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GOVERNANCE ISSUES IN MALAYSIA'S LIMITED LIABILITY PARTNERSHIPS (LLP)

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Abstract: *Limited liability partnerships (LLP) are a new hybrid business vehicle in Malaysia that are governed under the Limited Liability Partnerships Act 2012. The main uniqueness of LLPs is that they can be set up not only by business partners, but any two or more individuals - from family members, professionals, and other legal entity such as the Federal Teritory of Labuan or even the Football Association of Malaysia (FAM). This paper dliberates the corporate governance models from the other countries that are pertinent to the current practices for LLPs. In comparison with other countries such as United Kingdom, India and Singapore, the Malaysian LLP has similar attributes as a body corporate, offering internal flexibility similar to a partnership, but regulated by the members' or partnership agreement. Despite being a body corporate, LLPs face the inappropriteness of direct applications of corporate governance principles, as profound systems to control and manage LLPs within the accontability of its partners and stakeholders. Thus, this paper highlights the major governance issues for the LLPs in Malaysia: inclusive jurisdictions or legal issues and other aspects.*

Keywords: *Limited liability partnership, governance issue, governance principle*

I. INTRODUCTİON

A Limited Liability Partnership is an alternative business vehicle newly introduced in Malaysia that combines the characteristics of a private company and a conventional partnership. They are regulated under the Limited Liability Partnerships Act 2012. LLPs may be formed by professional partnerships such as lawyers, chartered accountants, contractors, surveyors, and Company Secretaries, for the purpose of carrying on their professional practice (Morris, P. and Stevenson, J., 1997; Abd. Ghadas, Z.A., 2013; Abd. Ghadas, Z.A., 2013). Given that the liability of the partners of an LLP is limited, the LLP business vehicle has gained popularity among start-ups and smallmedium enterprises ("SMEs to grow their businesses without having to worry about their personal liabilities and personal assets (Kashyap, D. and Kashyap, A.K., 2010).

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Small Medium Enterprise (SME), normally start as sole proprietorship or partnership entities that comprise of either family members, friends or business partners with common interest in expanding the business. These types of entity do not limit the liability of the individual or partners in such cases of financial obligations, taxation or bankrupcy - since there is no limited liability (unlike in limited companies). Therefore in order to expand, businesses will have to change their entity structure to a limited company or corporation, to ensure the benefits of the partners or shareholders can be well protected. LLPs therefore become a new solution for entrepreneurs to resolve these limited liability issues (Po, F. and Lum, P., 2013).

In the example of a family business becoming an LLP, it can be seen that the business structure intertwines with the issue of good governance, since the ownership structure is characterized by significant family control and interlocking shareholdings among affiliated firms (Khan, H. A., 2003). The excessive powers of the dominant family member(s) as the majority shareholder(s) raise the likelihood of pursuance of their personal interests at the expense of minority shareholders, creditors, and other stakeholders. Therefore good corporate governance is an important consideration because of these overlapping personal relationships between members, who are operating with the legal structure of a business as a body corporate (Goh, K.S., 2008).

Similar to a family business, an LLP ownership structure is based upon certain "personal relationships" between partners which arises from the requirement of trust and fiduciary duties under the partnership agreement (Steele, M.T., 2007). With such disparity from the conventional corporate structure, it is observed that the corporate governance framework of LLPs cannot be similar to a company, albeit its similarity with body corporate status (Abd. Ghadas, Z.A., 2013).

II. METHODOLOGY

This research adopts a legal methodology to achieve the objectives of the research. In building the literature review, and carrying out an investigation of the concepts of corporate governance for LLPs, statutory and doctrinal analyses are applied. The doctrinal legal approach relies heavily on primary sources of law, which includes legislation, legal cases, and other legal documentation. Additionally secondary sources are also used, which include journal articles and case commentaries.

III. RESULTS AND DISCUSSION

Limited Liability Partnerships (LLPs)

LLPs are a unique business vehicle as they are a hybrid business structure which combines the best attributes of a company, and the best attributes of a partnership (Suresh, I., 2010). Its external attributes are generally similar to a company, with a separate legal entity, perpetual succession and ability to limit liability of its members. On the other hand, the internal regulation of a LLP is governed by an agreement between the members, which is generally similar to a partnership.

LLPs are a body corporate, and have a legal personality separate from its partners (which are separate legal entity) (Walker, J., 1998). At any time, two or more individuals or body corporates may form an LLP as a separate entity for any lawful business in accordance with the terms of an LLP agreement executed between them. The liabilities of the partners of an LLP are limited, and have unlimited capability in conducting business, and holding property. An LLP is also capable of suing and being sued, has a perpetual succession so any change in the partners of the LLP will not affect the existence, rights or liabilities of the LLP. LLPs also provide stakeholders with freedom and flexibility to select a suitable business model with their business structure through the partnership agreement.

Interestingly LLPs' legal status differs according to the recognition of the law of the country. At present LLPs can either have the legal status of a partnership (a legal entity which is not a body corporate), or a legal entity as a body corporate. In the United Kingdom for example, off-shores' LLPs (such as those in the Isle of Jersey) have the status of a legal entity which is not a body corporate; whilst in mainland UK LLPs have the status of a body corporate. This shows that there is no common or standardized legal status for LLPs.

Limited Liability Partnership (LLP) in Malaysia

In Malaysia LLPs (or better known in Malaysia as *Perkongsian Liabiliti Terhad)* are regulated by the Limited Liability Partnership Act 2012 (Act 743) (LLP Act 2012) (Bishop, C.G., 1997). It has become a popular new form of business vehicle since it combines the characteristics of a company and a partnership firm, providing the protection of limited liability for its partners, and the flexibility of the partnership arrangement for the internal management of its business (Birds, J., 2000). Some important aspects of Malaysian LLP are:

1. LLP Registration

Under Section 10 (1) of the LLP Act 2012, formal registration is required for an LLP. However, the partnership agreement is not required to be lodged in the incorporation documents with the Registrar (section 10(2)). Memberships of the proposed LLP are open to both natural and artificial person (section 6), and although there is a statutory requirement for the minimum number of members (two) (section 6), there is no restriction on a maximum number of members. In the case that the number of partners falls below two, the LLP can still operate within a grace period of no longer than six months (or longer if determined by the Registrar) (section 7(1)). Failure to fulfil the minimum requirements shall make the partners jointly and severally liable with the LLP for all the LLP's obligations (section 7(2)).

2. Legal Status

Malaysian LLPs are generally similar to British, Singaporean and Indian LLPs, whereby the LLP shall have the status of a body corporate (section 3(1). With body corporate status the LLP has similar attributes to a company - i.e. separate legal entity, right to acquire and own property, perpetual succession, right to enter legal proceedings, and to limit liability of its partners.

Liability of Partners

Different from a company - where all members have limited liability against debts of the company (Salomon v. A. Salomon & Co. Ltd., 1897) - the protection of limited liability of partners in LLP is only partial. This is because under the Act, although the LLP shall be liable for all claims against it (section 21(2)), the defaulted partners who caused or contributed to the claims shall be jointly liable with the LLP for the claims of the third party (section 21(3); (4)). Innocent partners however are protected from any liability against the third-party claims as the LLP shall be liable for them (section 27(3)).

Internal Regulation

LLPs are governed by the partnership agreement (section 9(1) (a)), and in the absence of a partnership agreement, the default rules as provided in the Second Schedule of the Act shall apply (section 9(1) (b)). The Act also provides that all partners are only agents to the LLP (section 23(1)), and that the LLP shall be liable for any act of the partners, which are committed within the partners' authority (section 23(2)).

Protection of Third Parties

The Act applies the claw-back mechanism, whereby in the event that the LLP is insolvent, the partners who have received any distributions from the LLP within the period of two years before the commencement of the winding up shall be personally liable to the third party, providing protection for creditors (section 22(1)(a) and (b)).

Corporate Governance

The essential ingredients of good corporate governance include honesty, trust and integrity, complete transparency, accountability and responsibility, protection of stakeholders interests and satisfaction, participation, business ethics and values, performance orientation, openness, mutual respect, and commitment to organisation. Convincing sincere compliance or adherence to these principles paves the way for the sustenance of business corporation, realisation of corporate goals and appreciable turn out in theveritable global marketplace (Mohd Ghazali, N.A., 2010).

The movement towards good corporate governance has surged globally, and this is reflected in a wave of dismissals of CEOs of mega corporations such as IBM, Kodak, Honeywell, and others, by their boards of directors - which consequently led to increased shareholder and government interest in corporate governance. The espoused principles of corporate governance are laid down as follows (Raut, S., 2003):

Rights and Equitable Treatment of Shareholders

There are certain rudimentary rights of shareholders which organisations must respect and strictly uphold. Shareholders should equally be allowed to exercise their rights without fear or favour. Organisations are duty bound to give clear interpretation of these rights for clarity by the shareholders, as well as ensuring shareholders' participation in the affairs of the corporation through general meetings.

Integrity and Ethical Behaviour

This is key to the practice of good governance. It involves ethical and responsible decision making - which is necessary for managing risk and avoiding legal issues. Corporate organisations should develop a clear code of conduct to guide the undertakings of their directors and executives to enhance their sense of duty and consciousness in the interest of all stakeholders.

Disclosure and Transparency

Good corporate governance requires a high level of accountability.Organisations should make substantial efforts to publicise the roles and responsibilities of board members and the management team, in order to make them accountable to shareholders. There should also be set of procedures to ensure independent verification of the company's financial reporting to safeguard the integrity of the organisation. All investors should have access to timely and balanced disclosures of materials and information pertaining to the organisation.

Mechanisms and Controls

In ensuring the effectiveness of the aforementioned principles, certain mechanisms have been designed by experts to control and reduce the inefficiencies that can arise from moral hazards and adverse choices, in relation to corporate governance. For instance, the behaviour of managers can be monitored and checked by an independent third party in the name of an external auditor, who attests to the accuracy of the information provided by the management to investors. Other mechanisms of control for the effectiveness of these principles include monitoring by the board of directors, internal control procedures and internal auditors, mitigating a balance of power, standardized remuneration, and internal competition. External mechanisms may include takeovers, media pressure, and surveillance, as well as government regulations.

3. CORPORATE GOVERNANCE İN MALAYSİA

There is significant concern about the governance of businesses in Malaysia – particularly to ensure that entities are free from fraud and corruption, and that they practice transparency in their operations locally and globally (Gregory, H.J. and Simms, M.E., 1999). The Malaysian Code of Corporate Governance (MCG) was introduced in 2000 (and was reviewed twice in 2007 and 2012). To further strenghten corporate governance and investor confidence the 2016 MCCG is currently under review by the Securities Commission of Malaysia. The MCCG has become the fundamental document for Malaysia's corporate governance standards that has significantly improved the governance of Malaysian listed companies. The primary focus of this corporate governance is to ensure more definite roles for the key stakeholders, in order to meet their demands and challenges (Zabri, S.M, e, al., 2016).

In the early stages corporate governance focused on the 'comply and explain 'ability to improve several aspects of companies' governance; however this still lacked in regards to surveillance and enforcement functions of the regulators. The new 2016 MCCG adopts a new approach of 'apply or explain an alternative', whereby companies are required to provide clear and meaningful explanation on how they have adopted better or progressive corporate provisions for meeting the neesd of the company and its stakeholders. This new approach divides corporate governance practices into two categories of *Core and Core+* practices whereby:

> "*Firstly companies are required to disclose their adherence to the Core practices on an 'apply or explain an alternative' basis. (Explanation in Section 2.0). And in addition to Core practices, the MCCG 2016 identifies a new Core+ category, consisting of exemplary practices that companies should aspire to achieve. While these practices are voluntary, companies are strongly encouraged to adopt them and disclose in the annual report how these practices are being undertaken or implemented*."

The four main principles of Malaysian corporate governance are: supporting board leadership and effectiveness, safeguarding the integrity of financial and corporate reporting, managing risks to preserve and create value, and strengthening relationships with shareholders. It has a focus on practices - i.e. actions, procedures, or processes which companies are expected to adopt, in order to support the long term success of the company, promote market confidence, and ensure business integrity.

If the company is unable to adopt the practices as specified, it must provide clear explanation for its non-adoption of the practices, and demonstrate how an alternative practice which it adopts is able to fulfill the intended outcome. Shareholders should also carefully consider the explanations provided by the company to ensure that the company is well-governed and demonstrating an intention to improve their practices. Where necessary and relevant, shareholders should consider requesting an explanation or clarification on their policies and practices.

Since the existing corporate governance framework is designed for public listed companies in Malaysia, there is no evaluation of the suitability of the specification for the new LLP entity. Previously it has been acknowledged that LLPs are not audited, and by right need not have the same detailed accounting or taxation procedures as companies. Therefore, finding the best corporate governance model as a framework for LLPs in Malaysia needs to be further investigate by scholars.

4. GOVERNANCE ISSUES IN LIMITED LIABILITY PARTNERSHIPS IN MALAYSIA

The governance of LLPs in Malaysia must take into consideration its unique nature of formation, the characteristics and the interests of various stakeholders, and the existing governance frameworks that focus on the corporate entities. These concerns underlie the governance issues that can be further investigated for the benefit of the LLPs in Malaysia – which include:

LLP Business Purposes and Governance Roles

LLPs originate from groups of individuals who become partners and share the same purpose doing business. An LLP is a legal entity by law that is constructed to accumulate capital and fund larger scale entrepreneurial activities, and share knowlege and expertise - at certain risks, which are shared. Being a profit making entity, LLPs must ensure that all partners understand the roles of governance in business practices, especially in managing the resources and receiving the residual profits. The ability of an LLP to return the partners' investements is crucial, as this provides a metric of whether the LLP is effective and efficient inits business conduct. Nevertheless, the purpose of an LLP should not only be maximising the partners' profits values, but should also be expanded to adding broader societal value. There should be a balance in the LLP's interests within the LLP Act, and its contribution to the society as a whole.

Two scholarly points of views can be reffered to concerning the balance in goverenance roles and the resposibilities of LLPs. Firstly, LLPs should focuss on improving the attention to financial reporting and compliance, and the member independence fuctions. Though LLPs are not required to undergo accounting audits, they have to follow the rules set by SSM for preparing the proper accounting documents for checking. Secondly, there should be proper mechanisms in place for assessing the accountability of partners and their proxies, in nominating the management teams, suppliers, and other stakeholders, in accordance with the rules and laws that govern ethical business practices.

The question that emerges in balancing the business pupose and good governance is whether LLPs are altering the balance between the roles of partners and whether any shifted activities is beneficial or detrimental to the LLPs; under the given federal law and regulations, listing rules, and other related influences.

The Formation of LLPs and its Consequences for Business Partners

LLPs, as a new business model, will move to a more profit-centric direction that should evidence better governance of its business activities. There remains however the question of whether the interference of more partners in an LLP will prove beneficial to various stakeholders. There are some reasons to indicate that if this new type of partnership posits a 'panacea' to partners' values and investment protections, that are central to the sustainability of an LLP in the long term.

The process of conversion to an LLP covers the formation of, or transfer to, a business entity either from a sole proprietorship or partnership. For existing partnerships there should not be any problem with the relationship between LLP partners, if they remain unchanged, and if the reason for conversion to an LLP is to protect their collective liabilities. However if they add new partner(s) there may be strain in the relationship, and a breakdown of mutual understanding about the reason for conversion to an LLP. Similar with sole proprietors (who used to managing business on their on), having new partner(s) will put them in a a totally new business scenario – particularly when faced with decison making. The consent of new partner(s) in managing the LLP is compulsory, in order to ensure business activity transparency and good governance of the entity. Thus, there is an issue of balancing the relationships of LLP partners with the goivernance of the LLP.

Proper Accounting Records for LLPs

Section 69 of Limited Liability Partnership Act 2012 states that:

"*an LLP must immediately keep proper accounting records that are sufficient to explain the financial position of the LLP. From time to time, all transactions, profit and loss accounts, balance sheets and explanatory notes of the accounts must be made availabe for fair view of the LLP state of affairs. If the LLP is previously a family business or small businesses that does not have much experience in preparing accounting documents, there are prossibilities that the LLP must allocate an amount of budget to hire experinced accountants to handle the acounting documentations. If the LLP is unable to prepare the accounting records accordingly to the normal accounting format, the LLP shall keep: i) information on income, (ii) information on expenditure, (iii) list of debtors and creditors or liabilities, (iv) list of all assets (current and fixed), (v) percentage of capital contribution by each partner, (vi) explanatory notes to items (i) to (v), and (vii) other supporting documents to prove the business transactions.*"

This requirement of the LLP Act 2012 may incurs additional costs that become a new burden for the LLP's financial management. Another aspect of the acounting that may become a governance issue is that under the LLP Act it states that:

> *"The accounting and other records shall not be required to be audited and are to be retained for 7 years, and shall be kept at the registered office or such other place as the partners think fit provided that the Malaysian Registrar of Business (SSM) is notified of that other place and the accounting and other records shall at all times be open to inspection by the partners*".

There are few concern under this provision, since the accounting records are only under preview by partners, and do not undergo an audit process by internal or external auditors. This may result in reduced transparency of business transactions or mismanagement of the LLP.

Short-Term Returns v. Long-Term Investment

Similar to other business entities, LLP management teams face significant pressure to maximize short-term results, at the expense of making necessary investment to position the LLP in the market for long-term success. Therefore there is a need for LLPs to have systematic and proper management teams that run the business based on the right standard operating procedures (SOP).

An issue arises in governing the LLP, whereby in the long run partners should be able to support the management team in balancing between the pressure of achieving short term results, profit making, and stakeholders demand for monetary or other benefits. Certain pressures may result in a tendency for unethical business conduct that should be avoided. Examples may include the misuse of business money, bribery, illegal activities, fraud, and others, to ensure that profit making is high. At the same time however these actions jeorperdize the fulfillment of the governance of LLP for the betterment of society.

Governance Values of LLP Partners and Stakeholders

LLP partners and stakeholders normally pressure for greater benefits from their investements - including efforts to influence LLPs' strategic direction, management succession, risk management approaches, and environmental and social impacts and responsibilities.

As responsible fiduciaries, LLP management teams must apply independent and objective judgment when both governance and finance. Some partners may pressure the LLP to adapt to suit their individual special interests which may not be in the best interest of the LLP. The ability of the management to address this type of pressure largely depends on the ability to communicate effectively on long-term strategy, risk oversight, management succession, and company performance.

To ensure systematic and effective communication, the LLP must manage partner relationships, as well as undertake proper accounting filings and statements, to enable partners and management to balance different needs. LLP partners and management teams should should periodically assess the company's strengths and weakensses, in order to prioritise areas for improvement, future directions, and to monitor negative influences on the business, such as ignorant or unethical conduct.

The central issue is the ability of the management to take the correct decisions, while at the same time protecting the interests of the partners. Financially focused partners may tend to seek relatively short term returns on investment. They may use tactics, such as influencing the seating of the company's top management team, as a means of acheiving their personal goals. Therefore partenrs and stakeholders must imbue good governance values to enable the LLP managment to protect the LLP's ethical standards.

Due Diligence and Governance of LLP

The nature of LLPs allows limited liability for the partners, which may result in unfair ligitation for any business loss, or for misconduct in business practice. In the context of due dilligence businesses are supposed to be liable on the due care of their activities but on a voluntary basis (Spedding, L.S., 2004). Failure to consider environmental, social and governance issues and opportunities during while conducting business may impact the values of the LLP. Moreover, the limited liability of LLPs can be perceive as a so-called "licence" for the partners to be responsible in doing their due dilligence. Unsurprisingly unethical LLPs may continue misconduct in order to reduce costs and increase profit making, being ignorant of the long term negative effects on society and the economy.

IV. CONCLUSION

An LLP shoud be managed with integrity and with the trust of society towards its direction of wealth creation for the partners. LLPs' contributions to the economy extend well beyond the return of profit, since LLPs can provide employment, support innovation, purchase goods and services, pay taxes, and support various social and charitable programs. Given the important role that LLPs play in our society, concerns about the use of management's power and the expectations from partners and stakeholders on LLPs continues to expand. into the oversight of risk management, compliance pracices and social responsibility.

LLPs may face challenges in avoiding the influence of partners' proxies (such as suppliers or business clients). The absence of a compulsory audit process exposes the LLPs to the management being unduely influenced - especially if each partner favors certain proxies in the operation of the LLP. In applying good governance, potential conflicts may arise beteen partners or the management. Weak governance practices for controlling improper proxies' engagement may lead to concerns from partners, management and public.

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