Issues and Challenges in Corporate Governance in Asia and Implications for Internal Auditors

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OUTLINE

► Approaches to Improving Corporate Governance: U.S. versus Asia

► The “Comply or Explain” Approach to Improving Corporate Governance and Implementation Challenges

► Relationship between Shareholders, Board of Directors and Management: U.S. versus Asia

► Independent Directors

► Audit Committees

► Issues and Challenges for Internal Auditors
Approaches to Improving Corporate Governance

- Unlike U.S., most other countries have adopted a Code of Corporate Governance whereby companies are expected to:
  - Describe their corporate governance practices in relation to principles and
  - Comply with guidelines or provisions under each principle or explain why if they do not comply
Implementation of the “Comply or Explain” Approach

► The effective implementation of the “comply or explain” approach depends on:
  ► Monitoring and enforcement of disclosure obligations by regulators
  ► Scrutiny of corporate governance disclosures by investors, media and other market participants
Implementation of the “Comply or Explain” Approach

A study of the implementation of the “comply or explain” approach in Singapore found the following problems:

- Non- or partial compliance with no explanations
- False or misleading disclosures
- Uninformative/boilerplate disclosures or explanations

Lack of regulatory and market sanctions have led to questions as to whether the “comply or explain” approach has been successful in raising corporate governance standards.
Barriers to Improving Corporate Governance in Asia

- Regulatory enforcement
  - Enforcement capacity
  - Balancing interests of suppliers versus users of capital
  - Concerns about business costs
  - Competition for listings
  - Concerns about shortage of qualified directors
  - Cross-border listings
Barriers to Improving Corporate Governance in Asia

- Market enforcement
  - Barriers to shareholder activism
  - Apathy amongst shareholders, including institutional shareholders
  - Shareholder lawsuits against directors are costly and therefore rare
  - Limits to media scrutiny
Board/Shareholder/Management Relationships

Typical Asian company
Board/Shareholder/Management Relationships

- There are significant implications for issues such as true independence of independent directors, and oversight of director and executive remuneration and related party transactions.
Independent Directors

Key issues surrounding independent directors:

Most companies have less than half of the board comprising of independent directors – is this enough?

- In 2004 CGFRC-S&P studies of large cap companies, % of companies having more than half independent directors were 9% in HK, 5% in Indonesia, 18% in Malaysia, 33% in Singapore and 6% in Thailand (but definition of independence is different across countries)

- In 2007, 20% of Mainboard Singapore-listed companies had more than half independent directors
Independent Directors

Percentage of independent directors on Singapore boards

- Less than 1/3 of the board independent: 8.85%
- 1/3 to 1/2 independent: 71.12%
- Majority independent: 20.03%
Independent Directors

- True independence vs definitional independence
- Approach to assessing independence – form versus substance
- “Emerging” threats to independence – long tenure, cross-directorships, method of compensation
- Multiple directorships
- Challenge for independent directors with dominance of controlling shareholders and management-cum-controlling shareholders
Independent Directors

- Duties of independent directors unresolved
- Supply and demand issues
- Competence of directors
- Appointment/removal/resignation of independent directors
Audit Committees

Key issues surrounding audit committees:

- Few audit committees have all independent directors (many have all non-executive directors)
  
  - 2004 studies of large cap companies show that % of wholly independent ACs were 58% in HK, 38% in Indonesia, 8% in Malaysia, 38% in Singapore and 80% in Thailand
  
  - Controlling shareholder may be on the AC, as may an executive director
Audit Committees

- Hong Kong and Malaysia stricter on need for accounting expertise on AC
  - Accounting/financial management expertise is often a matter of judgement for the board
  - It is not uncommon for lawyers to chair ACs
Audit Committees

Number of independent directors in ACs of Singapore companies with accounting/finance education or expertise
Developments Relating to Internal Auditors

- Stature of internal auditor has risen considerably and professional standards for internal auditing have improved considerably
- IA function is generally not mandatory (Malaysia has made it mandatory for listed companies)
- Most listed companies have an IA function
Developments Relating to Internal Auditors

- Outsourced IA is still very common, except amongst the largest companies.
- Corporate governance codes generally recommend that the Head of IA should report primarily to the AC.
- ACs generally view the IA as an essential partner for discharging its responsibilities.
Challenges for Internal Auditors

► IA function may exist, but IA may not be professionally trained and applying IA professional standards

► IA sometimes has too many roles, which may affect its independence and quality of the internal audit

► Primary reporting is to the AC, but AC may not be truly independent from management/major shareholders, or IA may still be beholden to management rather than accountable to AC
Challenges for Internal Auditors

► AC may not have the necessary competencies to understand the role of the IA and to oversee the IA (and to ask the proper questions about IA beyond a superficial level)

► AC members often sit on many boards and AC meetings are often infrequent and only a small amount of time is spent on IA matters
Thank you

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