MAZARS

Governance *matters*

Analysis of 10 best global practices

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> "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."
>
> – Sir Adrian Cadbury

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Foreword

The subject of corporate governance leapt to limelight from relative obscurity after a string of collapses of high profile companies at the start of this century, when events at a Houston based energy giant and at a global telecom behemoth in Missisipi, shocked the business world with both the scale and age of their unethical and illegal operations. Worse, they seemed to indicate only the tip of a dangerous iceberg. While corporate practices in the USA came under the scanner, it appeared that the problem was far more widespread.

Relatively similar issues at a large and reputed food group in Europe, at a multinational newspaper group in Canada and at an Indian technology major, revealed significant and deep-rooted problems, which inexplorably have the potential to creep in, at times and places where they are least expected. With this, the need for the identification and adoption of good tenets for governance has only got reinforced from time to time, but inevitably and inextricably, efforts to this end have gathered further momentum each time a new corporate scandal has come to light.

The spotlight is now firmly on key aspects of the governance framework, with particular emphasis on the audit and finance functions that have a legal, moral and ethical responsibility to identify and disclose aspects of a promoter-driven agenda that have the potential to impact the interests of other stakeholders adversely. The focus is now also on the responsibilities and liabilities that accompanies the board which clearly is vital, yet hitherto has at times been largely seen as a ceremonial function.

The concept of corporate governance is so dynamic in nature that at no point can a given set of requirements be determined as being sufficient for the sustained value creation of an organisation. Standards of corporate governance are changing rapidly, some in response to random events which capture public attention and others which are driven more by the realisation that in a free market ideology it is the responsible behaviour of organisations, as perceived by their customers, shareholders, workers, investors and society in general, that is ultimately reflected in their share prices. They are of course and will remain, skeletons in the cupboard, which will inevitably come out for all and sundry to see, especially during times of earnings misses, corporate developments and information-sensitive deals.

It would be a mistake to see any crisis of corporate governance that has been triggered by multi-billion swindles involving some iconic companies, primarily through the prism of transparency and compliance. The failure of some of the best intended laws and stringent disclosure norms to control the unbridled growth of corporate greed is a pointer to this. With trillions of dollars in capital sailing the globe in search of investments, the shareholders' crusade for more open and well governed companies is gaining strength across many major and emerging markets. In what some call a worldwide corporate-governance movement, shareholders are pushing for stronger governance frameworks, while teaming with investors and negotiating behind the scenes.

Through this publication Mazars has identified and analysed several successful governance practices across the globe, which are pertinent to the current scenario. In doing so, we have also assessed how different countries are dealing with their corporate governance problems, while short-listing those practices that are driven by aspects, which are participatory, consensus oriented, accountable, transparent, responsive and equitable. In the ensuing pages you will find benchmarks that can be used to develop a culture of values for professional and ethical behaviour on which well functioning markets depend. We are confident that you will find this publication useful to your business.

Monish Chatrath
Corporate Governance Expert
Mazars, India

Executive summary

Good governance is characterised by a firm commitment and adoption of ethical practices by an organisation across its entire value chain, in all of its dealings with a wide group of stakeholders encompassing employees, customers, vendors, regulators and shareholders (including the minority shareholders). To achieve this, certain checks and practices need to be whole-heartedly embraced. Trust and integrity play an essential role in economic life and for the sake of future prosperity, boards and management need to ensure that these attributes are adequately recognised.

The board has a key role in setting the ethical tone of a company. High ethical standards are in the long term interests of the company as a means to make it credible and trustworthy, not only in day-to-day operations but also with respect to longer term commitments. While codes of conduct and whistle blower policies are important, what is more important is the manner in which they are communicated and practiced. In this context, it is vital for board members and senior management to lead by example. Similarly, the concept of having independent directors is sound in theory, but more important is the process underlying the selection of independent directors. The selection process itself need to be rigorous, transparent, objective and aligned with the organisation's needs.

Board discussions inevitably entail discussions on earnings and it is equally if not more important to also constantly evaluate the sustainability of business models and consequent strategies. The focus should be not on just "how much?", but on "how?", "at what cost?" and "at whose expense?". Compensation of executive directors should flow from an objective performance evaluation process conducted by the board where a high level of transparency and disclosure of executive performance criteria are imperative.

Company boards and directors should provide levels of leadership and accountability that clearly determine the success of their organisation. In this context, an effective framework for management of the board is the key to achieve the objectives of an organisation. Various corporate governance guidelines and codes around the world have specific provisions regarding the composition, the frequency of board meetings and the performance evaluation of the boards. We have also seen several boards forming sub committees for an effective management of specific aspects relating to governance.

The role of nomination committee is important for the board. The main responsibilities and duties of the nomination committee must be to review and determine the structure, size and composition of the board regularly and also to give full consideration to aspects relating to planning the succession of directors.

Board level structures should be established in a way that facilitates the use of inherent expertise to improve decisions in key areas. This should be done in a manner that provides for effective communication with the shareholders and other stakeholders. The formation and charter of certain committees like the nomination committee, audit committee and remuneration committee feature as mandatory requirements of some corporate governance codes.

Another important aspect relates to the management of information and support. The management has the obligation to provide complete, adequate and timely information to the board members to enable them make informed decisions. It is also important for directors to access separate and independent sources of information.

Along with the importance of the right information, is the concept of accountability. Although the board needs to be headed by a chairman, the company's day to day affairs need to be run by a chief executive. Good governance requires the roles of the chairman and the chief executive to be separated so that there is a clear path of accountability for the chairman, the chief executive and the management team. The chairman must clearly and solely be a representative of shareholders with no conflict of interest. The removal of the joint role, wherever practical (i.e. in keeping with the nature, size and complexity of the business and the planned growth), reduces the temptation to act more in self-interest rather than purely in the interest of shareholders.

Employees may also be made shareholders of the company by offering stock options to them. Stock options are an important means of motivating and binding managers to the company over the long-term. By means of the stock options plan, the increase in the company's stock market value should be linked to an incentive for the management. Corporate governance codes in different countries provide guidelines on how to include long-term market oriented schemes like stock options in a manner in which they are not abused by the executives.

Shareholders are key stakeholders of the company and their relationship with the management and board forms an integral part of good governance. The board has the responsibility to pay special attention to the rights of shareholders and their equitable treatment. It is also the board's duty to provide fair, transparent, balanced and comprehensible information on the company's performance, position and future prospects and help shareholders make informed decisions. There should be a structure of review and authorisation that ensures the truthful and factual presentation of the company's performance and financial position. Audit committees help fulfill this requirement. The audit committee's responsibility is to monitor the integrity of the financial statements of the company and any formal

announcements relating to the company's financial performance, to review company's internal financial controls, risk management systems and internal audit function; and to appoint an external auditor while monitoring his independence and objectivity.

In most situations the traditional internal reporting lines are deemed sufficient to prevent malpractice. However there are situations where additional safeguard measures are required to stifle fraud, corruption or other malpractices that serve to undermine the company's internal controls. In this respect effective whistle blowing arrangements can serve as a deterrent to malpractice, while encouraging openness, promoting transparency and providing support to the audit committee's review and monitoring charter.

Supervisory, regulatory and enforcement authorities must have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained and clear signals should be given that they shall be proactive in imposing substantial penalties for non-compliance, so that compliance is strictly adhered to.

Although having tight financial controls is essential for market confidence, cultural and operational risks, if left unchecked, these can just as effectively damage a business. This is where the debate starts to take different paths; the Sarbanes-Oxley Act of 2002 ("SOX") in USA insists on management and auditor assertion on the financial control environment, whereas the combined code of corporate governance in the UK ("the UK Code") maintains a focus on the wider control environment, but without the requirement for positive assertion.

The French have introduced the Loi de Sécurité Financière ("LSF") which moves towards directors acknowledging their responsibility for having maintained a strong control environment, while Ireland and Germany, among others, also have similar frameworks. In India, listed companies are required to comply with the revised corporate governance requirements under Clause 49, which envisages mandatory risk assessments, certification of financial controls by Chief Executive officers ("CEO")s & Chief Financial officers ("CFO")s and a larger role for independent directors. However the question remains whether the development of an Enterprise Wide Risk Management framework in support of the harmonisation of financial markets and in pursuit of the transparency agenda is a Holy Grail or indeed a practical necessity? And if it is the latter, how does it get enforced?

The answer may possibly lie in the United Kingdom where the legislators are considering the relative merits of the prescriptive approach under SOX, as compared to their seemingly and relatively mature principles approach. By comparison, the governance codes in the UK, at least relatively, do not appear to incur excessive levels of cost. These provide the opportunity to provide clear and transparent disclosures, while moving away from one single overall claim of compliance and covering a wider proportion of the COSO model. Indeed we are fast approaching the point, where the debate as to which way to develop the corporate governance framework, must move from the esoteric to the practical.

In this context, the OECD Principles of Corporate Governance were originally developed on 27-28 April 1998, in conjunction with national governments, other relevant international organisations and the private sector. These Principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries; and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. Moreover, they have been adopted as one of the Twelve Key Standards for Sound Financial Systems by the Financial Stability Forum and they form the basis of the corporate governance component of the World Bank/IMF Reports on the Observance of Standards and Codes (ROSC).

A fair and effective corporate governance framework must evolve in the light of changing circumstances of business over time and the framework of the company should be tailored accordingly to deal with those circumstances. There is no 'one size fits all' approach to corporate governance. A number of countries (particularly in continental Europe) tend to adopt an inclusive 'stakeholder' approach where companies are considered 'social institutions' with responsibilities and accountability, not just to shareholders, but to employees and the wider community in general. This contrasts to the UK and the USA where there is an emphasis on creating wealth for shareholders. However, while approaches in individual countries may differ, there appears to be a global appreciation of generic corporate governance principles of responsibility, accountability, transparency and fairness.

A poorly conceived governance system can wreak havoc on any economy by misallocating resources or failing to check opportunistic behaviour. The question that often arises is whether corporate governance operates the same way in every economy. It may be well argued that cross-national patterns of corporate governance are either converging or will converge on either the Anglo-Saxon shareholder-centered model found in the USA and the UK, or a hybrid between the shareholder and stakeholder models typically found in Japan and Germany. Whichever model a country seeks to adopt, the fact remains that corporate governance and the competitive strategy of organisations are inextricably interrelated.

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MANAGEMENT OF RELATIONSHIPS WITH SHAREHOLDERS

Shareholders are key stakeholders of a company and a trusting relationship between management and shareholders eventually leads to increased shareholder wealth by developing intangible valuable assets, which can prove to be sources of competitive advantage. Their interest levels are evolving and with this is their desire to learn, not just more about the business where they have a stake but also its key drivers – and that too at a rapid pace. In the current environment, investors and lenders too are keen to see the manner in which shareholders oversee the performance of management and participate in key decisions.

While analyzing some good practices in shareholder relationship management we came across a large company in China which was seeking to build a new shareholder culture, based on the following aspects:

- An investor relationship management committee, constituted under the board of directors;
- Nominations from small to medium-sized investors for independent board directors;
- A system for publicly collecting opinions of small to medium-sized investors prior to executing the allocation proposal of the company;
- An “online dialogue with investors” in three tiers: a weekly dialogue hosted by the board secretary, a monthly dialogue hosted by the general manager and a quarterly dialogue hosted by the board chairman;
- Regular release of information on products, sales and project progress; &
- Invitations to investors to visit the site at least three times a year and send company members to visit investors.

Such measures not only show the importance that the said company attached to its investor relationship management, but also serve as a reference for other listed companies to build on their investor relationships in several aspects.

The UK Corporate Governance Code of June 2010 (“the UK Code”), provides for there to be a dialogue with shareholders, based on a mutual understanding of objectives. It states that the board as a whole has the responsibility to ensure a satisfactory dialogue and discussion about governance and strategy with shareholders. The chairman needs to ensure that the views of shareholders are communicated to the board as a whole and matter relating to governance and strategy are discussed with major shareholders. Non Executive Directors (“NED”)s need to be provided the opportunity to attend scheduled meetings with major shareholders and are expected to attend meetings if requested by major shareholders. The board is also required to state in the annual report the steps they have taken to ensure that the members of the board, and in particular the NEDs, have an understanding of the views of major shareholders about the company (through direct face-to-face contact, analysts’ or brokers’ briefings and surveys of shareholder opinion). The chairman is also required to arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the Annual General Meeting (“AGM”) and for all directors to attend.

The Recommendations on Corporate Governance by AFG France of January 2011 (“the French Code”) highlight the timing and information required before the general meeting. It emphasises on giving the chairperson full discretion to vote as a shareholder proxy. It also suggests that the rights of shareholders holding preferential shares should be respected based on the amount of capital they own in the company. The French Code grants double or multiple voting rights to reward the loyalty of certain shareholders.

The Code of Corporate Governance under the Corporate Governance Council of Singapore of June 2011 (“the Singapore Code”) identifies the importance of fair communication and shareholder-board dialogues while emphasizing that the shareholders have the right to be treated fairly and equitably and the companies should recognise, protect and facilitate the exercise of such rights. They should also get the opportunity to participate effectively in and vote at general meetings of shareholders

The Australian code by ASX Corporate Governance Council of 2010 (“the Australian Code”) also takes a similar view while asserting that companies should empower its shareholders by effective communication, giving them access to balanced and understandable information about the company and corporate proposals, and making it easy for them to participate in general meetings.

The King Committee on Governance in South Africa of 2009 (“the South African Code”) stresses on the importance of shareholders’ interests and proactive management of the relationship with shareholders. It goes on to state that the company should identify mechanisms to promote enhanced levels of constructive

stakeholder engagement and should strive for a correct balance between its various stakeholder groupings.

The German Corporate Governance Code, as amended on May 26, 2010 ("the German Code") articulates the shareholders' role and rights in general meetings. Companies need to arrange to appoint a representative to facilitate the shareholder's voting rights and to assist them in the use of postal votes and proxies. Focused on the shareholder's voting rights, it states that there are no shares with multiple voting rights, preferential voting rights or maximum voting rights. It also states that shareholders have preemptive rights corresponding to their share of the equity capital, whenever new shares are issued.

SOX stresses on importance of shareholder communication and requires specific disclosures on shareholder communications with the board. It also points to shareholder access to a company's proxy statement for purposes of nominating candidates for election as directors.

Various guidelines on Corporate Governance in India emphasise on the importance of general body meetings where shareholders can address their concerns to the board of directors and demand any explanation on the annual report or on the overall functioning of the company. Shareholders should have a right to participate in, and be sufficiently informed on decisions concerning fundamental corporate changes and other matters such as takeovers, sale of assets or divisions of the company and changes in capital structure, which will lead to change in control or may result in certain shareholders obtaining control disproportionate to the equity ownership.

In all OECD countries, the rights of stakeholders are established by law (e.g. labour, business, commercial and insolvency laws) or by contractual relations. Even in areas where stakeholder interests are not legislated, many firms make additional commitments to stakeholders, and concern over corporate reputation and corporate performance often requires the recognition of broader interests.

While various countries follow different practices, the fundamentals have remained the same. The essence has been to maintain healthy relationships between the shareholder and the boards while communicating fair and transparent information to the shareholders to help them make informed decisions.

"As the ecological environment and operating mechanisms of the current financial market are undergoing a series of major changes, listed companies should adapt positively to new trends and strive to protect the rights and interests of shareholders. For this they should cultivate a "shareholder right culture" and fulfil their obligations to shareholders by managing investor relationships and encouraging rational investment."

– Julie Laulusa
Mazars, Mainland China

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WHISTLE-BLOWING

Effective whistle-blowing arrangements act as a deterrent to malpractices, encourage openness, promote transparency, underpin the risk management systems of the company and help protect the reputation of the company and senior management. At the same time, an appropriate and effective whistle-blowing mechanism provides support to the audit committee's review and monitoring framework and this includes steps towards ensuring the integrity of financial statements. In order to develop and effectively implement whistle-blowing procedures, a strong sense of leadership is required to emanate from the board. At the same time, senior management needs to develop a culture in which employees are encouraged to raise their concerns internally through the organisation's whistle-blowing procedures. The whistle-blower should be seen essentially as a witness to the negative developments in a company and not as a complainant.

The UK Code requires the audit committee to review arrangements by which staff of a company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for a proportionate and independent investigation of such matters and for appropriate follow-up action.

The key elements of effective whistle-blowing arrangements entail:

- The board and senior management to set the tone by clearly stating that their company undertakes to take any matters raised in good faith and is serious in dealing with them;
- The board and senior management to ensure that they are aware of the whistle-blowing requirements in legislation and in regulations that apply to the company;
- A clear system of reporting to be put in place so that employees know what issues need to be raised and when, and the people in the company with whom they may safely raise their matters. Employees may also need reassurance about confidentiality and protection from adverse consequences;
- Encouraging employee support through a procedure for reporting back the outcome of any subsequent enquiry and as far as possible, any remedial action taken or to be taken. Failing to give feedback may be interpreted as failing to act, which could undermine the company's culture and discourage employees from raising concerns in future; &
- The company designating a senior individual whom employees can approach on a confidential basis. Employees should also be made aware of an independent person on board, who can provide advice to individuals on whistle-blowing in the public interest on a strictly confidential basis.

As with any case where an employee is found to be involved in wrongdoing, they will need to be dealt with effectively in accordance with employment laws and contracts of employment. If the policy is to succeed, whistle-blowing that is not upheld but was in good faith must not be a cause for action against the whistle-blower, although management should recognise that it may have consequences for relations between employees.

Although a whistle blowing mechanism has gradually become a standard feature in the corporate governance practices of Singapore listed companies, the Singapore Code does not provide for protection for a whistle-blower and the person runs the risk of being sued for defamation. Guideline 11.7 of the Singapore Code has expressly imposed a duty upon the audit committee to ensure that adequate whistle-blowing arrangements are in place. An audit committee should receive complaints on the part of the management from relevant employees in strict confidence. Upon careful valuation, the audit committee, if it deems fit, should cause an independent investigation which is to be carried out with appropriate follow-up actions.

The South African Code states that the audit committee should review the appropriateness of policies and procedures to facilitate whistle-blowing and the follow-up of information obtained from whistle-blowing.

According to the Australian Code, the whistle-blower policy should clearly provide for mechanisms by which the employee's complaints can be made (for example an internal or external 'Whistleblower Hotline') and a statement that all reports will be kept confidential and secure. There should also be a guarantee from the management that the whistle-blowers will receive feedback and the fact that the company is committed to protecting the whistle-blowers.

In Germany, whistle-blowing procedures are intended as an additional mechanism for employees to report misconduct internally through a specific channel. They complement the regular information and

reporting channels of the company, such as employee representative bodies, line management, quality assurance personnel or internal auditors who are appointed for the sole purpose of reporting such misconduct. Article 29 of Data Protection Working Party (WP 117) emphasises that whistle-blowing schemes can be implemented in the fields of accounting, internal accounting controls, auditing matters, fight against bribery, banking and financial crime.

In Japan, the purpose of the Whistleblower Protection Act is to protect the whistle-blower and to promote compliance with the laws and regulations concerning the protection of the life, health, property and any other interests of the whistle-blower by nullifying the dismissal of the person and prohibiting any other disadvantageous treatment to a whistle-blower due to his or her conduct. It also specifies the measures that the businesses and administrative division shall take with regard to whistle-blowing and to contribute to the stability of people's lives and sound development of the society and economy of Japan.

According to the Corporate Governance Voluntary Guidelines by Ministry of Corporate Affairs India (2009), companies should ensure institution of a mechanism for employees to report concerns about unethical behaviour, actual or suspected fraud, or violation of the company's code of conduct and ethics policy. Further, the companies should also provide adequate safeguard against victimisation of employees who avail of the mechanism and allow a direct access to the chairperson of the audit committee in exceptional cases.

Whistle-blowing should be considered an essential safety valve within the internal control environment. In most situations the traditional internal reporting lines will be sufficient to prevent malpractice. However where fraud, corruption or other malpractices have served to undermine the company's internal controls and lines of reporting, whistle-blowing can be an effective safeguard.

> "Pressures on corporate executives to produce results regardless of methods have never been greater. For some it is too much and it leads them to undertake unethical behavior and to pressurise their teams to do the same. It takes a lot of courage and determination for team members to report this unethical behaviour and not everyone has the tenacity to raise the flag. If whistleblowers have been brave enough to approach a regulator and are ignored, then unacceptable pressure gets exerted on that employee and the abuses continue. The severity of the consequences in such cases demonstrates the need for regulators to be geared up to deal with the concerns raised by whistleblowers and to consider steps such as those recently taken by the SEC."
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> — Craig Scarr
> Mazars, UK

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FINANCIAL AND BUSINESS REPORTING AND DISCLOSURES

Shareholders require periodic, reliable and comparable information sufficient to evaluate the operational conditions of the business. Further, timely disclosure on any material event taking place in the company is important to help them in making informed decisions. Various governance practices followed across the world emphasise on this particular aspect while also highlighting the need to safeguard the integrity of information with its disclosure processes.

The UK Code states that it is the board's responsibility to present a balanced and understandable assessment of the company's position and prospects. It should extend to interim and other price-sensitive public reports, reports to regulators and information dockets required to be presented as per statutory requirements.

The directors should explain in the annual report their responsibility for preparing the annual report and accounts and there should be a statement by the auditor about their reporting responsibility. They should include in the annual report an explanation of the basis on which the company generates or preserves value over a long term and the strategy for delivering the business objectives of the company. The directors should also report in annual and half-yearly financial statements that the business is a going concern, with supporting assumptions or qualifications as necessary.

The Singapore Code follows a similar approach by highlighting the importance of presenting a balanced and understandable assessment of the company's position and prospects. It also adds that the board should establish written policies to ensure compliance with legislative and regulatory requirements, including requirements under the listing rules of the securities exchange. Further it states that it is the responsibly of management to provide management accounts and information to the board members on a monthly basis to enable them to make an informed assessment of the company's performance.

The Australian Code requires companies to put in place a structure for review and authorisation that is designed to ensure a truthful and factual presentation of the company's financial position. It stresses on establishing an audit committee to safeguard the integrity of the company's financial reporting. Companies without an audit committee, in case of smaller boards, should have board processes in place which raise the issues that would otherwise be considered by the audit committee.

It is particularly important that companies disclose how their alternative approach assures the integrity of the financial statements of the company. In such cases, it further makes it mandatory for companies to make disclosures on the independence of the external auditor and cite reasons as to why an audit committee was not considered appropriate. It also states that companies should promote timely and balanced disclosures of all material matters concerning the company.

Under the South African Code, sustainable reporting and disclosure needs to be formalised as part of the company's reporting processes. The reporting should be timely, proactive, transparent and effective and should transparently disclose information that is material, relevant, accessible, understandable and comparable with the past performance of the company and the performance of others. It also adds that a formal process of assurance by an independent party is essential for impartial sustainability reporting.

In Japan, the Principles of Corporate Governance for Listed Companies ("the Japanese Code") states that the listed companies are obliged to make timely and accurate disclosures regarding

corporate activities including the financial condition, performance results and ownership distribution. Such disclosures are indispensable for appropriate investor evaluation of enterprises in the market and concurrently for the appropriate exercising of voting rights by shareholders.

According to the German Code, the consolidated financial statements must be prepared by the management board and examined by the auditor and supervisory board. In addition to this, the Financial Reporting Enforcement Panel and the Federal Financial Supervisory Authority are authorised to check that the consolidated financial statements comply with the applicable accounting regulations. The consolidated financial statements should be publicly accessible within 90 days of the end of the financial year; while interim reports should be publicly accessible within 45 days of the end of the reporting period. The company should also publish a list of third party companies in which it has a shareholding that is not of minor importance for the enterprise.

USA's SOX states there should be internal control over financial reporting and this process should be designed by or supervised by CEO and CFO and

should be effected by the board and management. This will provide the company with reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

The fundamentals remain the same in various codes and the focus should be on the provision of a balanced and comprehensible assessment of the company's performance, position and future prospects. Owing to dissimilar legal systems and cultures in different countries, varying practices are being adopted to implement the fundamental principles. The common thread is an approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

> "Looking at the socio-economic context of financial reporting, it is important to identify possible driving forces such as demographic developments, fraudulent conduct of reporting entities or the globalisation of capital markets, which are intrinsic forces causing the functional convergence towards a new system of accountancy."
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> — Hubertus Eichler
> Mazars, Germany

4

MANAGEMENT OF INFORMATION & SUPPORT

Management of information flows within an organisation and access to adequate and accurate information by the board are key ingredients of effective governance. Many corporate malpractices have remained undetected due to the fact that the board of directors have relied solely on the management and the independent auditors for information.

In order to fulfil the board's fiduciary duty to monitor management, the director must have reliable and independent sources of information. Directors cannot fulfill their duty to monitor management if all of their information comes from management.

The UK Code requires the board to be supplied with timely information in a form and of a quality that is appropriate to enable it discharge its duties. It adds that the chairman is responsible for ensuring that the directors receive accurate, timely and clear information. While the management has an obligation to provide such information, however directors are required to seek clarification or amplification where necessary. Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows to and within the board and its committees and between senior management and NEDs, as well as facilitating induction and assisting with professional development as required. The board should ensure that directors, especially NEDs, have access to independent professional advice at the company's expense wherever they deem it necessary to discharge their responsibilities as directors. In addition, committees should be provided with sufficient resources to undertake their duties. All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that the board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.

The Singapore Code adds that the board should have separate and independent access to the company's senior management. Though the Australian Code follows a similar approach related to access of information to the board, the same has not explicitly covered the matter of expenses related to sourcing of information from outside.

The South African Code stresses on a set procedures that need to be in place, when the board and its directors seek independent professional advice and the German Code provides for there to be cooperation between the management board and the supervisory board, for the benefit of the enterprise. The management board coordinates the organisation's strategic approach and discusses the current state of strategy implementation, planning, business development, risk situation, risk management and compliance with the supervisory board at regular intervals. The chairman of the supervisory board is required to regularly maintain contact with the management board and to be informed (without delay) of important events which are essential for the assessment of the situation and development as well as for the management of the company.

The Recommendations on Corporate Governance by AFG France (January 2011) also take the same position that the chairperson must supply each board member with information that may be useful to the performance of his or her duties. It asserts that the risk mapping, which includes not only financial risks but also all the risks identified by the company, must be transmitted to the board members. Board members must be provided upon request with any additional qualitative and quantitative information on the company and be able to interview any individual with information they deem useful for their work.

USA's SOX follows a rules based approach where non compliance is a matter of law. It

provides for the board and each committee to have the sole authority to retain, at the expense of the company, independent legal, financial or other advisors as it may deem necessary, without consulting or obtaining the approval of any officer of the company in advance. The directors have full and free access to officers and employees of the company and any meetings or contacts may be arranged through the chairman, the CEO, or the secretary of the company or directly by the director. The directors are also required to use their judgment to ensure that any such contact is not disruptive to the business operations of the company and does not inappropriately disclose any confidential or sensitive information in the possession of the director.

According to the Corporate Governance Voluntary Guidelines by Ministry of Corporate Affairs India (2009), this aspect is discretion based rather than being a compulsory practice. This code stresses that the independent directors should have the option and freedom to meet company management periodically in order to perform their functions effectively. They should be provided with timely and precise information and as well as adequate independent office space,

resources and support by the companies including the power to have access to additional information to enable them study and analyse various information and data provided by the company management.

The UK Code stresses that all directors should have access to the advice and services of the company secretary. Both the appointment and removal of the company secretary should be a matter for the board as a whole. The Australian Code also highlights that the company secretary should be accountable to the board, through the chair, on all governance matters. The South African Code takes a somewhat similar position to the UK Code. It states that the board should be assisted by a competent company secretary. It also goes on to say that the company secretary should be a central source of advice to the board, and the chairman and board may consult the company secretary for guidance on their responsibilities.

Directors must have their own and independent source of information into the company, separate from the information provided to them by management and the independent auditors, in order to fulfill their state law fiduciary duties. Independent auditors can be used for this purpose and an internal auditor too can assist the board of directors in obtaining the reliable and independent information they need in order to fulfill their fiduciary duties. If the organisation cannot afford a full-time internal auditor, internal auditing services may be outsourced.

“Governance needs continually to be administered and informed by information that is examined and carefully evaluated with reference to the intended objective of the corporate policy.”

— Annie Chan
Mazars, Hong Kong

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MANAGEMENT OF AUDITORS

The existence of an independent audit committee to independently and objectively manage relationships with auditors is recognised as an important feature of good corporate governance internationally.

According to the UK Code, the board should establish formal and transparent arrangements for maintaining an appropriate relationship with the company's auditor. It is the audit committee's responsibility to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, while reviewing significant financial reporting judgments contained in them and to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee, to review the company's internal control and risk management systems and to monitor and review the effectiveness of the company's internal audit function.

The audit committee needs to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor, while also reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process.

The UK Code also states that the audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action. The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report. The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditor. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position. The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

The Singapore Code takes a somewhat similar position. It provides that the audit committee should have explicit authority to investigate any matter within its terms of reference, have full co-operation by management and reasonable resources to enable it to discharge its functions properly. It is also the responsibility of the committee to state the total fees paid to the external auditors for that financial year, including fees for audit and non-audit services, in the annual report.

The Recommendations on Corporate Governance by AFG France (January 2011) highlight similar points as mentioned in the UK Code. It also emphasises that at least one third of the audit committee members should be free from conflict of interests. It also adds that company managers and company employees may not be members of this committee.

The Australian Code stresses on the fact that the ultimate responsibility for the integrity of a company's financial

reporting rests with the full board. Smaller companies without an audit committee should have board processes in place, which raise the same issues otherwise be raised by the audit committee. The audit committee should consist only of non-executive directors and majority of independent directors.

In the German Code, the supervisory board is required to set up an audit committee, which handles issues of accounting, risk management and compliance, the necessary independence required of the auditor, the issuing of the audit mandate to the auditor, the determination of auditing focal points and the fee agreements.

The South African Code states that the chief internal auditor should report directly to the audit committee.

The Corporate Governance Voluntary Guidelines by Ministry of Corporate Affairs India (2009) articulates similar roles and responsibilities for the audit committee. It also adds that the committee should have power to have independent back office support and other resources from the company; have access to information contained in the

records of the company; and obtain professional advice from external sources. The Audit Committee should also have the facility of separate discussions with both internal and external auditors as well as the management. It also highlights the importance of rotation of audit partners and firms in order to maintain independence and to carry out audit exercises with a fresh outlook.

In India, there is a special arrangement for the audit of companies where the equity participation by Government is 51% or more. The primary auditors of these companies are Chartered Accountants, appointed by the Comptroller and Auditor General of India, who gives the directions to the auditors on the manner in which the audit should be conducted by them. The Comptroller and Auditor General of India is also empowered to comment upon the audit reports of the primary auditors. In addition, the Comptroller and Auditor General of India conducts a test audit of the accounts of such companies and reports the results of his audit to Parliament and State Legislatures.

The term comptroller evolved in the 15th century through a blend of the Middle English counterroller (someone who checks a copy of a scroll, from the French contreroule "counter-roll, scroll copy") and the French compte (an account), thus creating a title for a compteroller who specialises in checking financial ledgers. This etymology explains why the name is pronounced identically to "controller" despite the unique spelling.

The existence of an independent audit committee to independently and objectively manage relationships with auditors is recognized as an important feature of good corporate governance internationally. This is an efficient mechanism for focusing on issues relevant to the company's financial position, verifying integrity of financial reporting and exercising independent judgment.

> "Audit committees must identify the key judgments made by management and auditors in preparing the company's financial statements. This will help them judge whether the statements present a reasonably complete and accurate picture of the company's financial position."
>
> — Cyrus Bharucha
> Mazars, India

6

ROLE OF NOMINATION COMMITTEE

The need for a nomination committee has been identified as one of the important aspects for securing independence on the board. Various codes for corporate governance have dealt with the role of the nomination committee and the key features relating to the roles and duties of a nomination committee have been summarised in the ensuing bullet points:

- To regularly review the structure, size and composition of the board and make recommendations to the board;
- To give full consideration to succession planning for directors;
- To regularly evaluate the balance of skills, knowledge and experience of the board;
- To prepare a description of the role and capabilities required for any particular board appointment including that of the chairman; &
- To identify and nominate the board candidates to fill board vacancies as and when they arise.

According to the UK Code, the nomination committee should give full consideration to succession planning in the course of its work, after taking into account the challenges and opportunities facing the company and the level of skills and expertise needed on the board.

While analyzing the succession planning processes in various organisations, we came across a company in the UK which had laid out a succession planning process, encompassing the following:

- To give full consideration to succession planning, taking into account the challenges and opportunities facing the organisation and what skills and expertise are therefore needed on the board in the future;
- To regularly review the structure, size and composition (including the skills, knowledge and experience) of the board and make recommendations to the board with regard to any changes; [in keeping with B.1 of the UK Corporate Governance Code, June 10]
- To review the succession plan for independent directors and report to the board;
- To keep under review the leadership needs of the organisation (including both executive and independent directors), with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace; &
- To review the independent director's re-appointment at the conclusion of any specified term of office, as appropriate, under the organisation's charter in respect of retirement by rotation.

In the same organisation it was felt that if an independent director has been on the board beyond six years, a rigorous review is required to be made to take into account the need for progressive refreshing of the board.

The UK Corporate Code also highlights that the nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board, and in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment. The Australian Code also recommends that the role of a nomination committee should include the review of board succession plans; the development of a process for the evaluation of the performance of the board; its committees and directors and the appointment and re-election of directors.

The Recommendations on Corporate Governance-AFG of France also mention that the main responsibility of this committee is to make proposals regarding the search for and appointment of board members, to contribute to the succession planning for both executive and non-executive directors as well as to organise

the integration of new directors into the board. It may also participate in the process for assessment of the board's performance. The French Code underlines the main responsibility of nomination committee as making proposals for the search and appointment of board members. It also mentions that the committee should contribute to the succession planning for both executive and non-executive directors as well as organise the integration and induction of new directors into the board. It may also participate on the assessment of the board's performance.

The German Code does not mention a detailed list of roles and responsibilities of the nomination committee but highlights that a nomination committee would exclusively be composed of shareholder representatives and they would propose suitable candidates to the supervisory board for recommendation to the AGM. The German Code states that the supervisory board should ensure that a long term succession plan is drawn.

The Singapore Code provides for the nomination committee to be charged with the responsibilities of making

recommendations to the board on the matters relating to review of board succession plans for directors, the development of a process for evaluation of the performance of the board, its committees and directors. It also includes the review of training programs for the board and the appointment and re-election of directors.

The Australian Code also emphasises that board renewal is critical to a company's performance and its directors should be conscious of the duration of each director's tenure in succession planning. The nomination committee should consider whether succession plans are in place to maintain an appropriate mix of skills, experience, expertise and diversity on the board.

In the last decade, various governance principles have been implemented in India and with this the need for a comprehensive succession strategy has been given importance within companies. The importance of good succession planning is acknowledged by all and numerous discussions have led to defining the criteria and benefits of building a long-term strategy for succession. The Corporate Governance Voluntary Guidelines emphasises the need for nomination committee to be engaged in the proposals for searching, evaluating, and recommending appropriate Independent Directors and NEDs, determining processes for evaluating the skill, knowledge, experience and effectiveness of individual directors as well as the Board as a whole.

> "The nomination committee should be designed to function independently of the board, the supporting organisations and advisory committees."
>
> – Dera Mc Loughlin
> Mazars, Ireland

MANAGEMENT OF BOARDS

The board plays a very important role of steering a company to meet its business objectives - both in the short and long term. Hence, an effective management of the board is vital for the growth and sustainability of a company. The board is the link between the owners and the management of the company, where the interests of the owners/shareholders need to be protected by the board.

The board should be constituted and managed in a manner in which they are able to exercise objective independent judgment on corporate affairs. To achieve this objective boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.

The UK Code specifies that the board should not be large and unwieldy. It should be sufficiently sized and the members should have the right balance of skills and experience as deemed appropriate for the requirements of the business. The board should be just adequately sized so that changes to the board's composition could be managed without undue disruption. This code also underline the importance of having a strong presence of both executive and NEDs.

The Singapore Code also emphasises that the board should examine its constitution and determine the impact of its size on the effectiveness vis-à-vis objective decision making. It also emphasises on the board to have a strong and independent element in the form of independent directors which should make up at least one-third of the board.

The Recommendations on Corporate Governance-AFG code of France also highlight a similar view on the composition of the board. It specifies that the board should be free from conflict of interest by having at least one-third independent members. It also recommends that the composition of the board should be diversified in terms of educational background, nationality, gender, etc., as diversity entails a better functioning.

Similarly, the German Code advocates a two tier structure and suggests that its members of the supervisory board, as a group, possess the knowledge, ability and expertise required to properly complete its tasks.

Certain clauses pertaining to board meetings have been laid down in the various corporate governance codes. The UK Code states that the board should meet regularly and the results of that meeting should be included in the annual report as a high level statement of operation. The annual report should identify attendance and names of chairman, CEO, senior independent, others and committee nature and membership. It also stresses that the chairman should hold separate meetings with NEDs and NEDs should meet to discuss chairman's performance. Any unresolved meeting concerns should be recorded in board meetings.

Other codes like the Singapore Code and the French Code also emphasise that the board should meet regularly enough in order to encourage exchanges between directors. The number of meetings and the attendance record of directors should be mentioned in the annual report.

According to the German Code, good corporate governance requires an open discussion between the management board and supervisory board as well as among the members within these boards. The supervisory boards with the representatives of the shareholders and employees should prepare the supervisory board meetings separately, possibly with members of the management board. If necessary, the supervisory board should meet without the management board. The chairman of the supervisory board should regularly maintain contact with the management board, in particular, with the chairman or spokesman of the management board and consult with him on strategy, business development and risk management of the enterprise.

The NYSE Euronext - Corporate Governance Guidelines in USA require the board to have no less than four meetings each year. Directors are expected to attend board meetings and meetings of committees on which they serve and to spend the time needed and meet as frequently as necessary to properly discharge their responsibilities.

Several governance codes have made provisions relating to the performance evaluation of the board. The UK Code specifies that the board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The chairman should act on the results of the

performance evaluation by recognizing the strengths and addressing the weaknesses of the board.

The Singapore Code recommends that there should be a formal assessment of the effectiveness of the board as a whole and the contribution by each director to the effectiveness of the board. Every board should implement a process to be carried out for assessing the effectiveness of the board as a whole and for assessing the contribution by each individual director to the effectiveness of the board. This assessment process should be disclosed annually.

Apart from recommending the regular and timely appraisals of the board, the South African Code also mentions that the board should meet at least once every year to consider the board appraisal results. The board should be of a size and composition that is conducive to making appropriate decisions. The board should be large enough to incorporate a variety of perspectives and skills and to represent the best interests of the company as a whole rather than of individual shareholders or interest groups. It should not, however, be so large that effective decision making is hindered. Individual board members should devote the necessary time to the tasks entrusted to them. All directors should consider the number and nature of their directorships and calls on their time from other commitments.

Directors, individually and collectively, have a primary responsibility for good governance. Consequently the governance framework should ensure that the board is able to provide strategic guidance to the company, while monitoring the performance of the management objectively and being accountable to the company and its shareholders.

"In a globalised, connected world, governance goes well beyond numbers. Too often we adopt a silo mentality full of meaningless compliance checklists. These do not help us to effectively govern but are a knee jerk reaction to an ever complex business environment. How we profitably relate to our environment, social matters, ethics and anti corruption are the issues that matter to our stakeholders and represent the very essence and long term sustainability of our company and our brand. Directors need to be aligned to this new reality."

— James Kallman
Mazars, Indonesia

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DIVISION OF THE RESPONSIBILITIES: MANAGEMENT OF THE BOARD VS. OPERATIONS

A clear segregation of role between the people managing day to day operations of a company and a chairperson with strategic decision powers is one of the vital requirements for an effective corporate governance framework. Most of the corporate governance codes are unequivocal with regard to separation of the roles of the chairman and the CEO.

The UK code recommends that, 'a clear division of responsibilities must exist between the head of the company and individuals who should have unfettered power of decision'. It also mentions that the chairman should be independent in the same way that NEDs are designated as being independent.

Such splitting of roles avoids conflict of interest. The chairman is clearly and solely a representative of shareholders with no conflict of interest, having a role as manager within the firm. The existence of the separate chairman's role provides a clear path of accountability for the CEO and the management team and removal of the joint role reduces the temptation to act more in self-interest rather than purely in the interest of the shareholder.

Two main models for corporate board structures exist around the world. The unitary board used in most common-law countries and the two-tier structure, characterises the German governance system. The German Code supports a dual board structure where the management board is responsible for managing the enterprise and the supervisory board appoints, supervises and advises the members of the management board.

The chairman of the supervisory board coordinates the work of the supervisory board. There are two predominant reasons for such a structure; the relationships of German banks with the companies; and the Co-determination Act 1979 which gives importance to the right for workers to be informed and involved in the decision which affects them.

German banks have much closer relationship with German companies. German banks mostly hold shares of the companies and other shareholders often deposit their shares and the rights associated with them with their banks. This forms a backdrop for creating board structures where these parties are actively involved in company affairs; hence a two tier structure.

In most countries, only one of the two board structures is available. The unitary board structure is followed in the UK and Spain. In France, the legal system allows firms to opt between a one-tier or two-tier board structure. Furthermore, like Germany, French companies operate in a unique environment characterised by the strong involvement of institutional investors and bank lenders.

The Australian Code recommends a unitary board structure where the majority of the board should be independent directors. It also emphasises on the split between the roles of chairman and the CEO, where the roles are exercised by two different individuals. It recommends chairman to be an independent director.

The Singapore Code is inclined towards a dual leadership structure where there is a separate CEO and chairman on the board. This code emphasises on the importance of separation of CEO and the chairman as it enhances the independence of the board in monitoring management. It states that the separation of roles of CEO and chairman is especially important in Singapore where the board tends to include a significant number of company executives, unlike most boards of the best-managed companies in the USA, where almost all directors are independent.

The South African Code also highlights the division of roles of the chairman and the CEO. The chairman is responsible for setting the ethical tone of the company; providing overall leadership; participating in selection of board members; and overseeing a formal succession plan of the board. The CEO is involved in the running of the business and in achieving financial and operating goals and objectives. This Code suggests that the CEO should not be a member of the board committee and he should attend meetings by invitation.

Reformers and investors have increasingly called for companies to separate the chairman and CEO jobs — a model of corporate governance that is prevalent in the United Kingdom (as well as in most European countries, not to mention Australia, Canada and New Zealand). At a first glance, splitting the two positions makes sense. After all, the same person acting as chairman and CEO looks suspiciously like the proverbial fox guarding the chicken

coop. However there are several large organisations who continue to combine the two top jobs, generally splitting them only as a temporary measure (for example, to facilitate a CEO's upcoming retirement).

Achieving such leadership by splitting the two positions has its own characteristic problems with a key consideration being whether such distinctions in roles would compromise on good leadership for the sake of better governance.

An effective corporate governance model would typically seek to combine features from both the shareholder and stakeholder models, defined by separation of ownership and managerial control. The fundamental aspect is that the board should not be dominated by a single powerful individual and the roles of CEO and the chairman should be clearly demarcated, wherever practical.

> "A Two-Tier-Board is unique in the sense that it creates a clear institutional and personal separation of monitoring and management organs, which facilitate a distinct distribution of responsibilities and powers within an organisation."
>
> — Olivier Lenel
> Mazars, France

9

STRUCTURE OF THE BOARD LEVEL COMMITTEES

An effective board is one that facilitates an effective discharge of the duties imposed by law on the directors and adds value in a way that is appropriate to the particular company's circumstances. The board should be structured in such a way that it has a proper understanding of and competence to deal with, the current and emerging issues of the business. It should also be able to exercise independent judgment and encourage enhanced performance of the company.

The board should effectively review and challenge the performance of management and this is being addressed by boards by constituting various committees (such as audit committee, remuneration committee, nominating committee, grievance committee and risk management committee) to assist in discharging its responsibilities.

The composition of the committees has been described in different codes across the globe. The UK Code suggests that the board should set up an audit committee and a nomination committee which should lead the process for board appointments and make recommendations to the board and a remuneration committee.

The Australian Code also suggests that the audit committee should consist of a majority of independent directors but it does not comment on whether any of the members should have financial experience or expertise. It does not clarify aspects relating to the chairman leading the nomination committee when it is dealing with the appointment of a successor to the chairmanship.

Germany follows a dual structure of board where the management board is responsible for managing the company and the supervisory board appoints, supervises and advises the members of the management board and is directly involved in decisions of fundamental importance to the enterprise. The supervisory board forms the committees with sufficient expertise depending on the specifics of the company. The chairperson of the respective committee reports regularly to the supervisory board, on the work of the committee. The supervisory board sets up an audit committee and its chairman needs to have specialist knowledge and experience in the application of accounting principles and internal control processes. The supervisory board also forms the nomination committee composed exclusively of shareholder representatives.

The Recommendations on Corporate Governance-AFG in France also emphasises on the independence of the committee members. It recommends that at least one-third of the audit committee members should be free from a conflict of interest. Company managers and company employees should not be members of the audit committee. The nominating committee must include at least three members of the board of directors or supervisory board and at least one third of the committee members must be free from conflicts of interest.

The French Code recommends that the chairperson of the compensation committee and a majority of its members should be free of conflicts of interest. In any case, persons with management responsibilities and company employees may not be members of the compensation committee.

The Corporate Governance Voluntary Guidelines, 2009 in India also recommends that the board should establish separate committees for nomination, audit and remuneration functions.

While there are merits of having board level committees, determination of the nature, type and number of such committees is important. Boards can get frustrated with their committees if they have too many of these and what further

accentuates the situation is when the board does not know what to do about them.

We have seen in some cases where some non-profit organisations have set up several board committees that have caused bureaucratic delays. A typical situation we had encountered was in the case of one such organisation which had constituted various committees, such as Finance, Personnel, Development, and of course an Executive Committee. This situation arose when one committee malfunctioned leading to the board appointing another. For example, when the Development Committee failed to raise funds, the board had appointed a special Annual Giving Committee to manage the yearly fund appeal. When none of this actually produced any appreciable increase in donations, the board had chartered a Major Gifts Committee to go after big donors.

In such cases nonprofits can do better by replacing this cumbersome structure with a simple three-committee structure consisting of Internal Affairs, External Affairs, and Governance. In addition, there could be an Executive Committee consisting of Chairs from each of the three

committees and the Board President/Chair; however, this committee should not be allowed to take over the decision-making function of the board as a whole.

This structure has several key advantages:

- Each board member serves on just one committee and focuses on interrelated issues;
- It requires fewer meetings, making less work for staff;
- The accountability lines of the three committees are clear; &
- Board meetings can be organised around the three committees' reports, reinforcing the importance of their work and affording more time for "generative thinking."

There are and will always be radical views which advocate the elimination of all (or most) of the board committees. Too many boards are bogged down by committees that are inactive or maybe even semi-fictitious. The reality is that very few committees need to exist in perpetuity. Instead of a permanent Personnel Committee, for example, the creation of a time-limited HR Task Force to oversee policy revision and then disbanding the same in due course is one option. Similarly in place of a standing Program Committee, the formation of a time-limited Library Committee that tackles reviewing library usage and then dissolving the group is another option. The same members could well volunteer for the subsequent Newsletter Overhaul Committee to reinvent the newsletter, and then move on after four months.

Task forces, ad hoc committees and temporary committees all have specific tasks to accomplish in a specific timeframe. Signing up to work on a project with a clear goal and a termination point always trumps the prospect of indefinite service on a committee weighed down by a vague purpose.

An added bonus resulting from shifting to temporary committees is the changing mix of team participants. Interaction among a variety of members on the board will result in having the right people "on the bus" more often, and by board members getting to know more people on the board.

> "Routine and narrow vision can create huge business risks. Outside board members can reduce this risk. Outside board members are essential in improving the creativity and delivering new ideas essential for business development in a dynamic and globalizing world."
>
> — Jan Matto RE RI
> Mazars, Netherlands

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MANAGEMENT OF STOCK OPTIONS

Share options provide additional incentives for executives to manage the organization effectively and efficiently thereby increasing the share prices. Consequently share options are believed to align the manager's goals with those of the shareholders. This alignment should, in theory, overcome the agency problem of operation between ownership and control since the executives in effect become the owner.

There are provisions made for the management of stock of options in various codes around the world. The UK Code has a detailed provision on the design of performance related pay. It recommends that executive share options should not be offered at a discount and should be approved by shareholders. Shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than three years.

Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to the need to finance any costs of acquisition and associated tax liabilities. To avoid 'short-termism' this code suggests that the payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives. Consideration should be given to criteria which reflect the company's performance relative to a group of comparator companies in some key variables such as total shareholder return. Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block.

The Australian Code also emphasises on designing the equity-based remuneration such that it is linked appropriately to the performance objectives or hurdles. It also underpins the limitations of equity-based remunerations of senior executives. According to the code, the terms of such schemes should clearly prohibit entering into transactions or arrangements which limit the economic risk of participating in unvested entitlements under these schemes. The exercise of any entitlements under these schemes should be timed to coincide with any trading windows under any trading policy established by the company.

The French Code has similar provisions regarding stock options and bonus shares. It states that stock options should be granted without a price discount and the absence of a price discount should be mentioned in the resolution authorizing such an attribution. It also recommends that the stock options should be granted with some stipulation like linking the stock options and performance criteria over a long period of time. The options should not be valid when the executive leaves the company and there should be terms where it would not be possible to alter ex-post the initial conditions for granting options.

The German Code also suggests that the supervisory board must ensure that the variable compensation elements are in general based on a multiyear assessment and both positive and negative developments should be taken into account when determining variable compensation components. The compensation structure should be such that it must not encourage executives to take unreasonable risks. This code suggests setting up a limitation (cap) which should be agreed upon by the supervisory board on the share or index-based compensation.

The Singapore Code has a similar approach to remunerations through stock options. It highlights that performance related remuneration should promote long-term success of the company, be aligned with the interests of shareholders, be symmetric with risk outcomes, be

sensitive to the time horizon of risks and should take account of the risk policies of the company

The South African Code recommends that the share option awards should not be granted within a closed period and should be related to a performance period of not less than three years, before vesting rights become effective. 'Clause 49' in India also provides similar guidelines on compensation paid by stock options. It recognises that a limit should be set for the maximum number of stock options that can be granted to non-executive directors in any financial year and in aggregate. It also specifies that the stock options granted to the NEDs shall vest after a period of at least one year from the date such NEDs have retired from the board of the company.

Stock options are extensively used in different countries as part of the remuneration paid to the executives. In the UK the main share incentive schemes for executives comprise long-term incentives (also known as performance share plans or "LTIPs") and executive share option schemes. LTIPs are more common than executive share option schemes, although some companies

operate both types of schemes. The 'guidelines for share incentive schemes' issued by ABI (Association of British Insurers) are a comprehensive statement of institutional investors' guidelines for developing and implementing share incentive schemes. The guidelines limit the percentage of new equity available under share schemes. ABI also recognises that share awards form part of an executive's annual remuneration package. The guidelines strongly encourage the adoption of the phased grants made on annual basis.

Reflecting the fact that share scheme awards attract a profit and account charge under IFRS2, the guidelines state that financial cost of a share scheme should be disclosed at the time shareholder approval for the scheme is sought. Though the approaches of using stock options for remuneration of the executives in different countries vary, the principles remain the same. They intend to avoid the conflict of interest between shareholders' wealth maximization and the personal objectives of the managers.

> "There exists a significant relationship between increased executive option holdings and the subsequent increased risks organisations take."
>
> — W. Alex Unterkoefler
> Mazars, USA

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Mazars has its own offices in 61 countries, with a force of more than 13,000 professionals. Mazars is continuously expanding its worldwide presence by entering new markets, including Eastern Europe, the USA, Asia Pacific and the Middle East.

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