

Troubles at another S-chip - with a twist

China Sky case highlights a conflict between an ID's role as AC chair and his firm's role

By MAK YUEN TEEN

MOST of the troubles faced by Chinese companies listed in Singapore - S-chips - can be attributed in the first instance to management of these companies and poor internal controls and accounting systems within these companies, even though independent directors in some of these companies may have contributed to the problems due to their lack of independence, competence or commitment.

On April 22, China Sky Chemical Fibre issued an announcement in response to a number of queries from the Singapore Exchange (SGX) which should set off alarm bells not only among investors but also among the local professional accountancy body and the regulators. It is unusual in that some of the most significant queries relate to the actions of a Singapore independent director, who is also a practising accountant.

China Sky has two Singapore independent directors, Er Kwong Wah and Lai Seng Kwoon. Both sit on multiple boards, including a number of S-chips. Indeed, in a report published in The Business Times on July 27, 2009, Mr Lai was referred to as 'Mr S-chips'.

In that report, Mr Lai was quoted as saying: 'I'm an ID who, I think, doesn't have a very glorious record . . . I have gone through an S-chip that has fraud, an S-chip that is experiencing bond and liquidity issues, I have gone through an S-chip that has a controlling shareholder pledging all his shares, and I have an S-chip with missing accounting records.'

To that list, we can now add that Mr Lai has now also gone through an S-chip where he is a major source of its problems.

Among other issues, the SGX asked China Sky to identify the director whose firm was reported to have provided professional services to the company under its disclosure of interested person transactions (IPTs), and to explain certain discrepancies in the disclosure of IPTs in the 2009 and 2010 annual reports.

It has now emerged that Mr Lai's accounting firm, SK Lai & Co, provided significant accounting-related services to China Sky, while Mr Lai was an independent director and chaired the audit committee (AC).

The payments for these services were recurring IPTs and amounted to some \$112,000 in 2008, \$183,000 in 2009 and \$72,000 in 2010. The services relate to assisting in the review of the company's internal, accounting and reporting controls, reviewing quarterly financial statements and results announcements, and providing consultancy and advisory services for various accounting procedures, including the consolidation of a subsidiary.

As the AC chairman, Mr Lai has a primary responsibility for overseeing the areas for which his firm is providing accounting-related services, and is therefore put in a position to review his own firm's work.

Further, the AC oversees the external auditors, who are expressing an opinion on the financial statements, while his firm is advising management on the controls and accounting procedures which underlie the preparation of these financial statements.

The amount of fees involved suggests that the work of his firm was substantial.

In my view, there is an unacceptable conflict between his role as AC chair and his firm's role in providing accounting-related services. While the company has claimed that the IPTs are conducted at arm's length and that each member of the AC abstained from voting on matters in which he is interested, it still begs the question as to how SK Lai & Co was appointed when there are many accounting firms that can provide such services.

Primary beneficiary

Further, the AC is also tasked with reviewing the IPTs, but Mr Lai's firm is the primary (only) beneficiary of the transactions which were reported. It has now also turned out that there were significant errors in the reporting of these IPTs.

The 2010 corporate governance report of the company includes a statement that the independent directors have confirmed that they do not have any relationship that could interfere, or be reasonably perceived to interfere, with the directors' independent business judgment.

The nominating committee, chaired by Mr Er with Mr Lai as one of its two other members, was reported to have reviewed and confirmed the independence of the independent directors - that is, their own independence. The query from SGX has now resulted in a further statement that the board assesses Mr Lai to be independent despite his significant business relationships with the company, because of his 'unequivocal ability to exercise strong independent judgement', 'to act professionally', 'to maintain a high standard of duty and care' and to 'observe the ethical standards of his profession'.

It is a mockery of our corporate governance regime if a director can still be considered to be an independent director given such significant business relationships and conflicts.

In The Business Times report mentioned above, Mr Lai was quoted as saying: 'Of course, given my experience, I would want to get onto more boards.'

Mr Lai was also further quoted as saying: 'Given the spectrum of experience I have on S-chips' boards, I would like to humbly submit that I am better positioned to deal with the issues surrounding them.'

In the China Sky case, I would also like to humbly submit that some of those issues are of Mr Lai's own doing.

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