

MINORITY SHAREHOLDERS WATCH GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
(Incorporated in Malaysia – Registration No.: 200001022382 (524989-M))

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The role of independent directors in focus

BY **ADAM AZIZ**

It took less than two weeks for Serba Dinamik Holdings Bhd's reshuffled board of directors to deliberate on its audit red flags, decide that they were trivial and subsequently mount a legal suit against its external auditor KPMG, instead of addressing the irregularities.

On the one hand, the speed at which they arrived at the legal decision could be reflective of the efficiency of the three new independent board members, who were appointed just 11 days prior.

The new independent non-executive chairman Datuk Mohamed Ilyas Pakeer Mohamed led a press conference on June 22, where he said he had read all the documents and was "surprised" at the "sub-standard auditing" involved.

However, a former audit partner emphasised that such reviews require extensive resources and can be time-consuming. It would be good for the chairman to reveal how exactly KPMG treated the audit in a trivial manner, he says.

"All the Big Four auditors have similar, stringent processes. A review takes weeks to be done. How do you justify commenting on such a technical issue in such a short span of time?" he adds.

With the mass resignation of independent directors last Friday, it will be interesting to see how the two remaining directors on the board convince shareholders that the audit issues are trivial and do not constitute red flags, and that it is indeed business as usual at the company.

Addressing an audit impasse

Serba Dinamik already had five independent directors on the board before Mohamed Ilyas and two others joined on June 11. Mohamed Ilyas' predecessor, Datuk Mohamed Nor Abu Bakar, resigned from the board on June 19. The rest,

including audit committee chairman Hasman Yusri Yusoff — a partner at KPMG until 2015 — resigned from the board on June 23 in protest against the KPMG suit filed the day before.

Recall that the original line-up of independent directors issued a statement on June 3 expressing concerns about the issues, and said the company would be forming an independent review to be reported to an independent committee "without element of interference from any party".

But following the boardroom changes, the independent review now appears to be up in the air. At the time of writing, there was no firm indication that such a review would take place.

Serba Dinamik group CEO and largest shareholder Datuk Mohd Abdul Karim Abdullah had contested KPMG's decision to bypass management and go straight to the independent directors (and later the Securities Commission Malaysia) to raise the red flags.

But as auditors play a role in prevention and detection of fraud, is it wrong to raise an audit red flag to independent directors directly? Further, what should independent directors do in such instances?

"The external auditors do not report to senior management," says Institute of Corporate Directors Malaysia president and CEO Michele Kythe Lim in an email reply to *The Edge*. "External auditors are responsible to shareholders and the line of reporting is to the audit committee, the majority of whom are independent directors.

"In line with Bursa Malaysia's guidance on effective audit and risk management, external auditors should have direct and unrestricted access and communication with the audit committee, with no barriers or interventions. In the event of any discrepancies, it is the fiduciary duty of the board to ensure accountability and consequence management

as well as, where appropriate, reporting to the regulators or authorities."

Minority Shareholder Watch Group CEO Devanesan Evanson concurs. "Where the audit committee and the auditors reach an impasse, the audit committee may recommend to the board to appoint a third party to conduct an independent review of the auditor's findings.

"We do not know exactly what transpired between the auditor and management. To date, we have heard the company's point of view, but not the auditor's.

"Presumably, the auditor reached an impasse when trying to resolve the matters with management. This impasse may have resulted in the auditors escalating the issues to the independent directors."

But more should be done, says the former audit partner *The Edge* spoke to earlier. "Upon such findings, independent directors should first ask interested board members to be recused, after which the non-interested board members can appoint a legal adviser and forensic audit team to look into the issues flagged."

To the question as to whether the issues were trivial enough to be addressed internally through alternative methods, an analyst covering the company says, "Auditors are not smoke detectors. They alert when there is already a fire; when the problem is already there."

Shareholders have a say on board representations

During Serba Dinamik's press conference on June 22, Mohamed Ilyas said the link between the three newly appointed independent directors — himself, Johan Mohamed Ishak and Masleena Zaid — was immaterial as they were still independent to Serba Dinamik.

Checks indicate that Mohamed Ilyas is chairman of AP Holdings Bhd, where Masleena

is a director. Johan is managing director of Awesome Media Network Sdn Bhd, whose sole shareholder is linked to Mohamed Ilyas.

"We wonder who identified the three new directors and how the nomination process was done. The sourcing and nomination of independent directors is a very, very important process," says Institutional Investors Council of Malaysia adviser Lya Rahman.

Serba Dinamik shareholders should emphasise on the nomination process for the replacements, where at least three more independent directors are required to meet the above 50% board composition under the Malaysian Code of Corporate Governance (MCCG). The company currently has four non-independent board members, including second largest shareholder Datuk Abdul Kadler Sahib, who had earlier proposed to remove KPMG as the external auditor.

Notably, directors of listed companies who are appointed mid-stream by the board must retire at the next AGM and seek re-election. Mazleena apparently resigned from the board on June 25, a day after the KPMG suit was filed and two weeks after she came on board, citing personal commitment.

"If shareholders are of the opinion that some independent directors satisfy the definition of independent directors 'in form' but not so 'in substance', the shareholders may vote not to re-elect those directors at the general meeting," says MSWG's Devanesan.

Meanwhile, Serba Dinamik's third largest shareholder, the Employees Provident Fund, has no nominee director but could request for one, although it is now unlikely as the fund has been paring its stake in the company. From more than 10% previously, EPF has reduced its shareholding to 8.57% as at June 21, having sold 51.06 million shares since the audit issues came up.