

**MALAYSIAN CODE ON CORPORATE
GOVERNANCE**

(Revised 2007)

Securities Commission

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PREFACE

The *Malaysian Code on Corporate Governance* (Code), first issued in March 2000, marked a significant milestone in corporate governance reform in Malaysia. It codified the principles and best practices of good governance and described optimal corporate governance structures and internal processes.

Since the release of the Code, the Malaysian corporate scene has made significant strides in corporate governance standards. The mandatory reporting of compliance with the Code has enabled shareholders and the public to assess and determine the standards of corporate governance by listed companies.

While significant improvement has been achieved, it is now timely to review the Code to further strengthen corporate governance practices in line with developments in the domestic and international capital markets. In this respect, the Prime Minister, Dato' Seri Abdullah Ahmad Badawi had announced in the Budget 2008 speech that "the Code is being reviewed to improve the quality of the board of public listed companies (PLCs) by putting in place the criteria for qualification of directors and strengthening the audit committee, as well as the internal audit function of the PLCs.... To ensure the effectiveness of the audit committee of PLCs, executive directors will no longer be allowed to become members of the audit committee. In addition, the internal audit function will be mandated for all PLCs, and the board of directors will be responsible for ensuring the adherence to the scope of internal audit functions...."

The *Malaysian Code on Corporate Governance* as revised in 2007 represents the continued collaborative efforts between Government and the industry. The Securities Commission (SC) would like to thank the Companies Commission of Malaysia, Bursa Malaysia Berhad, Bank Negara Malaysia, the Bar Council, the Federation of Public Listed Companies, the Malaysian Institute of Corporate Governance, the Minority Shareholders Watchdog Group, the Malaysian Accounting Standards Board, the Malaysian Institute of Accountants, the Malaysian Institute of Certified Public Accountants, The Institute of Internal Auditors Malaysia, the Malaysian Institute of Chartered Secretaries and Accountants and the Malaysian Investment Banking Association for their invaluable feedback and comments.

The Revised Code – Key Amendments

Key amendments to the Code are aimed at strengthening the board of directors and audit committees, and ensuring that the board of directors and audit committees discharge their roles and responsibilities effectively.

The amendments spell out the eligibility criteria for appointment of directors and the role of the nominating committee. On audit committees, the amendments spell out the eligibility criteria for appointment as an audit committee member, the composition of audit committees, the frequency of meetings and the need for continuous training. In addition, internal audit functions are now required in all PLCs and the reporting line for internal auditors clarified. For ease of reference, elaboration of the amendments (boxed) are provided in Part 2 of the Code.

Revised as at 1 October 2007.

INTRODUCTION

INTRODUCTION

1. THE SIGNIFICANCE OF A CODE ON CORPORATE GOVERNANCE FOR MALAYSIA

- 1.1 The *Malaysian Code on Corporate Governance* (Code) was developed by the Working Group on Best Practices in Corporate Governance (JPK1) and subsequently approved by the High Level Finance Committee on Corporate Governance. JPK1 was chaired by the Chairman of the Federation of Public Listed Companies. The members of JPK1 comprised a mix of private and public sector participation.
- 1.2 The Code was principally an initiative of the private sector. The need for a Code was inspired in part by a desire for the private sector to initiate and lead a review and to establish reforms of standards of corporate governance at a micro level. This was based on the belief that in some aspects, self-regulation was preferable and the standards developed by those involved would be more acceptable and thus more enduring.
- 1.3 The Code essentially aims to set out principles and best practices on structures and processes that companies may use in their operations towards achieving the optimal governance framework. These structures and processes exist at a micro-level which include issues 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.
- 1.4 The significance of the Code is that it allows for a more constructive and flexible response to raise standards in corporate governance as opposed to the more black and white response engendered by statute or regulation. It is in recognition of the fact that there are aspects of corporate governance where statutory regulation is necessary and others where self-regulation, complemented by market regulation is more appropriate.
- 1.5 The need for a code also results from economic forces and the need to reinvent the corporate enterprise, so as to efficiently meet emerging global competition. The world's economies are tending towards market orientation. In market-oriented economies, companies are less protected by traditional and prescriptive legal rules and regulations. Malaysia is no exception and the shift to a full-disclosure regime, already underway in Malaysia, is such an example. Hence, there is a need for companies to be more efficient and well managed than ever before to meet existing and anticipated world-wide competition. The role of directors then increases in importance. The role of the board in hiring the right management, compensating, monitoring, replacing and planning the succession of senior management is crucial, as management undertakes the key responsibility for the enterprise's efficiency and competitiveness. The role of the Code is to guide boards by clarifying their responsibilities and providing prescriptions, thereby strengthening the control exercised by boards over their companies.

- 1.6 Standards developed for Malaysia must measure up to international thinking on this subject. Therefore, in developing the Code, careful consideration has been given to developments in other jurisdictions.

2. THE APPROACH UNDER THE MALAYSIAN CODE ON CORPORATE GOVERNANCE

- 2.1 There are three broad approaches to the issue of corporate governance undertaken by jurisdictions around the world –

- A prescriptive approach – where the standard of corporate governance is set by specifying desirable practices coupled with a requirement to disclose compliance with them.
- A non-prescriptive approach – This approach requires corporate governance practices in a company to be disclosed. The emphasis here is on the disclosure of actual corporate governance practices. The thinking behind this approach is that each company's corporate governance needs are different and directors of companies should address these needs.
- The hybrid approach – This involves the use of broad principles which are applied flexibly to the varying circumstances of individual companies.

- 2.2 The Code draws from the United Kingdom's (UK) experience set out in the Hampel Report. This involved the use of best practice prescriptions together with a rule requiring disclosure of the extent to which listed companies have complied with the prescriptions and where they have not, the reasons why. It is not proposed that companies should be required to comply strictly with the prescriptions developed. Each company should have the flexibility to develop its own approach to corporate governance. And while the prescriptions establish a sound approach to corporate governance, companies may develop alternatives that may be just as sound. Nevertheless the prescriptions set the standard that companies must measure up to. Such a rule also ensures that the investment community receives an explanation for the company's approach to governance so that it is in a position to support the approach or work to influence change.

- 2.3 In addition, companies must be encouraged to consciously address their governance needs. In this respect, companies must avoid compliance with form or "box ticking" and instead, should focus their efforts on exercising their judgement on the corporate governance practices best suited for their companies.

- 2.4 Companies are therefore required to include in the annual report a narrative account of how they had apply the broad principles set out in the Code. However, the form and content of the statements are not prescribed. This aims to secure sufficient disclosure so that investors and others can assess the company's performance and governance practices, and can respond in an informed way.

3. THE RECOMMENDATIONS

The Code sets out three forms of recommendations:

- **Principles**

Part 1 sets out broad principles of good corporate governance for Malaysia. The objective of the principles is to allow companies flexibility in applying the principles according to the varying circumstances of individual companies. Companies will be required by the *Listing Requirements of Bursa Malaysia* to include in their narrative statements, have applied the relevant principles in the annual report. This is to secure sufficient disclosure so that investors and others can assess companies' performance and governance practices, and respond in an informed way.

- **Best practices in corporate governance**

Part 2 sets out best practices for companies. It identifies a set of guidelines or practices intended to assist companies in designing their approach to corporate governance. While compliance with best practices is voluntary, companies are required as a provision of the *Listing Requirements of Bursa Malaysia* to state in their annual reports, the extent to which they have complied with the best practices set out in Part 2 and explain the circumstances justifying departure from such best practices.

- **Exhortations to other participants**

Part 3 is not addressed to listed companies but to investors and auditors to enhance their role in corporate governance. These principles are voluntary.

4. COMPLIANCE

4.1 Paragraph 15.26 of the *Listing Requirements of Bursa Malaysia* requires all listed companies to state in their annual reports:

- how they have applied the principles set out in Part 1;
- the extent to which they have complied with the best practices set out in Part 2;
- identify and give reasons for areas of non-compliance; and
- where applicable, state the alternative practice(s) adopted.

4.2 In Parts 1 and 2, boards are not required to comment on every item of the revised Code which they have complied with, but to disclose each area of non-compliance.

Sanctions for non-disclosure

- 4.3 Where a company fails to disclose the matters in its annual report, set out in para 4.1 above, Bursa Malaysia can take action against the company or its directors as set out in the *Listing Requirements of Bursa Malaysia*.

Part 1

PRINCIPLES OF CORPORATE GOVERNANCE

Part 1

PRINCIPLES OF CORPORATE GOVERNANCE

A DIRECTORS

I The Board

Every listed company should be headed by an effective board which should lead and control the company.

II Board Balance

The board should include a balance of executive directors and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision making.

III Supply of Information

The board should be supplied in a timely fashion with information in a form and of a quality appropriate to enable it to discharge its duties.

IV Appointments to the Board

There should be a formal and transparent procedure for the appointment of new directors to the board.

V Re-election

All directors should be required to submit themselves for re-election at regular intervals and at least every three years.

B DIRECTORS' REMUNERATION

I The Level and Make-up of Remuneration

Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully. The component parts of remuneration should be structured so as to link rewards to corporate and individual performance, in the case of executive directors. In the case of non-executive directors, the level of remuneration should reflect the experience and level of responsibilities undertaken by the particular non-executive concerned.

II Procedure

Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.

III Disclosure

The company's annual report should contain details of the remuneration of each director.

C SHAREHOLDERS

I Dialogue Between Companies and Investors

Companies and institutional shareholders should each be ready, where practicable, to enter into a dialogue based on the mutual understanding of objectives.

II The AGM

Companies should use the AGM to communicate with private investors and encourage their participation.

D ACCOUNTABILITY AND AUDIT

I Financial Reporting

The board should present a balanced and understandable assessment on the company's position and prospects.

II Internal Control

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

III Relationship with Auditors

The board should establish formal and transparent arrangements for maintaining an appropriate relationship with the company's auditors.

Part 2

BEST PRACTICES IN CORPORATE GOVERNANCE

Part 2

BEST PRACTICES IN CORPORATE GOVERNANCE

AA THE BOARD OF DIRECTORS

I **Principal Responsibilities of the Board**

The board should explicitly assume the following six specific responsibilities, which facilitate the discharge of the board's stewardship responsibilities:

- Reviewing and adopting a strategic plan for the company;
- Overseeing the conduct of the company's business to evaluate whether the business is being properly managed;
- Identifying principal risks and ensuring the implementation of appropriate systems to manage these risks;
- Succession planning, including appointing, training, fixing the compensation of and where appropriate, replacing senior management;
- Developing and implementing an investor relations programme or shareholder communications policy for the company; and
- Reviewing the adequacy and the integrity of the company's internal control systems and management information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines.

Constituting an effective board

II **Chairman and Chief Executive Officer**

There should be a clearly accepted division of responsibilities at the head of the company which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the roles are combined there should be a strong independent element on the board. A decision to combine the roles of chairman and chief executive officer should be publicly explained.

III **Board Balance**

Non-executive directors should be persons of calibre, credibility and have the necessary skill and experience to bring an independent judgement to bear on the issues of strategy, performance and resources, including key appointments and standards of conduct. To be effective, independent non-executive directors should make up at least one-third of the board membership.

Size of non-executive participation

- IV** In circumstances where a company has a significant shareholder, in addition to the requirement that one-third of the board should comprise independent non-executive directors, the board should include a number of directors which fairly reflects the investment in the company by shareholders other than the significant shareholder. For this purpose, “significant shareholder” is defined as a shareholder with the ability to exercise a majority of votes for the election of directors.
- V** In circumstances where a shareholder holds less than the majority but is still the largest shareholder, the board will have to exercise judgement in determining the appropriate number of directors which will fairly reflect the interest of the remaining shareholders.
- VI** The board should disclose on an annual basis whether one-third of the board is independent, and in circumstances where the company has a significant shareholder, whether it satisfies the requirement to fairly reflect, through board representation, the investment of the minority shareholders in the company. The board should disclose its analysis of the application of the best practices set out above to the circumstances of the board.
- VII** Whether or not the role of chairman and chief executive officer are combined, the board should identify a senior independent non-executive director in the annual report to whom concerns may be conveyed.

VIII Appointments to the Board

The board of every company should appoint a committee of directors composed exclusively of non-executive directors, a majority of whom are independent, with the responsibility for proposing new nominees to the board and for assessing directors on an ongoing basis. The actual decision as to who should be nominated should be the responsibility of the full board after considering the recommendations of such a committee. The nominating committee should—

- recommend to the board, candidates for all directorships to be filled by the shareholders or the board. In making its recommendations, the nominating committee should consider the candidates’—
 - skills, knowledge, expertise and experience;
 - professionalism;
 - integrity; and
 - in the case of candidates for the position of independent non-executive directors, the nominating committee should also evaluate the candidates’ ability to discharge such responsibilities/functions as expected from independent non-executive directors;
- consider, in making its recommendations, candidates for directorships proposed by the chief executive officer and, within the bounds of practicability, by any other senior executive or any director or shareholder; and

*[Amended
1/10/2007]*

- recommend to the board, directors to fill the seats on board committees.

The revised Code provides greater clarity on the aspects which a nominating committee should consider when recommending candidates for directorships.

- IX** The board, through the nominating committee, should annually review its required mix of skills and experience and other qualities, including core competencies which non-executive directors should bring to the board. This should be disclosed in the annual report.
- X** The board should implement a process, to be carried out by the nominating committee annually, for assessing the effectiveness of the board as a whole, the committees of the board, and for assessing the contribution of each individual director, including independent non-executive directors, as well as the chief executive officer. All assessments and evaluations carried out by the nominating committee in the discharge of all its functions should be properly documented.

[Amended
1/10/2007]

[Amended
1/10/2007]

The revised Code places importance on the process carried out by the nominating committee in evaluating members of the board, including the independent non-executive directors and chief executive officer. A nominating committee should also ensure that its assessments and evaluations are properly documented.

- XI** Boards should be entitled to the services of a company secretary who must ensure that all appointments are properly made, that all necessary information is obtained from directors, both for the company's own records and for the purposes of meeting statutory obligations, as well as obligations arising from the *Listing Requirements of Bursa Malaysia* or other regulatory requirements.
- XII Size of Boards**
Every board should examine its size, with a view to determining the impact of the number upon its effectiveness.
- XIII Directors' Training**
As an integral element of the process of appointing new directors, each company should provide an orientation and education programme for new recruits to the board.

Board structures and procedures

- XIV** The board should meet regularly, with due notice of issues to be discussed. The board should record its deliberations, in terms of the issues discussed, and the conclusions in discharging its duties and responsibilities. The board should disclose the number of board meetings held a year and the details of attendance of each individual director in respect of meetings held.

[Amended
1/10/2007]

The revised Code requires the board to properly record not only decisions made but also all the issues discussed in arriving at the decisions. This serves to provide a historical record and insight into those decisions.

- XV** The board should have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the company is firmly in its hands.

Relationship of the board to management

- XVI** The board, together with the chief executive officer, should develop position descriptions for the board and for the chief executive officer, involving definition of the limits to management's responsibilities. In addition, the board should approve or develop, with the chief executive officer, the corporate objectives for which the chief executive officer is responsible to meet.

XVII Quality of Information

The board should receive information that is not just historical or bottom line and financial oriented, but information that goes beyond assessing the quantitative performance of the enterprise, and looks at other performance factors, such as customer satisfaction, product and service quality, market share, market reaction, environmental performance and so on, when dealing with any item on the agenda.

- XVIII** The chairman of the board should undertake primary responsibility for organising information necessary for the board to deal with the agenda and for providing this information to directors on a timely basis. If the chairman is also the chief executive officer, the board should also have in place a procedure to ensure that its agenda items are placed on the agenda and for providing this information to directors.

XIX Access to Information

Directors should have access to all information within a company whether as a full board or in their individual capacity, in furtherance of their duties.

XX Access to Advice

There should be an agreed procedure for directors, whether as a full board or in their individual capacity, in furtherance of their duties, to take independent professional advice at the company's expense, if necessary.

- XXI** All directors should have access to the advice and services of the company secretary.

- XXII** Directors should appoint as secretary, someone who is capable of carrying out the duties to which the post entails, and his removal should be a matter for the board as a whole. The board should recognise that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board.

XXIII Use of Board Committees

Where the board appoints a committee, it should spell out the authority of the committee and, in particular, whether the committee has the authority to act on behalf of the board or just the authority to examine a particular issue and report back to the board with a recommendation.

XXIV Remuneration Committees

Boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors, to recommend to the board the remuneration of the executive directors in all its forms, drawing from outside advice as necessary. Executive directors should play no part in decisions on their own remuneration. Membership of the remuneration committee should appear in the directors' report.

The determination of remuneration packages of non-executive directors, including non-executive chairmen, should be a matter for the board as a whole. The individuals concerned should abstain from discussing their own remuneration.

BB ACCOUNTABILITY AND AUDIT

The audit committee

- I** The board should establish an audit committee comprising at least three members, a majority of whom are independent. All members of the audit committee should be non-executive directors. The board should provide the audit committee with written terms of reference which deal clearly with its authority and duties.

[Amended
1/10/2007]

All members of the audit committee should be financially literate and at least one should be a member of an accounting association or body.

[Amended
1/10/2007]

The revised Code strives to strengthen the role of audit committees by requiring the committees to comprise fully of non-executive directors. In addition, all its members should be able to read, analyse and interpret financial statements so that they will be able to effectively discharge their functions.

- II** The duties of the audit committee should include the following:
- (i) To consider the appointment of the external auditor, the audit fee and any question of resignation or dismissal;
 - (ii) To discuss with the external auditor before the audit commences, the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved;
 - (iii) To review the quarterly and year-end financial statements of the board, focusing particularly on—

- any change in accounting policies and practices;
 - significant adjustments arising from the audit;
 - the going concern assumption; and
 - compliance with accounting standards and other legal requirements.
- (iv) To discuss problems and reservations arising from the interim and final audits, and any matter the auditor may wish to discuss (in the absence of management where necessary);
- (v) To review the external auditor's management letter and management's response;
- (vi) To do the following, in relation to the internal audit function–
- review the adequacy of the scope, functions and resources of the internal audit function, and that it has the necessary authority to carry out its work;
 - review the internal audit programme and results of the internal audit process and, where necessary, ensure that appropriate actions are taken on the recommendations of the internal audit function;
 - review any appraisal or assessment of the performance of members of the internal audit function;
 - approve any appointment or termination of senior staff members of the internal audit function; and
 - take cognisance of resignations of internal audit staff members and provide the resigning staff member an opportunity to submit his reasons for resigning.
- (vii) To consider any related-party transactions that may arise within the company or group;
- (viii) To consider the major findings of internal investigations and management's response; and
- (ix) To consider other topics as defined by the board.

*[Amended
1/10/2007]*

- III** The finance director, the head of internal audit and a representative of the external auditors should normally attend meetings. Other board members may attend meetings upon the invitation of the audit committee. However, the committee should meet with the external auditors without executive board members present at least twice a year.

*[Amended
1/10/2007]*

The revised Code increases the frequency of meetings between the audit committee and the external auditor without the executive board members present. This encourages a greater exchange of free and honest views and opinions between both parties.

- IV** The audit committee should have explicit authority to investigate any matter within its terms of reference, the resources to do so, and full access to information. The committee should be able to obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary.
- V** The audit committee should meet regularly, with due notice of issues to be discussed, and should record its conclusions in discharging its duties and responsibilities.

The chairman of the audit committee should engage on a continuous basis with senior management, such as the chairman, the chief executive officer, the finance director, the head of internal audit and the external auditors in order to be kept informed of matters affecting the company.

*[Amended
1/10/2007]*

The revised Code places greater emphasis on continuous engagement between the chairman of the audit committee and senior management of the company, as well as the external auditors. Through the engagements, relevant issues affecting the company can be brought to the attention of the audit committee in a timely manner.

- VI** The board should disclose in an informative way, details of the activities of audit committees, the number of audit meetings held in a year, details of attendance of each director in respect of meetings, and the details of relevant training attended by each director.
- VII** The board should establish an internal audit function and identify a head of internal audit who reports directly to the audit committee. The head of internal audit will be responsible for the regular review and/or appraisal of the effectiveness of the risk management, internal control, and governance processes within the company.

*[Amended
1/10/2007]*

*[Amended
1/10/2007]*

The revised Code recognises the importance of the internal audit function by requiring all companies to have an internal audit function. In order to preserve the independence of the internal audit function, the head of internal audit should report directly to the audit committee.

- VIII** The internal audit function should be independent of the activities they audit and should be performed with impartiality, proficiency and due professional care. The board or the audit committee should determine the remit of the internal audit function.

CC SHAREHOLDERS

The relationship between the board and shareholders

- I** The boards should maintain an effective communications policy that enables both the board and management to communicate effectively with its shareholders, stakeholders and the public. This policy must effectively interpret the operations of the company to the shareholders and must accommodate feedback from shareholders, which should be factored into the company's business decisions.

Part 3

PRINCIPLES AND BEST PRACTICES FOR OTHER CORPORATE PARTICIPANTS

Part 3

PRINCIPLES AND BEST PRACTICES FOR OTHER CORPORATE PARTICIPANTS

I Shareholder Voting

Institutional shareholders have a responsibility to make considered use of their votes.

II Dialogue between Companies and Investors

Institutional investors should encourage direct contact with companies, including constructive communication with both senior management and board members about performance, corporate governance, and other matters affecting shareholders' interest.

III Evaluation of Governance Disclosures

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors and their advisers should give due weight to all relevant factors drawn to their attention.

IV External Auditors

The external auditors should independently report to shareholders in accordance with statutory and professional requirements and independently assure the board on the discharge of its responsibilities under principles DI and DII of Part I in accordance with professional guidance.