

Ask Mr Sid

Dear Mr Sid

Re: Conflict over conflict of interest

I serve as chairman of a listed shipping company. For over a decade and a half, we maintained a bungalow for a senior expatriate manager. During Covid-19, we downsized, the expatriate returned home, and we decided to sell the property.

Covid-19 wasn't kind to the shipping industry, and our operating results were rather miserable. Since the bungalow was kept at historical cost in our books, we saw the opportunity to recognise a substantial capital gain in the property market. But given that the financial year-end was looming, speed was of the essence. There was no time to run a public process, so I reluctantly agreed to purchase it.

Our CFO set the price using indicative valuations from various real estate sources, and of course, we saved on the seller's commission. The sale resulted in the recognition of an \$18 million profit for the company, putting us back in the black for the financial year.

I intended the house for my son but his wife didn't like it. So, after two months, I sold it. Thanks to the effervescence of the property market, I made a small gain of \$1.6 million. It was a win-win-win all round.

That was a year ago. Last month, a whistleblower wrote that I had deliberately retrenched the

expatriate to profit personally from the property sale. The CEO told our internal auditor, quite rightly, to ignore the letter as it was written anonymously. But annoyingly, the writer had sent a copy to SGX, who began asking questions. Now, our audit committee chairman is in the loop and wants to bring in an external audit firm to conduct an investigation of the whistleblowing report and a review of conflict of interest.

I disagree. After all, there's no conflict of interest here! It was all above board. The board was informed of the property sale, so nothing was hidden. I was not involved with the expat retrenchment (that was a management decision). And the property was sold to me for good pragmatic reasons – it was expedient and saved costs. So, where's the conflict?

I told the audit committee chairman that we can be open and just tell all this to the regulator and be done with it, instead of wasting everyone's time and more money on the auditors. But he's insistent on proceeding with the investigation.

Mr Sid, how do you think I should respond?

Yours in clear conscience,

Not-Conflicted

Dear Not-Conflicted

Since you emphasise that you are not conflicted, let me be clear: There *is* a conflict of interest.

The conflict of interest exists in your property transaction irrespective of the process by which it was conducted. Rather than deny the conflict of interest, you are better off justifying that the process was proper (although there were several gaps, which we will come to).

Definition

Let's start by defining what a conflict of interest is. The *SID Board Guide* states that: "A conflict of interest is a situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person's self-interest and professional interest or public interest."

In your case, a conflict of interest arose the moment you decided to buy the property. Your personal interest (securing a favourable price for the property) clashed with the company's interest (getting the highest price possible).

Dealing with conflicts of interest

Conflicts of interest are almost inevitable in business because of the sheer number of transactions and parties a company is involved with.

The best approach for dealing with conflicts of interest is to avoid them in the first place. Many firms, for instance, refrain from having directors who are already engaged with key counterparties to avoid potential conflicts of interest.

However, when prevention is not possible and a conflict of interest arises, the next best thing to do is to manage it. Here are some best practices that boards follow:

- Proactive disclosures of potential conflicts and immediate disclosures when they do occur.
- Recusal of conflicted directors from board discussions and voting on the transactions.
- Annual declarations of compliance with conflict-of-interest (and other) policies.
- When in doubt, assume there is conflict.

Regulations

The authorities can be quite unforgiving when it comes to conflicts of interest in order to protect public trust, ensure fairness and prevent corruption. Thus, some breaches of conflict of interest can be criminal offences in law.

In your case, the following rules are pertinent:

- Companies Act Section 156 and 157: A director must act honestly and diligently, and disclose any interest (direct or indirect) in any or proposed transaction with the company.
- SGX Listing Rules Chapter 9: An issuer should resolve or mitigate conflict situations. It must announce interested party transactions as soon as possible and obtain shareholder approval for those that cross certain thresholds.
- Financial Reporting Standards 24: The company's financial statements must disclose related party transactions.
- Code of Corporate Governance Provision 1.1 and Practice Guidance 1: The board should have clear policies and procedures for conflicts of interest. Directors facing conflicts of interest must recuse

themselves from discussions and decisions on those matters.

You should take SGX's interest in the case seriously. You might even be required to resign and be suspended from further listed directorships if found to be in serious breach of conflict of interest.

The expatriate's house

Responding to the several points you made about the house transaction:

1. **There's no conflict of interest.** There certainly is, as explained above.
2. **The board was informed.** Just informing the board (especially after the fact) is insufficient. Did you disclose your potential interest and obtain the audit committee (AC) and board's approval before executing the transaction? Did you recuse yourself from the board's discussion and decision-making on this matter?
3. **You were not involved with the retrenchment of the expatriate.** You are fine here. It does not matter who decided and why the expatriate was retrenched. The conflict of interest did not arise from the retrenchment nor even the decision to sell. It arose from the decision of who it was sold to (namely you).
4. **The property was sold to you for good, pragmatic reasons.** Expediency (if dressing up the books is considered pragmatic) and cost savings (no sales commission apply) may be good business reasons, but they are not enough to justify not handling a conflict-of-interest situation properly.
5. **It was all above board.** It is not above board when you did not run a public process on the sale. Just having the CFO (who is an employee of the company you chair) check around for indicative prices and then determining the offer price is not adequate for an arms-length transaction. The fact that you made a profit

with a resale soon after is indicative that the company did not get the best possible price for the house.

Your letter was not clear whether the following important processes required for such transactions were complied with:

- Review and approval of this as an interested party transaction by the audit committee and the board, and your recusal from the relevant meetings.
- Disclosure of this as a related party transaction in the financial statement for the year.

Optics

If we could turn the clock back, I would have advised avoiding the conflict of interest in the first place – even if the company could and did manage the conflict-of-interest situation properly in full compliance with all requisite processes, etc. This would have been the best decision, especially since you were initially reluctant to purchase.

You see, perception is important, sometimes more so than reality. As long as there is a personal benefit (which there is in this case), the court of public opinion will likely be against you. What you gain financially is offset by the adverse impact on your own and the organisation's reputation, not to mention the legal risks and erosion of stakeholder trust.

Whistleblowing

I have two concerns about the whistleblowing process within the company:

- Whistleblowing letters should not go to the CEO and certainly not to you (as you are the subject of the complaint). It should go only to the internal auditor and the AC chair.
- Whistleblowing letters should not be dismissed outright based on their being anonymous. All whistleblowing letters should be reviewed to determine whether the allegations are

substantive and substantiable. If so, they should be investigated.

You said the AC chair wants an external audit firm to conduct the investigation. That is the right thing to do from the company's standpoint. An investigation into this matter itself creates conflict-of-interest situations, and using an independent third party minimises them.

What now?

You should let the whistleblowing investigation run its course.

Be open and transparent about what happened, and do not get involved in the investigations (other than when requested by the investigators) or board deliberations and decision-making on the matter. (The deputy chair or lead independent director can take over the chairing of such discussions).

Based on the limited facts provided, my assessment is that you have likely breached regulations and, certainly, good governance practices in this transaction. If you agree with this conclusion, you should consider returning your "small" profit on the house to the company. That way, you demonstrate that your purchase was purely to benefit the company and not yourself.

In the meantime, you should seek to fix the whistleblowing and conflict-of-interest processes per the above suggestions.

All the best in resolving this situation.

Yours sincerely



Mr Sid

Who is Mr Sid?



Mr Sid is a meek, mild-mannered geek who resides in the deep recesses of the reference archives of the Singapore Institute of Directors.

Burrowed among his favourite *Corporate Governance Guides for Boards in Singapore*, he relishes answering members' questions on corporate governance and directorship matters. But when the questions are too difficult, he transforms into Super SID, and flies out to his super network of boardroom kakis to find the answers.

Mr Sid's References (for this question)

Board Guide
Section 5.4: Duty to Avoid Conflicts of Interest
Appendix 5D: Duties Related to Conflicts of Interest
Appendix 5E: Sample Disclosure of Director's Interests
Appendix 5F: Conflict of Interest Transactions
Appendix 5G: Disclosure Guide for Conflicts of Interest

Audit Committee Guide
Section 3.4: Whistleblowing
Section 3.7: Interested Person and Related Party Transactions
Appendix 3B-9 Identifying Potential IPTs and RPTs
Appendix 3J: Sample Whistleblowing Policy
Appendix 3K: Whistleblowing Operations
Appendix 3O: IPT Definitions and Requirements
Appendix 3P: RPT Definitions and Requirements

Boardroom Matters
Vol 2, Chapter 29: "Whistleblowers: The Director's Ally" by Michael Gray
Vol 3, Chapter 39: "Duties and Consequences of Conflict of Interest Situations" by Gerard Tan
Vol 3, Chapter 40: "Perception is Reality in Conflicts of Interest" by Gerard Tan
Vol 3, Chapter 41: "Determining Interested Persons and Related Parties" by Gerard Tan
Vol 3, Chapter 42: "How Would You Know That It is a Conflict of Interest" by Gerard Tan
Vol 4, Chapter 38: "Responding to Anonymous Whistleblowers" by Willie Cheng
14 November 2022: "How should a director respond to a criminal investigation?" by Loong Tse Chuan

SID Directors Bulletin
2018 Q4: "The Morality of Doing Business Purposefully" by Abhijeet Vadera and Gerard George

SID Statement of Good Practice
SGP 13 (2014) Whistleblowing Policy

SID Courses
Listed Entity Director Programme:
- LED 1 (Listed Entity Director Essentials)
- LED 5 (Audit Committee Essentials)