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PROGRAM KEPIMPINAN DAN TADBIR URUS BAIK LEMBAGA PENGARAH SYARIKAT MENTERI KEWANGAN (DIPERBADANKAN) DAN BADAN BERKANUN PERSEKUTUAN

20 July 2023
Hosted by Bahagian Syarikat Pelaburan Kerajaan

MAKING AN IMPACT THAT MATTERS since 1845

Module 2:
Value proposition of good governance, fiduciary responsibilities and conduct expectations of directors

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Program Overview

Objective and Learning Outcomes

The overall objective of this training is to instill a deeper appreciation for corporate governance to new and current Board members acting as Ministry of Finance ("MOF") and other Ministry representatives in corporate Boards.

Specifically, this training aims to achieve the following outcomes:

- Understanding the importance of good corporate governance;
- Understanding Directors' fiduciaries duties and conduct expectations of Directors;
- Sharpening clarity on applicable governance frameworks such as MOF Inc. Guidelines and the Perkukuh Initiative;
- Enhancing knowledge on key governance elements including nomination of Directors, setting of KPIs, investment due diligence and disclosures;
- Understanding the consequences of poor corporate governance; and
- Responsibilities of the Board with regards to fraud and corruption risks.

Duration

Module 2 – 40 minutes
The Value Proposition of Good Governance, Fiduciary Responsibilities and Conduct Expectations of Directors

Module 3 – 40 minutes
Governance Frameworks for Minister of Finance Incorporated ("MOF Inc.") Companies and Key Governance Elements

Module 4 – 40 minutes
Responsibilities of the Board on Fraud and Corruption

Module 5 – 30 minutes
Lessons learnt from cases reported in Auditor General's Report and White Papers

Module 2 – Value proposition of good governance, fiduciary responsibilities and conduct expectations of directors

The principles of corporate governance

The importance of good governance

The role of GLICs and GLCs in promoting good governance

Directors’ duties

Expectations on director conduct

Understanding corporate governance

01 Shared responsibility between Board, Management, and investors

02 Building a culture of empowerment and trust

03 Creating a long-term value for all stakeholders

04 Accountability and transparency

05 Aligning actions and intent

The above principles of corporate governance then manifest into three essential building blocks to create a strong governance foundation

Board mindset

- Structure and independence
- Candor and courage
- Competence and experience
- Alignment of values

Investor mindset

- Long term horizon
- Value over valuation
- High standard of governance
- Enabling environment

Management mindset

- Integrity
- Culture
- Financial discipline
- Transparency

Why is there a need for Good Governance?

Some of the benefits of implementing a robust governance program include:

- **Improves operational performance, efficient management, and ensures informed decision making**
- **Promotes competitive advantage**
- **Lowers cost of capital and improve access to external financing**
- **Increases market valuations and better growth prospects**
- **Reduces risk of corporate scandals and subsequent fluctuations in market value**
- **Strengthens the "social contract" and mitigates the risk of undue regulatory pressure**
- **Introduces transparency and accountability to deployment of public finance**
- **Improves key talent retention**
- **Indirect socioeconomic benefits such as greater employer creation and income inequality reduction**

The role of GLCs and GLICs in promoting good governance

It is important for Government-linked companies (GLCs) and Government-linked investment companies (GLICs) to balance between autonomy afforded and ensuring robust accountability to promote good corporate governance and reap its benefits.

Autonomy

- Financial management
- Board composition, diversity, and independence
- Compensation for Board and Senior Management
- Procurement, M&A, investment, and divestment
- Corporate culture
- Economy and social development
- Corporate policies, procedures, and frameworks
- Audit, risk and sustainability oversight

Accountability

- Monitoring financial and non-financial performance
- Impact to shareholders and wider stakeholders
- Disclosures and reporting
- External audits and evaluations
- Institutional investors investment policies
- Soundness and adherence to policies and procedures
- Oversight on emerging trends – sustainability, ERM

Governance = Performance + Conformance

Directors’ Fiduciary Duties

Section 213 of the Companies Act 2016

(1) A director of a company shall at all times exercise his powers in accordance with this Act, for a proper purpose and in good faith in the best interest of the company.

(2) A director of a company shall exercise reasonable care, skill and diligence with –

a) the knowledge, skill and experience which may reasonably be expected of a director having the same responsibilities; and

b) any additional knowledge, skill and experience which the director in fact has.

Fiduciary duties of directors

- “**Fiduciary**” carries a similar meaning to “trustee”. A fiduciary refers to someone who looks after the business and affairs of a beneficiary.
- Directors of a company, both executive and non-executive, serve as fiduciaries and have a legal obligation to exercise unfettered judgment, in good faith with due care and skill.

Directors' core duties

Fiduciary duties

- Act in good faith
- Ensure integrity of financial information
- Exercise power for a proper purpose
- Avoid conflict and self-dealing
- Exercise discretion properly

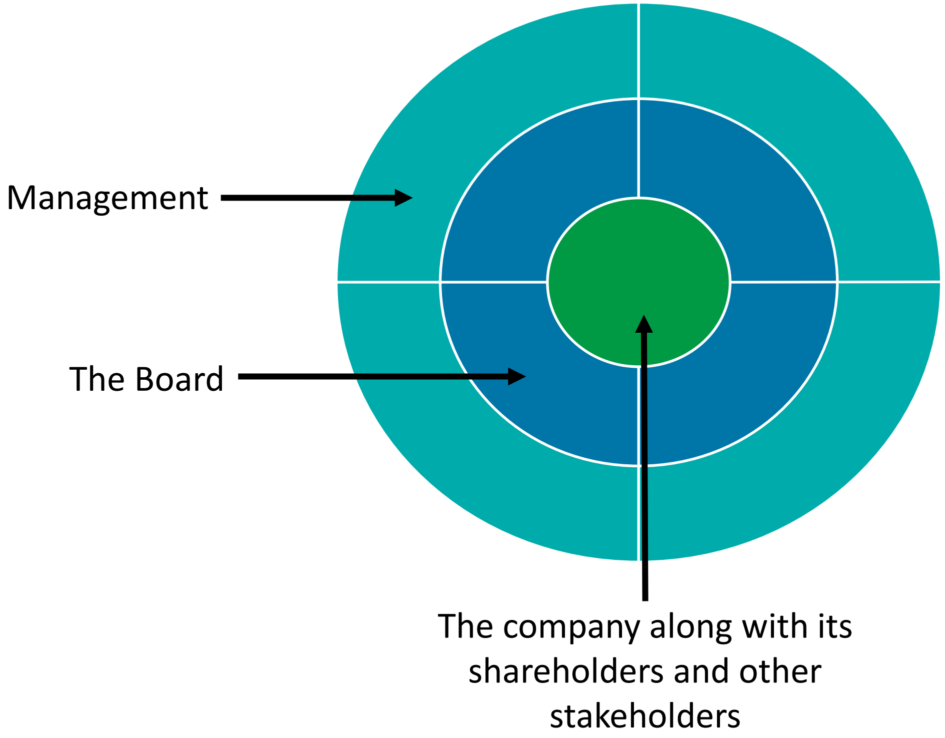
Duty to use reasonable care, skill and diligence

- 01 Ensure compliance with regulatory requirements
- 02 Remain well-informed on subject matter of business judgement
- 03 Make business judgement for a proper purpose and in good faith
- 04 Possess reasonable level of general knowledge, skills and experience expected of a director

Directors' duties of care, candor and loyalty

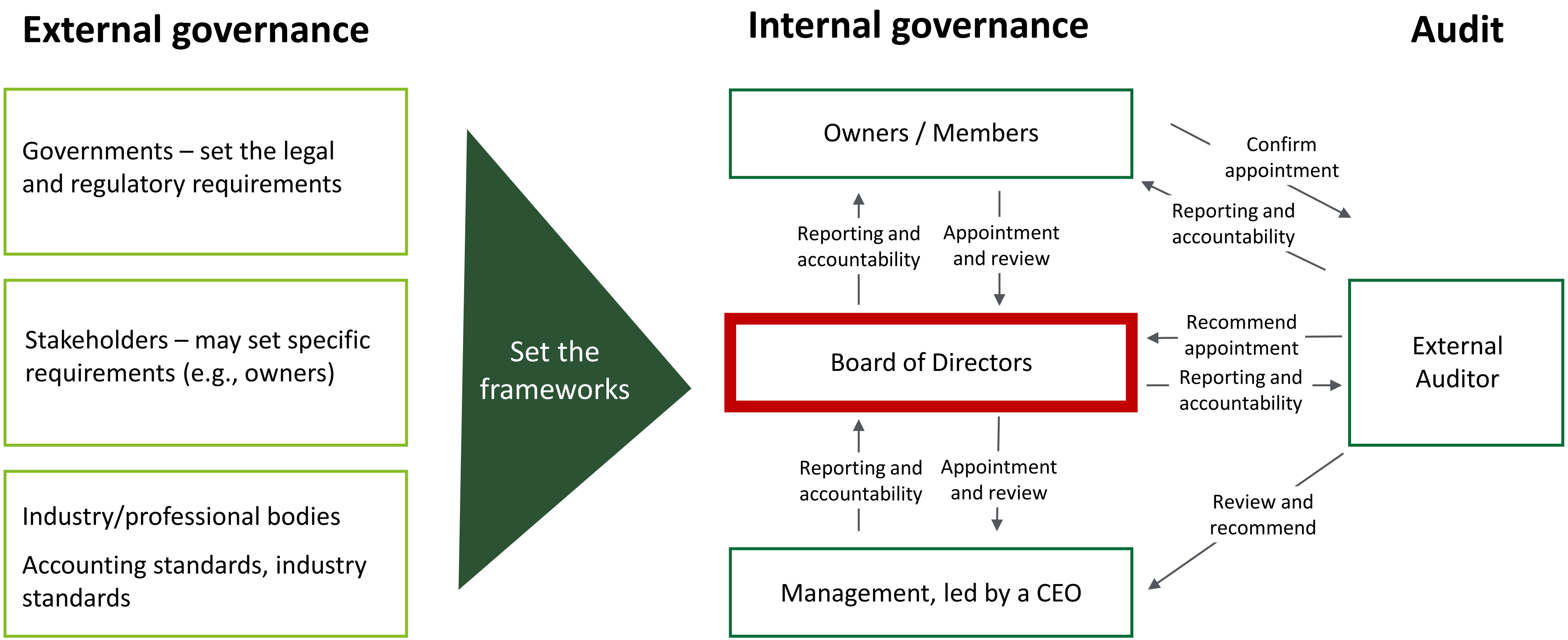
Ten responsibilities that Boards should discharge in meeting the goals and objectives of a company.

1	**Promote good governance culture in the company, alongside management**
2	**Review, challenge, decide, monitor management's proposal and implementation for the company**
3	**Ensure strategic plan supports value creation**
4	**Supervise and assess management performance**
5	**Ensure sound framework for internal controls and risk management**
6	**Understand the principal risks affecting the company**
7	**Set the risk appetite and establish a sound framework for risk management**
8	**Oversee the orderly succession plan of board and management personnel**
9	**Institute procedures to enable effective communication with stakeholders**
10	**Ensure the integrity of the company's financial and non-financial reporting**



The Board is responsible for the exercise of legitimate authority, direction, oversight and control of a company in order to ensure that the company's organisational mission is achieved.

Corporate Governance Framework



Primary functions of the Board

Providing accountability
- Outward looking
- Past and present-focused

Strategy Formulation
- Outward looking
- Future-focused

Approve and work with and through management

Monitoring & supervising
- Inward looking
- Past and present-focused

Policymaking
- Inward looking
- Future-focused

Adapted from Oxford University Press (Corporate Governance Principles, Policies and Practices, 3rd ed., 2015)

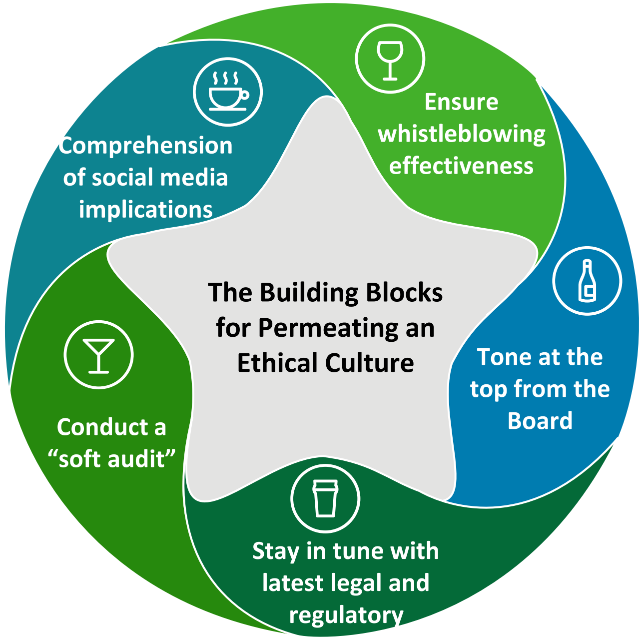
The tone at the top and tune in the middle

Practice 1.2 of the Principles on Good Governance for GLICs ("PGG")

- The Board sets the right tone from the top and champions the adoption of good governance culture and practices throughout the entity and other entities within its control.
- In doing so, Guidance to the abovementioned Practice outlines that the board, together with the management, drive and promote the adoption of good governance culture and practices, which reinforces ethical, prudent and professional conduct throughout the entity and other entities within its control.

"All Directors **must lead by example** based on principles as well as duty in **accuracy**, **transparency** and **loyalty**."

Tengku Datuk Seri Zafrul Abdul Aziz
April 2022



Recommendations for Board and management in establishing, enforcing, promoting and overseeing organisational culture

- Establish clarity on organisational behavior via policies and controls.
- Adopt forward-looking culture oversight, comparable to leading practices.
- Clearly delineate via charters and terms of reference on ethical culture oversight responsibilities.
- Regular review of the organisational culture of all levels via formal evaluations and informal conversation.
- Management personnel affiliated with risk management, compliance and internal control roles are well equipped to support the appropriate culture
- Integrate ethics and culture matters into board agenda, conversations with management, shareholder and stakeholder communication
- Set clear and measurable KPIs for Management relating to ethical behaviors and organizational culture
- Make ethics and culture a criterion in the selection, evaluation, and succession planning of the CEO and wider Management cohort.
- Review compensation and incentive system to ensure they reinforce desired culture.

Inordinate Overlapping Directorships, Competing Interests and Time Commitment

Directors should be available to commit sufficient time to Company affairs, without significant impairment to their ability to perform.

Practice 1.1.7 of The Green Book

To ensure that directors have the time to focus and fulfill their roles and responsibilities effectively (…) GLC Directors cannot sit on the Boards of more than five (5) listed companies, excluding the GLC's subsidiaries.

In addition, GLC Directors cannot sit on more than 10 non-listed company Boards.

Example of overboarding

It was noted from a past inquest of a GLC, one Director was found to hold Chairmanship positions in the holding company, the listed company and twenty (20) other strategic subsidiaries of the listed company.

Time commitment issues	Activist institutional shareholders on conflict of interest
It was noted in one of the state-based GLCs (which had 15 board members, with 7 political appointees) that 2 of the Board Members did not fully attend the Annual General Meeting ("AGM") of the GLC due to conflicting events. In addition, many of its board members are not only politicians on board but also assume chief executive/managing director position in other companies or firms, as well as chairmanship positions. These appointments of over-boarded directors are alarming especially in relation to time commitment given the difficult circumstances of that particular GLC.	In a past AGM of a GLC, domestic institutional shareholders have collectively voted against the re-election of a director in a large GLC on grounds of perceived conflict of interest. As an added heft, institutional shareholders are also voting against the re-election of non-conflicted directors that are bestowed with additional responsibilities (e.g., chairmen of the board and nominating committees) for their inaction in averting such occurrences.

Module 3:
Governance framework for MoF Inc Companies and key governance elements

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Module 3 – Governance Frameworks for Minister of Finance Incorporated ("MOF Inc.") Companies and Key Governance Elements

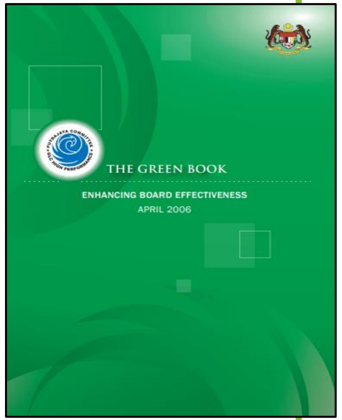
The primary references for MOF Inc. Governance Frameworks

Nomination of Directors

Key Performance Indicators ("KPIs") setting

Investment due diligence and disclosures

The primary references for MOF Inc. Governance Frameworks



Green Book – Enhancing Board Effectiveness

- Established by the Putrajaya Committee – GLC High Performance ("PCG") in 2005.
- The objective of the Green Book is to establish Guidelines for GLC Boards to enhance the effectiveness of their interactions, particularly through revamping Board practices and processes.
- The Green Book contains an approach to improving Board effectiveness that has been piloted at several GLC Boards.
- Some of the key highlights of the Green Book include:
  - → Establishing clear roles and responsibilities
  - → Enhancing board composition
  - → Elevating boardroom diversity
  - → Learning and development
  - → Transparency and accountability

Garis Panduan Ahli Lembaga Pengarah Lantikan Menteri Kewangan (Diperbadankan)

- Established by the Menteri Kewangan (Diperbadankan) or MOF Inc. in December 2014.
- The main roles of the Guidelines are to ensure:
  - → Better governance from companies under MOF Inc.
  - → Companies under MOF Inc. are in line with the objectives, by implementing business plans that are sustainable and viable.
  - → All MOF Inc. directives are abided by and fully implemented by the companies under MOF Inc.
- The Guidelines cover a multitude of pertinent governance considerations including the board's responsibilities, board composition, payment of dividends, Key Performance Indicator ("KPI") setting and assessing board performance/effectiveness.

The primary references for MOF Inc. Governance Frameworks

Principles on Good Governance for Government Linked Companies (PGG)

- The PGG was launched by the then-Government in April 2022.
- Represents the sole frame of reference to all GLICs on the governance and sustainability practices expected from these GLICs.
- Based on three main principles, namely:
  - → Leadership and board effectiveness;
  - → Ensuring an optimal, qualified and credible board composition; and
  - → Supporting the effective handling of investments.
- Takes into account current developments and discussions on the principles and practices of best governance at the local and international levels, including the Malaysian Code on Corporate Governance (MCCG) launched by the Securities Commission Malaysia.

Note:
Further insights and supplementary case studies are also gathered from secondary sources such as:

- Auditor General Reports
- Board effectiveness anecdotes
- Scholastic journals, and international best practices and guidelines

The Perkukuh Pelaburan Rakyat ("Perkukuh") Initiative -

PERKUKUH is a medium-term strategic transformation program that was launched by the then-Government in 2021.

The main objective is to re-state the role and renew the capabilities of Malaysia's GLIC to enhance the GLIC setup and optimise the role of government in business.

Perkukuh seeks to achieve 5 key outcomes:

- Sharpened clarity on the mandate of each GLIC;
- Enhanced focus on developmental and catalytical investments to spur new growth and enhanced socio-economic impact;
- Crowd-in private sector while streamlining the role of government;
- Future-proof GLICs with best-in-class governance, capabilities and strategies; and
- Strengthen social safeguards and fiscal resilience.

The initiative is targeted to be implemented in stages with the involvement of relevant agencies as well as regulators and is expected to be completed by 2024.

Practice 1.3.1 of the Green Book

The Nomination Committee should recommend to the Board a clear and appropriate selection criteria for Directorships. This recommendation should be based on an annual review of the Board's required mix of skills and experiences, taking into account the current, and future needs of the company. This review should be matched against the current composition of Directors to identify any gaps.

Practice 1.3.3 of the Green Book

In addition to the current pool of Directors, and the traditional sources for GLC directors, the PCG recommends that GLC Boards broaden their view of the potential pool of individuals who are suitable to be GLC Directors. In particular, the PCG recommends that, over time, GLCs proactively tap into new sources (….)

Section 3 of Garis Panduan ALP Lantikan Menteri Kewangan (Diperbadankan)

This section stipulates that any matters relating to appointment or reappointment, as well as the terms and conditions of board member should obtain approval from Ministry of Finance (Inc.). This section also mentions that the maximum tenure of directors is six (6) years.

Guidance to Practice 2.2 of PGG for GLICs

The Nomination Committee should identify candidates based on the criteria set by the Ministry and guided by the board skills matrix. Transparency on the selection criteria and process will also help maintain trust and confidence of stakeholders in the governance and leadership of the entity. (…)

The "red lines" in nomination of directors of MoF (Inc.) companies

The Golden Share

A type of share that gives its shareholder (usually a government or state) veto power which holds special voting rights that annuls ordinary shares.

The Golden Share in MOF (Inc.) companies

30 Golden Share Companies → **7** PLCs

Source: MoF

Stipulation of a golden share company's constitution

The Special Share may only be held by or transferred to the MoF (Inc.) or its successor or any person authorised by it to hold the Special Share.

Among others, the special Shareholder shall have the right to nominate any Director as a Government Appointed Director ("GAD"), and to nominate any of the GAD as the Board Chairman.

In the local context, there is a growing narrative on the need for Government to move away from having direct involvement in the management of GLCs via golden shares, as it can impose a threat to the market.

Additionally, there is advocacy for regulatory institutions and their framework to be empowered and strengthened in order to ensure a fair competition and efficient running of the industries.

Source: Does the government need the golden shares in hand, The Edge, 2020

Appointment process for directors in GLCs with special shareholders

Step 1
Needs analysis and profile development

Evaluation on the agreed profile of the slate
- Independence
- Evaluation of skill set
- Board diversity (age, gender, ethnicity)

<u>NC toolkit</u>
- Training Needs analysis
- Board skills matrix
- Strategic Model for Search and selection

Communicating skills matrix gap or vacancies to special shareholder

Step 2
Search

- Potential sources
- Referrals
- Registries
- Search firms
- Proposed candidates/ nominations from special shareholder

Step 3
Selection

Produce a shortlist and assess:
- Potential director's background, skills and experience against the agreed profile
- Review nominations from special shareholder

Due diligence
- Track record
- Verification checks

Interview the selected candidates

Step 4
Nomination

Facilitate dialogues with special shareholder on the outcome of selection process. If available, submit other candidatures for special shareholder's consideration

Make recommendations to the Board

Board approval

Seek approval from special shareholder

Step 5
Appointment

Letter of Appointment

Induction

Establish certain "red-lines" that are clearly communicated, negotiated and agreed upon with the special shareholders in regards to the nomination of Directors

Achieving a balance between shareholders' expectation and directors' conduct

Practice 2.8 – 2.11 of PGG for GLICs

2.8 The board implements a remuneration policy to determine the remuneration of directors and management. The policy is published on the entity's website and is periodically updated.

2.9 The board ensures that the determination of remuneration takes into consideration among others, the performance and contribution of the individual, the financial and non-financial performance of the entity, and the long-term objectives of the entity.

2.10 The board explains in the annual report how the remuneration of the board and management were determined including the alignment between pay and performance.

2.11 The board discloses the remuneration of directors and member of management in bands of RM 50,000 in its annual report.

The disclosure of Directors' remuneration is important to assist shareholders in making an informed decision while voting on remuneration, based on how remuneration:

- **Is commensurate with company and individual performance**
- **Aligns with the long-term strategies of the company**
- **Promotes responsible business conduct by the board and members of senior management**

Institutional investors' perspective

In the local context, institutional investors are increasingly encouraging the disclosure of the remuneration component of non-executive directors, as well as the how the remuneration of senior management personnel is determined. Additionally, institutional investors have stated that they will vote against Directors' remuneration if the fees are excessive and unjustifiable, does not commensurate with the responsibilities of the Director, and if the Board has been ineffective in performing their duties.

Setting Key Performance Indicators (“KPIs”)

Practice 3.33 of Garis Panduan ALP Lantikan Menteri Kewangan (Diperbadankan)

Key Performance Indicators (KPIs)

3.33. The Board of Directors needs to ensure that all companies owned by the Ministry of Finance (Inc.) set their respective KPIs based on elements that suit the company's mandate and operations, such as:-

a. Financial performance indicators (e.g. revenue targets, operational cost reduction initiatives, etc.);

b. Non-financial performance indicators (e.g. service level targets, compliance with standards, customer satisfaction surveys, etc.) and;

c. Set the appropriate weighting for each indicator based on the core business of the company.

Examples of common KPIs

- Financial performance KPIs
- Operational performance KPIs
- Strategic performance KPIs
- Corporate and organisational culture KPIs

Approaches to setting KPIs

Key Performance Indicators

KPIs are quantifiable metrices that are used to measure progress towards an organisation’s goals and objectives

Based on disclosure, each **financial** or **non-financial metric** identified as a KPI is further classified into one of **these 3 groups:**

Stand-alone metrics

A metric falls within this group if it is disclosed as a separate, stand-alone metric. In plans with additive payout formulas, these metrics usually come with their own distinct weighting.

Part of a metric bundle

A metric falls within this group if it is part of a bundle of metrics which solely includes financial or non-financial metrics. Weightings for the specific metrics are usually not available, but the weighting of the bundle can be used to determine the overall weighting of financial or non-financial metrics within a plan.

Part of a broader metric bundle

A metric falls within this group if it is part of a broad bundle of metrics which contains financial as well as non-financial metrics. A weighting for the respective portion of the bundle is usually not available.

Due diligence in investments

Practice 3.4.3 of the Green Book

The board considers the risk factors in all major decisions via a culture of identifying and managing risks throughout the organisation. One way to do so is by setting the right example, and tone, and **ensure that in-depth risk analysis and quantification is conducted for all major investments or strategic decisions prior to board's decisions.**

Practice 1.18 of PGG for GLICs

The board governance framework should include the establishment of an Investment Panel, responsible for the oversight of investment matters, which among others is to **develop investment strategies, objectives, and policies that are in line with risk appetite and mandate of the entity**.

The guidebook further outlines on how board should ensure the required framework and policies enables the entity to fulfil its stewardship responsibilities, which includes among others, the **adoption of a responsible investment approach which enhances long-term value by considering wider ethical, environmental, and social factors**

Areas of consideration for investment and risk oversight

- Knowledge, competency, and independence of advisers, investment panel members, and relevant management personnel
- Reporting lines to effectively raise concerns with investment panel members, portfolio managers and senior management team
- Cross-functional framework for integrated investment approach (e.g. involvement of risk, strategy, and finance function)
- Adherence to internal and external promulgations, policies, and procedures
- Performance and benchmarking for investment process and outcomes in specific market environments
- Stress test and modelling of "black swan" events
- Risks, including absolute volatility, market, and active management risks

Oversight elements on investment performance

- **Relative performance:** performance relative to benchmarks and peers
- **Investment process:** adherence of managers with established investment process
- **Implementation:** Effective implementation of investment strategies
- **Lesson learned:** Changes to investment process and portfolio structures based on experience

Due diligence in disclosures

Guidance to Practice 1.1 of PGG for GLICs

In discharging its responsibilities, the **board should** among others, **ensure that there are mechanisms to enable effective communication with stakeholders**.

Guidance to Practice 3.2 of PGG for GLICs

The annual report should be prepared in line with disclosure requirements and standards applicable to public listed companies. The annual report should contain among others:

- a statement by the board on how it has executed its responsibilities during the year;
- the financial and non-financial performance of the entity;
- discussion on emerging risks, including environmental, social and governance risks; and
- the remuneration of individual board members and management, as well as an explanation of the link between remuneration and performance.

The information disclosed should be balanced and relevant that promotes greater transparency to stakeholders.

Paragraph 3.36 – 3.39 of Garis Panduan ALP Lantikan Menteri Kewangan (Diperbadankan)

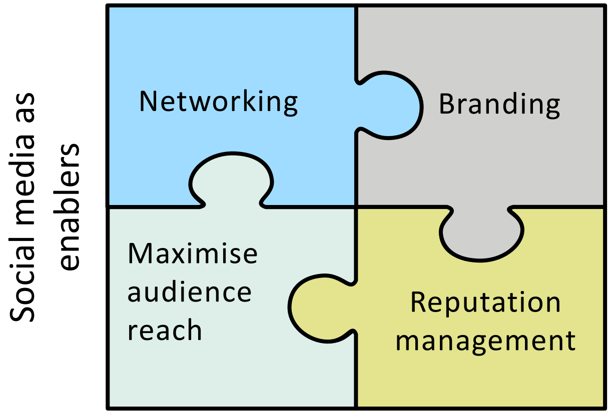
The GLC is responsible to submit an annual report to MoF (Inc.), consisting :

- Business planning and annual budget;
- Financial projection based on business planning; and
- Projection of dividend payments

In addition, a quarterly financial and management report should be submitted

Stakeholder communication channels

Formal	Emerging and contemporary
• Meetings, engagement, briefings and dialogues • Internal and external surveys • Roadshows, site visits, audit and inspection • AGMs and Annual Reports • Company briefings • Interviews, media press release, and conferences • Industry meetings, leadership platforms, capacity building workshops	• Company intranet and newsletter • Company website and social media • Investor relation and analyst function • Whistleblowing function • Active engagements with regulators, suppliers, rating agencies, and research houses • Company events (town halls, mentoring, and gatherings) • Collaboration and project partnership • CSR programs



Materiality

An information that has significant effect on the:

- Price, value, and market activity; or
- Investors' decision making

Timeliness

Material information must be announced immediately, whilst upholding confidentiality obligations

Implementation considerations in disclosures

Insightful, accurate, transparent, and timely for informed decision

Aligned to **stakeholder mapping and engagement plan**

Establish **quality assurance process** prior to release of information

Track and monitor feedback on quality and effectiveness

Contents (non-exhaustive)

- Contact of designated person for queries and whistleblowing
- Announcements, circulars, other company news for investors, media, and public
- Notice, agenda, and minutes of general meetings
- Financial calendar, highlights, dividend policy, stock trends
- Corporate structure, board and senior management, terms of references, charter

Focal spokesperson of a company

Guidance to Practice 1.15 of PGG for GLICs

Key responsibilities of the Chairman, among many others, includes acting as a primary liaison between the entity and its stakeholders and ensuring appropriate steps are taken to support effective communication with stakeholders

Codification via clear policies and procedures

As a better practice, companies should establish policies and procedures on stakeholder engagement and corporate disclosure, which should include a section on the authorised and designated spokesperson personnel, their responsibilities, limitations, and implementation of internal governance procedures.

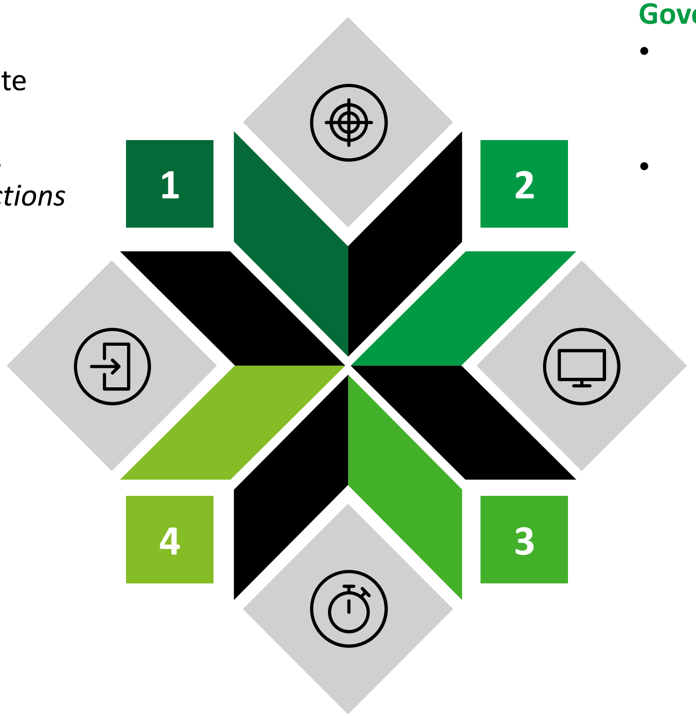
Companies can move beyond appointing the Chairman as the sole spokesperson. To this end, the President, CEO, CFO, Chief Counsel, Chief Strategy Officer, Head of Investor Relations Department, Company Secretary and Head of Group Governance can be appointed, based on the type of stakeholders and context of engagement.

Responsibilities of a spokesperson (non-exhaustive)

- Determine if an information fulfils disclosure stipulations and promulgations, as well as the need for voluntary disclosure of information, before being circulated
- Ensure timely, adequate and accurate disclosure of Material Information in accordance with applicable laws and regulations
- Ensure information are reviewed and approved by relevant parties before release
- Review replies to queries, liaise in relation to any joint announcements, and determine action required to any rumours, reports, and unusual market activities
- Provide oral clarifications or statements to media, investment community, or other parties

Public sector governance reforms on the horizon

On 24 February 2023, the Budget 2023 speech by the Prime Minister outlined the Government's priorities in expediting efforts aimed at transforming the governance practices of the public sector. For each of these reform measures, corporates, particularly **GLICs and GLCs need to stay cognizant of the changing regulatory landscape and associated requirements**. These requirements could potentially range from disclosing the company's political donations to enhancing its existing whistleblowing frameworks.



Political Financing Act

- The proposed Act is meant to govern how politicians and political parties receive and use money by ensuring adequate disclosures of sources and amounts of funding received.
- The proposed Act is meant to fill in existing legislative gaps, operating on a wider breadth compared to the existing *Elections Offences Act 1954* and *Societies Act 1966*.

Government Procurement Act

- The proposed Act is aimed at ensuring public accountability, transparency, best value for money, open competition and fair dealing in the public procurement life cycle.
- The proposed Act is expected to be tabled to the Dewan Rakyat by the end of 2023.

Whistleblower Protection Act

- The Government intends to table the amendments to the Act by the end of 2023.
- Possible amendments may include:
  - Guaranteeing immunity from criminal prosecution for whistleblowers who contravene other laws;
  - Allowing whistleblowers to lodge reports to external parties beyond enforcement agencies; and
  - Defining action to be taken against those who are found to have retaliated against whistleblowers or leaking whistleblower identities.

GLIC and GLC-related reform measures

- Under Measure 5 (Public Sector Reform) of Budget 2023, the Government has also proposed the following reform measures targeted at GLICs and GLCs:
  - to prohibit GLCs and Federal Statutory Bodies from engaging in activities that are not aligned with their original mandate of establishment; and
  - Undertake a review of the remuneration package of Chief Executives and top management of GLCs and statutory bodies.

Module 4:
Responsibilities of the board on fraud and corruption

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Asia Pacific Conduct Watch Leader, Deloitte
Forensic Leader, Deloitte Malaysia

What is fraud and corruption?

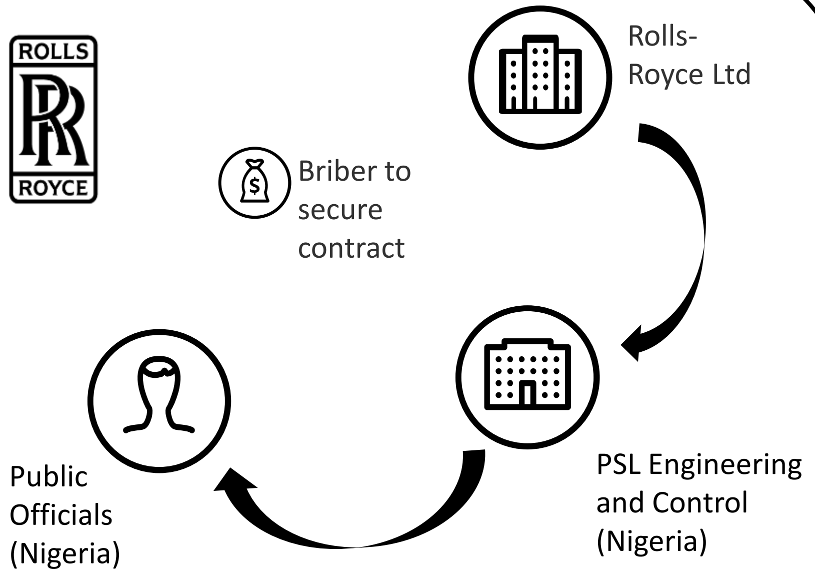
Fraud refers to wrongful or criminal deception, intended to result in financial or personal gain.

Fraud

- Asset misappropriation
- **Corruption** (An abuse of entrusted power for the advantage of financial or personal gain.)
  - Illegal gratuities
  - Conflicts of interest
    - Purchasing schemes
    - Sales schemes
  - Bribery
    - Invoice kickbacks
    - Bid rigging
  - Economic extortion
- Financial statement fraud

Source: ACFE, Fraud 101, for the full fraud tree click here

Key notable cases



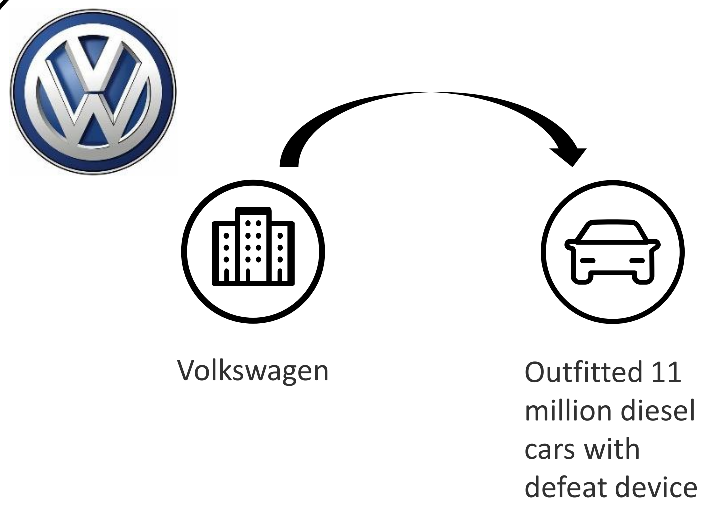
Corrupt activity undertaken

Business partners and agents bribed Public Officials to win contract bids.

Consequences

- Financial penalty of £671m
- 38 employees faced disciplinary proceedings. 11 resigned and 6 dismissed
- 88 intermediary relationships suspended

Source: BBC News, for the full Rolls Royce story click here



Fraudulent activity undertaken

Volkswagen outfitted around 11 million diesel cars with a defeat device, that allowed vehicles to recognise when being tested in laboratory conditions.

Consequences

- CEO stepped down and charged with conspiring to defraud U.S. and violating the Clean Air Act
- $5.6 billion fine from UK, German and US regulators
- €30 billion in legal fees and payouts to customers
- First quarterly loss in 15 years of €2.5 billion

Source: BBC News, The Detroit News and Guardian, for the full Volkswagen story click here, here and here

Why is this important?

Directors have the responsibility to exercise reasonable care, skill and diligence in protecting the company against fraud and corruption.

Internal fraud

- Fictitious revenues
- Theft by employees
- Ghost employees
- Altered payees

External fraud

- Supplier fraud
- Cyber fraud
- False sales and shipping

Consequences on a company

- Financial loses
- Disruption of operations
- Drop in stock price
- Reputational damage
- Heavy fines
- Loss of employees
- Loss of customers
- Diminished employee morale

Consequences on its directors

Reputational Damage

Financial penalties (fines, compensation clawback)

Imprisonment

Did you know?

The UK government is in the process of creating a new failure to prevent fraud offence to hold organisations to account if they profit from fraud committed by their employees. This bill is still under discussions, though the current expectation is that company bosses will not be held individually liable for failure to prevent. Under existing legislation, individuals within companies can already be prosecuted for committing, encouraging or assisting fraud.

Unveiling key matrix

10%

Malaysia's total trade which constituted illicit financial flows*

43%

Malaysian businesses that have experienced fraud, corruption or other economic crime within the last 24 months

24%

Malaysian businesses which have reported losses of up to USD 1 million within the last two years due to fraud

80%

Malaysian SMEs which consider fraud and corruption major problems within the SME sector

50%

Malaysian SMEs which believe that economic crime can be expected to increase over time

36%

Malaysian SMEs which disclosed losses as a result of fraud, corruption or other economic crimes

** Definition: the illegal movements of money or capital from one country to another*
Source: Global Financial Integrity (2017); PwC (2020); Sow et al. (2018)

Spotlight on MACC S17A

requirements (Effective 1 June 2020)


LAWS OF MALAYSIA

Act 694

MALAYSIAN ANTI-CORRUPTION COMMISSION ACT 2009

As at 1 June 2015

<u>Section 17A Offence by commercial organisation</u>

- Committed if a person associated with the commercial organisation corruptly gives, agrees to give, promises or offers to any persons any gratification for the benefit of that person or another person with intent:
    1. To obtain or retain business for the commercial organisation.
    2. To obtain or retain an advantage in the conduct of business for the commercial organisation.

This includes:

- Directors
- Partners
- Employees
- Vendors
- Agents
- Any other person who performs services for and on behalf of the commercial organisation

Up to 20 years' imprisonment

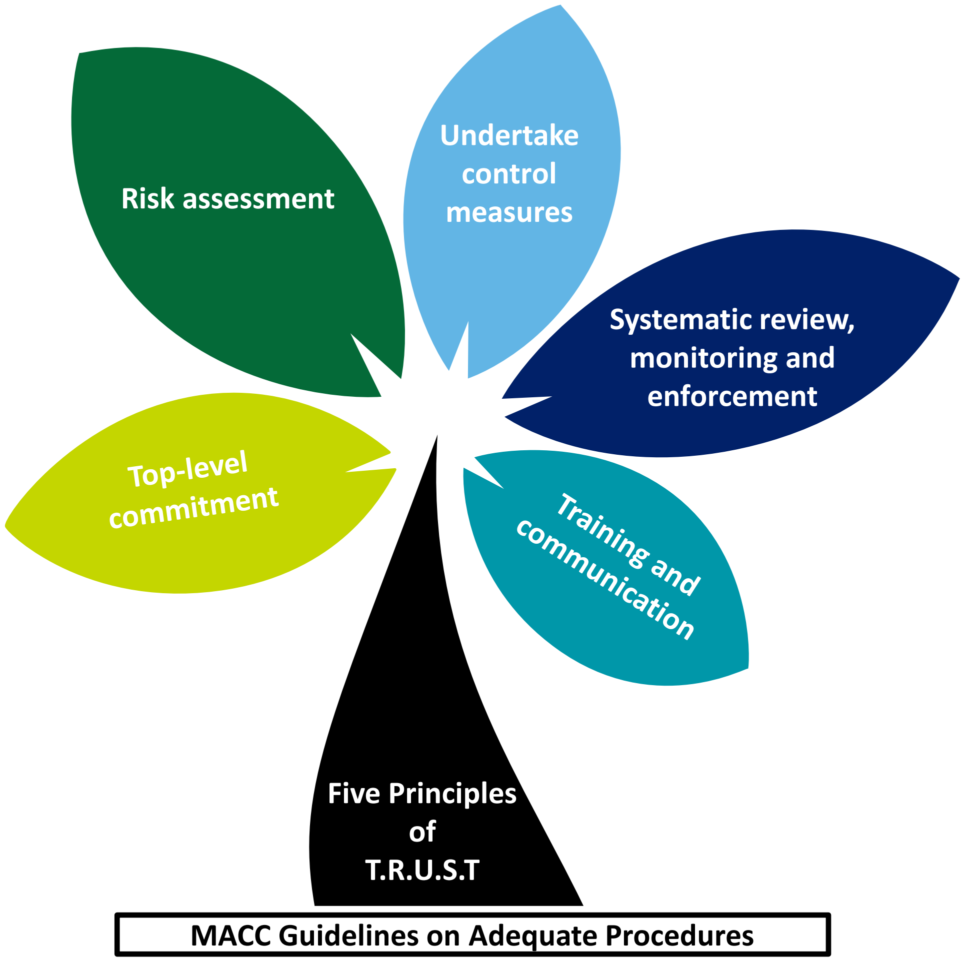
Fines of not less than 10 times gratification value, or RM1,000,000 whichever is higher

The only defence available to organisations is having "adequate procedures" in place. As per the Guidelines on Adequate Procedures issued pursuant to Section S17A, top level management play a central role in establishing, maintaining and monitoring adequate procedures.

Source: MACC Amendment Act 2018, for more information click here

Five principles of T.R.U.S.T

The Adequate Procedures is based on the five principles:



Source: Guidelines on Adequate Procedures, for more information click here

Top-level commitment
Demonstrating top-level commitment for preventing corruption. This involves internal and external communication of policies, and senior management involvement in developing corruption-prevention procedures.

Risk assessment
Performing periodic assessments of internal and external risk and managing identified corruption risks.

Undertake control measures
Establishing appropriate policies and procedures which outline responsibility for the compliance system, internal controls, auditing practices, documentation practices and disciplinary procedures.

Systematic review, monitoring and enforcement
Monitoring and reviewing existing systems and controls to identify deficiencies and changes in organisation risk profile. Employees should also be able to report violations through a proper channel based on confidentiality.

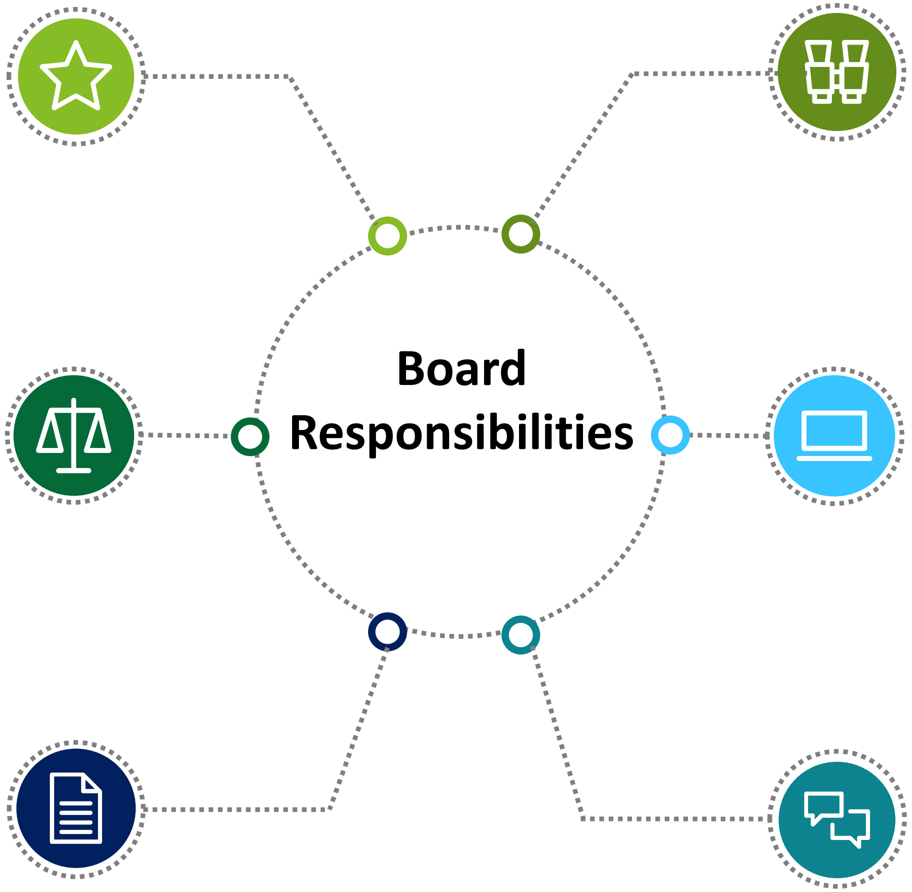
Training and communication
Providing sufficient trainings and bribery/corruption-related communications to internal (e.g. employees) and external (e.g. suppliers and contractors) stakeholders.

Responsibilities of the Board

Tone at the top
The Board's actions and decisions should reflect a commitment to the highest standards of honesty, transparency and accountability. The Board should also demonstrate personal integrity and ethical behaviour, serving as role models for the organisation.

Risk assessment
The Board should review the assessment and management of fraud and corruption risks to understand specific risks faced by the company, evaluate effectiveness of existing controls and ensure that appropriate measures are in place to mitigate risks.

Policy approval
The Board should ensure that the policies and procedures developed are aligned with legal and regulatory requirements, promote ethical behaviour and support the management of fraud and corruption risks.



Oversight and governance
The Board are responsible for overseeing the design and effectiveness of internal controls in place to prevent and detect fraud and corruption, including segregation of duties, regular audits, and independent reviews.

Monitoring and reporting
The Board should ensure that they receive sufficient and timely information (e.g. key performance indicators, reports) related to fraud and corruption, that allows them to review and assess the effectiveness of the organisation's anti-fraud and corruption efforts.

Whistleblowing mechanisms
The Board should ensure the existence of robust and confidential whistleblowing channels for employees and stakeholders to report wrongdoing. The Board should also ensure that these channels are well-publicised, independent and protected against retaliation.

Elements of an effective whistleblowing framework

1 **Board level ownership**
While the execution of whistleblowing programs may be delegated, the ultimate ownership and responsibility of the program should rest with Board who they set the tone for ethical conduct and establish the organisation's values and expectations.

2 **Robust whistleblowing policies and procedures**
Clear provisions should be established to protect the rights of whistleblowers, foster accountability, and provide clarity on how to report concerns and the investigation approach for received disclosures.

3 **Comprehensive awareness and communications program**
Dedicated programs should be implemented to increase awareness of the whistleblowing program and the importance of speaking up.

4 **Accessible reporting channels**
Having multiple reporting channels provide accessibility, flexibility and inclusivity in the reporting process.

5 **Organised disclosure and case management system**
Disclosures should be managed in a prompt, clear and transparent manner via a trackable system. Case progress should be communicated to the whistleblower in a timely basis to assure them that their concerns are taken seriously.

6 **Holistic measurement of the effectiveness of whistleblowing program**
Selecting the right metrices is critical in providing organisations with insights into the effectiveness of their program current and areas for improvement.

Source: Deloitte Asia Pacific 2023 Conduct Watch Survey Report, for more information [click here]

Module 5:
Lessons learnt from cases reported in Auditor General's Report and White Papers

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Case Study I: Unclear Leadership, Strategy and KPI Setting

Background of the case

1. In 2020, the Auditor General Report revealed several weaknesses concerning a GLC subsidiary's performance and management of activities, with a recorded loss in excess of RM100 million
2. The report further noted that there were **frequent changes in strategy due to revolving leadership**, which has led to **ineffective outlook and oversight of the strategic direction of the company.**
3. To add severity to this issue, the unstructured governance of the subsidiary has resulted in **inconsistent and unmeasurable KPIs**
4. From a corporate governance standpoint, **constant shift in leadership would contribute to a lack of institutional memory within the board**, escalating to ineffective monitoring of strategy
5. In addition, the board comprises **majority of non-independent directors** and has the **presence of active politicians**, which has led to a **conflict of interest situation** and further disabling the Board in undertaking its fiduciary, strategic, and generative roles

Key takeaways

- **Refreshment of the board** to attain one third of independent directors
- **Active politicians or individuals linked directly with executive powers** should not be appointed to the board
- Board's responsibility to include **oversight on business operations and affairs**
- Establishment of **clear Limits of Authority, Terms of Reference and Standard Operating Procedure** for good group governance
- Co-creation with management in **setting the company strategy as well as clear and measurable KPI targets** for the management

Case Study II: Unmanaged Risks in Investments

Background of the case

1. In 2019, a White Paper report uncovered several corporate governance weaknesses concerning a GLC. The report has focused on the **GLC's investment processes and decision-making**, exposing the GLC to multiple risks and scrutiny.
2. An independent audit was conducted on the GLC indicated an inconsistent internal control measures, whereby there is an **absence of a structured review process before an investment decision is made at the Board level.**
3. In addition, analysis of meeting minutes further indicated that **discussions on the risk outlook and management process was not undertaken for investment considerations.**
4. The audit findings also highlighted **weaknesses in the procurement process,** where there has been an absence of the approval of the board and without due diligence.
5. To add severity to this matter, it was found that certain **investments were made without a proper due diligence process, and even with the objection from the Board.**

Key takeaways

- Review of **internal control process** to include risk outlook and management
- **Review of company policies** to include 'check and balance' and 'good governance' practices, especially for the Limits of Authority given to the Ministry and Board
- Responsibility of the Board to include **oversight on group governance matters**
- **Enhance internal audit process** on investment matters
- **Review of investment process** to include risk assessment and mitigation measures
- Establish an **effective reporting line** from management-only investment committee to board-level investment committee and later to the board, with clear Limits of Authority at each level

Case Study III: Non-Compliance with Accounting Standards

Background of the case

1. In 2018, a GLIC came under public scrutiny after its management lodged police reports against its former leadership over past financial transactions, involving its former chairperson, CEOs, COO, CFO, legal adviser, and senior general manager

2. A government's report highlighted **illegal dividend distribution since 2014, assets shrinkage amounting to billions of ringgit, and claims of accounting irregularities to mask higher profit**. This finding was supported by investigation by independent auditors, which unearthed that the GLIC has a hole to the tune of billions of ringgit

3. In addition, the **state-owned fund was used for political activities**, which contradicts its memorandum an articles of association

4. Another report was rolled out, allegedly stating that **three senior officers misrepresented and withheld material information involving the entity's major stake**

5. Following these reports, the Auditor General Report for FY ending 2017 revealed that the state-owned fund **did not record an impairment totaling hundreds of millions of ringgit**, aside from having an inconsistent policy on reporting impairment of assets

6. The financial scandal has pushed the government to embark on a comprehensive turnaround plan to plug the hole and the entity was placed under the supervision of the Central Bank

Key takeaways

- **Establish ethical and transparent policies and procedures for financial and non-financial reporting**, which follows promulgations and international standards (e.g., International Financial Reporting Standards (IFRS) Foundation).
- The **Audit Committee must be independent** to oversee internal controls as well as to review financial position and disclosures, prior to board's approval
- **Establishment of an effective internal audit function** to support the audit committee over financial reporting, financial accounting systems, or amount or disclosures that are material to the financial statement
- **Engagement with external auditors** to audit financial statement before disclosure

Thank you!

Questions and Answer session

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Contact us for more information

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