Thought Leadership Insights

April 2019

Alignments:
Directors' Corporate Governance Responsibilities In Nigerian Companies

Thought Leadership by:

Titilade Adelekun Ilesanmi

t.adelekun@lelawlegal.com

> "A Critical Objective Of CG Is To Ensure Effective Communication Between Shareholders And Directors Of The Company. In Order To Keep Stakeholders Conversant With The Activities Of The Company"

Corporate Governance (CG) is how a company is directed and managed in achieving its objectives subject to relevant rules and regulations. It is essential for the smooth running and decision making process of a company, thus ensuring transparency; accountability in the directors' dealings; protection of stakeholders' interest; improving the share value of public companies in the stock market; and boosting investor confidence in a company.

In Nigeria, CG is primarily governed by ***the Companies and Allied Matters Act (CAMA),***[1] ***Financial Reporting Council of Nigeria Act,***[2] ***(FRCN Act) FRCN National Code for Corporate Governance, 2018 (FRCN Code*** or ***the Code)***[3] and other sectoral codes of corporate governance, such as: ***Securities and Exchange Commission Code of Corporate Governance for Public Companies, 2014 (SEC Code); National Insurance Commission Nigerian Code of Corporate Governance for the Insurance Industry, 2009 (NAICOM Code); Central Bank of Nigeria Code of Corporate Governance for Banks and***

1 ***Cap. C20, Laws of the Federation of Nigeria (LFN), 2004.***

2 ***Act No.6 of 2011.***

3 ***Paragraph 1(1), Regulation on the Adoption and Compliance with Nigerian Code of Corporate Governance 2018*** describes the applicability of **the Code** as follows: *" From the commencement of this Regulation, the following entities shall adopt and comply with Nigerian Code of Corporate Governance 2018, which is the Schedule to this Regulation: (a) all public companies (whether a listed company or not); (b) all private companies that are holding companies of public companies or other regulated entities; (c) all concessioned or privatised companies; and (d) all regulated private companies being private companies that file returns to any regulatory authority other than the Federal Inland Revenue Service (FIRS) and the Corporate Affairs Commission (CAC)."* Pursuant to ***Paragraph 2(2)***: *"These entities shall report on the application of the Code in their annual reports for financial years ending after January 1, 2020 in the form and manner prescribed by the Financial Reporting Council of Nigeria."*

Discount Houses in Nigeria, 2014 (CBN Code); Nigerian Communications Commission Code of Corporate Governance for Telecommunications Industry, 2016 (NCC Code); National Pension Commission Code of Corporate Governance for Licensed Pension Operators, 2008 (PENCOM Code), etc.[4]

Directors on the other hand are regarded as the *alter egos* of a company, appointed by shareholders to direct and manage its affairs on their behalf: ***section 244(1) CAMA***.[5] Their effectiveness is hinged on ensuring a Board that comprises the right balance of Non-Executive Directors (NED) and Executive Directors (ED), with requisite diverse knowledge, experience and skills that will help in properly governing the company.[6] In addition, the directors must be trusting and understanding of each other. Also, Board Committees must be effective.

The process and structure of decision-making in an organisation can cause conflict between the shareholders and management of a company. However a major objective of CG practice is addressing and balancing these conflicts of interest that may arise between the shareholders and the management of a company These conflicts may be as a result of perceived low levels of effort (inadequate attention to directors' duties) or lack professionalism to the company especially if they are not 'owners' and seen to be more interested in the perquisites of office (director's fees, sitting allowances, bonuses, benefits-in-kind, etc.) from the company; the tendency for directors to be more concerned with increasing the size of the company rather than the size or returns to the shareholders, because their take home entitlements is tied to the size of a company etc. [7]

Thus, CG exists to ensure that shareholders (or the company itself) are not left at the mercy of directors. In furtherance of this, the law alongside various codes and principles of CG have created a form of checks and balances for shareholders to monitor the activities of the Board. A statutory requirement for example is that the Board is mandated to present a report on the financial performance of the company to the shareholders at the Annual General Meeting, for the previous year and at the end of that year - ***section 334(1) and (2) (b) CAMA.***

This article seeks to highlight some of the "stay awake" areas of CG that could be potentially breached by directors and how they can be addressed and balanced.

Director and Shareholder Relations

A critical objective of CG is to ensure effective communication between shareholders and directors of the company in order to keep stakeholders conversant with the activities of the Company. ***Article 27.1 FRCN Code*** *provides that "the Board should adopt and implement a stakeholder management and communication policy"*; while ***Article 28.9 FRCN Code*** also provides that *"Companies should establish policies and procedures for the identification, communication and response to concerns from stakeholders."* Generally, management and ownership in large corporations are separate, thus shareholders are left with trusting that the management will run the company in their interest.

By ***Article 24.3.2 FRCN Code***,[8] directors owe a fiduciary duty to the company[9] to ensure that they exercise their powers and discharge their duties honestly, in good faith and in the best interest of the company.[10] Thus, stakeholders are entitled to directors' 'best' services.[11] But this has not entirely been the case, as instances abound of directors' involvement in corporate malpractices that are inimical to corporate and stakeholders' interests.

Notorious examples include insider loans, non-performing loans, insider dealings, conflicts

4 Situations may arise where two (2) codes have different provisions or requirements on the same issue. Whilst the draft **FRCN Code** (***Paragraph 2, Relationship with Sectoral Guidelines***), provided that *"where there is a difference between the provisions of this Code and any sectoral governance guidelines, the stricter provision shall apply"*, the issued **FRCN Code** omitted such provision. However, ***Article 1.3(g) SEC Code*** (which has narrower applicability than the **FRCN Code**) provides to such effect that: *"Where there is a conflict between this code and the provisions of any other code in relation to a company covered by the two codes, the code that makes a stricter provision shall apply."*

5 This was also judicially confirmed by the Supreme Court (SC) in ***Longe v. FBN Plc (2010) LPELR-1793(SC).***

6 Since the board typically comprises people of diverse backgrounds, personality types, and viewpoints, it is unlikely for directors to always agree on every issue. Thus, it is essential that a company has an issue driven voting system that is likely to result in decisions that are in the best interest of the company.

7 Abraham Hongze Lu and Didier Cossin, ***'The Four Tiers of Conflict of Interest Faced by Board Directors'***, *IMD Global Board Centre:* https://www.imd.org/board/publications/the-four-tiers-of-conflict-of-interest-faced-by-board-directors/ (accessed 18th June 2018).

8 This is also statutorily enshrined in ***sections 279 and 282 CAMA.***

9 Directors do not solely by virtue of their office, owe a fiduciary duty to the company's shareholders; they do so only to the company. See ***Sharp and Ors v. Blank and Ors [2015] EWHC 3220 (Ch) at 15***, where the England and Wales High Court (EWHC) held that if directors owed a fiduciary duty to the shareholders it would create *"harassing actions by minority shareholders, and expose directors to a multiplicity of actions, each shareholder having his own personal claim."*

10 Being a director requires time and effort, thus it is advisable that directors do not sit on too many boards, in order to give them enough time to process and make informed decisions: ***Article 2.8 FRC Code.***

11 ***Delta Steel Nigeria Ltd. v. American Computer Tech Inc. [1999] 4 NWLR (Pt. 597), 53.***

of interest, etc. dominant in the banking industry. The eras of failed banks in Nigeria (in the early/mid 1990s and mid/late 2000s), properly exemplifies the foregoing. For example, the latter led to regulatory induced restructuring/consolidation as a result of weakened balance sheets reflective of negative shareholder equity mostly due to improper transactions leading to non-performing loans.

In 'the second bank failure era', the then CBN Governor, Mallam Lamido Sanusi publicly announced that based on findings by the CBN and Nigeria Deposit Insurance Corporation (NDIC), five banks (Affected Banks), had been found to be in *'grave situation'* within the context of ***section 35 Banks and Other Financial Institution Act (BOFIA)***.[12] ***Section 35*** provided for *"failing bank and powers of the Governor to act thereon."*[13] At the heart of their findings was the ripple effect of the 2007 global financial crisis leading to high level of non-performing loans in the Affected Banks attributable to poor CG practices.

For instance, some directors obtained unsecured loans from their banks; some Boards lacked independence as the Board was easily influenced by the CEO or Chairman; Board Committees were dormant, etc.[14] Consequently, the CBN exercised its powers under ***sections 33 and 35 BOFIA*** and injected about ₦400 billion as Tier II Capital in the Affected Banks; removed the Managing Directors and executives of the Affected Banks and appointed new ones; and made various directives at the Affected banks such as restricting credit grants, declaration of dividend, holding Annual General Meetings etc.[15]

However, even after the regulatory induced restructuring of the banking sector, non-performing loans which was at the heart of the problem, is rearing its head again. Recently, due to the rising non-performing loans, the CBN stopped payment of dividends by Deposit Money Banks (DMB) and discount houses with huge bad loans and low capital base.[16]

From the foregoing, it can be gleaned that some directors in the banking industry, in breach of CG principles at some point, acted more in self-interest and at the expense of shareholders/their banks. Therefore key safeguards such as: (a) directors discharging their duties with due care and diligence; (b) directors serving as each other's watchdog on the Board, prioritizing the interest of the company (since directors have collective or joint and several liability)); and (c) the Board/ company adhering to international CG best practices such as Board evaluation, diversity and balance in Board composition, etc. are very helpful.

Nonetheless, it is important to point out that a director is not automatically guilty where a company is found to have committed an offence, he must have been involved in taking decisions in the company: ***Olawepo v. SEC***.[17] It is also important to be mindful of

12 ***Cap. B3, LFN 2004.***
13 Professor Konyinsola Ajayi (SAN), ***'The Bank Director: Duties and Imperative of Corporate Governance',*** *The Gravitas Review of Business & Property Law, June 2015, Vol.6. No.2, Page 12.*
14 Sanusi Lamido Sanusi, ***'The Nigerian Banking Industry: What Went Wrong and the Way Forward'***, *Speech at Bayero University, Kano, 26 February 2010:* http://w1219.cbn.gov.ng/OUT/SPEECHES/2010/THE%20NIGERIAN%20BANKING%20INDUSTRY%20WHAT%20WENT%20WRONG%20AND%20THE%20WAY%20FORWARD_FINAL _260210.PDF (accessed 12th July 2018).
15 ***'CBN sacks 5 banks' CEOs, appoints acting MD/CEOs'***, *The Vanguard, 14th August 2009:* (accessed 28th March 2019).
16 *Paul Ogbuokiri* ***'Fear Rises Over Banks' Non-Performing Loans'***, *The New Telegraph, 11th March 2018:* (accessed 6th August 2018).
17 ***[2011] 16 NWLR (Pt. 122), 131.***

section 65 CAMA provision that: *"any act of the members in general meeting, the board of directors, or of a managing director while carrying on in the usual way the business of the company shall be treated as the act of the company itself and the company shall be criminally and civilly liable therefore to the same extent as if it were a natural person."*

Financial Reporting and Auditing

Directors are obliged to keep proper and accurate records of accounts and prepare Financial Statements (FS) yearly, and the Board is expected to ensure the integrity of annual reports and accounts and all material information provided to regulators and other stakeholders: ***Article 1.15 FRCN Code.***[18] Also ***Article 28.1 FRCN Code,*** mandates the Board to include a corporate governance report in the Company's annual report.

Indeed there are penalties for non-compliance, such as provided in ***section 333 CAMA,***[19] which states that "*Where a company fails to keep proper accounting records, every officer of the company who is in default shall be liable to imprisonment not exceeding 6 months or fine of N500."* The FS and accounts is one of the principal way directors remain accountable to shareholders, and for shareholders to monitor and evaluate the company's financial performance and reporting systems; and also oversee the integrity of the external audit.

However, there are numerous instances of directors doctoring reports in order to *"improve the optics"* of the financial position or reported performance of a company; this is often deceptive to shareholders and investors. Meanwhile, FS are expected to represent a 'true and fair' reflection of the company's financial position. The corporate failures of *Enron Corporation (Enron)* and *MCI Worldcom* where the directors with the connivance of auditors concealed the true financials of the company, very well illustrate these CG malfeasances.

In ***Enron***, the Chief Financial Officer and some company executives were involved in illegal accounting practices which concealed company debts from failed projects, running into billions of dollars. The external auditors, *Arthur Andersen then one of the 'Big Five'* ignored these issues by failing to provide an objective and unbiased audit report showing Enron's financial position. Eventually, the massive fraud in Enron was uncovered through a whistle-blower who exposed the misdeeds of the company's executives. Subsequently the company filed for bankruptcy, some of its executives were jailed and Arthur Andersen dissolved by an order of court for its lack of professionalism in accordance with accounting standards.[20]

Another fallout of doctoring reports is declaration of dividends on fictitious profits by directors, thus consequently leading to payments out of the company's capital. For example in 2017, it was reported that a company in the energy sector reportedly declared improper dividends and such led to huge furore, leading to suspension of the company's shares on the stock exchange. This has generated a lot of follow on actions including forensic investigations. This mischief is targeted, for example, by ***Section 386 CAMA***, which provides that *"any director who knowingly pays or are a party to payment of dividends out of capital will be personally jointly and severally to refund the sum back to the company."*[21]

18 ***Article 3.1(h) SEC Code, Article 5.06(iv) NAICOM Code, Article 5.2.5 CBN Code.***

19 See also ***Section 24 BOFIA,*** which provides that *"If any person being a director, manager or officer of a bank fails to take all reasonable steps to secure compliance with keeping proper books of account or has by his wilful act been the cause of any default thereof, such officer shall be liable to a fine of N10,000 or N50,000 respectively , or liable to both such fine and imprisonment of not exceeding 10 years."*

20 C. William Thomas, ***'The Rise and Fall of Enron'***, 'Journal of Accountancy', 1st April 2002: (accessed 13th July 2018).

21 ***Article 16.10 FRC Code*** - *"Clawback can be triggered if the account or financial performance on which the reward was based is later found to be materially false, misstated, misleading, erroneous, etc..."*

Good CG is benched on having transparency in FS. Where this is not practiced the core of an organisation is threatened as was the case with some Nigerian subsidiaries of leading fast moving consumer goods (FMCG) players in 2006. There, external auditors allegedly failed in their duties, compromised their independence to issue flawed FS, largely as a result of *"strong relationships"* with some executives.[22]

The need for auditors to proactively check the soundness of the company's internal controls and recommend changes and improvements where required, cannot be overemphasized. Window dressing reports by directors for better financial 'optics' have not been uncommon in recent times; thus companies need to be alert and ensure that the necessary preventive measures are in place to guard against such behaviour.
This may include having functional Board committees to serve as checks; ensuring the Chairman/CEO position is not held by the same individual; having a balanced Board comprising of the requisite number of NEDs and EDs etc. In normal circumstances any act committed by the management in the usual way of business will be considered as an act of the company and the company can be criminally or civilly liable therefor.[23]

However, *"where an offence is committed by a company in connivance with or attributable or negligent of a director or any officer of the company, such director or officer shall be deemed to be guilty of the offence and liable to be proceeded against"*: ***Olawepo v. SEC.***[24] In ***Mandilas & Karaberis Limited & Anor v. Inspector-General of Police,***[25] the SC held the company and its managers jointly liable for stealing by fraudulent conversion. The foregoing provides deterrence framework against companies' committing corporate crimes which would turn out to negatively impact the general public. In this way, Corporate Criminal Responsibility (CCR) is a veritable tool in incentivising appropriate and ethical business behaviour.[26]

Whistle-Blowing

Internal Control Systems (ICS) are the control measures put in place by a company to avoid, identify and restrict the consequence of corporate failures. It is an aspect of CG because the Board is responsible for ensuring safety of assets and interests of the company through an effective ICS.

A major feature of ICS is whistle-blowing. This is when a person exposes any activity or information that is illegal, unethical, or improper within an organization, such disclosure must be made in the reasonable belief that it is in public interest.[27] ***Article 19 FRCN Code*** provides for recommended practices for an effective whistle-blowing framework for reporting any illegal or unethical behaviour. For example, ***Article 19.1 FRCN Code*** provides that *"the Board should establish a whistle-blowing framework known to employees and external stakeholders, to bring unethical conduct and violations of laws and regulations to the attention of an internal and/or external authority..."*

Directors who are expected to ensure that an appropriate system of ICS is in place and oversee a formal risk management process for example under ***Articles 1.12 & 1.16 FRCN Code***[28] are in most cases at the receiving ends of a whistleblowing procedure, like in *Enron's case*. Several other examples of whistle blowing has exposed high profile corporate scandals such as the one involving ***Olympus Corporation (Olympus)***.

22 See Titilade Adelekun Ilesanmi, ***'Attentions: Auditors Independence and Sound Financial Reporting in Nigeria'***, *LeLaw Thought Leadership*, October 2018: http://www.lelawlegal.com/pdf/Auditors%20Independ ence.pdf (accessed 28th March 2019).
23 ***Section 65 CAMA.***
24 ***[2011] 16 NWLR (Pt. 122), 131 at 146, F-G.***
25 ***[1958] 3 FSC 20.***
26 See Yewande Obayomi, ***'Some Thoughts on Corporate Criminal Responsibility in Nigeria'***, *LeLaw Thought Leadership*, September 2017: http://lelawlegal.com/pdf/Corporate-Criminal-Responsibility.pdf (accessed 24th March 2019).
27 Here, the English Court of Appeal (CA) decided that an employee had a reasonable belief, that his disclosures about his employer's manipulation of profit and loss accounts were made in the public interest, despite his personal motivation in doing so: ***Chesterton Global Ltd v. Nurmohamed [2017] EWCA Civ 979.***
28 ***Article 6.1.2 CBN Code; Article 3.1(b) & (d) SEC Code;*** and ***Article 5.06(i) NAICOM Code.***

In the *Olympus scandal,*[29] Michael Woodward (Woodward) former Chief Executive Officer (CEO) and President of Olympus discovered various inappropriate accounting practices such as irregular payments for acquisitions, concealment of investment losses, etc. and when he questioned these practices he was unexpectedly ousted from his position barely seven (7) months after his appointment. Woodward proceeded to carry out his own investigations and also assisted the authorities in their investigation by providing relevant information and documents. The truth came out and Olympus admitted to inappropriate accounting practices. As a result of his bravery and whistleblowing, Woodward was recognised with various awards and money sum by the court as damages for defamation and wrongful dismissal.

Whistle blowing in Nigeria has recorded a few successes. As at April 2018, the Federal Government reported 8,373 enquiries and 1,231 tips since its whistleblowing policy was introduced in 2016. Consequently, upon completion of investigations, ₦7.8 billion, US$378 million and £27,800 have been recovered so far pursuant to the policy. [30]

The value of having an effective whistle blowing platform should not be underestimated. Thus companies are urged to have a policy that encourages staff and other relevant stakeholders to report any unethical or illegal conduct Also, such platforms should be anonymous so that whistle-blowers will not be identifiable and consequently subject to harassment or victimization in the place of work.[31] ***Olympus*** shows that whistle blowers need not be only low or mid-level personnel. The company secretary also has a responsibility to assist in facilitating a whistle-blowing policy and can help to implement whistle-blowing as an internal regulator for ensuring good CG to 'balance' the powers of the directors.

There are certain elements that must be comprised in a good whistle blowing policy. According to ***Article 19.2 FRCN Code***, the policy must be reliable, accessible and guarantee the anonymity of the whistle-blower, and that all disclosures resulting from whistleblowing are treated in a confidential manner. The identity of the whistle-blower should be kept confidential, thus protecting the whistle-blower from victimisation or discrimination for exposing information: ***Article 4.0 CBN Code***. Also there must be zero tolerance for false or malicious whistle blowing; specifying a type of misconduct level of proof needed; promised confidentiality on reports to eradicate fear; informing the whistle-blower of the outcome of the investigation, etc.[32]

Conclusion

Good CG practice no doubt has a multiplier effect on corporate success and wellbeing of an organisation. Directors, by virtue of their sensitive positions, are to demand a high level of professionalism from themselves. This is consistent with ***sections 279-282 CAMA*** provisions that directors shall discharge their duties of their office honestly, in good faith and in the best interests of the company, and shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances.[33]

LeLaw Disclaimer

Thank you for reading this article. Although we hope you find it informative, please note that same is not legal advice and must not be construed as such. However, if you have any enquiries, please contact the author, Titilade Adelekun Ilesanmi at t.adelekun@lelawlegal.com or email: info@lelawlegal.com.

29 Floyd Norris ***'Deep Roots of Fraud at Olympus'***, *The New York Times - Business Day, 8th December 2011*: (accessed 13th July 2018).

30 Joseph Jibueze and Nduka Chiejina, ***'Whistle Blower Policy Yields ₦132bn'***, *The Nation Newspaper, 14th April 2018*: http://thenationonlineng.net/whistle-blower-policy-yields-n123bn/ (accessed 3rd March 2019).

31 ***Article 5.3 CBN Code.***

32 CPA Australia, ***'A Good Practice Guide to Whistleblowing Policies'***, 'Good Corporate Guide', *May 2007*: http://governanceforstakeholders.com/wp-content/uploads/2013/04/Whistleblower-policy.pdf (accessed 7th August 2018).

33 See also ***RE: Oshinowo (1969) LPELR- 25541(SC), paras. B-E***, where **Coker JSC** stated: "*… a director certainly is not expected to abdicate his responsibility but he is undoubtedly entitled to rely on the judgments of responsible assistants with the requisite knowledge, training and expertise…*"

©LeLaw Barristers & Solicitors 2019
Plot 9A, Olatunji Moore Street, off TF Kuboye Road, Lekki Phase 1, Lagos, Nigeria.
Website: www.lelawlegal.com; Email: info@lelawlegal.com.