The Malaysian Code Of Corporate Governance:An Effort To Improve The Quality Of Financial Reporting

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Several initiatives were taken by the policy makers and regulators to improve the quality of financial reporting by Malaysian companies. One of the initiatives was to strengthen the corporate governance of Malaysian public listed companies by introducing a code of corporate governance. The Malaysian Code on Corporate Governance was drafted in 1999 and introduced in March 2000. The code was then revised in 2007 to include additional recommendations relating to the board of directors and audit committees. The code was basically issued to serve as a guideline to enhance corporate governance practices among public listed companies in Malaysia.

The Malaysian Code of Corporate governance was based on the recommendations of the Cadbury Report (1992) and the Hampel Report (1998) in the United Kingdom. The code sets out the principles and best practices on corporate governance to improve the monitoring function of the board of directors, audit committee, and the external audit. This includes the essential criteria for the structure and operational process of the monitoring units, such as the composition of the board, procedures for recruiting new directors, remuneration of directors, the use of board committees, their mandates and their activities.

As illustrated in Figure 1, the Malaysian Code on Corporate Governance consists of three main components. Part 1 sets out broad principles of good corporate governance that are flexible and adaptable to varying circumstances of individual companies. It proposes the application of 13 broad principles that are related to the board of directors, shareholders, internal control, financial reporting, auditors and directors' remuneration. Under Bursa Malaysia listing requirements, companies are required to include in their annual report a narrative statement of how they apply the principles to their particular circumstances. Part 2 provides a set of guidelines and best practices to assist companies in adopting adequate corporate governance instruments. It contains 33 provisions that include matters relating to the construction of an effective board, the number of non-executive directors, board structure and procedures, relationship of the board to management, establishment of board committees and the relationship between the board and shareholders. The compliance with best practices in Part 2 is voluntary. However, under Bursa Malaysia listing requirements, companies are required to disclose their level of compliance with best practices and explain any circumstances justifying departure from such best practices in their annual reports. Part 3 sets out the principles and best practices for other corporate participants such as investors and auditors with the aim of improving their role in corporate governance. The recommendations in Part 3 are purely voluntary. In addition to the three main sections in the code, explanatory notes to Parts 1, 2 and 3 are provided in Part 4. The section also includes “mere best practices” in addition to the recommendations in earlier sections. The mere best practices are completely voluntary, and companies are not required to state or explain any departure from the recommendations.

Figure 1: Summary Content of the Malaysian Code on Corporate Governance

PART 1 **Broad Principles of Corporate Governance for Publicly Listed Companies**	**PART 2** **Best Practices of Corporate Governance for Publicly Listed Companies**	**PART 3** **Principles and Best Practices for Other Corporate Participants**
•The board of directors •Board balance •Supply of information •Appointment to the board •Re-election of the board •Dialogue between companies and investors •The annual general meeting •Internal control •Financial reporting •Relationship with auditors •Level and makeup of directors' remuneration •Remuneration procedure •Disclosure	•Six principal responsibilities of the board •Separation between chairman and chief executive officer •Board balance •Board meetings and procedure •Supply of information to the board of directors by company secretary •Establishment of board committees, such as audit committee, nomination committee and remuneration committee •Relationship of the board to management •The audit committee size, financial literacy, meetings, duties and responsibilities •The relationship between the board and shareholders	•Institutional shareholders' responsibility to vote •Constructive communication between institutional investors and companies management and board •Evaluation of governance disclosures by institutional investors •The role and responsibility of extenal auditors

Source: Malaysian Code on Corporate Governance (Revised, 2007)

Under the Malaysian Code on Corporate Governance, the role, composition and structure of the board of directors are viewed as the most important elements for effective corporate governance. The board is responsible for reviewing and approving a strategic plan and to oversee the business operations, while directly monitoring and evaluating the management’s performance and to ensure the integrity of accounting and financial reporting systems. A well balanced and effective board would take the lead role in establishing best corporate governance practices. According to the code, a well-balanced board has a good mixture of executive directors and non-executive directors, including independent directors. The revised code specifically recommends that independent non-executive directors should make up at least one-third of the members of a board. This is to ensure that any decision made by the board is independent and not dominated by an individual or a small group of individuals. In view of that, the code also recommends the separation of responsibilities between the chairman and the CEO. Moreover, the code also specifies that non-executive directors should have the necessary skills and experience and be a person of calibre and credibility so as to bring independent judgment to the board.

The Malaysian Code on Corporate Governance recommends the establishment of the audit, remuneration, nomination, risk management and corporate governance committees by the board of directors . The nomination committee is responsible for proposing new nominees for the board and assessing performance of the directors on an ongoing basis. It should comprise of non-executive directors, with a majority of independent directors. Under the Bursa Malaysia listing requirements, all directors are subject to retirement and re-election at least once every three years. The audit committee should meet the following requirements: (1) must be composed of not fewer than three members (all must be non-executive directors); (2) a majority of the audit committee members must be independent directors; and (3) at least one member of the audit committee must be a member of the Malaysian Institute of Accountants (MIA) or possesses sufficient accounting experience and qualification, or deemed to be “financially literate”. A member of the audit committee is financially literate if he/she has the ability to read and understand financial statements, analyze financial statements and ask pertinent questions about the company’s operations against internal controls and risk factors, and understand and interpret the application of approved accounting standards (Bursa Malaysia, 2009).

Initially, compliance with the all principles and best practices recommended in the Malaysian Code on Corporate Governance was completely voluntary. Disclosure of compliance with the code was made mandatory by Bursa Malaysia after the revision of its listing requirements in January 2001. The revised Bursa Malaysia listing requirements are more demanding on public listed companies to enhance Malaysia’s corporate governance regime (Yatim, Kent, & Clarkson, 2006). All publicly listed companies are required to include a Statement of Corporate Governance in their annual reports, starting from 1 July 2001. In the statement, the companies are obliged to disclose their level of compliance with the code’s recommendation of best practices and explain any departure from the code in their annual reports.

Bursa Malaysia has also taken another initiative to promote good corporate governance practices among publicly listed companies. The stock exchange requires all directors to undergo continuous training, such as the Mandatory Accreditation Programme and the Continuing Education Programme to improve their capabilities in performing their duties as directors and influence corporate thinking on issues related to corporate governance. The training of directors is set as a condition for continued listing and is required to be disclosed in annual reports, starting from 31 December 2005.

On 29 April 2012, the Malaysian Securities Commision released the Malaysian Code of Corporate Governance 2012 (MCCG2012), which supersedes the previous code. The new code was made effective from 31 December 2012. There are several improvements made to the existing code as MCCG2012 puts more emphasis on strengthening the board structure and composition as well as self and market discipline. Among the new recommendations introduced in MCCG2012 are that the board should (1) formalise ethical standards and ensure its compliance, (2) ensure that its strategy promotes sustainability, (3) formalise, make a periodic review, and make public its board charter, (4) undertake annual assessment of independent directors, (5) ensure that the tenure of independent directors do not exceed a period of nine years, or else have to seek for shareholders' approval, (6) ensure that majority of the board are independent directors, but not the chairman, (7) set out expectations on time commitment on its member, (8) ensure that board members have continuing education programmes, (9) ensure that company has appropriate corporate disclosure policy and procedures, (10) encourage company to invest in information technology, and (11) encourage poll voting.

A more recent update on the Malaysian code of corporate governance is the release of Code on Corporate Governance 2017 (MCCG2017) that took effect on the 26 April 2017, which supersedes the 2012 code. MCCG 2017 introduces substantial changes and recommendations especially in terms of the composition of board of directors, two-tier voting process, board gender diversity, transparency in directors' remuneration, the independence of audit committee, establishment of risk management committee, and shareholders' participation at general meetings.

References

Yatim, P., Kent, P., & Clarkson, P. (2006). Governance structures, ethnicity, and audit fees of Malaysian listed firms. *Managerial Auditing Journal*, *21*(7), 757-782.