industry and regulatory environment?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
9.	Does the board consist of a good balance of independent directors or are there too many directors closely affiliated with the executive board members?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
10.	Have potential areas of conflicts that may impair independence of the independent directors been resolved?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	

B. Board operations		Rating					Action plan
1.	Are board meetings held with appropriate frequency?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
2.	Is information on the agenda items provided well in advance of board meetings, with sufficient time for preparation?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
3.	Is financial information adequately provided to help directors understand the important issues and trends in the business prior to board meetings?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
4.	Is information on subject matter adequately and sufficiently supplied for good decision-making, i.e. is the information presented in a concise manner, highlighting key issues and risk areas with relevant details for further analysis, allowing directors to understand and evaluate agenda items of the board meetings and to take effective decisions?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
5.	Is there adequate time allocated between board discussions and management presentations?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
6.	Are board meetings carried out in an open communication environment with meaningful participation and timely and constructive resolution of issues?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
7.	Do directors have sufficient access to management and/or the board chairman?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	

C. Board roles and responsibilities		Rating					Action plan
1.	Do you feel that the board understands its role, authority, and priorities?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
2.	Does the board understand the company's values, mission, and strategic and business plans, and reflect this understanding on key issues throughout the year?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
3.	How effective is the board in setting and reviewing the company's strategic plan?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
4.	Has the board identified the relevant tools, i.e. key performance indicators, to monitor executive and senior management's performance?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	

C. Board roles and responsibilities		Rating					Action plan
5.	Has the board adequately identified and managed risks that could have a significant impact on the company?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
6.	Has the board established a succession plan that considers the appointment, training and fixing of the CEO's and senior management's remuneration?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
7.	Has the board considered its role in protecting shareholders' interests?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
8.	How would you rate the board's deliberation of the company's investor relations program in its decision-making process?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
9.	Has the board reviewed the company's system of internal control and considered its adequacy and integrity?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	

D. Board chairman's role and responsibilities		Rating					Action plan
1.	Is the chairman building healthy boardroom dynamics and dealing effectively with dissent and working constructively towards consensus?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
2.	Does the chairman oversee an effective decision-making process and ensure crucial alternatives are considered?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
3.	Does the chairman aim to ensure the board's workload is properly managed and, where appropriate, allocated to delegated committees with specific terms of reference approved by the board?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	

Overall comments:

II. Board Committees

		Rating					Action plan
1.	Does each committee have the right composition? I) Nominating committee II) Remuneration committee III) Audit committee IV) Risk Management committee	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
2.	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? I) Nominating committee II) Remuneration committee III) Audit committee IV) Risk management committee	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
3.	Do the members of the committee have sufficient, recent and relevant expertise in fulfilling their roles?						
	I) Nominating committee: Director A _____ Director B _____ Director C _____	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
	II) Remuneration committee: Director A _____ Director B _____ Director C _____	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
	III) Audit committee: Director A _____ Director B _____ Director C _____	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
	IV) Risk management committee: Director A _____ Director B _____ Director C _____	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
4.	Are committee chairs properly discharging their responsibilities, deploying resources and expertise, and providing appropriate reporting and recommendations to the board? I) Nominating committee II) Remuneration committee III) Audit committee IV) Risk management committee	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	

		Rating					Action plan
5.	Are the appointment of board and committee chairman based on appropriate criteria? Are we properly considering the responsibilities of the position, including the ability, experience and expected performance of the candidate? I) Nominating committee II) Remuneration committee III) Audit committee IV) Risk management committee	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
6.	Is the quality of the board committee's communications to the board about the committee's deliberations assessed regularly? I) Nominating committee II) Remuneration committee III) Audit committee IV) Risk management committee	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
7.	Is there an assessment by the board of the quality of the minutes of the board committee's meetings? I) Nominating committee II) Remuneration committee III) Audit committee IV) Risk management committee	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	
8.	Is the board well informed on a sufficiently timely basis regarding the committee's deliberations? I) Nominating committee II) Remuneration committee III) Audit committee IV) Risk management committee	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>	

Overall comments:

Exhibit 10

Performance Evaluation Sheet – Individual Director Self/Peer Evaluation⁴³

This sample performance self-assessment sheet is designed to assist the evaluation process and may be customised to meet the requirements of each individual director.

Upon the director’s evaluation, the nominating committee will compile and evaluate the assessment prior to its reporting and presentation to the board.

This self-assessment is to be completed by each director on a confidential basis based on the following ratings:

- 1 = Weak 3 = Adequate 5 = Strong
 2 = Needs improvement 4 = Consistently good

		Directors								Comments
		1	2	3	4	5	6	7	8	
Contribution to interaction										
1.	Shares information or insights									
2.	Regular and timely attendance of board meetings									
3.	Participates actively in board activities, works constructively with peers									
4.	Takes strong constructive stands at board or committee meetings, where necessary									
5.	Encourages feedback from board									
6.	Encourages meetings to focus on the agenda									
7.	Confronts conflicts and participates in finding a resolution									
Quality of input										
8.	Provides logical honest opinions on issues presented									
9.	Provides unique insight to issues presented – has valuable skills									
10.	Prioritises context of issues to be in line with objectives									

⁴³ Source: *The Green Book, Enhancing Board Effectiveness, April 2006*

		Directors								Comments
		1	2	3	4	5	6	7	8	
11.	Motivates others to get things done, is decisive and action-oriented									
12.	Provides realism and practical advice to board deliberations									
13.	Applies analytical and conceptual skills to the decision-making process									
14.	Communicates persuasively in a clear and non-confrontational manner									
Understanding of role										
15.	Adds value to board meetings – attends meetings well prepared									
16.	Takes initiative to request for more information									
17.	Ensures that individual contribution is relevant – up-to-date with developments									
18.	Focuses on accomplishing the objectives									
19.	Assesses and links short-term issues to the long-term strategy									
20.	Ensures performance of financial and human capital, keeping in mind the strategic plan when making investment decisions									
Board chairman's role										
21.	Chairman is able to lead the board effectively – encouraging contribution from all members									
22.	Chairman and CEO have a good working relationship									
23.	Chairman and CEO understand their respective roles									

Please state the names of the director numbered above:

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____
8. _____

Exhibit 11

Sample Statement on Internal Audit Function

The Internal Audit ('IA') function is considered an integral part of the assurance framework and its primary mission is to provide assurance on the adequacy and effectiveness of the risk, control and governance framework of the company. The purpose, authority and responsibility of the internal audit department /function (IAD) as well as the nature of the assurance and consultancy activities provided by the function are articulated in the internal audit charter.

The IAD reports directly to the audit committee who reviews and approves the IAD's annual audit plan, financial budget and human resource requirements to ensure that the function is adequately resourced with competent and proficient internal auditors.

During the year, the IAD conducted various internal audit engagements in accordance with the risk-based audit plans that are consistent with the organisation's goals. The IAD evaluated the adequacy and effectiveness of key controls in responding to risks within the organisation's governance, operations and information systems regarding the:

- Reliability and integrity of financial and operational information;
- Effectiveness and efficiency of operations;
- Safeguarding of assets; and
- Compliance with laws, regulations and contractual obligations.

All the internal audit activities were performed in-house with the exception of two information technology (IT) audit engagements which were outsourced to a service provider.

The total cost incurred in managing the IAD in 2009 was RM _____.

A summary of the internal audit cost is as follows:

Cost Category	RM ('000)	% of total cost
Manpower		
Training		
Outsource Service Provider		
Travelling (inclusive of accommodation)		