The Enforcement of Accounting Fraud under the Capital Markets and Services Act 2007

There is a growing recognition globally that healthy capital markets require an effective regime for financial reporting. Disclosures in a listed company's financial statements provide critical information relating to the company's affairs and for this reason, the law has clear provisions addressing the disclosure of false or misleading information to the regulators and the public.

A provision which is used by the Securities Commission Malaysia ("**SC**") to enforce breaches relating to financial mis-statements of public listed companies ("**PLC**") is section 369 of the Capital Markets and Services Act 2007 ("**CMSA**"). This section prohibits the furnishing of any information which is false or misleading to the SC and the stock exchange, among others. As there are various types of information that are required to be furnished to the regulators, this provision can be broad in terms of its ambit. The statements may cover both year-end audited accounts, as well as quarterly financial reports as these relate to the affairs of a PLC and must be furnished to the stock exchange as part of their disclosure obligations. A conviction may result in imprisonment for a term not exceeding 10 years and a fine not exceeding RM3 million.

It is useful to consider the attitude of the courts when dealing with disclosure breaches by PLCs. In the past several years, we have seen courts impose deterrent sentences in light of the sentiment that disclosure of false or misleading information to the investing public is a serious breach.

In the case of *Dato' Dr Hj Mohd Adam Che Harun v. Public Prosecutor [2019] MLJU 2146*, The High Court of Malaysia affirmed the Sessions Court decision convicting the accused of furnishing the stock exchange in 2007 with false information relating to the affairs of Megan Media Holdings Berhad, a PLC at the time. In his judgment, Justice Mohd Nazlan Mohd Ghazali pointed out that an offence of furnishing misleading information to the stock exchange is serious in nature.

> *"It has wide ranging negative repercussions on the integrity of the stock market operated by Bursa Securities. False information betrays the very basis of market transactions on any stock exchange which is anchored on the principle of symmetry of information that must be accurate in the first place."*

The conviction was affirmed by the Malaysian Court of Appeal in 2020, including the sentence of 18 months imprisonment imposed by the Sessions Court.

In another case, criminal action for misleading disclosures was brought against the former independent directors of Transmile Group Bhd. Transmile, at the time, was an air freight carrier which was listed on Bursa Malaysia. After a full trial, the independent directors were sentenced to a jail term of one year and a fine of RM300,000 for the furnishing of misleading information to the stock exchange in 2007 (*PP v. Chin Kim Feung [2014] 4 CLJ*) (the decisions of the Sessions Court and High Court were affirmed by the Court of Appeal in 2017).

A separate case involved the former CEO of Transmile, Gan Boon Aun, who in August 2020, was convicted by the Sessions Court on a charge of furnishing a misleading statement to Bursa Malaysia in the company's unaudited financial results. The charge in this case involved the offence under section 122B of the Securities Industry Act 1983 ("**SIA**"), (now in s.369 of the CMSA) read together with section 122(1) of the SIA, the deeming provision under the SIA at the time. The deeming provision was earlier in 2017 upheld by the Federal Court as being constitutional following a challenge brought about by Gan in *Public Prosecutor v. Gan Boon Aun [2017] 3MLJ 12.* In the Sessions Court, Gan has been sentenced to a fine of RM2.5 million and one day imprisonment. As reported on the SC's website, the SC has filed an appeal to the High Court against the sentence imposed by the Sessions Court, whilst Gan is appealing against the conviction and sentence.

The creation of fictitious revenue in companies can take place even prior to the company's listing on the stock exchange, at times continuing post listing. In the case of *PP v. Mok Chin Fan [2015] 6 MLJ 857*, several of the company directors and an employee were prosecuted for their role in the furnishing of false information to the stock exchange not only in the company prospectus but also in its quarterly unaudited reports following the company's listing.

In this case the first, second and fourth respondents were directors of Inix Technologies Holdings Bhd ("**Inix**"). Inix had issued a prospectus in which 97.1% of its revenue as reported was found to be false. The prospectus was issued before the listing of Inix and the respondent directors had approved the issuance of the prospectus. Inix's senior financial executive (the third respondent) was in charge of the financial matters of the company and had assisted in fabricating fictitious sales and figures in the financial reports. After the listing, the first, second and fourth respondents had authorised the furnishing of false and misleading statements to Bursa Malaysia in four of the company's quarterly reports. The directors were charged with the furnishing of the false statements to the stock exchange, as well as for the false statements in the prospectus. The senior financial executive was charged with abetting the directors in the submission of the quarterly financial statements to the stock exchange.

The respondents who had earlier pleaded guilty were imposed with fines in the Sessions Court. On appeal by the prosecution, they were imposed with jail terms ranging from six to nine months for the mis-statements which were contained both in the prospectus and quarterly statements of the company. On the issue of false statements submitted in the quarterly reports, the Court of Appeal pointed out that Bursa Malaysia, as an exchange, is vested with statutory duties and powers to protect investors and to ensure public confidence in the investment environment. The false information furnished to the exchange would defeat the objective and stifle Bursa Malaysia's statutory roles and duties to ensure and maintain a credible and transparent capital market, and maintain investor confidence.

Cases such as these are not peculiar to the Malaysian market. In the US, for example, the collapse of Enron, at the time one of the largest companies in America, resulted in the loss of thousands of jobs and billions of dollars in the form of pension plans for employees. It also shook the energy markets where Enron was a key player, as well as Wall Street, given its large market capitalisation. Poor accounting practices and the use of special purpose vehicles were said to have allowed the company to hide its mountains of debt and toxic assets from investors and creditors.

Other accounting scandals such as Satyam in India and Worldcom in the US only serve as a grim reminder that even dominant players in a particular industry can be vulnerable to unlawful practices leading to their collapse.

Could cases such as these have been avoided? As the saying goes, it's easy to have 2020 vision in hindsight. However, we can learn from past mistakes. The key players in ensuring that these collapses can be avoided are invariably those closest to the company itself. For one, the collective and individual responsibility of directors cannot be overemphasised.

One of the most valuable lessons that we can learn from accounting scandals is that those who take on the mantle of directorship of companies have an important role to play. In playing a fiduciary role, it is vital to bring to the table the necessary objectivity, honesty and diligence that the role requires.

An important safeguard for directors is to pay heed to the advice of auditors who, in the course of performance of their duties, may encounter what in their professional opinion has been a breach of the law, the rules of the exchange or any matter which may adversely affect to a material extent the

financial position of the PLC. This can occur when the auditors, in the course of conducting their year-end financial audit, come across irregularities with respect to transactions that the company has entered into. Auditors themselves play a key role in the process of financial reporting by PLCs and are themselves duty bound under section 320 of the CMSA, to report such breaches or matters to the authorities. For this reason, where external auditors are removed from office or give notice to the PLC of their desire to resign as external auditors, the company must forward to the Exchange a copy of any written representations or statement of circumstances connected with the resignation made by the external auditors. This must be done at the same time as copies of such representations or statement of circumstances are submitted to the Registrar of Companies pursuant to section 284 of the Companies Act 2016**.**

Other useful safeguards for directors would be to use the board meetings to effectively ventilate queries. Where a transaction is significant or unusual, even if it does not trigger the listing requirements' thresholds for shareholder approval for example, it still behoves directors to seek to understand the nature and purpose of these transactions. Self-censorship is a mindset and approach that directors would do well to avoid, replacing this with healthy and robust discussions to apprise themselves of the goings-on in the company. Ensuring that questions raised and explanations offered are duly captured in meeting minutes is key to this process, and directors who take their role seriously can find this simple step to be very effective in the long run.

Finally, a proper understanding of their role requires directors and company management to appreciate not only their duties but also their rights. The Listing Requirements of Bursa Malaysia, for example, provide that the Audit Committee has the right to have full and unrestricted access to any information pertaining to the listed issuer, have direct communication channels with the external and internal auditors, are able to obtain independent professional or other advice and are able to convene meetings with external and internal auditors, even excluding the attendance of other directors and employees of the listed issuer, if this is deemed necessary.

In public markets, the veracity of financial information is key in empowering investors to make informed investment decisions. Where the information becomes unreliable, the loss of confidence in the company can be an insurmountable challenge. Many companies involved in accounting scandals have been delisted from their respective stock exchanges, resulting not only in loss of employment but also widespread losses to investors holding the company's shares or other securities. For balance sheets, at least, sunlight might still be the best disinfectant.