

CASE OF PUBLIC REPRIMANDS

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Abstract

This paper examines the relationship between the contents of a report, the Statement of Corporate Governance, required to be included in the Annual Report of listed corporations, and the receipt of public reprimands. Since the formalization of good corporate governance in the Code, all listed companies are required by rule PN9 to include how they have applied the principles and the extent of compliance with best practice found in the Code. The paper is based on companies that received public reprimands in the first three quarters of 2005 and we compared the contents of the statement of corporate governance of a matched pair of companies which did not receive public reprimands to see if such statements differ between the two groups. We do not see any difference between the two groups.

Keywords: corporate governance, annual reports, the Code

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Introduction

Governments of many nations today have realized that to manage a country is to manage its economy and it is business that drives an economy. To encourage business to flourish capital providers must be convinced that a business is worth investing in and that conviction is based on faith, for it is faith that sustains an investor's interest in a business venture and the lack of faith will drive away investors from a business. One way to convince investors is to provide a framework within which businesses take place such that the laws and regulations pertaining to business puts the investors' interest as a priority agenda. Such a framework is found in the Malaysian Capital Market Master plan launched in 2001. The bases of the Master plan are good corporate governance, transparency and disclosure. The objective of the Master plan is to make Malaysia a premier capital market in this region. The outcome of good corporate governance is an accountable board of directors who ensures that the investors' interests are not jeopardized. An accountable board will also accept their responsibility for ensuring that financial statements issued to external users will be reliable and therefore useful for investors, both locals and also from the international community, to make informed judgements. In that way Malaysian corporations will merit themselves the title of a global corporation by virtue of being included in the international investors' orbit. This paper is structured as follows: first a discussion is made of what constitutes corporate governance and good corporate governance. The corporate governance framework in Malaysia follows this. Next the paper describes the governance role of accounting information, following which the paper focuses on the accountability theories. Then the paper reports on incidence of public reprimands as a

measure of non-compliance with good governance behaviour. The contents of the Statement of Corporate Governance are then compared to see whether the imposition of fines and receipt of reprimands have been mentioned or not. The paper concludes with future directions of research in corporate governance that can contribute towards making our corporations good global corporate citizens

What is corporate governance?

In March 2000, a document called Code of Corporate Governance was published based on a report called the High Level Finance Committee Report on Corporate Governance. To give the Code a legal clout several amendments were made to the Securities Act 1993 to enable certain parts of the Code to be enforced. Pursuant to Section 1 of the Securities Industry Act 1993, regulatory agencies such as Bursa Malaysia and the Security Commission may take action against listed companies or directors for failures to comply with the Code. Although the requirement to comply with the Code is voluntary, companies have to comply with the disclosure requirement to include in their Annual Report the extent of their compliance with best practices contained in the Code. The High Level Finance Committee was set up in 1998 by the Ministry of Finance to further develop the corporate governance framework and to set best practices for the industry.

The High Level Finance Committee defines corporate governance as "the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value, whilst taking into account the interest of other stakeholders." Most definitions of corporate governance found in other jurisdictions appear to

converge along similar lines in that it refers to two things: the mechanisms by which corporations are directed and controlled; and the mechanisms by which those who direct and control a corporation are supervised.

The essential common points in many codes are:

- a. Corporate governance is a means of ensuring that the way corporation exercise economic power is tied to accountability –whether to shareholders or to a wider community of stakeholders;
- b. Boards have a supervisory and managerial function;
- c. There should be separation between the supervisory and managerial roles. In the Malaysian Code, for example, it is deemed “Best Practice” that the role of chairman is separate from that of the CEO, independent directors are appointed to the board and the use of board committees particularly in the areas where the interests of management and that of the company may come into conflict. Hence there ought to be an audit committee, a nomination committee and a remuneration committee.

Hence the elements of good corporate governance found in the Malaysian Code already mirror best practices globally. An OECD paper in 1991 puts it aptly in that “If countries are to reap the full benefit of the global capital market corporate governance arrangements must be credible and well understood across borders.” A survey by McKinsey in 2002 on corporate governance showed that on average investors were willing to pay a premium of 22% for well governed companies in Asia compared to 14% in Europe and 13 % in North America.

Corporate governance framework in Malaysia

Thillainathan et al. (1999) identify company law, securities law, exchange listing requirements, financial accounting standards, insolvency laws and regulations, commercial laws and consumer laws as forming the legal framework of corporate governance in Malaysia. Taken together these laws spell out the rights and duties of shareholders as investors as well as the duties and qualifications of directors. In addition the laws also require listed companies to disclose timely, material and accurate information.

Anwar and Kar (2003) describe the Malaysian corporate governance framework as holistic and market based. Using a broad approach, the framework begins with the foundation layer of a professional and ethical management. Only ethical management can ensure a fit and proper management of a corporation. Building upward on this foundation is the next layer of best standards and practices such as Financial Reporting Standards, Code of Corporate Governance and the Capital Market Master plan. Enveloping the two layers will then be the rules and regulations as found in the relevant commercial laws, guidelines and Bursa Malaysia Listing Rules all of which will have to be observed by market participants. At the top or the peak will be the Enforcement task not only by front line regulators but also shareholders themselves. At the heart of corporate governance framework is the Code because it sets the tone at the very heart of a corporation – the effectiveness of the board of

directors. One of the ways of ensuring boards are accountable to investors is to require boards to produce reliable financial reports. Given this duty, the question then is: are such reports reliable? The reliability of the information is important because only if it is reliable can investors make informed judgement.

The role of accounting information in corporate governance

Bushman and Smith (2001) argue that financial accounting information can affect economic performance. The effects flow through three channels: first financial accounting information help managers and investors identify and distinguish between good and bad investment opportunities. The absence of reliable information can hinder the flow of both human and financial capital towards good investments. As a result of reliable reports, there is a more accurate allocation of capital, selected, say on the basis of profit margins reported. Second, the authors maintain that reliable financial reports constrain managers from acting against the interests of shareholders and enables the market to monitor the managers’ performance. According to the authors, this is the governance role of accounting information and it can help reduce the risk premium demanded by investors. Third, timely and high quality financial accounting information can reduce investors’ liquidity risks. In short, financial accounting information can play a governance role and in doing so help enhance economic performance. The reliability of accounting information is further enhanced when its truth and fairness is attested to by an external, independent party, the external auditor.

PN9/2001: Disclosure in relation to the Malaysian Code on Corporate Governance and the State of Internal Control

Beginning from June 1 2001, listed companies must include in their Annual Reports a Corporate Governance Statement to show (i) how they have applied the Principles of the Code and (ii) extent of compliance with Best Practices of the Code, stating reasons for each non-compliance, if any.

What is Public Reprimand?

This is a form of sanction Bursa Malaysia is empowered to impose on listed companies for breach of its listing requirements. It is part of its duty to enforce the listing requirements so that the Malaysian capital market maintains a standard of good governance, especially on the part of the board of directors. A company receiving a public reprimand will be more closely monitored by the Bursa and stricter penalties will be imposed for companies found to be repeat “offenders”.

Accountability theories

Boards of directors of listed companies are made accountable to many stakeholders and the Statement

of Corporate Governance is one form of reporting as to how such accountability has been discharged. In all the public reprimands issued by Bursa Malaysia, it reiterates that it views such contraventions (of the Listing Requirements) seriously and cautions the company and its board of directors on their responsibilities to maintain an appropriate standard of corporate responsibility and accountability in order to achieve greater disclosure and transparency to the shareholders and the investing public.

Schlenker (1997) defines accountability as being answerable to audiences for performing up to prescribed standards relevant to fulfilling obligations, duties, expectations and other charges. In their study on accountability in the World Bank and NGO's, Fox and Brown (1998, p. 12) describe accountability as "the process of holding actors responsible for their actions" Cornwall et al (2000) broaden this perspective by suggesting that accountability is both about being "held responsible" by others and about taking responsibility for oneself. Therefore accountability has both an external (obligation to meet expected standards of behaviour) as well as internal (individual action) dimensions. Accountability mechanisms such as annual reports are used to track compliance of accountability. Hence there is a form of resource interdependence whereby companies rely on investors for their funding and investors rely on the quality of directorship and quality of information to make informed investment decisions. However the demand for accountability comes not just from investors but also from regulators. Therefore mechanisms have sprung in place to monitor and enforce accountability on the part of directors, one of which is to prescribe minimum standards of good corporate governance and the penalties for non-compliance thereof. Disclosure statements and reports are among the most widely used tools of accountability and are frequently required by laws of many countries. Hence PN9 in the Annual Report of listed companies is one such example. Such disclosures enable some degree of accountability to investors, regulators and others in the public domain. That it forms part of the Listing Requirements enables the Bursa to take actions in the event of non-compliance and therefore forms part of the tools of accountability in that such statements should make available basic information about the quality of corporate governance of a particular company. It is an external approach to accountability enforced through punitive threats such as a public reprimand and fines. While this is important do these external approaches encourage companies to take internal responsibility for shaping the culture of good governance for their companies?

Methodology

This study is based on secondary data sourced from the Annual Reports of listed companies in Malaysia for 2005 (therefore referring to 2004 financial year reports). Since all public reprimands are posted on the

website of Bursa Malaysia, this study identifies all public reprimands issued up to 31 October 2005 listed on the site. The nature of the non-compliance are then identified and categorized. Next the contents of the statement of corporate governance are scrutinized in order to identify how principles of corporate governance are applied and whether there is any mention of non-compliance with best practices of the Code. The statement is compared between reprimanded and non-reprimanded companies. The matched non-reprimanded companies were selected based on the same sector and board listing.

Results and discussion

Up to 31 October 2005, a total of 43 Public Reprimands were issued to 34 companies listed on Main board, second board and the MSDAQ market. Of the 34 companies publicly reprimanded, 10 had been reprimanded more than once in 2005 and 8 companies had been reprimanded before 2005 ("repeat offenders"). From Table 1 below we see that the number of reprimands issued is slightly more than the average found in a previous study by Hashanah and Razaman (2003)

Table 1. Public Reprimands 1998 – 2002 and 2005

Year	# of Public Reprimands	# of Companies
1998	18	16
1999	36	36
2000	34	27
2001	50	45
2002	38	35
2005	43	34

Grounds for Public Reprimands

Similar to the findings from the study by Hashanah and Razman (2003), the single most common grounds for sanction is late submission of either the annual accounts or quarterly financial statements followed by provision of information deemed as misleading or inaccurate and ambiguous. Table 2 below summarizes the main causes of sanctions:

Table 2. Nature and frequency of non-compliance

Sections not complied with	# reprimanded
7.24(e)	2
7.24(f)	1
7.25 [^]	1
7.33	1
8.11	1
9.03	1
9.04	1
9.11	1
9.16+	11
9.19 (Failure to make immediate announcement)	4
9.22**	8
9.23 *	17

[^] Delay in submission of quarterly financial report for MESDAQ market

+ Quality of announcement: failure to provide clear, factual account
*Failure to submit annual audited accounts on time
** Failure to submit quarterly report on time

Best Practice of the Code, amongst other things, stipulates that boards must ensure that audit committees review compliance with accounting standards and legal requirements.

What do the Statements of Corporate Governance tell?

Out of the 34 companies reprimanded, 6 companies did not have the annual reports posted (Reason for being reprimanded, up to today the annual accounts have not been submitted) and therefore not possible to view their statements of corporate governance. One company is now in the process of being de-listed by Bursa. Overall the 28 reprimanded companies and the 28 non-reprimanded companies described or provided narratives of how they applied the governance principles and all covered the four main areas of:

1. Effective board

All companies explained how they perceive effectiveness by describing board composition and balance touching on experience, expertise, and management skills. Although board size varied, all complied with the need to have independent members of the board at least 1/3. All the statements detail board responsibilities to cover control over strategic, financial, compliance and governance issues. Board meetings are regularly held with adequate information supplied as agenda together with regular updates on statutory regulations. Only one reprimanded company did not have a nominating and remuneration committee and is now in the process of appointing them.

2. Directors' Remuneration

All companies declared that they have a formal and transparent procedure for policy on remuneration of directors but none disclose details of EACH director's remuneration on the grounds of confidentiality.

3. Accountability and Audit

The principles of accountability cover financial reporting, internal control and relationships with auditors. Nothing in this section indicates a reprimand being received.

4. Shareholders

In respect of investor relations, all companies report that the board and management have conveyed information about the group's performance and other matters affecting shareholders' interests to shareholders via a timely dissemination of information including annual reports, quarterly announcements, relevant circulars and press release.

All companies examined stated their commitment to uphold a high standard of corporate governance,

regardless of whether they were previously and/or currently reprimanded or not. In respect of Best Practices only one company reported non compliance with the requirement to have internal audit, otherwise silence is taken to indicate that best practices as found in the Code have been met.

Is the statement useful?

Given the very close similarities in contents of the statement of corporate governance for both Reprimanded and non-reprimanded companies, no statistical analysis was carried out. There has been no record to date of any action taken for non-compliance with best practice or principles of the code as explained in the Statement of corporate governance (PN9). So far no action has been taken in respect of the accuracy or quality of these statements. It is left to investors to decide. The statement appears to be one of disclosure rather than application of principles per se. The most honest disclosure was found outside the statement of Corporate governance i.e. Additional Statement of Compliance

Conclusion

Bursa Malaysia Securities Bhd (Bursa Securities) has made amendments to the Listing requirements for the Main, Second boards and MESADAQ market in relation to delays in issuance of financial statements by issuing the following directives: the Bursa securities will impose suspension on the trading of securities of a listed issuer if it fails to issue the quarterly report, the annual audited or the annual report for a period exceeding three months from the respective dates for submission of accounts. This reflects a more firm stance on the part of the Exchange to ensure that investors are provided with information on the financial affairs of listed issuers in a timely manner so as to aid informed investment decisions. That timeliness is a critical quality of useful information now is sanctioned via de-listing procedures. The De-listing policy takes effect from January 1 2006. Based on the Statement of Corporate Governance included in a company's annual Report, this study finds that it is more of a motherhood statement without enabling a reader to identify whether in the year there has been any breach of regulations or rules or not. In form the information mimics those found in the Code but in substance it is not clear whether the statement indicates the quality of accountability practices by the board.

References

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