



# Financial misreporting and securities fraud — public and private enforcement

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*Between 2004 and 2006 several companies in Malaysia were involved in financial misreporting probes by the securities regulators. In the majority of the cases of financial misreporting enforcement action was taken by these regulators. There does not appear to have been any private enforcement action taken in respect of financial misreporting in public companies. Where private actions have been taken over financial misreporting they have been applications for oppression remedies in private companies. Enforcement proceedings in public companies have not relied on oppression. This article discusses the various enforcement actions taken by the securities market regulators. It also discusses the possibility of private enforcement of securities law contraventions and whether the enforcement actions taken by the regulators could be useful in private enforcement. This article also considers whether the recent company and securities law amendments, ie, the Companies (Amendment) Act 2007 and the Capital Market and Services Act 2007 will assist shareholder activism in this area.*

## 1 Introduction

Between 2004 and 2006, several companies in Malaysia were involved in financial misreporting or misstatements probes by the securities market regulators, ie, the Securities Commission (SC) and Bursa Securities Malaysia Berhad (Bursa Securities). The financial misstatements occurred in the context of the financial information contained in the annual reports, in relation to the quarterly reporting obligation under the Listing Requirements or in relation to specific various capital raising proposals submitted to the SC. The concerns about the revision of a company's financial statements which have been disclosed to the regulator and the public stems from the view that earnings restatements are recognised as a 'proxy for fraud'<sup>1</sup> and the possibility that the restatement is the result of managers misrepresenting the company's true financial health. Nonetheless, some restatements are not necessarily fraudulent. A restatement may be attributed to changes in regulatory requirements, in accounting rules or as part of an earnings management

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<sup>1</sup> J C Coffee Jr, 'Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms' in G Ferrarini, K J Hopt and J Winter et al, *Reforming Company and Takeover Law in Europe*, Oxford University Press, Oxford, 2004, p 463.

strategy.<sup>2</sup> However, in some of the more well known corporate scandals in recent years, misreporting of earnings were part of elaborate plans by managers or directors to ensure personal financial benefits. There is also empirical research showing the possibility of insider trading during the periods in which the financial misreporting was in existence in which insiders benefited from the inflated earnings or where insiders did not sell hoping that the information would not be revealed and that the company's share price would continue to rise.<sup>3</sup> In the United States, for example, several reasons have been identified as providing the motive for, and creating the opportunity for instances of, financial misreporting:

the sustained bull market, which made investors pay less attention to issuer credibility; judicial and legislative developments making private securities litigation harder to bring; a reduction in SEC fiscal and political resources; conflicts of interest in the accounting profession and elsewhere, and financial innovation, technological innovation, and the explosive growth of options-based executive compensation<sup>4</sup>

Failure at board level which may be attributed to human greed and lack of business morality has also been identified as another reason for financial misreporting.<sup>5</sup>

This article discusses the various enforcement tools that are available to the securities market regulators that range from a reprimand to judicial proceedings and litigation, reflecting what the securities market regulator — specifically the SC — state as a strategic approach to enforcement. While this reflects an awareness of the need to have a range of enforcement tools to suit the severity of a contravention and reflects the approach now widely applied by regulatory authorities elsewhere, the instances of financial misreporting in relation to public companies have largely been left to the securities regulator to enforce, in contrast to shareholders' suits which are common in more advanced economies. This article also discusses the possibility of private enforcement of securities law contraventions and whether the enforcement actions taken by regulators could be useful to a private litigant. It considers whether the recent company and securities law amendments, ie, the Companies (Amendment) Act 2007 and the Capital Market and Services Act 2007) will increase shareholder activism in this area.

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<sup>2</sup> Ibid, pp 465–6.

<sup>3</sup> See O Z Li and Y Zhang, 'Financial Restatement Announcements and Insider Trading', October 2006, at <<http://ssrn.com/abstract=929539>>; S L Summers and J T Sweeney, 'Fraudulently Misstated Financial Statements and Insider Trading: An Empirical Analysis' (1998) 73(1) *The Accounting Review* 131–46; M S Beasley, 'An Empirical Analysis of the Relation between the Board of Director Composition and Financial Statement Fraud' (1996) 71(4) *The Accounting Review* 443–65.

<sup>4</sup> D C Langevoort, 'Robert Clark's Corporate Law: Twenty Years of Change: Internal Controls After Sarbanes-Oxley: Revisiting Corporate Law's "Duty of Care as Responsibility for Systems"' (2006) 31 *Iowa Jnl of Corporation Law* 949; citing J C Coffee Jr, 'Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms' (2004) 84 *Boston Uni L Rev* 301.

<sup>5</sup> See Coffee, above n 1, p 456.

## 2 Public enforcement of financial misreporting

In general, the main statute regulating the securities market in Malaysia is the newly passed Capital Market and Services Act 2007 (CMSA).<sup>6</sup> Under the CMSA, the SC is authorised to initiate criminal proceedings as well as civil actions for contravention of the securities law, in addition to administrative sanctions that may be imposed without having recourse to the courts.

### (a) Criminal prosecutions

Throughout 2007, 16 persons were charged with financial misreporting.<sup>7</sup> In these criminal proceedings, the SC has taken the stance that instances of financial misreporting in the annual report could be prosecuted as disseminating false or misleading information under ss 122B and 122C of the SIA.<sup>8</sup> These are now ss 369 and 370 of the CMSA 2007. An example is Transmile Group. On 15 February 2007, the board of Transmile approved the unaudited results and released them to Bursa Malaysia. The approval was given despite several audit concerns and issues which were highlighted in the audit committee meeting a day earlier. These matters were not brought to the attention of the board by the audit committee until much later, on 27 April 2007. Immediately after, on 30 April 2007, Transmile applied to Bursa Malaysia to postpone the release of its audited accounts but the application was rejected. Bursa Malaysia's announcement on that day indicated that Transmile had failed to submit its audited financial statements as the auditor was still finalising the financial statements. On 4 May 2007, the company's external auditor informed the board in writing that it was unable to obtain relevant supporting documents from management. These documents were required to verify certain transactions relating to trade receivables and related sales and additions to property, plant and equipment that would have enabled the auditors to satisfy themselves on the fairness or validity of those transactions. The board also announced that it had commissioned a special audit relating to these matters.<sup>9</sup> The unaudited results which were approved by the board and released to Bursa Malaysia showed that the company's profit before tax for the year ended 31 December 2006 was RM206.734 million. The final report of the special audit showed that instead of making a profit, the

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6 The CMSA is a consolidating Act which now encompasses the former Securities Industry Act 1983, the Futures Industry Act 1993 and Pt IV of the Securities Commission Act 1993 which deals with fund raising activities. The CMSA is supported by the Capital Markets and Services Regulations 2007, the Licensing Handbook and the Guidelines on Regulation of Markets. The CMSA which was passed by Parliament in May 2007, came into force on 28 September 2007.

7 See at <<http://www.sc.com.my/eng/html/enforcement/CriProsecution2007.html>>.

8 More recently, the SC has also commenced criminal proceedings against directors of Megan Media for financial misreporting. The charges were for making false statements to Bursa Malaysia in relation to the company's revenue figures. SC Press Release, 'SC charges Megan Media financial controller and executive chairman — seeking Interpol to help arrest Megan Media executive director', 10 December 2007. See also SC Press Release, 'SC charges Dato Ng Kim Weng for falsifying information in Polymate Holdings Berhad 2003 Annual Report', 7 February 2007. Several of the directors of Nasioncom have been charged either for authorising the making of false and misleading statements or abetting the commission of the offence.

9 Announcement to Bursa Malaysia dated 7 May 2007.

company had suffered loss of RM172 million. The special audit was also extended to cover 2004 and 2005 and the financial statements were also shown to be inaccurate in indicating profit instead of loss.

The SC subsequently initiated criminal proceedings against several directors. They were the chief executive officer (Gan), the chief financial officer (Lo), an executive director (Khiudin) and two non-executive directors (Chin and Shukri). While Gan, Lo and Khiuddin were charged with abetting the making of a statement that was misleading in a material particular under s 86(b) of the SIA, read with s 122C(c), the charges against the non-executive directors were for knowingly permitting the making of a misleading statement to Bursa Malaysia, under s 122B of the SIA. It was alleged that they knew that the statement submitted was misleading when they authorised its submission to the SC. The criminal proceedings against the two non-executive directors were only initiated after they had failed to pay the compound of RM500,000, an administrative penalty offered to each of them by the SC. These cases are still pending.

While criminal sanctions have both a deterrent and punitive value, they are perceived as too draconian as they often include custodial sentences which may not be appropriate. There are also views that courts are reluctant to make an order for a custodial sentence and instead impose modest fines that give the appearance that the law is weak, thus affecting the effectiveness of criminal sanctions as a deterrence mechanism.<sup>10</sup> This view is reflected in two cases prosecuted by the SC relating to the submission of false and misleading information where the courts substituted a fine for the custodial sentence.<sup>11</sup> In one a prosecution was brought by the SC against Yap Kim Seng the former managing director of Pasaraya Hiong Kong Sdn Bhd (PHK). Yap was charged on 25 April 2005 with submitting false information on the revenue of PHK for the year ended 31 March 2003. This information was submitted to the SC in connection with Ocean Capital Berhad's proposed corporate restructuring which included the proposed acquisition of PHK. Yap admitted that PHK's financial statements for the year ended 31 March 2003 contained fictitious

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10 Senate Standing Committee on Legal and Constitutional Affairs, *Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, AGPS, Canberra, 1989. A civil penalty provision is enforced by ASIC where a civil standard of proof is applicable. The civil penalty provision was first introduced in relation to the duties of directors but has since been expanded to cover the failure to comply with the statutory requirement to keep financial records and reports, prohibition against insolvent trading, financial benefits to related parties, share capital transactions, duties imposed on those involved in the management of managed investment schemes and market misconduct provisions which include the continuous disclosure obligation, market manipulation, insider trading, false trading, market rigging and dissemination of information about illegal transactions. The remedies available for the contravention of the above are a pecuniary order (ie, payment of a sum of money to ASIC), a compensation order for the corporation or a disqualification order.

11 See <<http://www.sc.com.my/eng/html/enforcement/CriProsecution2006.html>>. The prosecution was against Wira Tjakrawinata, also known as Kenneth Chow, and was relating to Omega Holdings Bhd. He was sentenced in the Sessions Court to one year's imprisonment and fined RM500,000 (in default one month's imprisonment). The High Court allowed the appeal against the sentence and quashed the decision by the Session Court and substituted the sentence with one day's imprisonment and RM2 million fine (in default of 24 months' imprisonment).

sales which had the effect of increasing PHK's profit before tax. The Sessions Court had imposed a sentence of two years imprisonment on him on 16 January 2006 after he pleaded guilty to the charge.<sup>12</sup> However, on his appeal against the custodial sentence, the High Court allowed the appeal and substituted a fine of RM500,000 for the custodial sentence.<sup>13</sup>

### (b) Civil proceedings by the regulators

While the sanctions regime for corporate and securities law in Malaysia largely relies on criminal proceedings and criminal sanctions, the SC is authorised to commence civil actions for contravention of the securities law. This power has not been in existence for very long. Civil actions by the securities market regulator, ie, the Securities Commission, for securities law contraventions were only introduced in 2000. Originally this was confined to insider trading cases.<sup>14</sup> It was later expanded to other market offences. The new Capital Market and Services Act 2007 has given the SC additional powers to initiate tougher civil actions for contraventions of the securities law and extends to cover conduct amounting to false trading, market manipulation, fraudulently inducing persons to deal in securities and disseminating information that is false or misleading,<sup>15</sup> the use of manipulative and deceptive devices,<sup>16</sup> insider trading,<sup>17</sup> offences relating to futures trading<sup>18</sup> and for any contravention of the securities law relating to fundraising activities.<sup>19</sup> The civil action may be taken if the SC considers that it is in the public interest to initiate a civil action. This power has been used by the SC in relation to an insider trading case,<sup>20</sup> the disgorgement of profits wrongfully obtained and the freezing of a company's assets.<sup>21</sup> It has also been taken for the recovery of funds for investors in relation to unauthorised fundraising activities involving

12 SC Press Release, 'SC secures conviction of Yap Kim Seng for falsifying information in Pasaraya Hiong Kong case', 16 January 2006. Another director, Yap Kim Fatt was also charged but the charge against him was withdrawn when Yap Kim Seng made a guilty plea.

13 See at <<http://www.sc.com.my/eng/html/enforcement/CriProsecution2006.html>>.

14 Section 90A of the SIA 1983, now s 201 of the CMSA 2007.

15 See the former s 86 of the Securities Industry Act 1983:

Subject to section 87B, a person shall not make a statement, or disseminate information, that is false or misleading in a material particular and is likely to induce the sale or purchase of securities by other persons or is likely to have the effect of raising, lowering, maintaining or stabilising the market price of securities if, when he makes the statement or disseminates the information

(a) he does not care whether the statement or information is true or false; or

(b) he knows or ought reasonably to have known that the statement or information is false or misleading in a material particular.

See also Securities Industry (Compliance with Approved Accounting Standards) Regulations 1999.

16 Section 200 of the CMSA 2007 for contravention of ss 175, 176, 177, 178, 179 and 181 of the CMSA 2007.

17 Section 201(5) for contravention of s 188 of the CMSA 2007.

18 Section 211 for contravention of ss 202, 203, 204, 205, 206, 207 and 208 of the CMSA 2007.

19 Section 358 for contravention of Pt IV and any regulations under the CMSA 2007.

20 SC Press Release, '90% aggrieved Bernas investors compensated milestone SC civil recovery action — 41 others yet to claim entitlement', 24 August 2006.

21 SC Press Release, 'SC obtains injunction to safeguard RM20 million in Ayer Molek's monies', 7 September 2007; SC Press release, 'SC files RM2.5 million restitution suit against FTEC Resources Managing Director', 1 October 2007.

a fund management company which had engaged unlicensed individuals to solicit and receive funds on its behalf for an unapproved investment scheme. While a substantial amount had been returned to investors, the shortfall was recovered from the company and its executive director by the SC.<sup>22</sup> Nonetheless, there have not been any civil proceedings taken by the regulatory authority for financial misreporting.

The consequence of a civil action by the SC is that the wrongdoer can be ordered to disgorge profits made out of the wrongful conduct, in addition to a civil penalty not exceeding RM1 million that may be obtained by the SC or, in the case of a contravention of the fundraising activities, triple the amount of the contravention or any disqualification action that may also be initiated by the SC.<sup>23</sup> The amount recovered by the SC under the civil penalty provision may be used firstly to reimburse the SC for costs and expenses incurred and to compensate any person who has suffered loss due to the contravention. Nonetheless, the SC is given the discretion not to distribute the compensation recovered if it considers that it is not practicable to compensate aggrieved persons because of the amount of the potential distribution or the difficulty of ascertaining or notifying the persons who are entitled to be compensated. In such a case the amount will be put into a fidelity fund or used to defray the costs of regulating the capital market.

The SC's enforcement tools that now includes initiating civil actions and civil penalty actions is similar to the powers of the Australian Securities and Investments Commission (ASIC). It is to be noted that the SC's power under the CMSA to commence a civil action in the public interest is not confined to breach of directors' duty but may be initiated in relation to any of the specified offences. In addition, although the SC has adopted the range of enforcement activities now practised by ASIC, the civil action that may be initiated does not reflect the ASIC's threefold categories of possible criminal, civil penalty or civil actions. The sanctions regime in Australia comprises of criminal and civil penalties enforced by the regulator as well as civil remedies which may be privately enforced by the company or its members. The range of enforcement actions in Australia that may be taken was introduced as a response to 'responsive regulation' theory.<sup>24</sup> In addition, under s 50 of the Australian Securities and Investments Commission Act 2001, ASIC may sue a director to recover compensation from the director who has breached his or her duties if it appears to ASIC that it is in the interest of the public. In

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22 SC Press Release, 'SC files R1.93 restitution suit against Powerhouse Asset Management and its executive directors', 7 November 2007.

23 Section 360 of the CMSA 2007, where one of the orders that the court may make upon application by the SC is as follows:

(L) in a case where the person is a chief executive or director, an order removing him from office or that he be barred from becoming a chief executive, director or be involved in the management directly or indirectly, of any other public company for such period of time as may be determined by the court.

24 See J Braithwaite and I Ayers, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, 1992; Australian Treasury, *Review of Sanctions in Corporate Law*, March 2007; G Gilligan, H Bird and I Ramsay, *Regulating Directors' Duties: How Effective are the Civil Penalty Sanctions in the Australian Corporations Law?*, Centre for Corporate Law and Securities Regulation 1999; M Welsh, 'Eleven years on — An examination of ASIC's use of an expanding civil penalty regime' (2004) 17 *AJCL* 175.

contrast, the sanctions regime for corporate law in the United Kingdom is comprised primarily of a statutory penalty regime enforced by the regulator and the private enforcement of civil remedies which may be initiated by the company or its members. The former UK Companies Act 1985 contained s 438 under which the Secretary of State could bring civil proceedings on a company's behalf if it appeared to him or her that it would be in the interest of the public to do so. However, the UK Company Law Review has recommended the deletion of this provision.<sup>25</sup> The Company Law Review, while acknowledging the relevance of civil remedies, did not favour the involvement of the regulator 'in initiating proceedings to vindicate purely private rights' and that 'any such rights should be enforceable only by or on behalf of the persons who benefit from them'.<sup>26</sup>

### (c) Public/private reprimand and/or fine

Instances of financial misreporting have been largely enforced by SC and Bursa Malaysia by way of a public reprimand and fines imposed on the company as well as its directors. On 19 April 2005, Bursa Malaysia publicly reprimanded and imposed a fine on Goh Ban Huat in relation to inaccuracies in its unaudited fourth quarterly results for the financial year ending 31 December 2004. This reprimand arose out of the company's announcement in February 2005 of its unaudited accounts for the financial year which stated that the company had made a net profit of RM100.06 million. Not surprisingly, the company's share price increased tremendously after the announcement of the net profit.<sup>27</sup> On 7 March 2005, the company announced that it had become aware that it had made a mistake in relation to the accounting principles adopted in reporting its intra-group sales and purchase of assets. Its shares were immediately suspended from trading. On 8 March 2005 the company announced that instead of making a profit, it had actually made a net loss of RM20.84 million. The company's failure to eliminate profits arising from intra-group property sales had resulted in an overstatement of profits. On 17 May 2005, the SC publicly reprimanded Goh Ban Huat and its board of directors and imposed a fine of RM50,000 each against the managing directors and one of the executive directors.

On 7 August 2006, Bursa Malaysia publicly reprimanded Comsa Farms Berhad (COMSA) and its directors for inaccuracies in its fourth quarterly report for the financial year ended 31 March 2005 which had been released to the public.<sup>28</sup> This followed the company's failure to submit its annual audited accounts for that financial year for which the company had also been given a public reprimand and fine on 2 November 2005. According to the Listing Rules, the audited accounts for the financial year ended 31 March 2005 had to

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25 UK Steering Committee on Company Law Review, *Modern Company Law: Completing the Structure*, [please provide publisher details] Ch 13.

26 *Ibid*, p 317.

27 The share price rose dramatically by 61% to RM1.32 from 82 sen on 28 February 2005. When the shares were suspended on 7 March 2005, a total of 1.16 million shares had changed hands.

28 Bursa Malaysia Media release at <<http://www.bursamalaysia.com>> dated 7 August 2006 (viewed 19 September 2006). On 7 June 2005, Comsa announced its fourth quarterly report for the financial year ended 31 March 2005.

be submitted to Bursa Malaysia on or by 30 October 2005. The company was informed that if it failed to do so the company's shares would be suspended from trading. The company applied to Bursa Malaysia for an extension of two months until 30 September 2005 to furnish its 2005 annual audited accounts but Bursa Securities rejected the application on 12 August 2005. On 10 October 2005, an announcement was made through Bursa Malaysia that the existing auditor has indicated its intention to resign and a change of auditor was effected through an extraordinary general meeting on 26 October 2005. On 21 November 2005, the new auditors were requested by the SC to undertake a verification exercise in relation to the draft audited accounts of the company for the financial year ended 31 March 2005. The audited accounts showed discrepancies between them and the unaudited accounts. The audited accounts were submitted only on 17 November 2006. They reported a loss of RM196 million compared to the profit of RM12.6 million in the unaudited accounts. One of the reasons for the deviation between the results as shown in the unaudited and audited accounts was the overstatement of sales.<sup>29</sup>

Bursa Securities also changed its enforcement focus in relation to financial statements in 2006, bringing more enforcement actions against directors of public listed companies that have delayed issuing their financial statements.<sup>30</sup> Executive directors, especially managing directors<sup>31</sup> and audit committee members<sup>32</sup> were also more frequently disciplined in relation to the financial misreporting. Often the director was given a public reprimand for permitting, either knowingly or where he or she had reasonable means for obtaining such knowledge, the company to breach a Listing Rule. In the criminal proceedings initiated by the SC for financial misreporting in Transmile and Megan Media, actions were initiated against the executive directors while non-executive directors were normally disciplined by other enforcement tools.

While a personal fine or reprimand against the directors is appropriate, the companies also have to bear the costs of the directors' mismanagement by being publicly reprimanded by Bursa Malaysia, as noted in the enforcement actions above. This is an issue that the UK Company Law Review discussed, ie, the appropriateness of imposing sanctions on either the officer in default or the company. It recommended that in general, there should be a presumption against criminal liability unless the act in question was capable of seriously

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29 <<http://www.bursamalaysia.com>> dated 5 April 2006 (viewed 19 September 2006), general announcement reference No CC-060405-69720.

30 Bursa Securities Annual Report 2006, p 42.

31 'Public reprimand on WIMEMS Corporation Berhad and Public Reprimand and Fine on a Director of WIMEMS', 1 November 2007. The relevant listing rule that has been breached is for failure to take into account the adjustments as stated in the company's announcement which has resulted in a deviation between the company unaudited results and audited results. In this case, it was relating to a much higher loss.

32 See SC Press Release, 'Public Reprimand and Fine on Talam Corporation Berhad and Public Reprimand on the Directors of Talam Corporation Berhad', 9 April 2005. The audit committee members were given the public reprimand for permitting, either knowingly or where they had reasonable means for obtaining such knowledge, the company to breach a listing rule. The relevant listing rule that has been breached is for failure to take into account the adjustments as stated in the company's announcement which has resulted in a deviation of 50.33% between the company unaudited results and audited results for the financial year ended 31 January 2006.



damaging the company and where making the individual personally liable would have a sufficient deterrent effect.<sup>33</sup> The UK Companies Act 2006 also provides that a director is liable to compensate the company for any loss suffered by the company as a result of any untrue or misleading statement in the directors' report, the directors' remuneration report, a summary financial statement so far as it is derived from either of those reports or the omission from the report of anything required to be included in the report.<sup>34</sup> The court may order the directors who were party to the approval of the defective accounts or report to bear the costs of the application and any reasonable expenses incurred by the company in connection with or in consequence of the preparation of revised accounts or a revised report.<sup>35</sup> It is also worth noting that in some of the companies that have been subject to enforcement actions by the securities market regulators in Malaysia, there have been previous instances of financial misreporting where there were inaccuracies and discrepancies between the unaudited and audited figures for previous financial years. For example, in Goh Ban Huat's case, there were discrepancies between the unaudited and audited figures for the financial year ended 2002 and 2003.<sup>36</sup> In such cases, it is the officers in default who should have enforcement action taken against them, and in cases of persistent contravention, criminal prosecutions should be initiated.

While 2007 saw several criminal proceedings for financial misreporting,<sup>37</sup> criminal prosecutions were not taken in all cases. The SC has utilised its power to offer compounds, that is monetary penalties, to settle the issue, under s 373 of the CMSA 2007 prior to commencing criminal prosecutions.<sup>38</sup> In Transmile, an offer to compound was made to the non-executive directors who did not pay it. Criminal prosecutions were only commenced when they failed to accept the offer and pay the monetary penalty. In contrast, in Hospitech Resources Berhad's case, the SC made an offer to compound to the managing director of the company. The offer was made in relation to the application by the company for listing on the MESDAQ market in which the prospectus

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33 UK CLR, *Modern Company Law: Final Report*, 2001, p 315. See also D C Langevoort, 'Duties of the Modern Corporate Executive: Article & Essay: on Leaving Corporate Executives "Naked, Homeless and Without Wheels": Corporate Fraud, Equitable Remedies, and the Debate over Entity versus Individual Liability' (2007) 42 *Wake Forest L Rev* 627.

34 Sections 454–462 of the UK Companies Act 2006; see also s 463 of the UK Companies Act 2006.

35 See s 456(5) of the UK Companies Act 2006:

(5) For this purpose every director of the company at the time of the approval of the accounts or report shall be taken to have been a party to the approval unless he shows that he took all reasonable steps to prevent that approval.

(6) Where the court makes an order under subsection (5) it shall have regard to whether the directors party to the approval of the defective accounts or report knew or ought to have known that the accounts or report did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation), and it may exclude one or more directors from the order or order the payment of different amounts by different directors.

36 See <<http://www.bursamalaysia.com>>.

37 See <<http://www.sc.com.my/eng/html/enforcement/CriProsecution2007.html>>.

38 See the former s 124 of the SIA 1983. In 2007, there were two cases compounded by SC involving the submission of false and misleading statements as to company's financial statements in the annual report.

issued by the company contained false revenue figures in relation to one of the company's subsidiaries.<sup>39</sup>

#### (d) Other enforcement tools

The SC has also made use of its power to request several listed companies to reissue their accounts.<sup>40</sup> On 24 June 2005, Bursa Securities issued a public reprimand to Oilcorp Berhad for failure to ensure that the annual audited accounts for the financial year ended 31 December 2003 were factual, clear, unambiguous, accurate and succinct to enable investors to make informed investment decisions. The company's audited results were RM3.333 million lower than the unaudited results which were stated as RM15.333 million.<sup>41</sup> The SC had then taken action against Oilcorp Berhad on 24 March 2005 by requesting that the company reissue its accounts.<sup>42</sup> Another company, Aktif Lifestyle Corporation Berhad, was publicly reprimanded on 4 May 2005 and requested to reissue its accounts to ensure that the company's consolidated financial statements complied with approved accounting standards.<sup>43</sup>

Another listed company, Talam Corporation Bhd, was also requested by the SC to reissue its financial statements for 2006 and 2007.<sup>44</sup> The company, as well as several of its directors, were also publicly reprimanded and fined by Bursa Malaysia for failure to furnish quarterly reports and the annual report within the time frame required by the Bursa Securities Listing Requirements as well as for inconsistencies between its unaudited and audited accounts for the financial year ended 31 January 2006. The company's auditor, Ernst & Young, had indicated that it did not have sufficient evidence to satisfy itself that the accounting treatment of several transactions by the company was appropriate.

An interesting challenge to the enforcement action taken by the securities regulators was initiated by a listed company, Nasioncom. Bursa Malaysia had issued a public reprimand to the company and several of its directors for failure to submit its annual audited accounts and quarterly reports on time.<sup>45</sup> The company indicated that it intended to compel Bursa Malaysia to allow more time for the company to issue its financial accounts for the fourth quarter

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39 SC Press Release, 'SC Imposes RM500000 compound on Hospitech director', 23 November 2006.

40 The UK Companies Act 2006 provides that while the directors have the power to voluntarily revise defective accounts and reports, ie, the company's annual accounts, the directors' remuneration report or the directors' report, or a summary financial statement of the company, the Secretary of State or person authorised by him may apply to court to order the directors of the company to prepare revised accounts or a revised report; see above nn 34–35.

41 <<http://www.bursamalaysia.com>>, Company announcement reference No 00-050429-C1AB0, dated 29 April 2005.

42 See ss 454–462 of the UK Companies Act 2006 where the Secretary of State or person authorised by him may apply to court to order the directors of the company to prepare revised accounts or a revised report.

43 <<http://www.sc.com.my>> dated 4 May 2005 (accessed 16 September 2006).

44 <<http://www.sc.com.my>>; Chan Ching Thut, 'SC asks Talam to reissue financial statements', *The STAR*, StarBiz, Thursday 4 October 2007, B1.

45 Bursa Securities Media Release, 18 December 2007.

ended 31 December 2006.<sup>46</sup> Nasioncom was found to have inflated its revenue figures for the financial year ended 31 December 2005 and had been reprimanded for the misleading information. Several directors have also been charged in relation to the misleading information. Nasioncom stated that the preparation of the quarterly reports could not be conducted on time as some financial documents were currently in the possession of the SC and because some key personnel had resigned following the investigation initiated by the SC into the 2005 inflated earnings. Several of the company's directors have been charged with either authorising the making of false and misleading statements or abetting the commission of the offence.<sup>47</sup> Bursa Securities has also ordered the companies concerned to appoint an external auditor to conduct a limited review on the company's next four quarterly reports.

Other enforcement actions that are available to the regulator is delisting or suspending share trading and the disqualification of directors. In relation to financial statements, Bursa Securities has exercised its power to suspend the trading of a non-compliant company that has not been able to submit its financial statements, and has indicated that it may initiate delisting procedures against companies that fail to issue outstanding financial statements.<sup>48</sup>

The table below shows enforcement actions taken against listed companies in relation to a breach of the Listing Requirements that involves financial statements.<sup>49</sup> In most cases, financial misreporting is often preceded or accompanied by a delay in submitting the financial statements on time.

46 'Bursa erred in rejecting appeal, saya Nasioncom', *The STAR*, StarBiz, Tuesday 10 July 2007, B6.

47 The directors are Datuk Chee Kok Wing, Shamsul Khalid Ismail, Mah Soon Chai and Tan Teck Hong. See below n 53.

48 Bursa Malaysia Media release, 'Imposition of suspension on trading of securities due to delay in submission of financial statements', 30 November 2007.

49 Annual Reports of 2004 and 2006 did not contain categorisation of the type of non-compliance. See below Bursa Securities *Annual Report 2006*.

Sanctions imposed	PLCs	Directors/ principal officers of PLCs	Advisers	Sponsors	Total
Warnings/reminder letters	182	32	7	4	223
Private reprimand	50	4	1	0	55
Public reprimand	32	29	0	0	61
Public reprimand and fine*	38	17	0	0	55
Total	300	82	8	4	394
*total fines(RM million)	2.1	1.7	-	-	3.8

**Table A**

	2003		2005	
Failure to furnish annual audited accounts on time	4 (public reprimand) *1 company was given a warning, ie, caution & impress	16 (Total fine RM 405,500)		20 (Total fine RM1,679,000)
Failure to furnish annual accounts/reports on time	4 (public reprimand)	4 (total fine RM 68,750)	1	9

Source: KLSE Annual Report 2003; Annual Report of Bursa Securities 2005.

A search of the Bursa Malaysia website showed that there were eight companies that had enforcement actions taken against them in 2007 as compared to three companies in 2006.

**Table B — Enforcement action by Bursa Securities taken against companies relating to financial misreporting, ie, where there is discrepancies between the unaudited and audited accounts**

Types of 'sanctions'	2006	2007
1 Public reprimand on companies	3	8
2 Public reprimand on directors — 'for permitting, either knowingly or where he had reasonable means of obtaining such knowledge, a listed issuer to commit a breach of these Requirements' and fine	3	6
3 External auditor to be appointed to review accounts prior to submission to Bursa	1	6

Source: Bursa Securities Press Release 2006, 2007

### 3 Private enforcement — shareholders' litigation

The Annual Report of the SC showed that it has encountered several cases where the profits were significantly overstated through the creation of fictitious sales and debtors, the use of fictitious invoices and diversion of company funds to related parties, increasing earnings by deferring current year's cost to future years by categorising such cost items in the balance sheet and by boosting profits by not eliminating inter-company transactions through

the use of a third-party intermediary.<sup>50</sup> An example is the conviction of Lim Chai Hock on 3 September 2003, a former managing director of a wooden furniture manufacturer, for authorising the furnishing of false statements to the Kuala Lumpur Stock Exchange (now Bursa Securities). The investigation revealed numerous forged documents used to boost the profits of the Tat Sang Group.<sup>51</sup> In the case of Transmile, the final report of the special audit which the SC required the company to conduct revealed that there were several transactions which could not be substantiated, where some payments were not recorded while there were several fabricated invoices. Interestingly, there was also the possibility of under-billing or non-billing of transactions with CEN Worldwide Sdn Bhd, a company associated with several of Transmile's directors.<sup>52</sup> On 19 June 2007, the company announced that it had lodged a police report in respect of the false documents. In the case of Megan Media, the auditors discovered the possibility of fake trade debtors and creditors as well as misappropriation of company's assets.<sup>53</sup>

While financial misreporting is enforceable by the regulators under the CMSA 2007 and the Companies Act,<sup>54</sup> it is arguable that this does not provide shareholders with a cause of action under the common law. Financial misreporting enables the controllers of the company to enter into transactions that are not in the best interests of the company. It is often a method adopted to cover misappropriation of assets or abuse of position to obtain private benefits. As such the financial misreporting may be used to cover up breaches of the duty of loyalty that directors owe the company. It is possible that the financial misreporting may also give rise to a breach of the duty of care in the directors' failure to keep themselves informed of the company's financial position. An action for damages for breach of duty of care requires the company to have suffered loss, thus it is possible that where the company is penalised for financial misreporting, the directors are in breach of the duty of care. The Malaysian Companies (Amendment) Act 2007 has introduced a new statutory provision which states that:

directors of a public company or subsidiary of a public company shall have in place a system of internal control that will provide reasonable assurance that . . . all transactions are properly authorised and that they are recorded as necessary to enable the preparation of true and fair profit and loss accounts and balance sheets and to give a proper account of the company's assets.

Thus financial misreporting is now arguably a contravention of the Companies Act 1965 in addition to being a contravention of the CMSA 2007 for making

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50 Securities Commission, *Annual Report 2005*, pp 259–60; *Annual Report 2004*, p 257.

51 Securities Commission, *Annual Report 2003*, p 287.

52 CEN Worldwide Sdn Bhd is owned by CEN Sdn Bhd and two of the directors of Transmile were also on the board of CEN Sdn Bhd. Khiudin Mohd one of the directors of Transmile which has been charged by SC is a director of CEN Sdn Bhd. Another director, Gan Eu Jin, is the nephew of Transmile's founder Gan Boon Aun. <<http://announcements.bursamalaysia.com>>, 'Transmile Group Berhad Final report on Special Audit', announced 16 June 2007.

53 '20-06-2007: Megan Media an affected listed issuer', at <<http://www.theedgedaily.com>>.

54 Dato Chee Kok Wing was charged with an offence under the Companies Act 1965 for authorising the making of false statements in documents which are used in the preparation of financial statements contained in the annual report for 2005 for NasionCom Holdings Bhd, at <<http://www.sc.com.my/eng/html/enforcement/CriProsecution2007.html>>.

a false and misleading statement. There is a scarcity of Malaysian cases on the breach of the duty of care in general and specifically involving the failure of the directors to keep themselves informed of the company's financial position.<sup>55</sup> In contrast, it has been held in Australia that where a director made misleading or incomplete disclosure in circumstances where the information to be disclosed was known to the director, there is a failure to exercise the duty of care and diligence.<sup>56</sup>

Financial misreporting in some of the enforcement actions taken is often preceded or accompanied by delay in submitting the financial statements on time. (See Table A above.) In one case, the delay in submitting the financial statements to shareholders has been successfully argued to support a claim under the oppression provision, ie, s 181 of the Companies Act 1965.

In *Chiew Size Sun v Cast Iron Products Sdn Bhd*,<sup>57</sup> the allegation was that there was oppression and mismanagement of company's affairs and that the delay in tabling the unaudited accounts was due to no proper accounting records being kept by the company. The unaudited 1981 accounts were submitted to shareholders in 1986. The 1981 audited accounts were submitted in 1987 with the delay being attributed to computer failure. The 1981 audited accounts were only submitted after the petitioner sent a letter demanding to see the accounts. It was alleged that the delay was to enable a cover up of the misappropriation of the company's assets and unauthorised disposal of company assets by some of the directors. Dividends were also not declared since the directors stated that there were no available profits. However the shareholders argued that the absence of dividends to shareholders was unjustified when the company had available profits which had been carried forward for several years. There was also tax mismanagement due to the delay in the preparation of inadequate accounts which resulted in the company having to pay additional assessment rates and penalty tax. The court held that there was oppression and granted an order for a company auditor to examine the company records since its incorporation and to prepare proper accounts and a report for shareholders for the purpose of the valuation of company assets for the shareholders. The costs for the examination and preparation of the company's accounts and records were to be borne by the company. Once this had been done the directors of the company were required to purchase the shares of the petitioners in equal proportions.

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55 See further A N M Sulaiman, 'Duty of care, skill and diligence: A Survey on Non-Executive Directors in Public Listed Companies In Malaysia' (2005) 1(2) *Corporate Governance L Rev* 205; A N M Sulaiman, 'Revising Directors' Duty of Care, Skill and Diligence In Malaysia' (2004) 17(2) *AJCL* 196.

56 *ASIC v Vines* (2006) 58 ACSR 298; [2006] NSWSC 760; BC200605863; 'Court finds against former officers of GIO Insurance', ASIC News, August 2005, Issue 86; 'Court imposes penalties on former GIO directors and clarifies role of company executives', Wednesday 2 August 2006, ASIC Media and Information Release 06-261, at <[www.asic.gov.au/publications](http://www.asic.gov.au/publications)>; see 'ASIC commences civil proceedings against former officers of GIO Insurance', Wednesday 20 June 2001, ASIC Media and Information Release 01/217, 20 June 2001, at <[www.asic.gov.au/publications](http://www.asic.gov.au/publications)>, where ASIC alleges that the respondents failed to exercise the duties of care and diligence required by the Corporations Law when preparing forecasts and other relevant information for consideration by the GIO Australia Board and the Due Diligence Committee.

57 [1994] 1 CLJ 157.

Under the common law, general investors would have to rely on an action in misrepresentation to be compensated for losses incurred by manipulative statements.<sup>58</sup> The CMSA, however, enables civil actions to be initiated by persons who have suffered loss ‘by reason of, or by relying on’ the conduct of another person<sup>59</sup> amounting to false trading, market manipulation, fraudulently inducing persons to deal in securities by disseminating information that is false or misleading, using manipulative and deceptive devices,<sup>60</sup> insider trading<sup>61</sup> and offences relating to futures trading.<sup>62</sup> This private right of action accrues irrespective of whether or not ‘the person has been charged with an offence in respect of the contravention or whether or not a contravention has been proved in a prosecution’.<sup>63</sup>

Nonetheless, there has not been any case brought by investors or shareholders under the CMSA 2007 (or the former SIA 1983). Malaysian investors have not taken an active stance in bringing investors-related civil proceedings and instead have relied on the regulators to initiate legal proceedings. This is despite such actions being authorised under the previous SIA 1983 as early as 2000 and now enhanced by the CMSA 2007.<sup>64</sup> Class action suits, as found in the United States<sup>65</sup> and Australia,<sup>66</sup> have also yet to

58 For a comparative study of the reliance on misrepresentation as a cause of action, see A F H Loke, ‘The Investors’ protected interest against market manipulation in the United Kingdom, Australia and Singapore’ (2007) 21 *AJCL* 22.

59 See *GPG (Australia Trading) Pty Ltd v GIO Australia Holdings Ltd* (2001) 117 FCR 23; 191 ALR 342 at [104] where it was held that:

The misleading conduct need not be the sole or dominant cause of the decision to invest, provided that it played a part in and contributed to the decision (*Henville v Walker* (2001) 75 ALJR 1410 . . . whether or not to invest in the company

See also M Duffy, ‘Fraud On The Market: Judicial Approaches To Causation And Loss From Securities Nondisclosure In The United States, Canada And Australia’ (2005) 29 *MULR* 621 at 658, citing the decisions under the Trade Practices Act 1974 (Cth) in Australia that involves the issue of causation in relation to misleading and deceptive conduct and concluding that the Australian law ‘would appear already to accept that reliance by shareholders on a person or persons who had themselves relied on misleading representations by a company may be sufficient causation in the case of corporate misstatements’.

60 Section 199 of the CMSA 2007 for contravention of ss 175, 176, 177, 178, 179 and 181 of the CMSA 2007.

61 Section 201 for contravention of s 188 of the CMSA 2007.

62 Section 210 for contravention of ss 202, 203, 204, 205, 206, 207 and 208 of the CMSA 2007.

63 See, eg, ss 199, 210 and 357 of the CMSA 2007.

64 See ss 199, 201 and 210 of the CMSA 2007.

65 In the United States this has been facilitated by the Private Securities Litigation Reform Act (PSLRA) of 1995, which encouraged institutional investors, ie, specifically identified public pension funds, to take the lead role in monitoring and prosecuting securities class actions.

66 See *King v GIO Australia Holdings Ltd* [2001] FCA 270; BC200101025; *King v AG Australia Holdings Ltd (formerly GIO Australia Holdings Ltd)* [2003] FCA 980; BC200305403; *P Dawson Nominees Pty Ltd v Multiplex Ltd* (2007) 242 ALR 111; [2007] FCA 1061; BC200705629; *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (2005) 147 FCR 394; 67 IPR 124 which was commenced in late 2003, became the first Australian shareholder class action to proceed to trial in October 2007. Australia has relied on the representative action procedure under Pt IVA of the Federal Court of Australia Act 1976 (Cth). See also Duffy, above n 59; ‘Class action culture spreads across Australia’, *The Financial Times*, 8 March 2006; ‘Investors Revolt — More and More Shareholders are Fighting Back with Class Actions’, *Business Review Weekly*, 9 February 2006. See also V Morabito, ‘An

become part of the popular jurisprudence of corporate and securities law in Malaysia despite the availability of representative proceedings under procedural law. While there are views that class actions are not going to be popular in Malaysia in the absence of a specific statutory provision enabling class action suits in corporate or securities law, the Australian experience indicates that this is not necessary.<sup>67</sup> However, as indicated in the US cases, the lead plaintiff in private financial misreporting enforcement proceedings is usually an institutional shareholder, normally a private pension funds.<sup>68</sup> The most prominent public pensions fund in Malaysia is the Employees Provident Fund (EPF) which currently invests in about 190 companies listed on the Bursa Securities. Its current allocation for equity investment is RM55 million<sup>69</sup> while the total net-asset-value of unit trust funds make up about 13.54% of the total market capitalisation of the Stock Exchange.<sup>70</sup> Institutional investors in Malaysia, like the EPF and unit trust funds, have often shown the characteristics of reluctant investors.<sup>71</sup> But even in more advanced economies, a civil action by investors may be a remedy of last resort. An example is an investors' class action suit against Telstra. In that case, the class action was initiated due to the regulators' failure to commence legal proceedings.<sup>72</sup> In relation to Multiplex, by contrast, ASIC obtained an enforceable undertaking which included a compensation fund payable to investors who, upon accepting the payment, waived their rights to pursue legal action.<sup>73</sup> On the other hand, Loke identifies the funding of such litigation as

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Australian Perspective on Class Action Settlements' (2006) 69(3) *Mod L Rev* 347. Another country that has specifically provided for class action in relation to corporate and securities law is New Zealand. See s 173 of the NZCA.

67 Above nn 58 and 65.

68 See R Romano, 'The Shareholder Suit, Litigation without Foundation' (1991) 7 *J L Econ & Org* 55 where one of the conclusions is that 'lawsuit likelihood is significantly correlated with the presence of outside block shareholders'; see also below n 75.

69 A P Raj, 'EPF to raise stock market allocation', *Business Times*, Friday, 21 September 2007.

70 As at 31 December 2006, total funds managed by licensed fund management companies in Malaysia increased by 22.6% to RM164.42 billion as compared to 2005. Unit trust funds continued to be the main source of funds under management, reaching RM121.77 billion as at end 2006, compared to RM98.48 billion as at end 2005. Other types of funds under management included funds of charitable bodies, corporate bodies, Employees Provident Funds and their contributors, government bodies/agencies, individuals, insurance companies and private pension funds: source: Securities Commission.

71 However, in 2005, EPF started becoming a more active investor when it rejected two corporate proposals on the ground that they were unfavourable to the pension fund and also initiated a court action for an injunction against the company's share swap exercise. The injunction was applied for and granted because EPF contended that the conduct of the EGM was improper. In this EGM, EPF demanded a poll which was not complied with by the chairman of the EGM: L Barrock, 'EPF's Audacious Move', *The Edge*, 4 April 2005; K Yap, 'Protecting its Equity Interest', *The Edge*, 4 April 2005.

72 See J Coffey, 'Enforcement of continuous disclosure in the Australian stock market' (2007) 20 *AJCL* 301; '05-391 ASIC warns Telstra on disclosure procedures', Wednesday 14 December 2005, at <<http://www.fido.gov.au>>.

73 '06-443 ASIC accepts an enforceable undertaking from the Multiplex Group', Wednesday 20 December 2006, at <<http://www.fido.gov.au>>.

The \$32 million compensation fund will be available to investors who contracted to purchase and held Multiplex shares between 3 February 2005 (the date ASIC believes the market should have been informed) and 24 February 2005 (the date the announcement was made). . . . In return for compensation, shareholders who accept the offer will waive



a restriction on private enforcement of securities law contraventions. He has pointed out that in Australia as a result of the decision of the High Court in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd*,<sup>74</sup> (*Fostif's* case), which upheld the validity of litigation funding agreements or arrangements for securities class action suits, more private enforcement can be expected.<sup>75</sup> Loke is of the view that the Singapore courts will be receptive to the reasoning in *Fostif's* case but that the paucity of private enforcement in Singapore could be due to the absence of litigation funders.

In the US, financial misreporting and overstatement of revenues, ie, misstatements and non disclosure, have been relied on by shareholders, including institutional shareholders, as the basis for a claim for recovery of the loss suffered by investors in class action suits and in some derivative actions.<sup>76</sup> The most recent cases relate to misleading statements about the financial status of US mortgage lenders. CalPERS has been actively involved in securities class action suits involving, amongst other grounds, financial misreporting. One example is the derivative action and class action suit it initiated in June 1998. CalPERS, together with the New York State Common Retirement Fund<sup>77</sup> and the New York City pension funds, filed proceedings against Cendant Corporation, alleging that Cendant issued false and misleading financial statements to the investing public about the company's income and earnings. There was also an allegation that certain former officers and directors of the company sold or filed intentions to sell over 4 million shares of Cendant common stock preceding the announcement. At the time of the filing, the pension funds estimated that they had lost approximately US\$89 million as a result of Cendant's alleged misstatements.<sup>78</sup> In 2003, the California Public Employees' Retirement System (CalPERS) also brought a class action suit against Time Warner, several of that company's present and

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their right to take any legal action in respect to the issue. . . . Shareholders who are related parties, such as members of the Roberts family, directors of Multiplex and executive staff at the relevant time, are excluded from applying for compensation under this undertaking.

74 (2006) 229 CLR 386; 229 ALR 58.

75 See Loke, above n 58, at 29.

76 See D C Langevoort, 'Duties of the Modern Corporate Executive: Article & Essay: on Leaving Corporate Executives "Naked, Homeless and Without Wheels": Corporate Fraud, Equitable Remedies, and the Debate over Entity versus Individual Liability' (2007) 42 *Wake Forest L Rev* 627; R B Thompson and R S Thomas, 'The Public and Private Faces of Derivative Lawsuits' (2004) 57 *Vanderbilt L Rev* 1747.

77 The New York State Common Retirement Fund has been authorised to act as lead plaintiff in a securities class action suit against Countrywide Financial Corp alleging that certain of its officers and directors violated federal securities laws by making false and misleading statements regarding the changing quality of the company's mortgage loan portfolio. As late as April 2007, Countrywide stated that credit rating agency Moody's upgraded the rating of the company's banking segment and announced that its home loans segment was also under review for possible upgrade. Then on 12 June 2007, the company boasted of its position as the number one mortgage originator in the United States. These announcements concealed the alarming growth of loan defaulters, amongst others, which had adverse impacts on the quality of the information relating to the company's earnings and profits.

78 CalPERS Press Release, 'CalPERS Emerges Victor in Cendant Securities Lawsuit — \$2.8 Billion Recovered And Cendant Corporate Governance Reforms Promised', 7 December 1999. In August 2000, CalPERS brought a securities class action lawsuit against Chubb Corporation seeking recovery of losses as a result of false and misleading

former directors and officers, its accounting firm, Ernst & Young, and the company's financial advisors. The suit alleged that there were accounting irregularities in relation to the company's merger with America Online (AOL). AOL was alleged to have overstated its advertising revenue and income through the use of sham transactions and improper accounting practices before and after the merger. As a result, federal investigations were initiated and the combined company later restated revenues on three occasions for a total of more than US\$1 billion. Subsequently, there was a settlement of the suit except in relation to Ernst & Young against whom the case is pending.<sup>79</sup>

A significant issue in private enforcement is whether there are adequate legal rules to encourage shareholders activism, especially in relation to access to information. The Malaysian corporate and securities regulators, ie, the Companies Commission and the SC, have wide investigatory powers. The privilege against self-incrimination does not apply in the context of investigations conducted by these Malaysian corporate regulators<sup>80</sup> but client-lawyer privilege is specifically provided for.<sup>81</sup> While this means that the regulatory authorities' power to obtain information is wider than its counterpart in some other jurisdictions, for example, Australia,<sup>82</sup> the usefulness of the information to private litigants in Malaysia is limited.<sup>83</sup> While information obtained by the regulators may be used in any *civil* or criminal proceedings, access to the information depends on whether the regulators are willing to recognise that one of its roles is assisting victims of corporate wrongdoing to bring private actions.<sup>84</sup> ASIC, on the other hand, was of the view that when it brought civil penalty proceedings against a former executive of GIO, this would be helpful to the shareholders in their class action.<sup>85</sup> However, ASIC has also been known to resist the release of information from its investigations for use in class action claims. This was an issue in *P Dawson Nominees Pty Ltd v Multiplex Ltd*.<sup>86</sup>

Nonetheless, in Malaysia this problem of access to information has been addressed somewhat by several amendments to corporate and securities

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statements and irregularities in accounting practice by the company. The suit however was dismissed by the court, at <<http://www.calpers-governance.org/litigation/activity.asp>> (accessed 5 December 2007).

79 CalPERS Press Release, 'CalPERS Recovers \$117.7 Million in Time Warner Lawsuit', 14 March 2007, at <<http://www.calpers.ca.gov>> (accessed 5 December 2007).

80 See ss 7B, 7C and 7D of the Companies Act 1965 and ss 134(2) and 151 of the Securities Commission Act 1993.

81 Section 351 of the CMSA 2007.

82 See V Comino, 'High Court relegates strategic regulation and pyramidal enforcement to insignificance' (2005) *AJCL* 48; N Andrews, 'If the dog catches the mice: The civil settlement of criminal conduct under the Corporations Act and the Australian Securities and Investments Act' (2003) *AJCL* 137.

83 See further A N Mohd Sulaiman, 'Civil Proceedings in Companies and Securities Regulation: Access to Information for private Enforcement and Shareholders' Consent' [1999] 4 *MLJ* xlvi. See also A N Mohd Sulaiman, 'Overcoming regulatory Authority's Resistance to Disclose Information' [2000] 4 *MLJ* lxxiii.

84 See s 148 of the SCA 1993.

85 'ASIC commences civil proceedings against former officers of GIO Insurance', Wednesday 20 June 2001, ASIC Media and Information Release 01/217, 20 June 2001, at <[www.asic.gov.au/publications](http://www.asic.gov.au/publications)>.

86 (2007) ACSR 239; [2007] FCA 1659; BC200709376.

legislation. For example, the statutory derivative action, ie, s 181A, introduced by the Companies (Amendment) Act 2007, enables the court to make an order 'for any person to provide assistance and information to the complainant'. This should enable shareholders to have access to information that has been gathered by the regulators. However, this access is available in relation to a derivative action and would not be available on its own or to support an action for oppression. Shareholders or investors may also now be able to find out more about any enforcement action that has been, or is being, taken by the SC. This is the result of the recent amendment to the Securities Commission Act 1993 that now allows the SC to publish information:

in the interest of the public or for the protection of investors in relation to . . . the compounding of any offence under the securities law or . . . any civil or criminal proceedings brought under the securities law and the outcome of any proceedings including any settlement whether on or out of court.<sup>87</sup>

The Companies (Amendment) Act 2007 has also given a wider power to the regulator and an 'aggrieved person' to apply for an injunction against contraventions of the Companies Act 1965.

While the cases in Malaysia have focused on enforcement actions against the company as well as directors and senior management for financial misreporting, enforcement actions have also been initiated against gatekeepers in other jurisdictions. These are auditors, securities analysts and securities attorneys who prepare, review or analyse disclosure documents.<sup>88</sup> Actions against auditors in relation to financial misreporting in Malaysia are scarce,<sup>89</sup> unlike numerous actions taken by CalPERS and the New York pension funds against Ernst & Young, which was the former external auditor in relation to the Cendant Corporation case referred to above,<sup>90</sup> and in the Time Warner merger with AOL.<sup>91</sup>

Coffee identified gatekeeper failure as a reason for the increase in financial misreporting and suggested that 'noisy withdrawal' and 'up the ladder' reporting creates one of the incentives for clients not to shop around for a favourable opinion and may contribute to preventing gatekeeper failures.<sup>92</sup> In the context of the current discussion on financial misstatements, the CMSA 2007 and the Companies Amendment Act 2007 both require disclosure to the regulatory authorities when an auditor ceases to hold office or when the auditor indicates its intention to resign as auditor. While this reform does not focus on enforcement activities, the announcement of the reason for resignation should be a signal to the shareholders and the investing public.

## 4 Conclusion

The article has given an account of recent misstatements in financial reporting involving several listed companies and explained the range of enforcement

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<sup>87</sup> Section 152A of the SCA 1993 was amended.

<sup>88</sup> See Coffee, above n 1, p 457.

<sup>89</sup> Securities Commission, Press Release, 'SC sanctions Deloitte KassimChan and Hwang-DBS Securities Berhad for lapses in due diligence responsibilities', 30 August 2006.

<sup>90</sup> CalPERS Press Release, above n 78.

<sup>91</sup> CalPERS Press Release, above n 79.

<sup>92</sup> Coffee, above n 1.

actions that are available to, and have been relied on by, the regulators. Instances of financial misreporting are becoming more common (see Table B) and, increasingly, both anecdotal evidence from newspaper reports and published statistics on enforcement actions, especially criminal proceedings, indicates that in most cases, these were not innocent mistakes. The SC, as the securities market regulator, has been relying on a range of enforcement actions such as criminal, civil and administrative actions. While the increasing number of enforcement activities indicates that the regulator is more serious about the impact of financial misreporting instances on the market, there are cases involving persistent defaults in relation to financial misreporting which were not prosecuted but were enforced by way of public or private reprimands. There is also an increase in the number of enforcement actions taken against directors, in addition to enforcement actions against the company. This indicates a shift from institutional liability to individual liability and is a positive move to make directors more accountable, especially in cases of persistent non-compliance. Where private enforcement of financial misreporting is concerned, there have been no civil proceedings brought by investors or shareholders under the CMSA for financial misreporting specifically or for contravention of the securities law in general. Financial misreporting, however, has been relied on in relation to the oppression remedy in Malaysia and in relation to breach of directors' duty of care in Australia. The recent amendments to the Malaysian companies and securities regulation should encourage more private litigation in this area but actual civil proceedings by private litigants still depends on the willingness of shareholders, most probably institutional shareholders, in Malaysia to lead in taking such actions.