cutting through complexity

AUDIT COMMITTEE INSTITUTE

The Directors' Prism: Building Better Boards

7 Questions to Help Shape Board Success

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KPMG IN MALAYSIA

Foreword

Tan Sri Zarinah Anwar
Chairman
Securities Commission Malaysia

In an increasingly competitive environment, good corporate governance is fundamental to the success of companies and is a key element underlying the sustainable growth of companies, while ensuring public confidence in the integrity of our markets by safeguarding against unethical conduct and fraudulent management.

The role of boards as corporate stewards has become more challenging, with intense scrutiny focused on corporate conduct in efforts to reinforce public confidence in public listed companies. Expectations have evolved, driven by changes in the corporate and regulatory landscape, requiring boards to be accountable for a wide range of issues.

The heightened focus on corporate governance, arising from poor corporate conduct and financial irregularities, as well as rising shareholder activism, therefore requires boards to be extremely vigilant in the discharge of their responsibilities.

Knowing the critical factors to help shape better board performance is thus imperative. A publication such as this which directs attention to pertinent areas for more effective functioning of boards is an invaluable guide to boards in the discharge of their responsibilities.

Corporate governance is the shared responsibility of all stakeholders who can contribute to value creation and sustainable growth through mutually reinforcing efforts. Initiatives such as reflected by this Audit Committee Institute publication to enhance the effectiveness of boards of directors are a welcome contribution.

Indeed, this is a positive reflection of stakeholder commitment and reinforces the collaborative efforts to enhance the standards of corporate governance in Malaysia, in line with the thrust of the Capital Market Master Plan 2 and the goals of the Corporate Governance Blueprint 2011.

I would like to express my appreciation to the Audit Committee Institute for its support and contribution to Malaysia's corporate governance agenda, reflecting a shared commitment towards excellence in corporate governance.

Foreword

David Lim
Chairman
Audit Committee Institute Malaysia

Corporate Malaysia is growing at a quantum pace and doing business in Malaysia is getting increasingly complex. Expectations of stakeholders have never been higher, and the scrutiny by regulators and investors never more stringent. As a consequence, boards of directors are increasingly feeling the pressure.

Raising the bar on corporate reporting is now a given expectation of the shareholders. Warren Buffett suggested four questions which audit committees should always ask the external auditors:

i. if the external auditors were preparing the financial statements, would anything be reported differently?

ii. if the auditor was an investor, has sufficient information been received to enable him to understand the financial statements?

iii. is the company following the same internal audit procedures had the auditor been the CEO?

iv. is the auditor aware of any actions that have resulted in revenues or expenses being reported in a different period than the period being audited?

The role of the board of directors has rapidly increased in importance and expanded in scope. Now, more than ever, the boards of directors need a keen awareness of current and emerging issues. They must assess what they are doing now and how they are doing it to help ensure they are ready for the challenges ahead. The importance of the role of the chairman of the board is greater than before. Not just limited to an honorary title, the chairman should be acknowledged as having the personal courage to raise and deal with tough issues and support other directors to do the same.

With this in mind and following on from the momentum of our last publication "Shareholders' Questions 2010", the Audit Committee Institute has compiled these 7 questions to help shape success for boards of directors. The questions are centred around The Directors' Prism which focuses on the position of the board and its committees – who are responsible to stakeholders and who rely on management, internal auditors and external auditors to carry out these responsibilities.

While this publication focuses on questions that apply mainly to public listed companies, boards of directors of both private companies and publicly accountable entities, such as governmental or not-for-profit organisations, can easily apply these questions to their respective organisations. We identify current and emerging issues that most boards must understand, including being on the board of an owner-managed business – a common scenario in the Malaysian landscape. We describe directors' practices that provide the support and structure necessary to bring success to the board, and ultimately, the organisation. We also delve into whether directors, in particular audit committees, are making full use of the internal and external auditors.

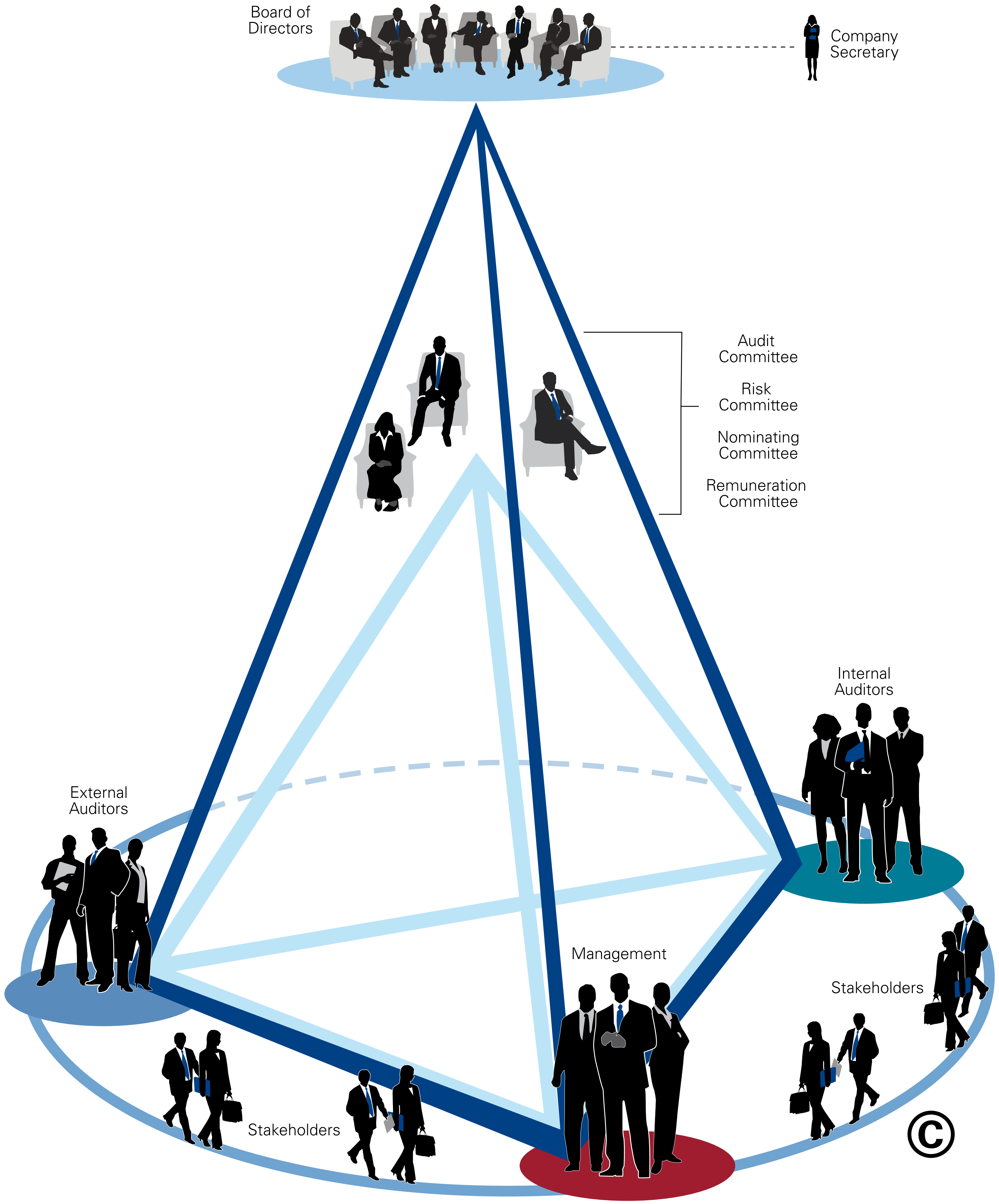
Having dedicated 33 years of service with KPMG in Malaysia, I will be retiring by the end of 2011. It is with pride and a little sadness, that I am also relinquishing my post as ACI Chairman. Being at the helm of ACI Malaysia has been a great journey and I owe my thanks to everyone who has supported ACI Malaysia since its formation. I am confident that this book will serve as a definitive guide for boards of directors in Malaysia and help board members meet the challenges demanded of them.

Contents

'The Directors' Prism: Building Better Boards - 7 Questions to Help Shape Board Success' forms a part of, and should be read in conjuction with, "Guidance Material".

Introducing The Directors' Prism

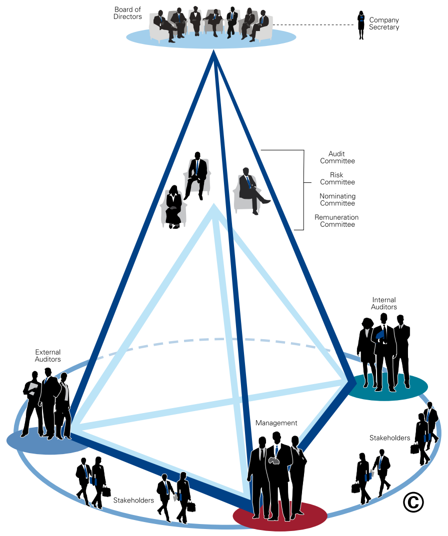
The Audit Committee Institute has developed "The Directors' Prism" - a diagrammatic expression of the position of the board of directors and its committees, and how the roles of these committees, utilising the resources of management, internal auditors and external auditors, play an important part in the whole board decision-making process.



The Directors' Prism

Those seeking to strengthen corporate governance and enhance the board's oversight often look for (and recommend) 'leading' or 'best' practices – and with good reason: they suggest processes, policies or approaches that work.

Yet, practices that work best for one organisation may not be ideal for another – especially in a corporate governance environment where corporate culture, financial reporting risks and governance needs can vary dramatically from entity to entity.



Understanding the Directors' Prism
A board of directors that strives to add value in addition to achieving basic compliance is likely to discharge its oversight responsibilities more effectively. For this to be achieved, the relationship between the management, internal auditors and external auditors with the board, should be one of trust and mutual respect. These people must work with the board to help ensure the board meets its objectives in a dynamic environment.

The board - the pinnacle of the prism
Boards of directors have evolved from having just a few defined responsibilities to what they are today: a critical working group. A board must, of course, be aware of the growing burden of complying with ever increasing regulations and legislation affecting its responsibilities.

Effective boards of directors are supported by fundamental building blocks: an appropriate structure and foundation, reasonable and well defined responsibilities, and an understanding of current and emerging issues. With these in mind, the board has been positioned at the top of the prism representing the board's responsibility for overseeing the entire organisation.

The board committees - the centre of the prism
The board committees – usually comprising the audit committee, risk committee, nominating committee and remuneration committee – are positioned in the centre of The Directors' Prism, symbolising the importance of their roles in holding together the organisation. The board cascades down its responsibilities to the various board committees, which in turn carry out these responsibilities in their respective capacities.

Management and auditors - the base of the prism
The base of the prism is represented by management, the internal auditors and the external auditors - signifying their importance as the foundation of the company. The board committees normally rely on management and auditors to a certain extent as key drivers in execution of the respective committees' oversight responsibilities.

Stakeholders - surrounding the prism
Surrounding the prism are the stakeholders of the organisation. Whether they are shareholders, employees, customers, suppliers, bankers, etc, the collective stakeholders will be seeking assurance from the board that the company is being well run and that obligations will be met.

The guiding principles for boards of directors
With The Directors' Prism in mind, the 7 questions asked in this publication are meant to challenge the conventional. The agendas to answer these questions effectively will vary widely. Each board must assess its own circumstances – financial situation, industry, stage of development, environment and issues – to build its own agenda. This process should be repeated on a regular basis.

The ACI has also developed the "Guiding Principles for Boards of Directors" (see *Appendix 2*), consisting of five key principles to consider when developing, evaluating and refining the board's oversight processes and practices. As emphasised in the first guiding principle – "recognise that one size does not fit all" – each board should develop a set of practices that is considered best in its individual circumstances.

A board should not, however, avoid practices simply because they appear onerous. Often, those are the practices that may be most effective and should receive additional attention.

The Directors' Prism and the Guiding Principles for Boards of Directors, both developed by the ACI, are discussed in greater detail in **Appendix 1 - The Directors' Prism** and **Appendix 2 - The Guiding Principles for Boards of Directors.**

The Guiding Principles for Boards of Directors:

1. Recognise that one size does not fit all.
2. Have the 'right' people on the board.
3. Monitor and insist on the right 'tone from the top.'
4. Ensure the oversight process facilitates the board's understanding and monitoring of key roles, responsibilities and risks within the financial reporting environment.
5. Continually reinforce the board's direct responsibility for the external auditor.

The Corporate Governance Blueprint, 2011

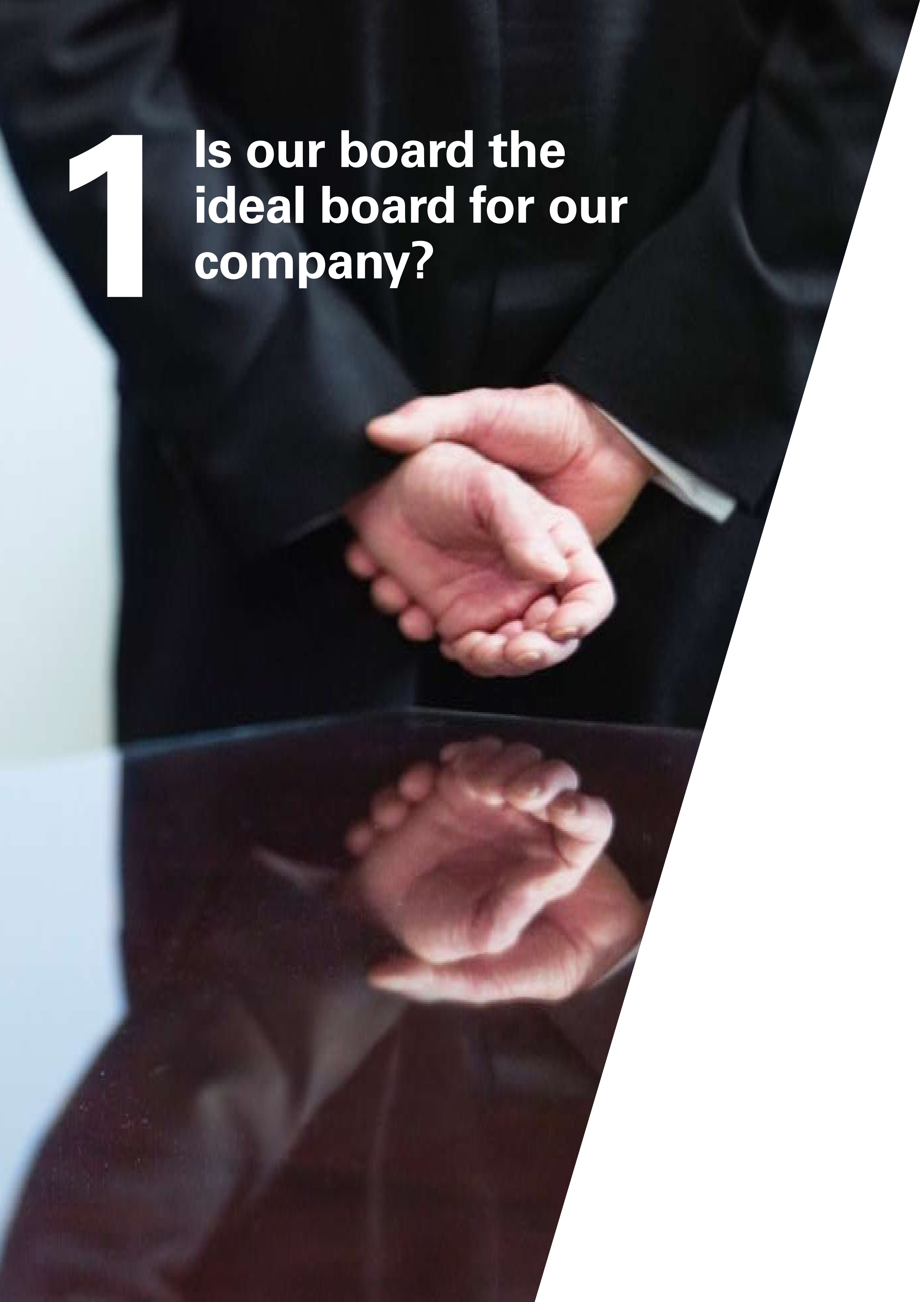
In July 2011, the Securities Commission released a blueprint consisting of 35 recommendations spanning 6 key aspects of corporate governance in a five-year Corporate Governance Blueprint, to chart action plans in the nation's quest towards corporate governance excellence.

Some key points of the Securities Commission's Corporate Governance Blueprint are:

- Enhancing the independence of directors by limiting their cumulative tenure of office as independent directors to 9 years, after which they are to be redesignated as non-independent non-executive directors.
- Roles of Board Chairman and Chief Executive Officer are to be held by 2 different persons to enhance board activities.
- Transforming board diversity by bringing women directors onto boards, targeting a board composition of 30% women by 2016.

On the back of the recommendations stemming from the Blueprint, relevant recommendations have been linked to the 7 questions asked in this publication. Legends have been added to show how these relevant recommendations are to be realised as follows:

Legend	Description
LR	To be effected via Listing Requirements (mandatory)
C	To be effected via new Corporate Governance Code (probably only best practice)
L	To be effected via changes to legislation / law
TF	To be effected via formation of a task force
PC	Public consultation will be undertaken



1 Is our board the ideal board for our company?

Constructing an ideal board of directors varies according to the abilities of the board members, the clarity of the board's mission, and the tone set at the top of the governance structure.

We present some of the characteristics and practices that, based on our experience, are hallmarks of a strong and effective board of directors. We encourage each director to review these characteristics, not as elements carved in stone, but as components in a process that can be – and should be – continually improved to enhance the board's effectiveness.

Mandate formalisation of board charter & disclosure in annual report (LR)

- Delineate roles & responsibilities of Board, Chairman & CEO
- Set out key values, principles & ethos of company
- Disclose charter in annual report

Are we choosing the right members? How many?

In Malaysia, the Companies Act, 1965 specifies a minimum of 2 directors per company but does not set a maximum number of directors, although companies normally specify a maximum within their Articles of Association. The size of the board of directors will vary depending upon the needs and culture of the company. As for the listed issuers, the Listing Requirements of Bursa influence the size of the board in view of the various type of directors, e.g. executive, non-executive and independent non-executive.

Mandate assessment on independence & its disclosure (C & LR)

- Boards undertake assessment on independence of independent directors annually, upon their re-admission & when new interests or relationships surface - based on criteria set by Board
- Boards disclose in company's proxy form & annual report that such assessment has been done

What about independence?

In recent years, there has been recognition in Malaysia of the potential benefits that can be derived from independent representation on boards. 'Cronyism' is no longer tolerated in the boardrooms of Malaysia. Even organisations not governed by corporate governance regulations have begun to recruit independent directors.

The potential benefits are recognised by the Listing Requirements which recommend that listed companies have at least two directors or one-third of its board (whichever is higher) as independent directors.

Mandate limit in tenure of independent directors (LR)

- A cumulative term limit of up to **9 years** imposed on Independent Non-Executive Directors. Directors may continue to serve thereafter but re-designated as Non-Executive Directors

An independent director is someone who, apart from his fee as director, has no other pecuniary or material interest in the company or its management, dealings, promoters, subsidiaries or anything else which the company's board finds might otherwise impede such a director's judgement.

In Malaysia, it is common that the chairman of the board is the managing director or the CEO. Put simply, such a director embodies the exact reverse of an independent director.

Although there are currently no requirements in Malaysia for the chairman to be an independent director, other jurisdictions, such as the United Kingdom, require the chairman to be independent at the time of appointment.

The chairman should be acknowledged as having the personal courage to raise and deal with tough issues and support other directors to do the same

"Each of these three roles (effectiveness of the board, shareholder communication and working with the CEO) is challenging. Taken together, they may be almost impossible to do well, unless there is effective training in what it takes to be a chairman – training which, all too often, chairmen have not had."

John Zinkin, writing in his Starbiz column ***"Whose business is it anyway?"***

Mandate separation of position of Chairman & CEO - Chairman to be Non-Executive Director
- Position of Chairman & CEO not assumed by same person (C & LR)
- Chairman must be a Non-Executive Director (C & LR)
- Consultation on mandating independent chairmanship will be carried out (PC)

Who would be the ideal chairman of the board?
The effectiveness of the board often hinges on the chairman's effectiveness. The essential characteristics of a strong chairman are often personal attributes.

In Malaysia, there is a tendency for listed companies to appoint retired government servants with honorary titles as the chairman.

The chairman should be recognised for his or her leadership and vision, and be perceived by other directors and management as able to set and manage the board's agenda.

The chairman should be acknowledged as having the personal courage to raise and deal with tough issues and support other directors to do the same.

What type of expertise are we talking about?
Board members should (at least as a group) possess a wide range of knowledge, skills and personal attributes: sound judgment, integrity and high ethical standards; strong interpersonal skills; and the ability and willingness to challenge and probe. Specifically, certain board members must have expertise, or access to expertise, relevant to the line of business of the company.

In terms of the audit committee, the board needs to satisfy itself that all its audit committee members are financially literate and at least one member of the audit committee fulfills the *financial literacy* requisite under the Listing Requirements.

What is financial literacy?

- The ability to read and understand financial statements, including a company's statement of financial position, statement of comprehensive income 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 financial reporting standards.

Certain board members must have expertise, or access to expertise, relevant to the line of business of the company

In the ACI publication **"Shareholders' Questions 2010"**, over 500 questions were raised that shareholders could ask the board of directors during a company's Annual General Meeting. An effective board of directors should have the combined expertise to answer most, if not all, shareholders' questions and allay their concerns.

Create director's registry (TF)
- A registry of directors created & driven by private sector. To ensure quality recruits, adopt robust screening criteria for registering & de-registering candidates.

Does our board have the right personal qualities and experience?
In determining the composition of the board of directors, it is important to balance formal qualifications with consideration of personal qualities and relevant experience. In some circumstances, it may be more appropriate for the board to seek expert advice as the need arises, rather than trying to maintain particular expertise within the board at all times.

The members of the board should, as a group, possess a *wide range of knowledge, skills and personal attributes including*:

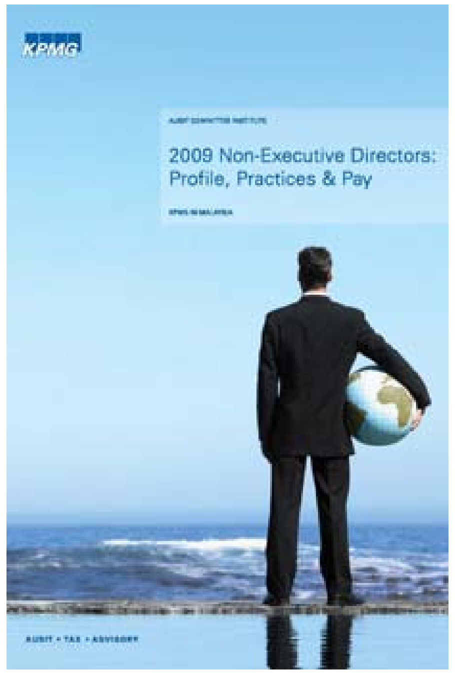
- integrity and high ethical standards;
- strong interpersonal skills;
- sound judgement;
- the ability and willingness to challenge and probe; and
- the time and personal commitment to perform effectively.

Directors should have experience in areas pertinent to the entity. A board's effectiveness in performing its mission can be enhanced by, and is often dependent upon, the directors' experience, knowledge and competence in business and operational matters, financial reporting, internal controls and risk management. It is important that the board is not reliant solely on management to provide it with such expertise.

Why do we need a senior independent non-executive director anyway?
The role of the senior independent non-executive director, as recommended by the Malaysian Code on Corporate Governance, is the director to whom concerns may be conveyed. He or she ensures that all directors have an opportunity to provide input on the agenda, voice their concerns and advise the chairman on the quality, quantity and timeliness of the information submitted by management that is necessary or appropriate for the directors to perform their duties effectively.

2 Are we able to sustain the board?

Identifying directors with characteristics and practices that mark a strong and effective board of directors is only the beginning of the journey. The directors should strive to sustain the effectiveness of the board. This part of the journey may prove to be the most challenging for the board.



"There is a world of a difference between **good sound reasons** and **reasons that sound good.**"

Anonymous

How can we get the board of directors' compensation right?

What are the compelling reasons for someone to be a director in Malaysia? That person could be doing it for the money or for the prestige of being 'at the top' or for networking or even as a favour for a friend. Whatever the reason, once appointed as a director, he or she will need to fulfill the fiduciary responsibilities of being a director.

Based on the ACI publication "**2009 Non-Executive Directors: Profile, Practices & Pay**", a typical Malaysian PLC non-executive director earned an average of RM72,000 p.a. in 2009. Based on our research, non-executive directors within the region earn an average SGD53,500 in Singapore, HKD200,000 in Hong Kong and AUD140,000 in Australia.

Carry out directors' compensation study (TF)
- Study of directors' compensation in Malaysia undertaken by private sector (professional bodies, academia, etc)

Remuneration for service can sometimes pose a dilemma for directors. While compensation should be enough to recognise the time commitment required and the risk accepted in order to attract good and responsible directors, the amount should not be excessive such that a conflict may be perceived to exist.

How do we keep our integrity intact?

Integrity is the quality of having high moral principles, being reliable and trustworthy. The mark of a director is shown in the ability to maintain his or her integrity as a board member. The ACI has developed a series of mini-questions in **Guidance Material 1 – How do I keep my integrity intact?** which comprise questions that directors can ask themselves to ascertain if they are letting go of their principles.

How do we fully utilise resources for the board?

The board should be provided with sufficient resources to undertake its duties. It should have access to the services of the company secretary on all matters, including supporting the chairman in planning the board's work and drawing up meeting agendas; maintaining minutes, drafting materials about the board's activities for the annual report; collecting and distributing information; and other support as needed.

Directors should take cognisance of related party transactions within the organisation, especially those involving members of the board

"Redtone International Berhad's total outstanding related party transactions receivables stood at RM1.2mil. Almost the entire sum is owed by eB Technologies Sdn Bhd (a related company) and the debt is more than a year overdue….. ACE market company Metronic Global Bhd has (RM36.3mil) due from a related party for a transaction that took place more than three years ago."

Izwan Idris, writing in his Starbiz article ***"Stepping up transparency"***

What are related party transactions and how do these affect me?

A related party transaction ("RPT") is a transfer of resources, services, obligations or risk between parties that are related, such as subsidiaries, directors and parties related to directors. Bursa Malaysia has carried out an assessment of receivables for RPTs involving listed companies on the bourse. Based on its evaluation, Bursa Malaysia directed a number of companies with outstanding receivables on RPTs beyond their credit period to take steps to recover the outstanding amounts. These companies were given directives to disclose the status of their outstanding RPT receivables.

Although the Listing Requirements stipulate that the Audit Committee is responsible to review related party transactions and conflict of interest situations, directors should take cognisance of RPTs within the organisation, especially those involving members of the board.

Limit number of directorships held by individual directors (LR)

- Directors permitted to serve up to **five** PLCs in Malaysia
- Directors must advise Chairman or Senior Independent Non-Executive Director in advance of accepting invitation to serve on another board
- Assessment through Nominating Committee & appoval of existing board required before accepting any new appointments on board of other PLCs
- Board to disclose in company's proxy form & annual report that such assessment has been done by Nominating Committee

Set out expectations of time commitment, including protocol for accepting other external appointments (C & LR)

- Boards should set out expectations on time commitment, including protocols for accepting other external appointments in **board charter**

Why do we need ongoing professional development?

Change is never-ending in the areas of regulatory compliance, technology and business risk, and financial reporting. It is essential that directors have sufficient training to enable them to keep abreast of such developments.

Companies should offer, and directors should insist on, the kind of training that could enhance their understanding of the business, including enhancing financial literacy, and make it possible for them to fulfill their fiduciary responsibilities.

Mandate continuing professional education for directors (LR)

- Re-introduce the mandatory Continuing Education Program on a phased basis by 2016 (new IPO directors, chairmen, CEOs, newly appointed directors, etc)

"Independent directors will need to be more technically skilled in assessing what is presented to them at board meetings and they will need to be much more involved in really getting to grips with what their business is all about and the strategic threats and opportunities it faces. It also means that they will be expected to contribute in board meetings through a process of careful and constructive challenge."

John Zinkin, writing in his Starbiz column ***"Whose business it is anyway?"***

Is induction for new directors really necessary?

It is now common practice to provide a formal induction programme for new board members. This helps to ensure they understand their responsibilities, current issues and the intricacies of the particular company. The programme may include meetings with senior management and site visits; the objective of which is to give new board members an insight into the operation of the business.

Newly-appointed board members may feel overwhelmed if they are given all the necessary information on their first day. It is important that the company secretary, or appointed person, plans the director's induction so that the programme is staggered over a suitable period of time. After a few months on the board, they should be given an opportunity to review the induction programme and raise questions on any areas.

The new directors' induction programme can include:

- ☑ being provided copies of:
  - ☑ the board's terms of reference and recent board minutes,
  - ☑ relevant company policies, including the code of conduct and whistle-blowing policy,
  - ☑ the most recent annual and interim reports to shareholders,
  - ☑ management's and any auditor's report on the effectiveness of internal control over financial reporting,
  - ☑ recent press releases, material change reports and correspondence with any securities regulatory authorities,
- ☑ obtaining an explanation from management and the internal auditor of the company's control, risk and compliance frameworks;
- ☑ site visits to major operating locations;
- ☑ meeting with management to discuss current issues including litigation; and
- ☑ being introduced to the internal and external auditors.

3 How can we enhance the board's effectiveness?

The question is a difficult one to answer. What may work within one organisation may be wholly unsuitable for another. Of course, there are varying degrees of effectiveness and the characteristics of any given board will, to some extent, be influenced by the culture of the company.

How effective are *in camera* or private meetings?
Increasingly, many boards are beginning their meetings with only the directors present. According to these boards, starting the meeting *in camera* gives the directors a good opportunity to discuss any issues or concerns among themselves and positions them to understand and also challenge management at the board meeting.

With regard to audit committee meetings, many agendas provide for the audit committee to hold separate *in camera* or private meetings with the external auditor. Frequently, such sessions are held at the end of the scheduled audit committee meeting. The executives are asked to leave, and the committee then invites comments from, and asks questions of the external auditor.

The Malaysian Code on Corporate Governance recommends at least two private meetings a year between the audit committee and the external auditors.The audit committee should also meet *in camera* with the chief internal auditor at key points during the year.

A private session with the external auditors, where management is not present, should allow the audit committee to ask questions on matters that might not have been specifically addressed as part of the audit. It allows the auditor to provide candid, often confidential, comments to the audit committee on such matters.

Why is it important to identify issues early?
Questions of substance *should not be raised* for the first time at the year-end board meeting. Serious problems may result if there are unexpected answers. If the year-end board meeting is to be conducted effectively, the chairman should be communicating with management, and the audit committee communicating with the internal and external auditors during the weeks before the year-end board meeting. An effective annual plan for meeting agendas can help the board to identify issues and discuss them as early as possible during the year.

"In the case of Kenmark Industrial Co (M) Bhd, there had been early signs of troubles in its books. The furniture maker had seen its receivables balloon considerably over the years, even before the sudden disappearance of its managing director."

Nadia Hassan, writing in her column ***"Big Money"*** in The Edge Malaysia

Why do we set meeting agendas?
A detailed agenda helps to keep the board focused. Effective agendas are set with input from the CEO, CFO, and the internal and external auditors. The chairman, however, should maintain accountability for the agenda and not delegate it to management. Management should make sure that the board receives the meeting agenda and supporting materials in a timely manner to enable directors to give full and proper consideration to the issues. **Guidance Material 2 - Potential board of directors' topics** provides some hot topics that deserve consideration.

Many boards of directors regularly invite the CEO, the CFO, the external audit partner and the chief internal auditor to attend board meetings

What is the right meeting frequency and timing?

The board should meet as often as its role and responsibilities require. 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 annually. An appropriate interval should be allowed between main board meetings and meetings of the committees to allow any work arising from the committee meetings to be carried out and reported to the board as appropriate.

Who should be attending the meetings?

Notwithstanding the existence of Audit Committees, many boards of directors regularly invite the CEO, the CFO, the external audit partner and the chief internal auditor to attend board meetings. The CEO often has valuable insights to share, but the chairman should make sure that the CEO does not inhibit open discussion at the meeting.

When the respective committees of the board are addressing a significant and complex issue, some committees may choose to invite all directors – essentially operating as a 'committee of the whole' with the meeting chaired by the committee chair. This approach enables all directors to understand the issue and apply their combined knowledge to an important issue.

How can reporting help the board to own up?

The chairman should receive reports from all the respective committees within the board, in sufficient depth, to enable the board to fulfill its oversight responsibilities.

How can board self-evaluation improve our functioning and output?

Each year, the board should make its own assessment of its performance and effectiveness, perhaps by even requesting feedback on performance from senior management.

Guidance Material 3 - Board of directors' self-assessment is a suggested framework for a board of directors' annual review of its own effectiveness and the adequacy of its terms of reference and work plans.

What are the attributes of an effective chairman?

Someone who is:

- a proactive leader with confidence and integrity;
- a highly respected and experienced director, who possesses the skills and time available to develop and monitor the board agenda;
- a person with an excellent working knowledge of the board's functions and able to coordinate the respective committees effectively;
- a good listener and communicator and one who can facilitate successfully;
- able to champion open and frank discussion with discipline; and
- tenacious and prepared to ask the tough questions.

Some key points on how to assess the board's effectiveness:

- Question the board's own satisfaction of its performance;
- Compare the board's activities to the Listing Requirements and Malaysian Code on Corporate Governance;
- Compare the board's activities to leading practices;
- Compare the board's activities to the terms of reference and any other objectives the board has set; and
- In the case of the audit committee, consult with external auditors to improve the audit committee's performance.

Once upon a time, in a land far, far away, there lived the seven dwarves.

We are all familiar with the classic children's tale "Snow White and the Seven Dwarves". On a lighter note, we have prepared a parody based on these seven vertically-challenged characters to look at the teachings they can provide to directors on building better boards:

BASHFUL
Self conscious, embarrassed and ill-at-ease with society - these are bashful characteristics that effective directors should not exhibit. Independent directors must assert themselves to courageously ask the questions that matter.

DOC
Seeking advice and input from reputable consultants is not a sign of weakness, but rather shows strength as the board is effectively utilising specialised advice from topical experts for the benefit of the company.

DOPEY
For a director to fully understand the company's business, a considerable amount of time will be required. Directors cannot afford to be dopey and need to be able to "hit the ground running" from day one.

GRUMPY
In order to manage disgruntled grumpy stakeholders, directors need to be able to conduct timely, open and honest communication to allay any of the stakeholders' concerns.

HAPPY
Every board should aim for sustainable long term happiness of the company. Directors should be thinking of "planting the seeds now to reap the harvest later" - instead of thinking about the round of golf arranged immediately after the quick board meeting.

SLEEPY
Directors should be committed to being alert at all times, especially during board meetings. Those who are not vigilant may find themselves "caught napping" when unpleasant surprises appear.

SNEEZY
Ahh... Choo! Sneezing is a warning sign from our body to shape up and get healthy. Similarly, directors need to be alert to the precursors of trouble to the company and react to prevent or manage them accordingly.

4 Does the board have cognisance over the company's strategy?

In the past few years, some high-profile irregularities reported in the media have been attributed to various inappropriate earnings-management practices. Such practices include questionable revenue recognition, inappropriate deferral of expenses, misuse of the materiality concept and misconstrued recognition, reversals, or use of provisions and allowances without events or circumstances to justify such actions.

How can our board be more alert to earnings management?
Directors need to know enough about their company to recognise when inappropriate earnings-management practices are present. In such cases, they need to receive what they hear with some scepticism. If the board is not alert and sceptical, many of the improvements in the quality and reliability of financial reporting in recent years could be undermined just when they are most needed.

Auditors must also play their part. No auditor should be unaware of the problem. The auditor's role is to express an opinion on the fairness of the financial statements, usually tested by reference to accounting standards and materiality.

There are circumstances, however, where materiality considerations should not cloud financial reporting integrity and ethics. For example, under some circumstances, an immaterial adjustment could make the difference between a company recording a profit or a loss.

Areas of potential concern

Specific areas of accounting warrant special attention. They can be particularly vulnerable to interpretations that may obscure financial volatility and adversely affect the quality of reported earnings:

- **Revenue recognition** - Recognising sales revenue before a sale is complete, or at a time when the customer still has options to terminate, void or delay the sale, has attracted great attention recently.

- **Changing estimates** - Changing estimates to make the numbers is another frequently used method for managing earnings. While changes to estimates may be perfectly acceptable when supported by real economic facts, all too often estimates are altered for 'convenience' and without disclosure to investors.

- **Abuse of the materiality concept** - Errors may be intentionally recorded under the assertion that their impact on the bottom line is not significant. However, given the markets' reaction to even small changes in earnings per share, what is or is not significant may not always be clear.

- **Capitalisation and deferral of expenses** - Costs that should be accounted for as a cost of the period may be capitalised or deferred, for example, ambiguously defined capitalisation criteria for property, plant and equipment and unreasonable amortisation periods.

In Malaysia, the Companies Act, 1965 states that the board of directors, and not management, is responsible for the preparation of the company's financial statements

"Two former directors of Transmile Group Bhd were each jailed a year (and fined RM300,000 each, in default six months' jail) for providing misleading information of revenue totalling almost RM1 bil to Bursa Malaysia Securities Bhd… Both were former independent non-executive directors of the air transportation company and also members of its audit committee at the time the offence was committed on Feb 15, 2007… the judgment was a milestone for corporate Malaysia as it was the first time in recent years that independent directors have been found guilty of not performing their duties."

Maizatul Nazlina, writing in her article ***"Ex-Transmile directors jailed"*** in The Star

Who is responsible for the financial statements - management or the board?

In Malaysia, the Companies Act, 1965 states that the board of directors, and not management, is responsible for the preparation of the company's financial statements. Interestingly, the Act does not differentiate whether the director is executive or otherwise – all directors are equally accountable.

The publicity over the past few years concerning high-profile irregularities has intensified the interest of both regulators and the investing public in the propriety of a company's financial reporting. In an environment where to miss analysts' expectations by a small amount can lead to significant decreases in share price, market capitalisation and overall investor confidence, this focus is hardly surprising.

"The recent spate of corporate scandals highlights the growing need for regulators to increase their vigilance. But investors could also play a role and actively look for clues before their investments turn sour. What are the red flags investors should look out for in a company? Here are some :

a) Turnover and receivables trend;
b) Shareholding structure;
c) Insider moves;
d) Unusually heavy capex;
e) Integrity of management;
f) Abnormal margins; and
g) Off-balance sheet financing or guarantees"

Loong Tse Min, writing in his article ***"Red flags that investors should look out for"*** in The Edge Malaysia

Do we really have to keep up to date with financial reporting developments?

The past few years have been marked by rapid and widespread developments in financial reporting. These developments reflect the increasingly complex and innovative transactions in today's business world, and address the growing information needs of the users of financial statements.

International harmonisation and convergence of accounting standards has brought about radical change to financial reporting by way of International Financial Reporting Standards ("IFRS"). This is particularly challenging in Malaysia where listed companies have only partially adopted IFRS (Malaysia will fully adopt IFRS in 2012) and some private companies have still retained the Private Entity Reporting Standards ("PERS") for their financial reporting.

Further, Bursa Malaysia has amended the Listing Requirements to enhance corporate disclosure. Supplemented by the Corporate Disclosure Guide, the amendments introduce new obligations and amplify disclosure requirements. Phrases such as 'cautiously optimistic', 'willing buyer, willing seller' and 'for working capital purposes' will no longer be enough for announcements.

Who should the board charge with responsibility for the financial statements?

The board of directors is remitted to present a balanced and understandable assessment of the company's position and prospects. The board should be assisted in its role by charging the audit committee with the specific responsibility of monitoring the integrity of the financial statements of the company and any formal announcements.

Where, following its review, the audit committee is not satisfied with any aspect of any proposed financial reporting by the company, it shall report its views to the board. To fulfil these responsibilities, the audit committee must understand current developments and emerging issues affecting financial reporting and disclosure.

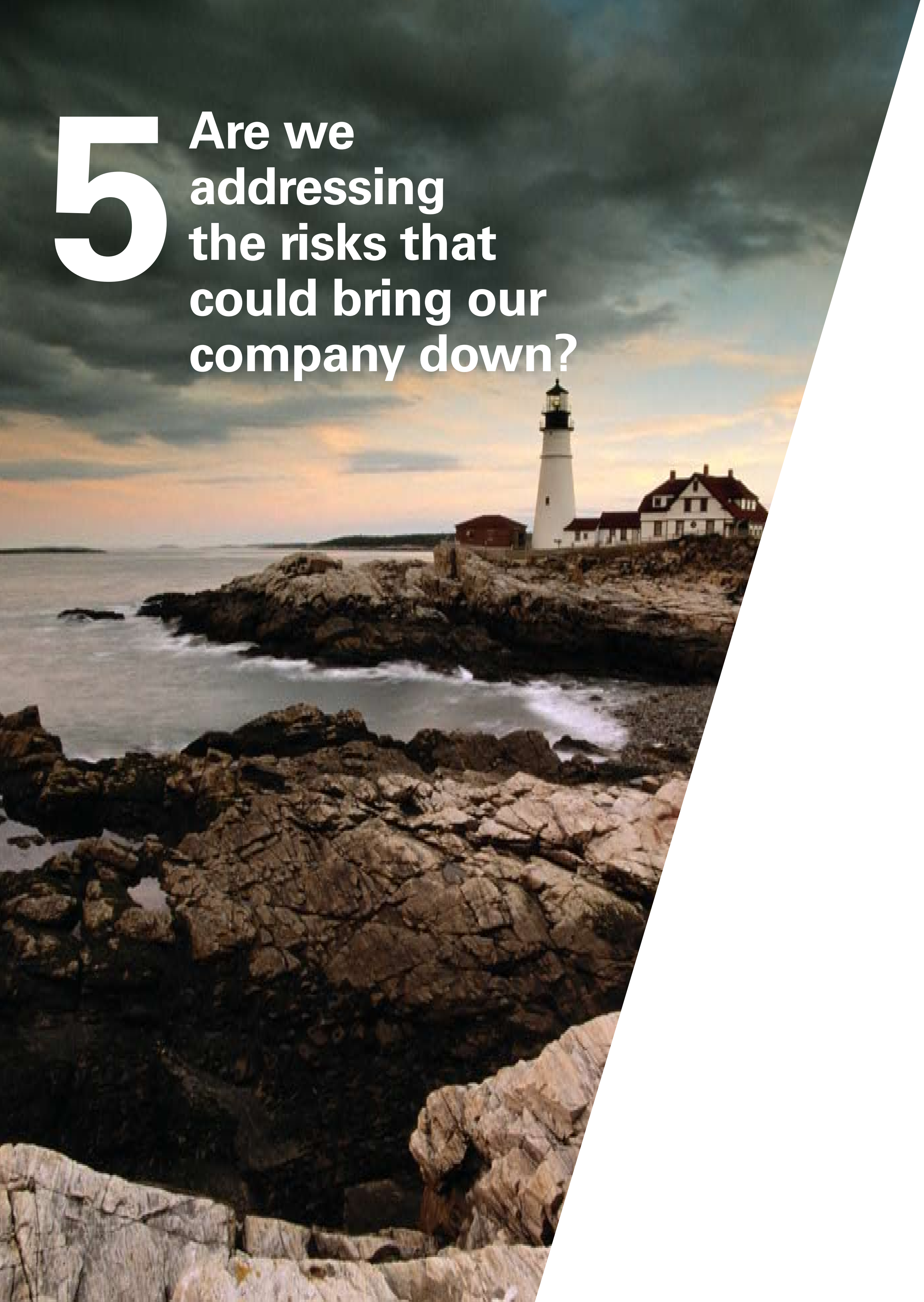
The audit committee's responsibilities should include the following:

- to consider significant accounting policies, any changes to them, and any significant estimates and judgements; and
- to review the clarity and completeness of disclosures in the financial statements and consider whether the disclosures made are set properly in context.

Review development in integrated reporting & to promote awareness & adoption by companies (TF)

Five pillars of disclosure and transparency

- **Truthfulness** - information disclosed must provide accurate description of circumstances
- **Completeness** - information disclosed must be sufficient to enable investors to make informed decisions. The information must include financial as well as non-financial matters
- **Materiality of information** - information disclosed must be material i.e. information which can influence investment decisions
- **Timeliness** - information disclosed must be timely to enable investors to react as quickly as possible
- **Accessibility** - information disclosed must be easily acessible, and available to investors at low cost



5 Are we addressing the risks that could bring our company down?

Directors must be critically aware of and clearly understand their oversight responsibilities for the organisation's risks process, in particular, financial risks. Some directors find the oversight of this area challenging because it encompasses a broad and difficult subject. In practice, many effective boards of directors perform their oversight by demanding relevant, timely and accurate information.

What risks should we be looking out for?

Boards may take several different approaches in identifying and assessing risks. The board may assume that responsibility itself or it may assign selected oversight responsibilities to one or more board committees. It is therefore vital that directors clearly understand the responsibilities of the board of directors and other board committees and the audit committee for overseeing risk management.

Risk management should always be on the board agenda, demonstrating the board's clear ownership of risk management oversight. To fulfil their responsibilities, the board and any board committees need to assess periodically whether they are receiving appropriate risk management information, regularly enough and in a format that meets their needs from management. **Guidance Material 4 - Example questions - identifying and assessing risk** contains high level questions that the board may consider in framing their discussions with management.

> "The emergence of new shareholders with little long-term interest have amplified risk-taking for short term gains (and contributed to excessive remuneration). Such conflict came into fore in the BP oil spill - many BP shareholders were eyeing hefty dividends and didn't pay enough attention to environmental risks."
>
> **Tan Sri Lin See Yan**, writing in his Starbiz column ***"What are we to do?"***

The 'tone from the top' should become the cultural core of the organisation and a model of appropriate conduct for every level

Why is it important to set the appropriate tone?
The integrity and attitude of senior management and the board of directors, including its committees, is often referred to as the 'tone from the top'. It is arguably the most important factor contributing to an organisation's effective management of risk. The tone from the top should become the cultural core of the organisation and a model of appropriate conduct for every level.

Organisations should demonstrate their commitment to organisational integrity by codifying their standards in a code of conduct. An organisation then demonstrates its commitment to its code of conduct by creating systems and procedures to introduce, monitor and enforce its application.

Set the 'tone from the top' by:

- assigning senior individuals to oversee compliance with the code of conduct;
- assessing the integrity of new appointees in the selection and promotion process;
- exercising due care in delegating discretionary authority;
- communicating with and training all employees regarding enterprise values, standards and compliance procedures;
- providing, monitoring and auditing safe systems for reporting unethical or risky behaviour;
- enforcing appropriate discipline with consistency; and
- responding to offences and preventing recurrence.

What are the warning signals of financial risk?
Companies may operate in one or several industries. The more diverse the company, the more attuned the board should be to different industry risks, accounting practices, laws, regulations, and reporting requirements. To facilitate identifying risk indicators, the company's senior executives should regularly report to the board to keep the directors informed of the risks and exposures facing the company.

Illustrated in **Guidance Material 5 - Warning signals** is a wide range of warning signals, including financial considerations that may arise from accounting, operational or external issues; concerns that may become evident through the board of directors, board committees or management; and signs that may come from employees or customers or other sources.

What if I am on the board of an owner-managed business?
The most common type of company in Malaysia is the owner-managed business. A director on the board of an owner-managed business will face different challenges altogether.

The owner-managed business:

- may lack a formalised management structure;
- may not have well-established corporate governance programmes; and,
- may have outdated policies, procedures, and processes.

Dominant leadership can put a strain on the enterprise's controls and corporate governance processes and set the wrong tone from the top.

Dominant individuals (usually family members) or autocratic management may be a cause for concern.

The board should question whether management has considered those risks likely to have the greatest financial, reputational or regulatory impact on the business

How should we address fraud and illegal acts?

The nature of fraud risk is expanding. Technological advances have changed the speed and ways of recording business transactions; these advances have enhanced opportunities for fraud and have greatly increased the potential quantum of losses arising from fraud.

Unpalatable though it may be, the board has to address the risk of fraud head-on. As an important first step, management should identify the risk of losses arising from fraud by conducting diagnostic studies of the risk of fraud and misconduct in the business. The board should question whether management has considered those risks likely to have the greatest financial, reputational or regulatory impact on the business.

Who are the worst rogue traders in banking history and what has unauthorised trading cost the banks?

1. **Nick Leeson**, arguably the most famous rogue trader in history, brought down Barings in 1995 with losses amounting to USD1.3 billion, almost the entire assets of the bank. Barings, the UK's oldest merchant bank, crashed and was bought for 1 pound by ING.

2. Societe Generale revealed in January 2008 that **Jérôme Kerviel** had lost the bank USD7.1 billion. The fraud virtually wiped out the 2007 profits at France's second-largest bank and sent shockwaves through European markets.

3. UBS, the largest Swiss Bank, hit the press after a trader, **Kweku Adoboli**, had lost them USD2.3 billion through rogue trading. The loss effectively cancelled out the USD2.3 billion saving UBS made in a cost-cutting drive involving 3,500 job cuts globally.

Are we also responsible for internal control processes?

An effective control environment needs more than good controls; it needs competent oversight. The board of directors, board committees, management, internal auditor and external auditor each have a role in helping to ensure that an effective control environment exists.

The board is ultimately responsible for overseeing risk management and the entity's internal control processes. The board has the discretion, however, to assign a board committee, such as the audit committee, the responsibility for overseeing compliance with applicable laws and regulations and/or specific aspects of internal control.

Internal controls should:

- facilitate the effectiveness and efficiency of operations;
- help to ensure the reliability of internal and external reporting;
- help safeguard assets; and
- assist with compliance with laws and regulations.

How do we enhance whistle-blowing procedures in our company?

The Institute of Chartered Accountants in England and Wales (ICAEW) states that "An appropriate and effective whistle-blowing mechanism should provide some support to the audit committee's other review and monitoring work; for example, in relation to the integrity of the financial statements."

The directors should ensure that whistle-blowers are given protection from victimisation and dismissal when they make certain disclosures in the public interest. It is essential for employees to feel they will be protected when they blow the whistle so that, if they ever bring a charge of non-compliance or unethical behaviour, they can do so without the fear of reprisals. An example is provided in **Guidance Material 6 – Example whistle-blowing policy**.

An appropriate and effective whistle-blowing mechanism should provide some support to the audit committee's other review and monitoring work

Mandate Boards to formulate ethical standards & system of compliance through company's code of conduct (C)

- Establish & maintain code of conduct
- Establish & maintain appropriate systems to support, promote & ensure its compliance
- Establish & maintain an internal whistle-blowing mechanism

Expand coverage of whistle-blowing provisions (L)

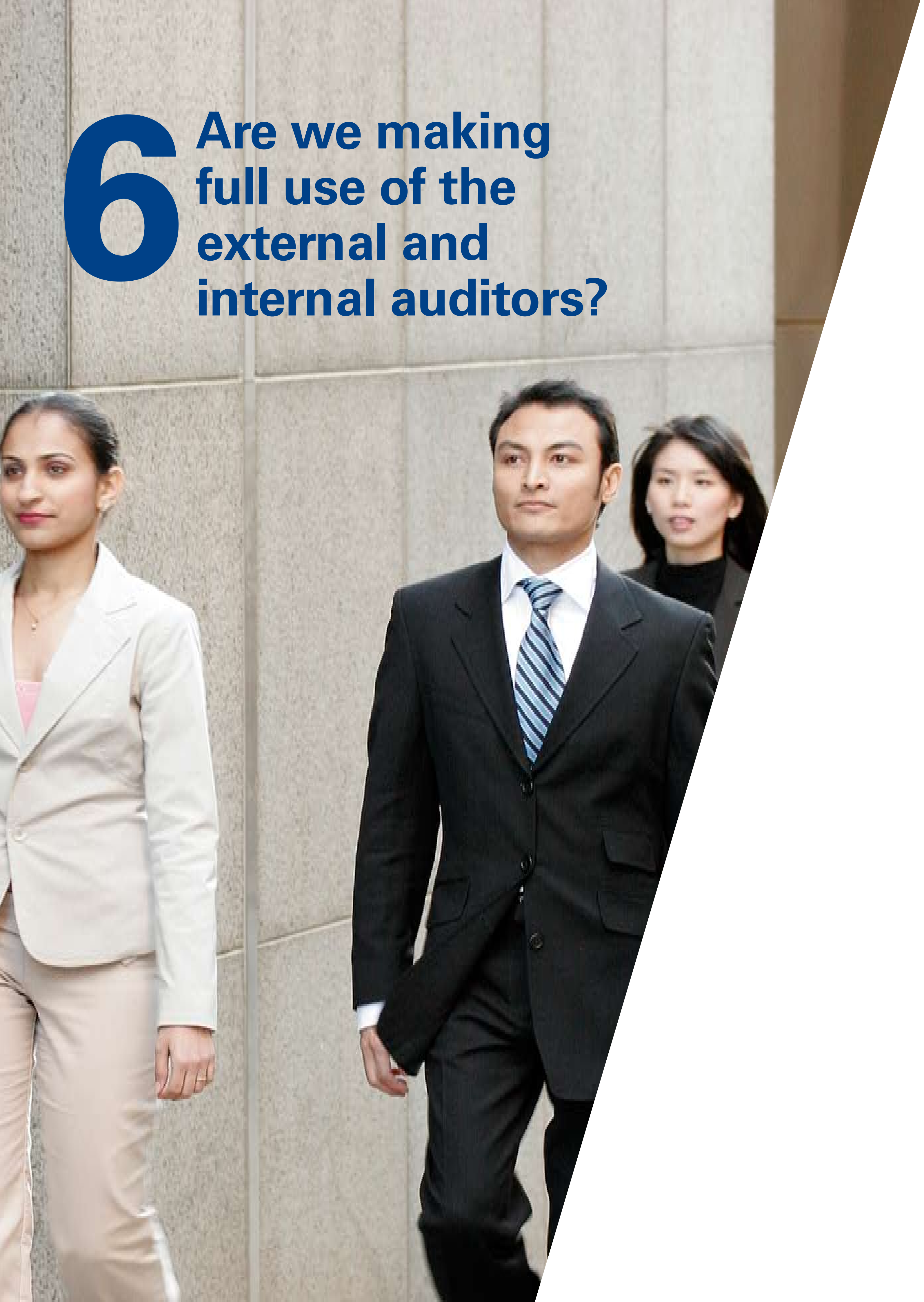
- Explore extending whistle-blowing obligations to corporate advisers & company secretaries

"Even though most won't come out and say it, whistleblowers play a critical role in a corporate environment. While it is true that most companies are transparent when it comes to their affairs, there will always be a part that is hidden behind a curtain of trade secrets that prevents full disclosure.

Hypothetically, could a whistleblower at Sime Darby have lessened the damage if the losses at its energy division had been revealed much sooner? As we ponder these issues, we should not forget that it was a whistleblower, and not a regulatory body, who first uncovered Bernard Madoff's role in what has been described as the largest Ponzi scheme in history."

Nadia Hassan, writing in her column ***"Big Money"*** in The Edge Malaysia

6 Are we making full use of the external and internal auditors?



The external auditors and the internal auditors function as key drivers in executing the board committees' oversight responsibilities. An efficient board of directors is one which can make full use of the external and internal auditors.

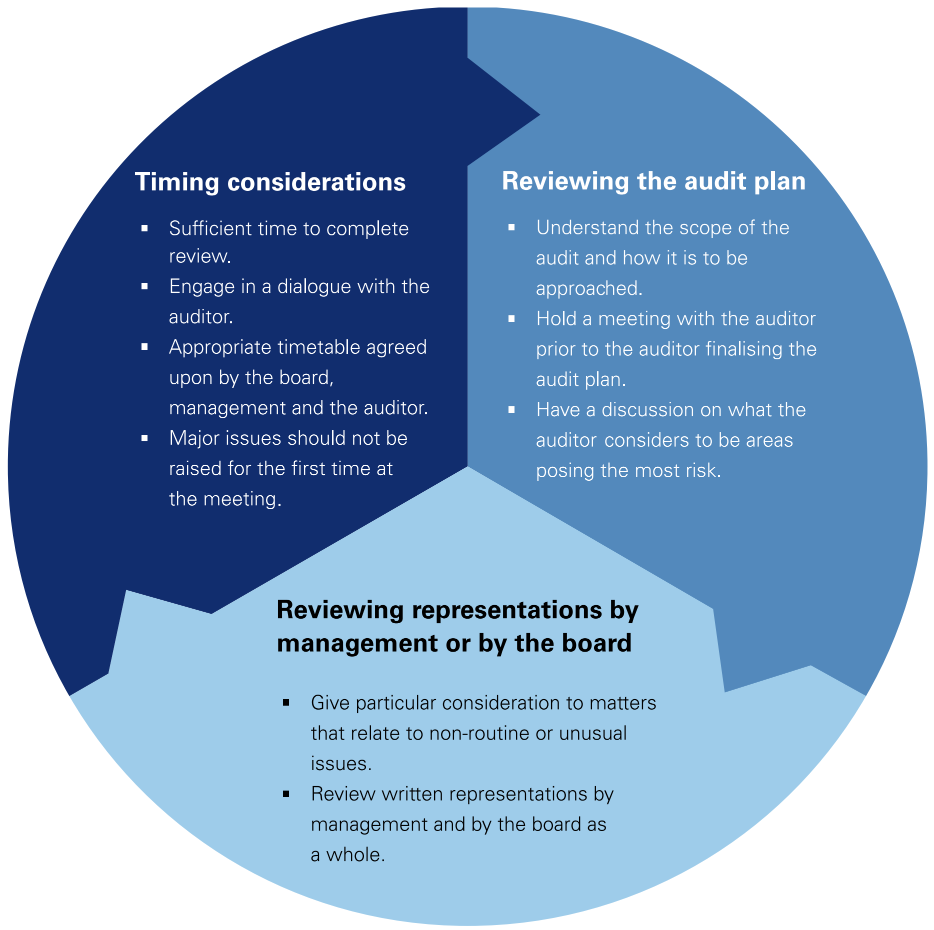
What else can the external auditor do for us?

The relationship with the external auditor is important to the audit committee. In order for it to be effective, or perceived to be effective, the audit committee should devote time to maintaining an effective relationship, developing policies on the appointment and removal of the external auditor and safeguarding auditor independence.

Understanding the audit cycle

A discussion with the external auditors may uncover areas where the audit committee assumes work is done when it is not, and other areas where audit effort is directed but of which the audit committee may not be aware.

The following is a typical audit cycle of a listed company in Malaysia:



The Audit Cycle

Companies need to weigh the potential benefits and costs of internal control processes

Assessing the external auditor's performance

The audit committee has primary responsibility for selecting, evaluating, and, if need be, replacing the auditor. The committee's evaluation should consider the auditor's competence, the quality and efficiency of the audit, whether the audit fee is appropriate in relation to size, complexity, and risk and control profile of the company to ensure that the company's audit is not compromised.

The Listing Requirements were recently amended to require the listed company, in appointing an external auditor, to consider the experience and resources of the accounting firm, the persons assigned to the audit, the accounting firm's audit engagements and the number of supervisory and professional staff assigned to the particular audit.

Guidance Material 7 - Evaluation of external auditors is a checklist framework for an audit committee to carry out a formal review of the effectiveness and efficiency of the external auditor.

What else can the internal auditor do for us?

Companies need to weigh the potential benefits and costs of internal control processes. One such decision relates to the need or desirability of having an internal audit function.

In Malaysia, the Listing Requirements make it compulsory for listed companies to have internal auditors. Designed and deployed effectively, internal audit can have a very positive impact on the control environment of an organisation and the effective design and operation of internal control.

Assessing internal audit's performance

Self-assessment by the head of internal audit is an effective assessment tool, but it should not be the sole means of assessing the effectiveness of internal audit. In evaluating the work of internal audit, the audit committee should review the annual internal audit work plan, receive periodic reports on the results of the internal auditor's work and monitor management's responsiveness to the internal auditor's findings and recommendations.

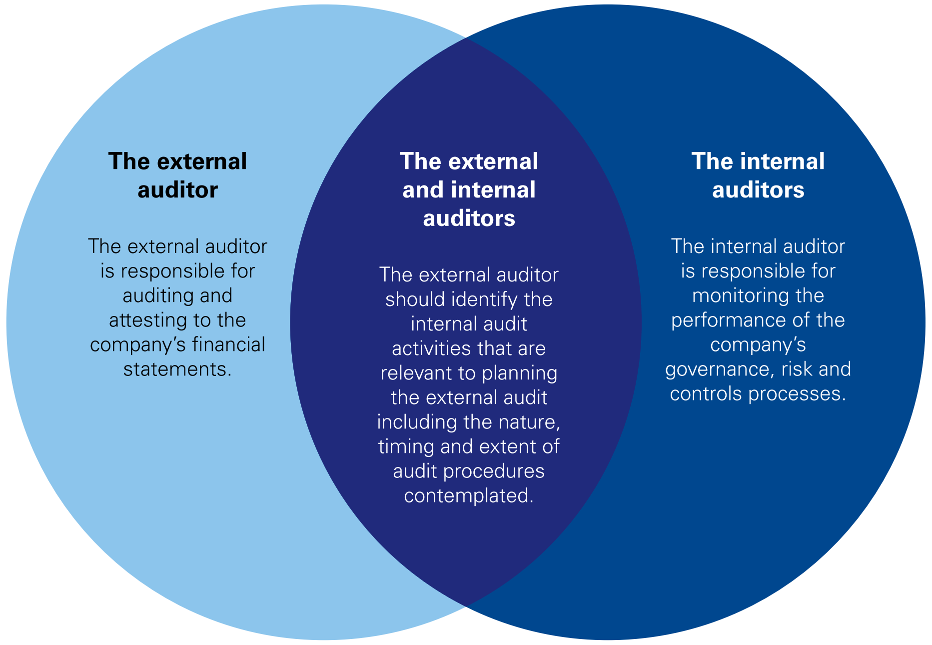
The International Standards for the Professional Practices of Internal Auditing under the ambit of the Institute of Internal Auditors Incoporated (IIA Inc) requires an external assessment of the internal audit function at least once every 5 years.

Guidance Material 8 - Evaluation of internal auditors provides a framework which audit committees can adapt when reviewing the effectiveness of the internal audit function.

How can we interface the external and internal auditors?

In an organisation, the external audit firm and the internal audit function both execute their own audit coverage. Each has unique responsibilities, as identified in the diagram on the right.

The audit committee should determine that these audit functions complement each other, that where appropriate they coordinate their audit efforts and that they communicate effectively with one another.



Unique responsibilities of the external and internal auditors

7 Is our board looking at the bigger picture?

The board of directors must monitor what is happening within the organisation now and, at the same time, what may happen in the future. In today's global economy and formidable business environment, being prepared and staying ahead of the curve, is a major ingredient for success. Because both regulators and the public have intense interest in the financial reporting process, prudent boards of directors are sharpening their focus on current and emerging issues and responding accordingly.

Amendment to the Capital Markets and Services Act, 2007
The amendment to Section 317A of the Capital Markets and Services Act, 2007 ("CMSA"), which came into force on 1 April 2010, states that the Securities Commission can prosecute a director or an officer of a listed company who has intentionally caused wrongful loss to the company. The section carries a punishment of a fine up to RM10 million and imprisonment of up to 10 years.

"According to a corporate lawyer, Section 317A covers instances, which are similar to directors' fiduciary duties that come under Section 132 of the Companies Act….

"The new amendment to the CMSA has given the SC new teeth," said the corporate lawyer, who pointed out that sentencing was ultimately in the hands of the courts."

Risen Jayaseelan writing in his Starbiz article ***"SC going after directors under new powers"***

"The SC has issued show-cause letters to several Sime Darby Bhd directors regarding possible breaches of the Listing Requirements, according to sources.

This marks another step in the investigation into Sime Darby's four key projects involving its energy & utilities division where the SC has initiated investigations into potential breaches of the Capital Markets and Services Act 2007."

Anita Gabriel writing in her Starbiz article ***"Show-cause letters"***

The New Economic Model
The New Economic Model (NEM), which was unveiled on 30 March 2010, will generate benefits for all Malaysians under its inclusive growth goal and approach.

The key goals of the NEM are to:

- elevate Malaysia to a high income country with per capita income of USD15,000, from the current USD7,000, in 10 years;
- focus on inclusiveness that enables all communities to fully benefit from the country's wealth; and,
- ensure sustainability of growth to meet current needs whilst bearing in mind future generations' needs.

Mandate Boards to formulate strategies addressing sustainability & stakeholder interests through internal policies (C)
- Establish & maintain policies on company's relationship with other stakeholders
- Establish & maintain environmental, occupational health & safety policies

The Competition Act, 2010 has two major prohibitions – anti-competitive agreements and abuse of dominant positions

"Sustainable development is about trying to find a magic balance between people, the planet and profit ... We think we're found it but we think it's the answer today - that balance keeps changing as the years go by."

Roundtable on Sustainable Palm Oil Secretary General **Darrel Webber**, as quoted in Elaine Lau's Options article **"Finding a magic balance"**

The Audit Oversight Board
According to the Securities Commission, auditors play a critical function as they are the first set of gatekeepers to company's transactions. Towards this objective, the Securities Commission established the Audit Oversight Board ("AOB") to provide independent audit oversight over public interest entities, including PLCs. The AOB was formalised on 1 April 2010.

The AOB will make inspections on audit firms to ensure they comply with quality standards outlined under the International Standard on Quality Control ("ISQC1"). The inspections cover two key components – inspection of audit firm compliance under ISQC1 and an engagement review. On those that fall short, the AOB would provide guidance and make suggestions and also monitor their progress over a period.

"AOB will exercise discretion in fulfilling its role. However, the board has full authority to penalise auditors and auditing firms that do not comply with the standards," (AOB Executive Chairman Nik Mohd Hasyudeen Yusoff) said."

Danny Yap, writing in his Starbiz article ***"Inspection on audit firms soon"***

Competition Act, 2010
Malaysia's Competition Act, 2010, which will come into force on 1 January 2012, is aimed to promote a competitive environment and give foreign investors more confidence in the country's business practices. This Act will govern all companies, including government-linked companies, except for certain corporations or businesses which are exempted.

The Act has two major prohibitions – anti-competitive agreements and abuse of dominant positions. Anti-competitive agreements include price fixing, import cartels, bid rigging, territorial allocation, limiting production and market sharing. The abuse of dominant positions includes predatory pricing, price discrimination, excessive pricing and denying market access.

What is round tripping?
Round tripping is the act of artificially inflating volume and revenues, but in reality adds no profit. Some of the more notable companies that engaged in round-trip trading include Enron, where Enron was able to increase its revenues (and expenses) without changing its net income.

Arising from recent events in Malaysia, there is a keen interest by the Securities Commission on the disclosures relating to round tripping among listed companies – to the extent that the Securities Commission is able to publicly caution companies on their disclosures.

"The review of Mudajaya (Group Berhad) started some time in July after a complaint was lodged with the regulator (Securities Commission (SC)), stating that Mudajaya had, among other things, over-paid for its investment in an Indian power plant. In a statement yesterday, the SC said it had required Mudajaya's auditor to produce a report on Mudajaya's Indian IPP project.

The SC said the report had revealed movement of funds between Mudajaya and related entities pursuant to the IPP project in India, "that is characteristic of the practice known as '**round-tripping**'. The practice of round tripping has been raised as a concern in several jurisdictions.

Risen Jayaseelan, writing in his Starbiz article ***"What is 'round tripping' and why is the SC reviewing its use and disclosure?"***

Power to Malaysian Women
The Malaysian government had announced a policy approved by the Cabinet, where the private sector has five years to ensure that women make up at least 30% of those in senior positions and on boards of directors.

Public listed companies, government-lined organisation, banks and financial institutions are expected to take the lead in achieving the 30% target.

Mandate formulation & disclosure of gender diversity policies & targets (LR)
- Companies must **disclose** in annual reports, policies & targets on composition of **women** on their boards

Is disgorgement sufficient?
Disgorgement, in a financial context, is the repayment of profits arising from irregularities in the trading of shares or other securities.

The Securities Commission is empowered by Sections 188 and 200 respectively of the Capital Markets and Services Act 2007 (previously under Sections 89E and 90(1) respectively of the Securities Industry Act 1983) on matters of disgorgement.

Section 89E refers to "prohibited conduct of persons in possession of inside information", while Section 90(1) provides that in relation to certain contraventions under the Act, the SC can institute civil proceedings against a person, regardless of whether that person has been charged with an offence in respect of the contravention, or whether a contravention has been proved in a prosecution.

"Three corporate personalities have agreed to pay the SC over RM200,000 following investigations into alleged irregularities in the trading of Nexnews Bhd's shares in 2007. In an update on enforcement actions posted on its website, the regulator said it had entered into separate settlements last month without admission of liability by the trio."

Taken from the Starbiz article ***"SC in settlement with 3 over alleged Nexnews trading irregularities"***

Making a difference to the community
Companies are only now recognising the significance and value of integrating Corporate Social Responsibility (CSR) into aspects of their operations and decision-making processes. More and more companies are realising that CSR is the key to corporate sustainability.

Corporate sustainability is more than just protecting wildlife, reducing waste, reusing and recycling. Sustainability is a process. It is a business approach used to create long term value by utilising the opportunities and managing the risks that emerge from economic, environmental and social developments. The long-term growth and profitability of companies are inextricably linked to the sustainability and the well-being of the community.

To this effect, the Malaysian government launched "The Prime Minister's CSR Awards" - the highest recognition to Malaysian corporate organisations that have made a significant and positive impact on the lives of people around them. The Awards are held once a year to recognise companies that have made a difference to the communities in which they are active through their CSR programmes.

Concluding remarks

The Audit Committee Institute has compiled these 7 questions to help shape success for boards of directors. These questions are by no means exhaustive and should act as a platform for further questioning by boards of directors.

The questions are centred around The Directors' Prism which focuses on the position of the board and its committees – who are responsible to the stakeholders and who rely on management, internal auditors and external auditors – to carry out these responsibilities.

Current and emerging issues that most boards must understand have been asked, including being on the board of an owner-managed company – a common scenario in the Malaysian landscape.

With this, we conclude by dispelling some of the common myths surrounding the boards of directors:

MYTH 1 – The board's involvement in a company is only limited to the boardroom.

TRUTH 1 – The board, through its board committees, has direct and indirect connection through management, internal and external auditors, resulting in a broad involvement that extends way beyond just the boardroom.

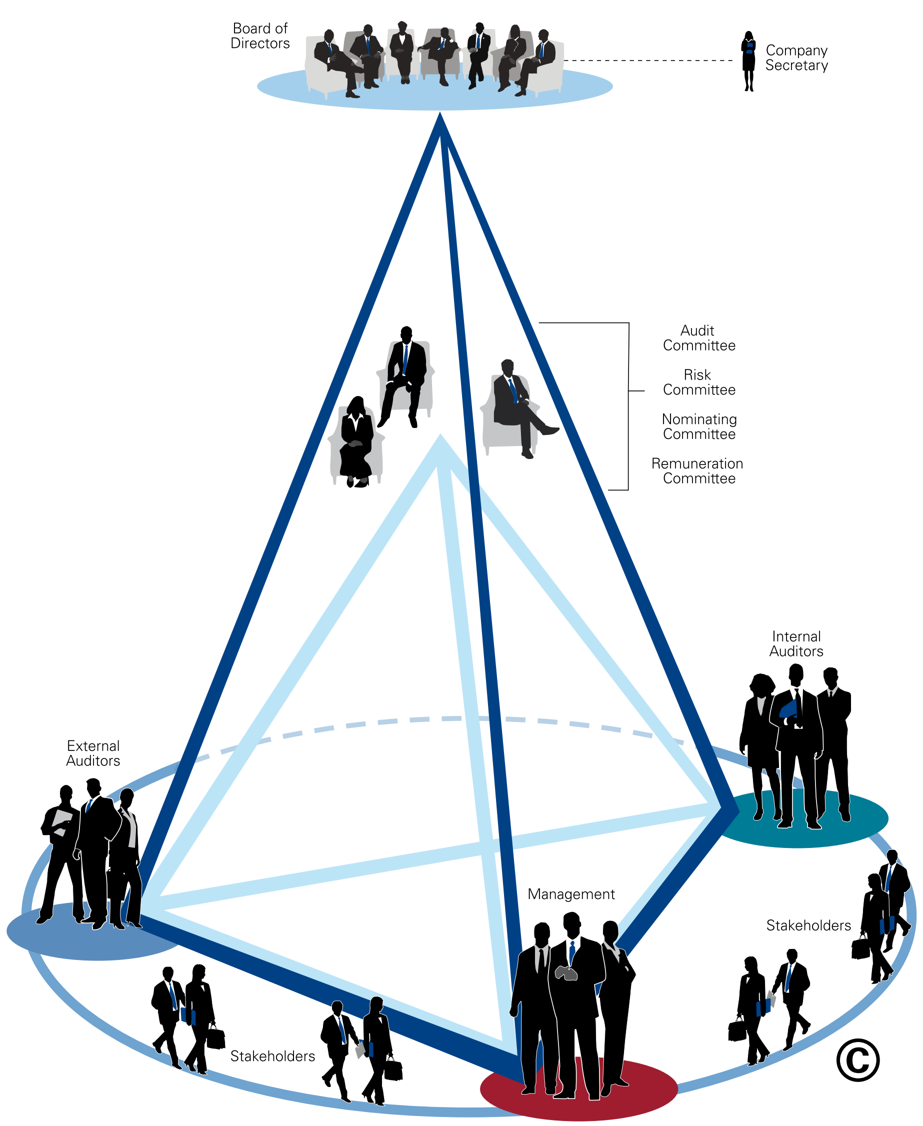
MYTH 2 – The board oversees management, but no one oversees the board. Directors have carte blanche over the company.

TRUTH 2 – Regulators and other stakeholders make sure the directors are behaving appropriately. Within the board, the independent directors, led by the senior independent non-executive director, have the role of keeping the other non-independent directors in check.

MYTH 3 – Related party transactions do not apply to directors.

TRUTH 3 – All related party transactions with directors and their connected parties have to be declared and disclosed in the company's financial statements.

Appendix 1 : The Directors' Prism



The Directors' Prism, developed by the ACI, is a diagrammatic expression of the position of the board of directors, the board committees, management, internal auditors, external auditors and the stakeholders of a company.

The board of directors is positioned at the top of the prism, representing the board's direct responsibility for overseeing the entire organisation.

The board committees – comprising the audit committee, risk committee, nominating committee and remuneration committee – are positioned in the centre of the directors' prism, symbolising the importance of their roles in holding together the organisation.

The base of the prism is represented by management, the internal auditors and the external auditors, signifying their importance as the foundation of the company.

Surrounding the prism are the stakeholders of the organisation, such as shareholders, employees, customers, suppliers, bankers, etc.

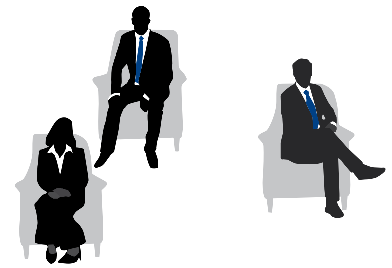
The board of directors
The primary responsibility of the board of directors is to protect the shareholders' assets and ensure they receive a decent return on their investment. However, in some companies, the sentiment is much different; many directors feel that it is their primary responsibility to protect the employees of a company first, the shareholders second.

The board of directors is the highest governing authority within the management structure at any public listed company. Committees are formed within the board, such as the audit committee, risk committee, nominating committee and remuneration committee in order to act on behalf of the board and carry out their respective duties.

The company secretary

The company secretary is an officer of the company responsible for the efficient administration of the company, particularly with regard to ensuring compliance with statutory and regulatory requirements, and for ensuring that decisions of the board of directors are implemented.

Enhance role of company secretaries in Corporate Governance (C)
- Enhance role of company secretaries through clarifying their role in Corporate Governance Code
- Relevant professional bodies to look into qualification requirements needed to raise skills & professional standards of company secretaries



The board committees:
1) The audit committee
Audit committees are designed to help boards and directors to discharge their duties regarding:

- reported financial information;
- internal controls; and
- corporate codes of conduct.

The role of the audit committee will typically cover overseeing the financial reporting process, improving the quality of financial reporting, recommending appointment of external auditors, appointment of internal auditors and reviewing the scope and results of the external and internal auditing processes. The audit committee is effectively the 'eyes and ears' of the board, and have the responsibility of ensuring that the board makes properly informed decisions regarding accounting policies, practices and disclosure.

2) The risk committee
As a number of governance observers have suggested, a risk committee might take on one or more of the following roles:

- Overseeing the company's risk management processes (as distinct from "risk content" or substantive areas of risk). Some boards - particularly for companies that are in the early stages of developing a risk management system - may want to focus more on risk management processes to help ensure a robust "risk governance" system is in place, and it may make sense to assign this responsibility to a risk committee; and
- Relieving the heavily burdened audit committee by having the risk committee take on responsibility for certain substantive areas of risk.

Ultimately, however, the question is whether there is a need for a risk committee to take on these responsibilities, or whether they are sufficiently – or better – cared for under the board's existing committee structure.

A risk committee may present the following advantages:

- sharpened focus on risk oversight;
- oversight of risk management processes;
- coordination of risk oversight activities; and
- relief for a heavily-burdened audit committee.

And the following disadvantages:

- fragmented committee structure;
- uncertainty about risk oversight roles and responsibilities; and
- false sense of security that all risk is "under control".

Any discussion of a risk committee should

- consider the broader context of board/committee structure; and
- recognise that the full board has primary responsibility for risk oversight.

Regulated enterprises like banks and financial institutions are required by Bank Negara Malaysia to establish a Risk Management Committee.

3) The nominating committee
The nominating committee has two key responsibilities, e.g. identifying and nominating directors and evaluating them on an annual basis. This is not as easy as it might seem because circumstances change, affecting who should be nominated and how they should be evaluated.

The nominating committee is expected to select candidates for the board whenever directors come up for re-election. This is often a formality, but it should not be, since all directors proposed for re-election should have been properly assessed for their past performance as board members.

Mandate Nominating Committee (C & LR)
- All Boards must establish a Nominating Committee ("NC")
- Chair of NC must be an INED. Where Senior INED position exists, SINED encouraged to assume NC Chair
- Role of NC enhanced - focus areas include recruitment, assessment, training & diversity of board members

4) The remuneration committee
A remuneration committee, in the context of the Malaysian Code on Corporate Governance, should consist "wholly or mainly of non-executive directors, to recommend to the board the remuneration of the executive directors in all of its forms, drawing from outside advice as necessary". The remuneration committee must therefore determine, on behalf of the board, the terms of engagement and remunerations of the CEO and executive directors.

Given the recent publicity on 'fat cat' Wall Street CEOs and large bonuses paid by US banks, the role of the remuneration committee is increasingly in the limelight and directors on the committee will need to understand the repercussions of the contracts and bonuses that they approve, should anything go wrong.

Management

Management's main role is to utilise the people within the organisation in order to accomplish achievable goals. Management mobilises or allocates resources to different departments such as human resource, finance, IT, etc, and organises these resources in such a way that organisational strategic goals are accomplished in the long run. Management also has a vital part in planning, organising, leading and controlling the organisation.

In short, management takes part in each and every aspect of the organisation. Management gives direction, aligns and achieves organisation goals with its available resources.

The internal auditors

Originally developed as a means of assisting organisations with safeguarding corporate assets and enforcing corporate policies to preserve value, internal audit is expanding its traditional role with a new focus on value creation activities.

The internal auditors of leading organisations are now taking a risk-based approach to their role as independent advisers. With a view toward value creation, internal auditors are expanding both their perspective and skill base, to develop and reallocate resources in a risk-based manner.

Essentially, internal auditors are now expanding their view beyond finance and into the business. In this way, internal auditors are once again serving as the independent, internal advisers - as it was historically before, so many of its efforts were largely compliance and finance-focused.

The external auditors

An external auditor is an audit professional who performs an audit on the financial statements of a company, government, individual, or any other legal entity or organisation, and who is independent of the entity being audited. Users of these entities' financial information, such as investors, government agencies, and the general public, rely on the external auditor to present an unbiased and independent evaluation on such entities.

The primary role of external auditors is to express an opinion on whether an entity's financial statements are free of material misstatements. The independence of external auditors is crucial to a correct and thorough appraisal of an entity's financial controls and statements. Any relationship between the external auditors and the entity, other than retention for the audit itself, must be disclosed in the external auditor's reports.

The stakeholders

A stakeholder is any individual or organisation that is affected by the activities of a business. They may have a direct or indirect interest in the business, and may be in contact with the business on a daily basis, or just occasionally.

The main stakeholders are:

- **Shareholders** - they will be interested in their dividends and capital growth of their shares. The Minority Shareholders' Watchdog Group plays an important role in Corporate Malaysia representing the rights of minority shareholders.
- **Employees –** they may also be shareholders – they will be interested in their job security, prospects and pay.
- **Customers –** they are interested in the quality of goods and services received from the company.
- **Suppliers –** they will be interested in a successful business relationship with the company, but will also be mindful of collecting payment for the supplies provided.
- **Banks –** and other financial organisations lending money to the business.
- **Government –** especially the Inland Revenue Board and Customs who will be collecting tax from them.
- **Regulators –** such as Bursa Malaysia, the Securities Commission, Bank Negara Malaysia and the Audit Oversight Board.
- **Trade Unions –** who will represent the interests of the workers.
- **Pressure Groups –**who are interested in whether the business is acting appropriately towards their area of interest.

Appendix 2: The Guiding Principles for Boards of Directors

The ACI believes that certain guiding principles underlie the effectiveness of every board. Even as specific oversight practices evolve to address changing risks, regulatory requirements and corporate governance needs, the right principles can help ensure that practices are applied effectively – that is, by the right people with the right information, processes and perspectives. To this end, we offer these guiding principles for boards of directors to consider when developing, evaluating, and refining the board's oversight processes and practices:

1. **Recognise that one size does not fit all.**
2. **Have the 'right' people on the board.**
3. **Monitor and insist on the right 'tone from the top.'**
4. **Ensure the oversight process facilitates the board's understanding and monitoring of key roles, responsibilities and risks within the financial reporting environment.**
5. **Continually reinforce the board's direct responsibility for the external auditor.**

These principles have long been important to board effectiveness and are vital to the independence, objectivity and integrity of the financial reporting process.

Refocusing on the basics

With compliance processes related to existing regulatory requirements widely in place, many boards are refocusing their agendas on matters they believe are most critical to the integrity of the financial reporting process – from critical accounting judgements and estimates, to internal audit resources, to the oversight of risks affecting financial reporting.

Given the demands of the new corporate governance environment, this 'back to basics' focus presents its own challenges. The complexity of accounting issues, increased oversight responsibilities, and unprecedented expectations of shareholders and regulators require boards to be more focused than ever on enhancing their efficiency and effectiveness, including improving the board's interaction with management, internal audit and the external auditor. In tackling these and other challenges, we encourage directors and others to consider the guiding principles presented here. We believe they can provide a strong foundation and framework for boards to develop their own 'leading practices' – and, ultimately, to be effective in their oversight of the financial reporting process.

The guiding principles for boards of directors

1. **One size does not fit all: When delegating oversight responsibilities to the board, recognise that the needs and dynamics of each company and board of directors are unique.**

In general, boards are responsible for oversight of the company's financial reporting process, including related risks and controls as well as the company's internal and external auditors.

Each board should factor in the unique needs, dynamics and culture of the company and the board.

The responsibilities of the board should be clearly communicated and precisely defined, and its workload and agenda should be appropriately limited and focused on essential issues, activities and responsibilities.

Once delegated, the activities of the board – including appropriate management interaction – should have the ongoing support of every director on the board.

2. **The board must try to ensure they comprise the 'right' individuals to provide objective and effective oversight.**

It is imperative that all board members are able, both in theory and in practice, to express views that are different to those of the owner (for owner-managed businesses) and be confident that, provided this is done in a considered way, they will not suffer.

In addition, members of the audit committee should be wholly non-executive with a majority being independent directors and wholly financially literate, and have the personal and professional characteristics necessary to be effective committee members. As a body, the audit committee should be informed, vigilant and effective overseers of the financial reporting process.

If audit committees are to provide meaningful protection for investors, they must be in a position to challenge management and draw sufficient attention to dubious practices – even in apparently successful companies. To do this, audit committee members must be prepared to invest the time necessary to understand why critical accounting policies were chosen, how they were applied, and why the end result fairly presents the company's actual status. In essence, this means that they need to understand their businesses and the substance of complex transactions, and determine that the financial statements reflect fairly their understanding.

Even where audit committees comprise vigorously independent directors, they are likely to prove ineffective unless they have both access to, and understanding of, all the relevant information. Perhaps the most important characteristic of an effective audit committee member is a willingness to challenge management; this is the essence of independence.

3. **The board must continually assess whether – and insist that – the 'tone from the top' sets an expectation of integrity and accuracy in financial reporting.**

In establishing the 'right tone,' the company's leaders – from the Managing Director, CEO, CFO and other senior management to line management across the enterprise – should be unequivocal in their insistence on accuracy and transparency in financial reporting. They must set the expectation that all financial numbers and statements represent the actual financial performance of the company.

The board, as part of a system of checks and balances on management and the guardian of shareholder interests, should continually assess whether management has set the 'right' tone and whether that tone is reaching the rest of the organisation.

Ultimately, an effective oversight process is one that is well defined, clearly articulated, and driven by informed and persistent listening, questioning, assessing and challenging on the part of the board.

To help maintain the right tone from the top – and throughout the company – the board should insist that management talk about the company's standards and expectations at every opportunity and demonstrate its commitment by putting its ethics policies into everyday practice.

4. **The board's oversight process should facilitate its understanding and monitoring of key roles, responsibilities and risks within the financial reporting environment.**

An effective oversight process – encompassing people, policies and practices – provides the framework for the board to carry out its oversight responsibilities by helping the committee understand and monitor:

- the company's critical financial reporting (and related) risks;
- the effectiveness of financial reporting controls;
- the role and effectiveness of the board (vis-à-vis the roles of the directors, management, and external auditors);
- the independence, accountability and effectiveness of the external auditor; and
- the transparency of financial reporting and disclosures.

Developing an effective oversight process for the board of directors requires the active participation of the audit committee, management, the internal auditor and the external auditor. To this end, the board should understand the specific and unique role that each party plays in the financial reporting process and must hold each participant accountable to the board and the audit committee.

An effective oversight process also is predicated on the board having an understanding of the company's financial reporting risks (and the controls related to those risks) as well as appropriately communicating and coordinating its responsibilities and activities with other committees of the board in areas of oversight that may overlap (e.g. risk management and compensation). Ultimately, an effective oversight process is one that is well defined, clearly articulated, and driven by informed and persistent listening, questioning, assessing and challenging on the part of the board.

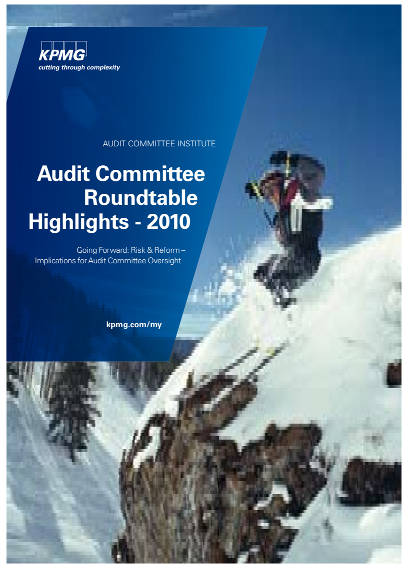
5. **The board must continually reinforce its direct responsibility for the external auditor.**

The audit committee is responsible for the external auditor – specifically, overseeing the auditor's work and independence, and recommending to the board its appointment and remuneration.

To help ensure the auditor's true independence from management, however, the audit committee's direct oversight responsibility for the auditor must be more than just words in the audit committee's terms of reference or items on its agenda.

All parties – the board, the audit committee, external auditor and senior management – must acknowledge and continually reinforce this direct reporting relationship in their everyday interactions, activities, communications and expectations through ongoing dialogue.

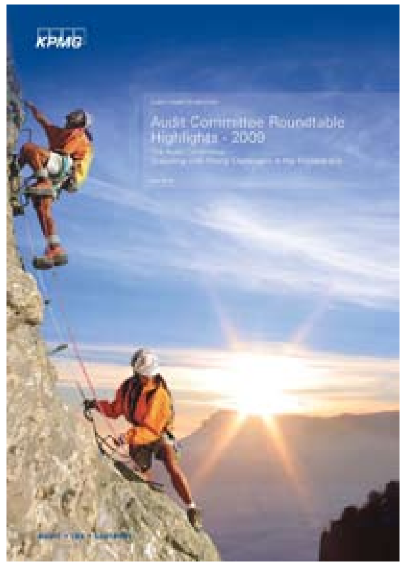
ACI Thought Leadership



Audit Committee Roundtable Highlights – 2010

Going Forward: Risk & Reform - Implications for Audit Committee Oversight

In 2010, ACI Malaysia organised several roundtable discussions entitled, "Going Forward: Risk & Reform – Implications for Audit Committee Oversight", aimed at assisting organisations and their Audit Committees to further gauge their roles in the context of global transformation. This report is a compilation of the feedback from participants at the various roundtable sessions, as well as comments proffered by ACI Malaysia.



Audit Committee Roundtable Highlights – 2009

The Audit Committee – Grappling with Rising Challenges in the Marketplace

This survey highlights the results of 154 participants over 6 interactive Roundtable discussions held during the last two quarters of 2009. It shows the participants' concerns, perspectives and preparedness on risk management in the midst of an economic downturn.

Shareholders' Questions 2010

Today's globalised environment has produced a new breed of shareholders, more technically savvy and more aware of their rights than their predecessors, the result of which directors can expect a challenging array of questions to be raised during the upcoming AGMs.

Audit Committee Roundtable Highlights – 2008

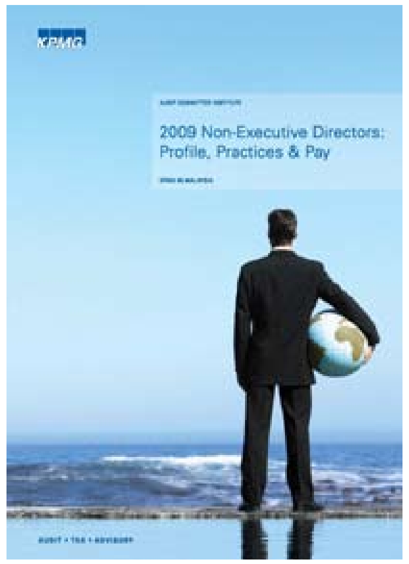
Oversight of Risk Management - Considering the Audit Committee's Role and Responsibilities

To help Audit Committee members, directors and senior management gain a better understanding in the oversight of the risk management process, ACI Malaysia hosted a series of roundtable discussions in 2008. This report is a compilation of the feedback provided by Audit Committee members and directors at the roundtable discussion series.

Audit Committee Roundtable Highlights – 2007

Building a Framework for Effective Audit Committee Oversight

In 2007, ACI Malaysia held a series of five roundtable discussions where 90 audit committee members and directors attended to explore the audit committee framework and oversights. This is the first report by ACI Malaysia which is a compilation of the feedback provided by the participants at the roundtable discussion series.



2009 Non-Executive Directors ("NEDs"): Profile, Practices & Pay

ACI's maiden study on the profile, practices and pay of NEDs of top 300 Market Capitalised Bursa listed companies. This publication has been very well received by Directors as well as other corporate players.

Contact us

Should you have any feedback on this report, or wish to obtain a complimentary copy, please drop us a note at **info@kpmg.com.my**

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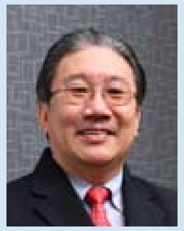

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To learn more about the Audit Committee Institute Malaysia or to access our resources, please visit our web site (www.kpmg.com.my/aci) or contact us by e-mail (info@kpmg.com.my).

About ACI Malaysia

In recognising the importance of audit committees, the Audit Committee Institute (ACI) Malaysia is created to assist audit committee members adapt to their changing role.

Sponsored by KPMG in Malaysia, the Institute's primary mission is to communicate with audit committee members to enhance their awareness of, commitment to, and ability to implement effective audit committee processes.

ACI Malaysia engages in a variety of initiatives to assist audit committee members by providing a range of resources through its web site, publications and roundtables all designed to facilitate the exchange of views and insights on audit committee best practices and processes, and other topics of interest.

The Institute has developed a range of tools to assist audit committee members in meeting their oversight role. These tools include:

- Audit Committee Guide – a comprehensive reference for audit committee members. It captures KPMG's insights into what makes a best practice audit committee and provides practical tools to help improve audit committee processes.
- Regular updates – ACI Malaysia will publish regular newsletters to provide audit committee members with timely updates on significant reporting and regulatory changes, and emerging issues.
- Website (www.kpmg.com.my/aci) – Designed to provide audit committee members, board members, senior executives and other interested parties with timely access to a wide range of useful resources. ACI Malaysia's website provides you access to updates on current and emerging issues related to governance, risk management, internal and external auditing, accounting, financial reporting and a library of reference materials.
- ACI Roundtables – ACI Malaysia facilitates interactive roundtable forums which provide a platform for the exchange of views and insights on topics of interest to board members, audit committees members and senior executives.

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