Role of Gatekeepers and Influencers
Chapter 5
ROLE OF GATEKEEPERS AND INFLUENCERS

Recognising and supporting the role of professionals in corporate governance

5.1 OVERVIEW

The effectiveness of the board in ensuring that all decisions are in the best interest of the company lies at the heart of good corporate governance. Boards however do not function in isolation. They often rely on professionals both within and outside the company, to approve financial statements, interpret laws, assess the company's internal controls and state of compliance, advise on reliability and quality of disclosures, provide corporate finance expertise and the like. These professionals include company secretaries and internal auditors who are typically employees of the company, as well as parties outside the company such as external auditors, corporate advisers, lawyers, rating agencies and valuers. The independence, integrity and professionalism of these advisers are critical in ensuring that decisions made by the board are in the best interest of the company. While the failure of these professionals in carrying out their responsibilities can have adverse consequences on the company, undue or misplaced reliance on them can result in boards being complacent and dependent.

While significant efforts have been pursued in Malaysia and elsewhere to improve the independence and professionalism of external auditors, the ability of the other professionals to influence corporate governance standards has perhaps not been fully recognised. Generically referred to as “gatekeepers”, this Blueprint acknowledges the important role that these professionals can play in influencing corporate governance standards and improving corporate governance culture. Consistent with our focus on self and market discipline, these gatekeepers can help lighten the burden of regulatory discipline on companies as well as regulators.

Other than the gatekeepers there is another group whose role and influence in improving corporate governance must also be recognised. Unlike the gatekeepers this group does not have explicit nexus with companies or their boards but they have an important role in promoting corporate governance through their ability to influence public opinion and to highlight poor governance practices. These include the analysts, financial journalists, watchdog groups and other corporate governance advocates. In this Blueprint they are generically described as “influencers” given their ability to influence and shape public opinion on corporate governance issues.

This chapter focuses on the role of these gatekeepers and influencers and how they can contribute towards a culture of transparency, integrity and accountability in companies.
5.2 STATE OF PLAY

5.2.1 Traditional gatekeepers

Company secretaries, internal and external auditors are often viewed as traditional gatekeepers within the corporate governance ecosystem; each has distinct and significant gatekeeping roles with respect to corporate governance. These professionals ensure among others, effective internal controls and auditing mechanisms, and appropriate disclosures, which are central pillars for effective governance of companies.

A company secretary as an officer of the company is accountable to the board. They are best placed to guide boards on proper corporate governance practices given their knowledge and familiarity with the records and charters of the board, the processes and procedures in accordance with the company’s memorandum and articles of association, and legal and regulatory requirements. The CA sets out the qualification, duties and responsibilities of a company secretary.

Internal auditors focus on risks and controls within the company and therefore have a key role in a company’s governance and financial reporting process. They should provide independent and objective opinion as to whether risks which may hinder the company from achieving its objectives are being adequately evaluated, managed and controlled. Internal auditors can also advise and advocate improvements to enhance organisational governance structure and practices.

The Listing Requirements and the CG Code underscore the importance of internal audit by mandating this function and requiring listed companies to include information pertaining to this in their annual reports.

External auditors are responsible for auditing the company’s financial statements and providing an opinion of the truth and fairness of the financial position as revealed in the accounts. They provide comfort to shareholders and other stakeholders through the assurance that no omissions, material errors or fraud have been detected. External auditors lend credibility to financial reports and reduce risks that reports are biased, misleading, inaccurate and incomplete.

Appointment of auditors is governed by the CA while the establishment of the AOB in 2010 provides the framework for oversight of auditors of public-interest entities which include listed companies.

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5.2.2 Transactional gatekeepers

The CA allows directors to delegate powers to, and rely on information or advice provided by, experts, advisers and employees in relation to matters that are within such persons’ professional competence or expertise. Depending on the type of expertise required, listed companies may from time-to-time engage the services of corporate advisers, credit rating agencies, lawyers, valuers and other professionals. Hence unlike company secretaries and internal and external auditors these professionals do not ordinarily have a continuing relationship with a company. They are termed as “transactional gatekeepers” in recognition of the fact that their gatekeeping role, whilst important, will be confined to the transactions for which their services have been sought by the company.

Professional advisers are employed by companies to advise on a broad range of areas straddling legal, financing and investment issues. As professionals who subscribe to high standards of ethical conduct, they are expected to minimise or avoid risks to their reputation as well as potential liability by declining to give consent or even withdrawing from advising on transactions that they may consider unethical or illegal. By providing their services to the company these professionals put their reputation at risk. It is for this reason that they are sometimes referred to as “reputational agents”.

For purposes of regulatory oversight, individuals and firms who act as corporate advisers are licensed by the SC while rating agencies are subject to registration. Both are governed by guidelines stipulating eligibility criteria and their responsibilities to ensure that they meet the required standards of professionalism and integrity. The SC has also issued guidelines to ensure that the reports and advice issued by credit rating agencies and valuers are transparent and objective and that advice provided on corporate transactions meet required standards.

Dedicated industry bodies have been established by the different professional groups with the objective of continuously upgrading professional standards and capabilities. Apart from issuing codes of conduct and guidelines, some of these industry bodies have the ability to regulate and take disciplinary action against their members.

5.2.3 Influencers

While financial journalists, analysts and watchdog groups do not have a direct role in corporate governance, they nonetheless make a valuable contribution in influencing public and investor opinion on corporate governance-related matters. In this regard, opportunities to broaden their role and to increase their effectiveness in shaping societal norms on corporate governance should be explored.
The influence of the media on corporate governance is evident through their ability to report, analyse and debate corporate decisions and transactions through the print, broadcast and online media. There appears to be considerable demand for financial news in Malaysia given the numerous media dedicated to business and finance reporting. Some highly-regarded journalists have established a credible reputation and are avidly read and their views and advice are followed by the investing public.

Apart from reporting and providing commentaries on corporate developments, financial journalists can be encouraged to assume a more significant role in increasing public awareness and influencing opinion on corporate governance through more frequent coverage and in-depth analysis of issues.

Over the years, journalists have played a significant role in highlighting governance failures and managerial malfeasance based on information from whistleblowers or from their own investigations. In several instances, early media exposure of suspicious transactions has prevented potential losses to the company when dubious transactions were aborted following public outcry. It is therefore important to cultivate a more transparent environment for assessing corporate decisions and transactions. Explicitly profiling the actions of companies, boards and individual directors through well researched articles and analysis can prevent ill-considered decisions and can deter others who may be considering schemes of a similar nature.

The terms “financial analysts” and “securities analysts” are often used interchangeably. While operating at arms-length from companies, they can have a substantial influence on retail and institutional investors as well as the general public through their analysis and research reports of the company. Given their in-depth knowledge of companies and the related industries, their role can be expanded to assessing corporate governance issues.

Watchdog groups which provide voting advice and proxy services are also “influencers” of corporate governance. Groups such as the MSWG have played an active role in highlighting issues in the media and at general meetings. They also play a useful role in alerting and educating retail investors by scrutinising and questioning decisions made by companies. Through actively raising issues for clarification by boards, watchdog groups act as the conscience of the companies and assist in raising the standards of transparency and disclosure.
5.3 CASE FOR CHANGE

5.3.1 Empowering gatekeepers

Typically, gatekeepers are paid by the party they are expected to monitor which is the company. While company secretaries and internal auditors are usually employees of the company, external auditors, lawyers and corporate advisers, credit rating agencies and other professionals are paid fees for the services they render to the company. Some of these professionals may over time develop close relationships with, and some degree of business dependency on, these companies. This may result in a lack of incentive for them to serve as vigilant gatekeepers, or worse, could result in their independence and professionalism being compromised. Over the years significant changes have been introduced to address some of these issues. The establishment of the AOB, the introduction of mandatory whistleblowing obligations for auditors, the protection accorded to certain categories of whistleblowers from within the company, the regulation of credit rating agencies, are all intended to enable these professionals to be more effective gatekeepers.

The critical role that gatekeepers can play in ensuring good governance is well documented. The 2009 KPMG Fraud Survey Report shows that 55% of respondents indicated internal controls were the most common method of fraud detection, followed by notification by employee (33%), internal audit review (30%) and notification by customer/supplier (25%). Anonymous letters or whistleblowers (25%) were also a major source of information on fraud.

It is therefore important that any impediments which prevent these professionals from acting as effective gatekeepers are addressed. In this regard, section 320 of the CMSA already imposes a mandatory duty on auditors to report breaches of securities laws. The law also provides protection to key officials of a company who whistleblow. These changes have had positive results as between 2007 and 2010, 34 cases were referred to the SC by whistleblowers pursuant to the CMSA.

It is thus appropriate and timely to consider amendments to the CMSA for the purposes of expanding the mandatory obligation for whistleblowing to certain other professionals such as corporate advisors and company secretaries. Considerations should also be given as to whether the statutory protection provided by the CMSA to certain company officials who whistleblow should be extended to others.

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5.3.2 Enhancing the role of company secretaries

Over the years, the role of company secretaries has changed from the traditional passive role of preparing the minutes of meetings to a more proactive and strategic role. Increasingly, company secretaries are being consulted by boards on procedural and regulatory requirements. Company secretaries can also play a role in the induction of new directors, and in assisting the chairman of the board in determining the annual board plan and the administration of other strategic issues.

There is increasing recognition of the need to elevate the position and function of company secretaries to allow them take on a stronger role in promoting governance within companies. For this purpose the CG Code should articulate the role of company secretaries in corporate governance.

In the light of the increasing complexity of businesses and the regulatory environment, it is recommended that the relevant professional bodies look into qualification requirements needed to raise the skills and professional standards of company secretaries of listed companies.

5.3.3 Taking responsibility in corporate transactions

Different professionals involved in corporate advisory work are governed by their respective professional bodies or industry associations. As a result common issues relating to their corporate advisory services may be dealt with differently by different groups. Notwithstanding the existing regulations and industry association guidelines on the qualifications and responsibilities of corporate advisers, there is a need to establish a responsibility sharing arrangement among those who are involved in corporate transactions. The responsibility sharing arrangement should clearly set out the respective roles and responsibilities of each professional in corporate transactions. To facilitate this, the SC will initiate a detailed review of the current approach adopted by advisers in corporate transactions and provide appropriate guidance.

5.3.4 Recognising the role and influence of the media

Given the important role of the media in influencing corporate governance culture, it is vital that bespoke corporate governance programmes be developed to meet the needs of financial journalists to equip them with specialised knowledge to expand their role in promoting good corporate governance. One commonly cited programme is the Media Training Programme conducted by the Global Corporate Governance Forum in partnership with the Thomson Reuters Foundation. It covers
different areas important for investigative reporting on corporate governance and perspectives on
corporate governance from industry leaders, capital markets professionals, regulators and foreign
institutional investors. There is room for collaboration with industry associations or bodies to develop
similar programmes for financial journalists in Malaysia.

The important work undertaken by financial journalists in highlighting corporate governance
issues and their contribution towards educating the public on corporate governance deserves due
acknowledgment. Towards this end, the provision of awards and scholarships for outstanding financial
journalists in promoting corporate governance should be considered.

5.3.5 Ensuring integrity and ethical conduct

Gatekeepers must serve the broader interests of the public and contribute to promoting a culture
of good governance while they serve the interests of their clients. In this context, gatekeepers in
the discharge of their roles and responsibilities must aspire to a higher standard of professionalism
beyond fulfilling the requirements of the law and expectations of clients.

The independence and objectivity of gatekeepers may be compromised due to long standing
relationships with clients. Conflicts of interests may also affect the independence of their
advice. Similarly, gatekeepers who have access to confidential price-sensitive information could
seek personal gains by dealing in shares using such non-public information.

While the CMSA has strict provisions prohibiting trading by anyone who possesses material
information that is not available to the general public (insider trading), nonetheless there is a need
to reinforce self discipline by enhancing internal codes of conduct and internal controls of the
various categories of gatekeepers and influencers to prevent abuse of market sensitive information
and to promote integrity and ethical conduct.

Gatekeepers must serve the broader interests of the public and contribute to promoting a culture of good
governance while they serve the interests of their clients.

RECOMMENDATIONS

I. Expand coverage of whistleblowing provisions
   - Explore extending whistleblowing obligations to corporate advisers and company secretaries.

II. Enhance role of company secretaries in corporate governance
   - Enhance the role of company secretaries through clarifying their role in the CG Code.
   - Relevant professional bodies to look into qualification requirements needed to raise the skills and professional standards of company secretaries of listed companies.

III. Establish a responsibility sharing arrangement for corporate advisers
   - The SC to initiate detailed review of the current approaches adopted by corporate advisers in advising on corporate transactions.

IV. Enhance role of media in corporate governance
   - Develop corporate governance training programmes for financial journalists.
   - Encourage the provision of awards and scholarships for outstanding financial journalists in promoting corporate governance.

V. Enhance internal codes of conduct and internal controls of gatekeepers and influencers to prevent the abuse of market sensitive information, and to promote integrity and ethical conduct