



Australian Government
The Treasury

Corporate Governance Pathfinder



A Report Prepared for the APEC Finance Ministers' Meeting, Santiago, Chile, 2004

APEC Corporate Governance Pathfinder Report

September 2004

© Commonwealth of Australia 2004

ISBN 0 642 74264 2

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth available from the Department of Communications, Information Technology and the Arts. Requests and inquiries concerning reproduction and rights should be addressed to:

The Commonwealth Copyright Administration
Intellectual Property Branch
Department of Communications, Information Technology and the Arts
GPO Box 2154
CANBERRA ACT 2601

Or posted at:

<http://www.dcita.gov.au/cca>.

CONTENTS

- KEY FINDINGS 1**
- INTRODUCTION 3**
- PART A: OVERVIEW OF ENVIRONMENT 5**
- PART B: DISCLOSURE AND TRANSPARENCY 10**
- PART C: RESPONSIBILITIES OF THE BOARD 14**
- APPENDIX A 19**
 - Summary Report 19
 - Questionnaire 21
 - Evaluation Framework — Key to Principles in Questionnaire 22
 - Section B: Disclosure and Transparency 22
 - Section C: Responsibilities of the Board 24

KEY FINDINGS

- All Core Group Member economies (Australia, Korea, Malaysia, Mexico, New Zealand and Singapore) who participated in the Pathfinder are to be congratulated. All have been open and honest about the challenges and successes of reform in their countries which has provided the basis for a useful and informative dialogue on issues still to be faced. It is hoped that the process has strengthened the resolve of the Core Group Member economies to continue dialogue and interaction in the course of moving forward. It also hoped that this Pathfinder will encourage all APEC members to involve themselves in future corporate governance initiatives within the APEC Finance Ministers' process.
- Data gathered from the responses by all Core Group Member economies showed that overall there was a high level of consistency with the OECD's *Principles of Corporate Governance* (2000). Three Core Group Member economies had systems that were consistent with all eighteen criteria. All Core Group Member economies had systems consistent with the standards on the prohibiting of insider trading, compliance with international standards of accounting and auditing, and the disclosure of conflict of interest or of duty by the board or executives. All members were either consistent or largely consistent with the OECD Principles in twelve out of the eighteen areas; no Core Group Member economy ranked lower than partially consistent in any area.
- A breakdown of the data into sections shows that, overall, Core Group Member economies were generally more consistent in the 'Disclosure and Transparency' section of the survey. Although the criteria in the 'Responsibilities of the Board' were slightly less consistent with the OECD Principles, they were still predominantly ranked largely consistent or higher in most criteria.
- Areas identified as needing further improvement in a number of economies include training of directors, tracing of beneficial ownership, independence of auditors, and access to information concerning directors.
- There have been a number of convergent trends identified within the Core Group Member economies. For example, increased use of a 'co-regulation' scheme (encompassing legislation, codes of best practice and listing rules) has expanded the flexibility of decision-makers in all Core Group Member economies. There have also been significant changes to transparency and shareholder protections.
- The rate of change in corporate governance continues to rise. It is important for all APEC member economies to be aware of, and involved in, the continuing dialogue on governance issues in international fora such as the OECD. The OECD's corporate governance principles and guidelines on multinational enterprises can provide members with guidance on continued improvement of their corporate governance systems.

APEC Corporate Governance Pathfinder Report

- An element of the design of the Pathfinder questionnaire and evaluation was to provide all APEC members with impetus and incentive to undergo a full World Bank ROSC evaluation on corporate governance. While the Pathfinder was very limited in scope, the ROSC process is a full independent examination and evaluation of an economy's corporate governance system. This is an invaluable tool for identifying areas for improvement and specific areas where technical assistance could prove beneficial.
- One of the most encouraging aspects of the survey has been the reports of ongoing improvement in corporate governance regimes over time. All Core Group Member economies have been working to identify weaknesses in their systems, and legislating or using other means to achieve improvement.
- It is important that all APEC members continue to recognise the need for continuous further improvement in corporate governance systems. The success of the systems is not based solely on the written rules — successful systems hinge on training and institutionalising a culture of good corporate governance. The World Bank recently noted that '... for law to be effective, it must become part of the institutional fabric of a society, contributing to the process of institutional innovation and change. Putting formal law on the books is not sufficient. Only when law is used — when it is modified in response to changing demands or socioeconomic conditions, such as changes in the size or ownership structure of firms or in the patterns of finance — will law be effective. In other words, the success of a legal system is not determined by having miraculously enacted good law at the outset but by developing the capacity to continuously find solutions to new problems.'¹
- One of the key aspects that has been identified by this survey is that the systems of Core Group Member economies are generally robust in terms of black letter law and its implementation. Nevertheless, ongoing monitoring by members of international best practice, such as the revised OECD's *Principles of Corporate Governance* (2004), is recommended. Participation in a full ROSC evaluation on corporate governance will address a wider range of areas and this is encouraged. In moving forward, it is also suggested that all APEC member economies should look beyond the rules, to matters such as training of directors, judicial decision-making, and the capacity of regulators.
- It is recommended that APEC Finance Ministers take note of these findings in the context of consideration of further APEC projects addressing issues related to corporate governance.

¹ World Bank, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' (by Kathanna Pistor, Yoram Keinan, Jan Kleinheisterkamp and Mark D. West), *The World Bank Research Observer*, 18:1 (Spring 2003), pp 89-112.

INTRODUCTION

1. Six APEC member economies comprised the Core Group which completed the Pathfinder Survey, participated in the summary process, and produced case studies: Australia, Korea, Malaysia, Mexico, New Zealand, and Singapore.
2. The APEC Pathfinder Survey on Corporate Governance (Pathfinder Survey) is designed to gather information on the Core Group Members' corporate governance regimes and to highlight the areas of strength and of concern. This report is intended to promote continued policy dialogue on corporate governance issues among APEC member economies and with other organisations such as the OECD, the World Bank and the Asian Development Bank. In addition, member economies may be encouraged to undertake the World Bank's Report on Observance of Standards and Codes (ROSC) process on corporate governance. The Pathfinder Survey is based on elements of the ROSC questionnaire.
3. The Pathfinder Survey comprises three parts: Overview of Environment; Disclosure and Transparency; and Responsibilities of the Board. 'Overview of Environment' consists of questions about the economy's regulatory and legislative framework as well as the bodies that govern it. 'Disclosure and Transparency' covers the reporting and disclosure requirements for companies and the bodies to which reports are made, and includes elements of shareholder rights. 'Responsibilities of the Board' covers the internal mechanisms of companies directed to ensuring compliance with all relevant laws and the relationship between the board, the shareholders and the regulators.
4. The quality of the survey responses from all Core Group Members was high. All Core Group Members were forthright and open about the challenges and successes they have experienced and the desire to keep improving their governance regime. The responses were evaluated against an abbreviated version of the ROSC evaluation matrix. The ROSC matrix was chosen due to its non-judgmental criteria and its ability to allow meaningful analysis of the trends and the challenges facing the region.
5. A review of the responses was conducted using a modified version of the World Bank ROSC evaluation. Only the law was evaluated and all information was derived solely from the responses by Core Group Members. Member economies were evaluated according to their degree of consistency with the OECD's Corporate Governance Principles:²

² Based on the original 2000 version of the OECD's *Principles of Corporate Governance*. These are broadly consistent with the revised OECD *Principles of Corporate Governance* released in May 2004.

APEC Corporate Governance Pathfinder Report

- **Consistent** = Consistent with all aspects of the OECD Corporate Governance principles.
 - **Largely Consistent** = Only minor divergences from the OECD Corporate Governance principles are observed.
 - **Partially Consistent** = While the legal and regulatory framework is consistent with the OECD Corporate Governance principles, practices and enforcement diverge.
 - **Materially not Consistent** = Divergences from the OECD Corporate Governance principles in respect of the legal and regulatory practices are significant, although some steps towards consistency with the principles have been made.
 - **Not Consistent** = No substantive steps towards consistency with the OECD Corporate Governance principles have been taken.
6. See **Appendix A** for copies of the Summary Report, Questionnaire, and Evaluation Framework (which sets out the subset of the eighteen OECD Corporate Governance Principles that were included in the evaluation).

PART A: OVERVIEW OF ENVIRONMENT

7. Corporate governance frameworks typically are made up of a mixture of legislation, rules, self-regulatory arrangements such as voluntary codes, and business practices. It is widely accepted that systems cannot function effectively without the support of efficient and effective regulatory bodies and courts.³ Not only is an effective corporate governance system important for the operation of business, but as noted by the World Bank in its *Doing Business in 2004* report '...there is a growing consensus that the quality of business regulation and the institutions that enforce it are a major determinant of prosperity.'⁴

8. The first section of the questionnaire focussed on the legislative framework and the relevant regulatory agencies, together with the semi-governmental organisations, sharemarket regulators and on the (generally) non-binding codes of best practice and corporate governance.

9. A noticeable trend in the frameworks of the respondents was the move towards 'comply or explain' style regulation. Comply or explain is generally used in conjunction with codes of best practice to encourage companies to improve their corporate governance practices while maintaining a degree of flexibility. This recognises not all companies are the same and some practices, though generally accepted as being desirable, may not necessarily produce the best outcomes in all cases.

10. Most Core Group Members have a single dominant stock exchange, with some minor stock exchanges listing mainly companies engaged in technology-related business. Listing of companies is governed by listing rules and overseen by a regulatory body. Some jurisdictions have some legislative backing for the listing rules in limited areas such as the rules relating to continuous disclosure.

11. There has been a high level of reform activity in the economies of all Core Group Members in the last five years. A number of member economies have strengthened laws in response to the Asian economic crisis and the high profile corporate failures of the last two years, as well as introducing new listing rules, codes of best practice and good governance guidelines. For example, the Sarbanes-Oxley legislation in the United States, the recent instalment of the Corporate Law Economic Reform Program in Australia and new legislation in South Korea have all addressed disclosure and duties of boards.

³ See, for example, OECD (2004), *OECD Principles of Corporate Governance*, p. 29 available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf>

⁴ World Bank (2004), *Doing Business in 2004: Understanding Regulation*, p. viii.

Case Study # 1

Role of Regulatory Bodies (South Korea)

Since the 1997 financial crisis, Korea has been making efforts to enhance corporate governance so that it meets the international standards and best practices in the areas of corporate management, accounting practices and information disclosure.

For example, in 2003, accounting practices were greatly improved with the introduction of the CEO Certification System and the practice of periodic accounting firm changes for long-term auditing cases.

In addition, class action lawsuit system is scheduled to be introduced in 2005 for false disclosure, window dressing and unfair trading including stock price manipulation.

In order to secure advanced corporate governance, public institutions (that is, the Ministry of Finance and Economy), and private institutions (for example, the Korea Stock Exchange and the Korea Corporate Governance Service) are undertaking the role of regulatory authorities.

Public Regulation

The Ministry of Justice handles the basic rules of corporate decision-making through the enforcement of the Commercial Code (the Company Act); and the Ministry of Finance and Economy regulates the overall corporate governance of public companies through the execution of the Securities and Exchange Act.

The Financial Supervisory Commission (FSC) supervises accounting and disclosure practices, and takes charge of enacting and amending relevant regulations. The Financial Supervisory Service plays the role of an executive authority to effectively supervise companies' accounting and disclosure practices under the FSC.

Moreover, the Securities and Futures Commission, which is under the FSC, regulates illegal trading practices, and corporate practices related to accounting and the employment of independent auditors.

Self-regulation in the Private Sector

The Korea Stock Exchange and Kosdaq Committee for the Kosdaq (technology stocks) market play the role of self-regulatory authorities by overseeing the soundness of the securities market and companies' information disclosure.

In particular, the Korea Stock Exchange has introduced the Korea Corporate Governance Stock Price Index for the top fifty companies with good corporate governance.

The Committee on Corporate Governance, which was temporarily established in 1999 consisting of experts from the private, financial, accounting and legal sector, drafted the Code of Best Practice for Corporate Governance.

Case Study # 1 (continued)

The Korea Corporate Governance Service was founded in 2002 under the joint sponsorship of securities-related institutions including the Korea Stock Exchange and the Kosdaq. It provides institutional services to help improve the corporate governance system in Korea, and strives to develop optimal governance practices, thereby contributing to the development of a healthy securities market in Korea.

Also, the Korea Listed Companies Association provides specific guidelines for areas not suitable for regulation by law, such as standard articles of incorporation and auditing committees' business standards.

In conclusion, Korea is making ongoing efforts to promote corporate governance to achieve greater transparency and accountability in the corporate sector.

As indicated above, public and self-regulatory bodies have both played important roles to help advanced corporate governance to become firmly established in the market. Through further harmonizing of developed regulatory structures, sound regulations, and good practices, Korea will continue its endeavour to enhance market-friendly corporate governance.

12. All Core Group Members have mechanisms in place for electronic information gathering, lodgement of statutory documents and information resources for investors. Access to information for investors has increased accordingly, especially for foreign investors, allowing for greater transparency in company transactions.

Case Study # 2

Electronic Disclosure and Access to Information (Singapore)

Listed Companies Announcement System

The Listed Companies Announcement system, set up in 1992, enables immediate dissemination of corporate announcements by listed companies. The application was developed by the Singapore Stock Exchange (SGX) and is hosted on the Monetary Authority of Singapore Network System ('MASNET') server. Fees are charged to MASNET subscribers and listed companies.

To make corporate announcements, listed companies connect to MASNET to create a draft of the announcement. When the announcement is ready to be broadcast, the companies will publicly release the document. Once broadcast, the system sends out an alert via MASNET to notify interested parties, such as news providers and financial institutions, of the new corporate announcement. The information is also posted immediately on the MASNET and SGX websites. These websites are accessible to the public without charge. The information on the websites is organized in the following categories:

Case Study # 2 (continued)

- Full-year and interim financial results
- Change of director's or substantial shareholder's interest
- Share buy-backs
- Trading halts or suspensions
- Corporate appointments of key personnel
- Other corporate announcements

Bizfile

Another system for dissemination of corporate information is Bizfile, operated by the Accounting and Corporate Regulatory Authority. Bizfile is web-based and allows companies to make statutory filings from any location with internet access 24 hours a days, 7 days a week.

Bizfile allows the filing of all prescribed company forms from incorporation to liquidation, and submissions of applications under the Companies Act. Information relating to companies as well as extracts of forms which have been lodged can also be purchased online. The types of information that can be purchased include the following:

- Profiles of companies ('Business Profile')
- Registers of company documents
- Profiles of individuals involved in companies
- Statistics of companies by industry, status or type

Information asymmetries are at the root of most market inefficiencies and misconduct. The Listed Companies Announcement and the Bizfile systems provide an efficient means for dissemination of corporate information pertaining to a large number of companies. These systems also enable such information to be readily accessible to the public via the internet.

13. There is little overt legislation or rules preventing foreign companies from operating or investing in Core Group Member economies. All Core Group Member economies allow foreign shareholders and directors, and many of the former restrictions on investment have been removed.

14. There is a trend toward convergence in the structure of corporate governance systems in the surveyed member economies. Most members have a single policy area within a government department responsible for the high level legislative policy and direction setting; a single, independent regulator; and a demutualised stock exchange. Co-regulatory systems (that is, regulation by a combination of a government agency and self-regulation through business organisations) is the norm.

PART B: DISCLOSURE AND TRANSPARENCY

15. It is generally accepted that a robust and effective disclosure regime is necessary for the smooth operation of markets. In its absence, prices can be inflated, companies placed at a comparative disadvantage and investors misled. Effective disclosure requires not only high quality legislation and subordinate rules and guidelines, but also effective implementation and policing.

16. The OECD's *White Paper on Corporate Governance in Asia*, encapsulates the importance of disclosure and transparency:

'Disclosure and transparency affect both a company's operations and its performance as an investment. Operationally, rigorous disclosure and transparency systems enable management and the board of directors to allocate resources rationally and to run the business in accordance with strategic plans. In this respect, disclosure and transparency to managers and directors influence the company's ability to generate cash flows, its *intrinsic* value.

From an investment perspective, full, accurate and timely disclosure of information permits the market to determine what this intrinsic value is. Effective disclosure and transparency also help set investors' level of confidence that intrinsic value is not being siphoned off or wasted by managers or insiders.⁵

17. The second part of the questionnaire dealt with the Core Group Member economies' disclosure regimes, the transparency of their laws and regulations, auditing and accounting standards and enforcement of the relevant laws. This section also included questions on shareholder rights.

18. All the Core Group Member economies' principal stock exchanges require continuous disclosure of any and all material information that may influence the price of listed shares. Definitions and rules concerning the continuous disclosure of material information are generally contained within the relevant listing rules.

19. All Core Group Member economies have requirements for disclosure of share ownership, but often not to the level of beneficial ownership. Some Core Group Member economies still allow the registration of shares under pseudonyms, and shares are often controlled through cross-shareholding and family trust structures. This practice can be confusing for investors because the records do not accurately reflect the ownership of the company.

5 OECD (2003), *White Paper on Corporate Governance*, Revised print 15 July, p. 36, paragraphs 180-181.

Case Study # 3

Protection of Minority Shareholders' Rights (Mexico)

Regarding minority shareholders' rights, the current framework aims to provide protection through different channels, that is, disclosure, corporate governance, explicit rights for minorities with certain ownership of a firm's equity, limits to the issuance of restricted shares and tender-offer requirements for change of control or significant transactions. For example:

Shareholders that represent at least 10 per cent of a public company's voting or limited voting capital are able to appoint a board member and his/her alternate.

Shareholders that represent at least 10 per cent of a public company's voting or limited voting capital are able to appoint a statutory examiner (comisario) and his/her alternate—the comisario takes part in the Board with a voice but no vote.

Shareholders that hold at least 10 per cent of the limited voting shares representing the outstanding capital stock may call for a shareholders' meeting.

Shareholders of companies who hold voting or limited voting shares representing at least 10 per cent of the shares represented at a shareholders' meeting are entitled to request a postponement of a vote on any matter if they consider that insufficient information has been provided.

Shareholders that hold at least 15 per cent of the outstanding capital stock of a company are entitled to commence a legal action for civil liability against directors, statutory auditors and members of the audit committee.

Shareholders of companies that hold voting or limited voting shares representing at least 20 per cent of the outstanding capital stock may judicially challenge resolutions of general shareholders' meetings in respect of which they have voting rights.

From the announcement of the date of a shareholders' meeting, information and materials concerning each of the agenda items must be made available to the shareholders immediately and free of charge.

20. Accounting and auditing standards have undergone some of the most extensive changes in the past five years, with all Core Group Member economies undertaking a review and legislative change, as well as changes in internal control mechanisms. Most of the Core Group Member economies' peak accounting and auditing bodies have also been undertaking reviews and reform of their best practice codes. As a result, the standards are generally converging.

21. Audit committees and auditor rotation are now required by a number of Core Group Member economies. Auditors are required to be more independent from client companies, by restricting the provision of non-audit services and restrictions on former auditors becoming officers/directors of the client company.

22. The changes to auditor and accounting standards have generally been in response to corporate collapse and inquiries into those collapses.

Case Study # 4

Accounting and Auditing Standards (Australia)

Australia has made a number of changes to auditing standards in response to several corporate collapses attributed to failures of probity and is in the process of adopting International Accounting Standards (IAS).

Accounting Standards

On 3 July 2002, the Financial Reporting Council (FRC) announced its support for the adoption of the International Accounting Standards Board's (IASB) accounting standards in Australia from 1 January 2005.

On 15 July 2004, the Australian Accounting Standards Board (AASB) formally made all Australian-equivalent International Financial Reporting Standards (IFRS) to apply from 1 January 2004.

For reporting entities with a 30 June balance date, the first accounts to be prepared in accordance with the new standards will be for the financial year commencing 1 July 2005. That said one-year comparative requirements will bring forward the application of the new standards to 1 July 2004.

The choice of the 2005 timetable largely reflected the decision of the European Union that EU-listed companies will be required to apply IFRS in their consolidated financial statements for reporting periods beginning on or after 1 January 2005.

Adoption of IFRS has been a stated objective of Australian accounting standard setting since the initial Corporate Law Economic Reform Program policy proposal paper.

- Closer alignment of Australian and international accounting standards was a recommendation of the Financial System Inquiry ('Wallis Report') in 1997.

The Australian Securities and Investments Commission (ASIC) Act 2001 was amended in 1999 to make a number of major changes to Australian accounting standard-setting arrangements, including inserting the objective of working towards the development of a single set of accounting standards for use in major capital markets.

Adoption of IFRS is expected to bring benefits in terms of more closely aligning Australian financial reporting with reporting in major financial markets. The adoption of IFRS will also progress Australian financial reporting, most notably in respect of accounting for financial instruments.

Case Study # 4 (continued)

Auditing Standards

Prior to 1 July 2004 Auditing Standards were developed by the Auditing and Assurance Standards Board (AUASB) but were approved by the executive councils of the Institute of Chartered Accountants in Australia (ICAA) and Certified Practising Accountants of Australia (CPAA). The standards provide guidance and prescribe the minimum criteria for the conduct of audit services.

Compliance with auditing standards, which was mandatory only for members of CPAA and ICAA, was enforced through members' professional rules. Members of the ICAA and CPAA could be disciplined by the Companies Auditors and Liquidators Disciplinary Board (CALDB) for failing to follow auditing standards. In this respect auditors could be deregistered for failing to comply with the standards, however no specific enforcement action could be taken by ASIC in the event of a breach of the standard.

The primary drivers for giving Auditing Standards legal backing are that as legal instruments:

- the corporate regulator (ASIC) is able to impose sanctions for non-compliance; and
- they can be applied consistently across the auditing profession. Prior to 1 July 2004 Auditing Standards were enforced primarily by the ICAA and CPAA on their members.

23. Many Core Group Member economies now require audit committees for listed companies. A range of other board committees, such as remuneration committees and corporate governance committees, are generally employed by larger companies in the Core Group Member economies. However, very few Core Group Member economies make them mandatory through legislation. Rather they are requirements of codes of best practice, listing rules, or encouraged by other methods.

24. The activity of the regulators in each of the member economies varies widely. However, nearly all have been given extra powers or had their capacity to issue fines increased over the past few years.

25. Overall, the Core Group Member economies' disclosure rules and legislation are generally consistent with the OECD Corporate Governance Principles. To the extent that there are inconsistencies, there are currently moves toward consistency through proposals to strengthen relevant legislation and listing rules.

PART C: RESPONSIBILITIES OF THE BOARD

26. The final section of the Pathfinder questionnaire deals with the responsibilities of the board to the company, shareholders and to the community.

27. With several high profile corporate collapses leading to criticism of the actions (or inactions) of the board, much attention has been focused on the role of the board in overseeing the operations of a company and how directors are remunerated.

28. All Core Group Member economies have unitary board structures. Although is not a legislative requirement in any of the member economies, there are some requirements for independent directors. All Core Group Member economies provide for directors to access independent information and professional advice at the expense of the company.

29. Shadow directors, that is, persons who are not official directors but serve behind the scenes with considerable influence and power, are becoming less prevalent in the countries surveyed. Prominent family and dominant shareholder appointments are still common, but this is being addressed by introducing requirements for independent shareholders and means of greater transparency in board decisions.

30. An important trend has been the ongoing reduction of government participation in the market. Although there are some notable government holdings in a number of member economies, there does not seem to be a noticeable affect on the operation of their corporate governance systems or an impact on the framing and implementation of legislation.

31. The revised OECD Principles of Corporate Governance note that where there are dominant controlling shareholders, independence of the board from them or another controlling body should be emphasised, especially if the rights of minority shareholders are weak and opportunities to obtain redress are limited.⁶

32. Ensuring that companies are not operated for the benefit of managers, directors, or dominant shareholders, needs vigilant and strong directors. All Core Group Member economies require conflicts of interest to be declared by directors, but since the beneficial owners of shares are not always known, some potential conflicts are not easy to discover. Regulation of conflicts is dealt with in legislation by some Core Group Member economies and in codes by others.

33. The training of directors is becoming widespread. Programs are available to directors in all jurisdictions of Core Group Member economies and are generally conducted by director associations.

6 OECD (2004), *OECD Principles of Corporate Governance*, p. 64.

Case Study # 5

Training and Education of Directors and Others within the Corporate Governance Context (Malaysia)

A survey conducted among public listed companies (PLCs) in Malaysia⁷ leading up to the release of the *Finance Committee Report on Corporate Governance*⁸ (the Report) revealed that 62 per cent of respondents placed education on existing rules as an area of priority for corporate governance reform. This point was also reiterated in the PriceWaterhouseCoopers (PWC) Governance Survey 2002.⁹ The survey reported that with increasing corporate governance responsibilities accorded to boards of directors, PLCs expressed the need for increased directors' training in respect of the Code and relevant laws and regulations. It was thus fitting that training and education were identified as a major area of focus in the Report.

The training and education aspect was particularly targeted at directors. The rationale for this was clear: even the most comprehensive rules, regulations and best practices would not achieve much by way of improving standards of corporate governance if the persons who are subject to these rules and regulations are not aware of their roles and responsibilities.¹⁰

The Mandatory Accreditation Programme (MAP)

The view was reached, therefore, that directors should receive education and training that would enhance their standards of competency and professionalism. It was also considered essential that directors appreciate the full extent of their duties, obligations and roles they are expected to perform.

Following this, the Kuala Lumpur Stock Exchange (KLSE)¹¹ listing requirements introduced the Mandatory Accreditation Programme (MAP) for directors of listed companies. At present, all directors of PLCs are required to attend the MAP; those who fail to attend the programme will be subject to enforcement actions by the Exchange.

The scope of the MAP covers amongst others, directors' duties and obligations under the *Companies Act 1965*, the KLSE Listing Rules, the Malaysian Code on Corporate Governance, risk management and internal controls and relevant securities laws.

7 Finance Committee on Corporate Governance (1999), 'The KLSE/PriceWaterhouse Joint Survey of the Corporate Governance Practices in Public Listed Companies – Executive Summary' *Report on Corporate Governance*, p.256.

8 A high level Finance Committee was established in 1998 to review the framework for corporate governance and to set best practices for the industry. The Committee released the *Report on Corporate Governance* (the Report) in 1999 setting out 72 recommendations to enhance corporate governance in Malaysia.

9 This was based on input canvassed from institutional investor groups, the independent non-executive directors and the public listed companies.

10 The KLSE-PriceWaterhouse Coopers (1999), *Corporate Governance 1998 Survey of Institutional Groups* also made this point.

11 As it was known then. The Exchange has subsequently demutualised and is now known as Bursa Malaysia Securities.

Case Study # 5 (continued)

To ensure high standards of accreditation, the training arm of the KLSE, that is, the Research Institute of Investment Analysts Malaysia (RIIAM) was appointed as the sole provider of the MAP for directors. The Institute began running MAP sessions in April 2001. At 2003 year's-end, 5,607 directors had attended the MAP.

The Continuing Education Programme (CEP)

MAP is reinforced by additional training programmes for directors on an annual basis through the introduction of the Continuing Education Programme (CEP). There are currently 21 course providers for the programme and 97 programmes have been accredited. At 2003 year's-end, 2,699 directors, representing approximately 50 per cent of the number of directors from the KLSE listed companies, have attended the CEP programme.

The Corporate Directors' Training Programme

Since May 2001, the Companies Commission Malaysia (CCM) also offers the Corporate Directors' Training Programme for directors. This programme is voluntary for directors of PLCs and non-listed companies.

Conclusion

The findings of surveys and studies indicate that Malaysia's efforts in relation to the training and education of directors have had an impact in enhancing good corporate governance in Malaysia. The CLSA Report on *Corporate Governance in Emerging Markets 2003* cited the directors' education programmes as one of the most significant moves implemented within the corporate governance. It noted that 'even the most senior of corporate directors were seen attending these programmes and some accompanied by English/Malay interpreters.'¹²

Indeed, the PWC Governance Survey 2002¹³ also demonstrated a high level of participation of company directors in the accredited and non-accredited directors' training programmes.

It is recognised that significant change will not happen overnight. However, it is hoped that the education and training provided to directors will assist in providing directors with the relevant skills and awareness so that they are able to make a more effective contribution to the boards of listed companies.

12 See p.62 of the report.

13 See p.58 of the survey.

34. Remuneration of directors is not always fully disclosed. This has become one of the most contentious issues for governments and for boards to deal with. Some Core Group Member economies have put legislation in place to increase the disclosure requirements for remuneration and some are now requiring non-binding votes on the remuneration of the directors at annual general meetings.

35. The legislative duties of the board are not always clear. However, all the basic duties of a board, a duty of care to the company or shareholders, a requirement to adhere to all applicable laws and to ensure the wellbeing of the company, are provided for in legislation by all Core Group Member economies. The chief executive officer and chairman are not usually the same person and a company will generally have a company secretary.

36. The move to 'comply or explain' principles in codes of best practice has served to increase the effectiveness of non-legislative rules regarding board responsibilities.

Case Study # 6

Board Independence and Duties (New Zealand)

New Zealand's Companies Act 1993 requires the business and affairs of a company to be managed by or under the direction or supervision of the board of directors. In carrying out their role, directors have the following duties:

- to act in good faith and in the best interests of the company;
- to exercise their powers for a proper purpose;
- to exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances;
- to promptly disclose to the board any self-interest in a proposed transaction between the company and a third party, and any interest in shares issued by the company;
- to comply with restrictions on insider trading and the use of information that is only available to them because of their role;
- not to contravene the Companies Act or the constitution of the company;
- not to engage in reckless trading; and
- not to permit the company to incur obligations unless, at the time of the decision, the directors believe on reasonable grounds that those obligations can be performed when required.

Case Study # 6(continued)

The board must also record decisions to provide indemnity insurance, payments, loans or other benefits to directors. Directors who vote in favour of authorising such benefits must certify that the proposal is fair to the company.

As the Companies Act applies to companies of all sizes, ranging from sole shareholder/director companies to large listed companies, it does not prescribe the makeup of the board. Companies listed on the New Zealand Exchange are, however, required by the rules of the Exchange to have at least three directors, with at least two of those directors being resident in New Zealand. Boards with fewer than eight directors must have two independent directors while larger boards must have three or one-third of the board, whichever is greater. The names of the independent directors must be disclosed to the market. With limited exceptions, the Exchange also imposes limits on the term of a director's office. Executive directors cannot be appointed for more than five years and at least one-third of the directors must retire from office each year. In both cases, the retiring director is eligible for re-election.

Listed companies must also have an audit committee to ensure that the board has accurate financial information, that independent audits are carried out, and that the lead auditor is replaced every five years. Only directors can sit on the audit committee. The Committee must have at least three members and the majority must be independent directors. One member must have an accounting or financial background.

Unlisted companies may make their own decisions about the composition of their boards, according to their ownership structure and purpose. It is widely accepted that companies benefit from having independent directors and the board chairperson should not be the CEO. However, this is not feasible for small, closely held companies. Entities that offer securities to the general public are regulated by the Securities Commission, which has recently published a set of Corporate Governance Principles. The Commission will be monitoring the uptake of those Principles.

APPENDIX A

SUMMARY REPORT

This is a Summary Report based on responses to the Pathfinder questionnaire. It has been broken down into two sections, the first is a brief summary of the information in the questionnaire response in dot point form and the second is a table based on the World Bank's ROSC evaluation table.

Once you have examined the Summary Report, any comments will be considered and appropriate amendments made to produce a final evaluation form.

The summary documents will be sources of data upon which the final Pathfinder report will be based, through collating and analysing the information contained in them. It is not proposed that the report would include full copies of either questionnaire responses or the final evaluation forms.

SUMMARY

Date submitted —

Overview of Environment

Disclosure and Transparency

Responsibilities of the Board

Notes on the Table

The table is based on the full ROSC evaluation table. It has been modified to fit the framework of the questionnaire and the proposed report framework. The principles are based on the OECD's Guidelines on Corporate Governance.

Key:

C = Consistent. Consistent with all aspects of the OECD Corporate Governance principles;

LC = Largely Consistent. Means only minor divergences from the OECD Corporate Governance principles are observed;

PC = Partially Consistent; Means that while the legal and regulatory framework is consistent with the OECD Corporate Governance principles, practices and enforcement diverge;

MC = Materially not Consistent; Means that divergences from the OECD Corporate Governance principles in respect of the legal and regulatory practices are significant, although some steps towards consistency with the principles have been made;

NC = Not Consistent; Means no substantive steps towards consistency with the OECD Corporate Governance principles have been taken.

QUESTIONNAIRE

Section A: Overview of Environment						
Stock Exchange:						
Main Govt. Agency:						
Central Bank:						
Main Legislation:						
Principle	C	LC	PC	MC	NC	Comment
Section B: Disclosure and transparency						
1. Basic shareholder rights						
2. Rights to participate in fundamental decisions						
3. Shareholders AGM rights						
4. Disproportionate control disclosure						
5. All shareholders should be treated equally						
6. Prohibit insider trading						
7. Standards of accounting & audit						
8. Independent audit annually						
9. Board/Managers disclose interests						
10. Access to information - Stakeholders						
11. Disclosure standards						
12. Fair & timely dissemination						
Section C: Responsibilities of the Board						
13. Acts with due diligence, care						
14. Treat all shareholders fairly						
15. Ensure compliance with the law						
16. The board should fulfil certain key functions						
17. The board should be able to exercise objective judgement						
18. Access to information – Directors						

EVALUATION FRAMEWORK — KEY TO PRINCIPLES IN QUESTIONNAIRE

Section B: Disclosure and Transparency

1. Principle — Basic shareholder rights

- The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to:
 - secure methods of ownership registration;
 - convey or transfer shares;
 - obtain relevant information on the corporation on a timely and regular basis;
 - participate and vote in general shareholder meetings;
 - elect members of the board; and
 - share in the profits of the corporation.

2. Principle — Rights to participate in fundamental changes

- Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:
 - amendments to the governing documents of the company;
 - the authorisation of additional shares; and
 - extraordinary transactions that in effect result in the sale of the company.

3. Principle — Shareholders AGM rights

- Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern them.
 - Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
 - Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations.

- Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.
4. Principle – Disproportionate control disclosure
 - Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
 5. Principle – All shareholders should be treated equally
 - The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same class should be treated equally.
 - Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote.
 - Votes should be cast by custodians or nominees in a manner agreed upon with the share's beneficial owner.
 6. Principle – Prohibit insider trading
 - Insider trading and abusive self-dealing should be prohibited.
 7. Principle – Standards of accounting and audit
 - Information should be prepared, audited and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure and audit.
 8. Principle – Independent audit annually
 - An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.
 9. Principle – Board/managers disclose interests
 - Members of the board and managers should be required to disclose any material interest in transactions or matters affecting the corporation.
 10. Principle – Access to information (stakeholders)
 - Where stakeholders participate in the corporate governance process, they should have access to relevant information.

11. Principle – Disclosure standards

- The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and the governance of the company. Disclosure should include, but not be limited to, material information on:
 - the financial and operating results of the company;
 - company objectives;
 - major share ownership and voting rights;
 - members of the board and key executives and their remuneration;
 - material foreseeable risk factors;
 - material issues regarding employees and other stakeholders;
 - governance structures and policies.

12. Principle – Fair and timely dissemination

- Channels for disseminating information should provide for fair, timely and cost effective access to relevant information by users.

Section C: Responsibilities of the Board

13. Principle – Acts with due diligence, care

- The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board and the board's accountability to the company and the shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interest of the company and the shareholders.

14. Principle – Treat all shareholders fairly

- Where the board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

15. Principle – Ensure compliance with the law

- The board should ensure compliance with applicable law and take into account the interests of stakeholders.

16. Principle – The board should fulfil certain key functions

- The board should fulfil certain key functions, including:
 - reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting key performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures;
 - selecting, compensating, monitoring and when necessary, replacing key executives and overseeing succession planning;
 - reviewing key executive and board remunerations and ensuring a formal and transparent board nomination process;
 - monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions;
 - ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control and compliance with the law;
 - monitoring the effectiveness of the governance practices under which it operates and making changes as needed;
 - overseeing the process of disclosure and communications.
- 17. Principle – The board should be able to exercise objective judgement
 - The board should be able to exercise objective judgement on corporate affairs independent, in particular, from management.
 - 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 financial reporting, nomination and executive and board remuneration.
 - Board members should devote sufficient time to their responsibilities.
- 18. Access to information (directors)
 - In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.