

**LEGAL ISSUES GERMANE  
TO  
CORPORATE  
GOVERNANCE**

**PSC Workshop  
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Hotel Tower Limited**

# What is corporate governance?

*“Corporate governance is the system by which businesses are directed and controlled.” Cadbury Report*

# Why should we care?

- Dominance of capitalism & rise of private sector
- Micro-economic growth engine
- High-profile corporate failures.
- World Bank / IMF
- Requirement of investors
- Requirement of other funding providers

# Legal Forms

Types of corporate governance regimes:

- Legislation e.g. companies act
- Regulation e.g. listing rules
- Self regulatory arrangements e.g. accounting and auditing profession
- Voluntary arrangements e.g. mutual agreement on form to adopt.

# Overview of Session

- **Global standard**
- **Where is world heading**
- **The Guyana scenario**

# Global Standard?

## OECD Principles

- Non-binding guidance for evaluation and improvements of existing frameworks.
- First published May 1999
- Revision published April 2004 incorporating new best practice.
- Focus on public companies.

# OECD Principles

## Six General Principles:

- I. Ensuring the basis for an effective corporate governance framework.
- II. The rights of shareholders and key ownership functions.
- III. The equitable treatment of shareholders.

# OECD Principles

- IV. The role of stakeholders in corporate governance
- V. Disclosure and transparency.
- VI. The responsibilities of the board.

# I: Effective Framework

*“The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity, and the incentives it creates for the market participants and the promotion of transparent and efficient market.”*

# I: Effective Framework

- Flexible laws & regulations maintaining transparency.
- Even-handed approach to legal and structural changes – consultation.
- With voluntary codes, clarity on terms of coverage, compliance, sanctions essential.
- Clear responsibilities for supervision, implementation and enforcement.

# I: Effective Framework

- Regulatory responsibilities should not give rise to conflict of interest.
- Regulators should be subject to judicial review.
- Regulators should be suitably qualified and experienced.

## II: Shareholder Rights

*“The corporate governance framework should protect and facilitate the exercise the shareholder’s rights.”*

## II: Shareholder Rights

- Have secure ownership of shares with ability to transfer.
- Obtain relevant company information on timely and regular basis.
- Participate and vote in general meetings.
- Elect members to the board.
- Share in the profits of the company.

## II: Shareholder Rights

- Participate in and be fully informed on fundamental corporate changes.
- Be informed of voting procedures.
- Provided with timely information on date, location, and agenda of general meeting.
- Given opportunity to ask questions of board, place items on agenda and propose resolutions.

## II: Shareholder Rights

- Participate in the nomination of board members & vote on nominees.
- Disclose remuneration policy.
- Able to vote without attending meeting through proxy.
- Distorting capital structures and voting arrangements should be disclosed to shareholders.

# III: Equitable Treatment

*“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.”*

# III: Equitable Treatment

- Within any class all shareholders should have the same voting rights.
- Any changes in rights should require approval by class negatively affected.
- Minority shareholders should be protected from abusive actions by controlling interests with a means of redress.

# III: Equitable Treatment

- Votes should be cast by custodians or nominees in a manner agreed by beneficial owner of shares.
- Procedures should not make it difficult or expensive to cast votes.
- Insider dealing should be prohibited.
- Disclosure of interest in transactions by board and managers.

## IV: Role of Stakeholders

*“ The corporate governance regime should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises. ”*

# IV: Role of Stakeholders

- Framework should ensure that rights of stakeholders are protected by law e.g. insolvency law, contract law, labour law.
- Permit performance enhancing mechanism e.g. employee representation, employee stock ownership, profit sharing plans.
- Able to communicate concerns (illegal or unethical practices) confidentially.

# V: Disclosure & Transparency

*“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 governance of the company.”*

# V: Disclosure & Transparency

- Annual accounts with comprehensive discussion and analysis of operations.
- Company objectives: commercial, business ethics, environment, public policy.
- Major share ownership and voting rights.
- Foreseeable risks: geographic, industry, commodity.

# V: Disclosure & Transparency

- Related party transactions.
- Remuneration details including policy for directors and key management. Link to company performance.
- Details on directors including qualification, share ownership, other directorships and independence status.

# V: Disclosure & Transparency

- High quality standards for accounting, financial and non-financial disclosure, and audit.
- External audit to be conducted by independent, qualified and competent auditor.
- Channels for disseminating information should be timely, fair and cost-efficient.

# VI: Board Responsibilities

*“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.”*

# VI: Board Responsibilities

- Duty of care and duty of loyalty.
- Even-handed treatment of all shareholders.
- Adopt high ethical standards – code of conduct.
- Review and guide corporate strategy, major action plans, risk policy, annual budgets, and business plans.
- Setting and monitoring performance objectives.

# VI: Board Responsibilities

- Overseeing major capital projects.
- Monitoring corporate governance practices.
- Selecting, compensating, monitoring and replacing directors and key executives.
- Overseeing succession planning.
- Ensure formal and transparent board nomination process.

# VI: Board Responsibilities

- Aligning remuneration of board and key management with company objectives.
- Monitoring and managing potential conflicts of interests e.g. misuse of assets and related party transactions.
- Monitor integrity of accounting and financial reporting system.

# VI: Board Responsibilities

- Monitor integrity of financial control and compliance issues.
- Sufficient number of independent NEDs, lead NED and separation of chair and CEO.
- Board members should have sufficient time to devote to responsibilities.
- Access to accurate, timely and relevant information – external advice?

# Global Standard?

OECD / World Bank Roundtables

- a) Asia
- b) Eurasia
- c) Latin America
- d) Russia
- e) South East Europe

# OECD Roundtables

Goal: To assist decision makers from the private and public sector in the developing markets in their efforts to improve corporate governance.

Outputs:

- a) Report of Experiences
- b) White Papers

# Report of Experiences

- Concentrated ownership: individuals and families, minority interests compromised? – improved transparency and disclosure
- Equitable treatment: controlling shareholders extract private benefits – greater use of NEDs
- Enforcement of existing laws – challenge human & financial resources.

# Report of Experiences

- “Rubber Stamp” boards – use more NEDs but are there enough?
- Inadequate disclosure – adoption of harmonized reporting standards
- Poor relations with human rights groups and environmentalists.

# Commonwealth Principles

- Commonwealth Association of Corporate Governance. Origination: 1998.
- Goal: *“To promote best international standards germane to a country on corporate governance through education, consultation and information throughout the Commonwealth”*

# Commonwealth Principles

- Non-binding principles issued 1999.  
Currently being redrafted.
- Primary focus of principles: Directors.

# Harmonization?

- Both the OECD and Commonwealth Principles are non-binding.
- Difficult to impose a “one-size fits all” methodology because of unique national characteristics that must be accounted.
- Efforts made in the European Union – Winter Report.

# Winter Report

- Company law experts to make recommendations on a modern regulatory framework EU re: company law and subsequently, corporate governance.
- Rejection of single EU code.
- CG: Partly rooted in Company Law which may be widely divergent.

# Winter Report

*“Effective harmonization of corporate governance codes while leaving company law untouched is not feasible.”*

EU should first coordinate the harmonization of company law, securities law as well as corporate governance codes.

# Winter Report

## Recommendations for action:

- Corporate governance statement.
- Use of proxies.
- Rights to ask questions, electronic means?
- Role of NEDs in widely dispersed investor
- NEDs should be competent and independent. Both should be explained.

# Caribbean Collective Efforts

- Caribbean Corporate Governance Forum.
- Promoted by the Eastern Caribbean Central Bank and Eastern Caribbean Securities Exchange.
- In coll. with Commonwealth Secretariat, GCGF, World Bank and the Caribbean Development Bank.
- No pronouncements to date.

# Where is the world heading?

- United States: Sarbanes / Oxley
- United Kingdom: Combined Code

# United States

- 51 States of union with individual state laws including company statute.
- Role of Federal government sought to be minimized.
- Role of Securities and Exchange Commission:  
*“ Protect investors and maintain integrity of the securities markets. ”*

# SEC

- Great Crash of 1929.
- Response was to pass Securities Act 1933 and the Securities Exchange Act 1934.
- SEC responsible for policing these acts +:
  - a) Investment Company Act 1940
  - b) Investment Advisers Act 1940
  - c) Sarbanes – Oxley Act 2002

# SOX 2002

- Public Company Accounting Reform and Investor Protection Act.
- Response to Enron, WorldCom.
- Coverage of:
  - a) Increased disclosure requirements.
  - b) Increased audit committee responsibility.
  - c) Increased focus on internal controls.
  - d) Increased oversight of auditors.

# SOX 2002

- Public Company Accounting Oversight Board (PCAOB) – overseen by SEC
- Independent, non-governmental board to oversee audits of public companies.
- To issue applicable auditing standards.
- Auditor registration required.
- Continuing program of inspection of audit work.
- Rules and procedures for disciplinary action.

# Auditor Independence

- a) Restriction of non-audit services such as: bookkeeping, financial information system design and implementation, appraisal or valuation services, actuarial services, internal audit, management functions, human resource services, legal services, investment advice.
- b) Other categories e.g. tax: AC approval

# Auditor Independence

- AC: Must pre-approve all audit, review and attestation services as well non-audit services
- Audit Partner Rotation: Rotate after 5 years and must spend 5 years time out.
- Cooling-off period: one year.
- Reports to AC (prior to SEC filing)

# Reports to be submitted

- Critical accounting issues.
- Alternative treatments of financial information – accounting and disclosure.
- Schedule of unadjusted errors.
- Management's representation letter.
- Reports on internal controls.
- Independence and engagement letters.

# Corporate Responsibility

- CEO and CFO certification of SEC filings
  - a) Reviewed the report
  - b) No untrue statements or material omission
  - c) Fair presentation
  - d) Responsible for and has designed, established and maintained controls, and evaluated those controls <90 days.

# Corporate Responsibility

- e) Deficiencies & weaknesses reported to AC.
  - Unlawful to manipulate or mislead auditor
  - Restatement due to non-compliance - forfeiture of bonuses and profits
  - June 2003: AC comprise independent persons, ability to engage experts.

# Enhanced Financial Disclosure

- MD&A expanded to include off-balance sheet items, unconsolidated subsidiaries and contractual obligations and non-GAAP measures.
- Unlawful to extend credit to director, even if through a subsidiary except if in ordinary course of business, made available to public & on commercial terms

# Enhanced Financial Disclosure

- Transactions involving directors, officers & shareholders (>10%) to be reported within 2 days of the transactions.
- S404!!!!
  - *Management Assessment of Internal Controls*
  - Applicable to all SEC filings: annual and quarterly.

# Section 404

- Responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting
  - Can't ask external auditors!!
  - Assessment of effectiveness.
  - Attestation by external auditor.
- 100% controls-based approach.

# Enhanced Financial Disclosure

- Adoption of Code of Ethics (or explain why not!).
- PwC Code of Conduct:
  - Is it against PwC or professional standards?
  - Does it feel right?
  - Is it legal?
  - Will it reflect negatively on you or PwC?

# Enhanced Financial Disclosure

- Who else could be affected by this?
- Would you be embarrassed if others knew you took this course of action?
- Is there an alternative action that does not pose an ethical conflict.
- How will it look in the newspapers?
- What would a reasonable person think?
- Can you sleep at night!!!???

# Enhanced Financial Disclosure

- AC financial expert.
- Independent?
- Attributes:
  - understand accounting principles
  - ability to apply accounting principles
  - experience in preparing, auditing, analyzing or evaluating financial statements.
  - Understand internal controls & FR procedures

# Enhanced Financial Disclosure

- understanding of AC functions
- education & experience

Other Disclosure Requirements:

Regulation S-K:

- Financial Information
- Management Discussion & Analysis
- Risks Faced
- Audit Committee Report
- Directors & Related Party Disclosures

# PwC September 2003 Survey

48 large US clients (T/O>\$18b)

- 94% revisited AC charter
- 81% implemented “whistleblower” process
- 50% performed self-assessment
- 46% changed AC composition.
- 85% hold more frequent AC meetings
- 83% hold longer AC meetings

# SEC Compliance Survey

5-year period – 515 enforcement actions.

- Improper revenue recognition – 126
- Improper expense recognition – 101
- Improper accg. business comb. – 23
- Inadequate MD&A & others – 137

# Combined Code

- Issued by the Financial Reporting Council
- Also sets accounting & auditing standards, & oversees professional bodies
- Separate CG committee
- Originally issued in 1998, combining previous reports: Cadbury, Greenbury and Hampel.
- Reissued in July 2003 – Smith & Higgs

# Combined Code

- Enforcer: Financial Services Authority
- Section of FSA: UK Listing Authority
- UKLA can impose penalties on both companies and directors.
- Code includes principles (generalized goals) & provisions (more specific recommendations)

# Combined Code

- Listing Rules require listed companies to:
  - a) Report how it applied principles
  - b) Confirm compliance with provisions, or explain why - **COMPLY OR EXPLAIN**
- PwC Survey in 2002 of 60 listed companies revealed high level of provision compliance
- Amazingly – no sanctions from FSA!

# “Comply or Explain”

Country	Issuer	Basis
Australia	Australian SX	C & E
Canada	Toronto SX	C & E
Germany	G’ovt Comm.	C & E
South Africa	Institute of Directors	C & E

# CC: The Board

- Annual report should identify :
  - what decisions are made by board and which delegated
  - Chair, CEO, SINED, Chair of Committee
- Chair to meet NEDs without executives
- NEDs should meet at least once annually
- Disagreement recorded in minutes

# CC: Chair/CEO & Board Balance

- Chair & CEO should not be same person.
- CEO should not go on to become the Chair

## BOARD BALANCE

- Annual report should identify which directors independent.
- At least half of board should be INDEPENDENT NEDs
- Independent Senior NED

# Independence

- Was an employee < 5 years
- Held material contract < 3 years
- Rec'd remuneration apart from director fees
- Has close family ties with other directors
- Represents a major shareholder
- Has served on board for more than 9 years
- Has significant links with other directors

# Appointments to Board

- Nomination committee with majority being INEDs
- Appointments based on skill, knowledge, and experience
- NEDs should have enough time. Executive not allowed > 1 NED on listed companies
- Description of work in the annual report, including process for appointments

# Development & Evaluation

- New directors should be provided with full, formal and tailored induction.
- Directors' access to professional advice at company's expense
- Directors' access to the company secretary.
- Annual report to state how directors are evaluated.
- SINED to evaluate chair

# Re-election

- Directors should stand at intervals not more than 3 years.
- Bio. data on directors for re-election
- Any term beyond 6 years for NED should be subject of rigorous review.
- NED serving after 9 years should be subject to annual re-election

# Remuneration

- Remuneration should be linked to performance.
- Remuneration Committee of at least 3 members who are all INEDs
- Responsible for setting remuneration of executive directors, senior management and chair
- Shareholders should determine NEDs' remuneration within Articles.

# Audit Committee

- Comprise at least 3 INEDs, including at least one financial expert.
- Responsibilities: Financial publications, financial controls, internal audit & external audit.
- Annual report should report on work of the committee, including safeguards for auditor independence re: non-audit services.

# Use of AGM

- Make use of AGM to communicate to investors and encourage participation
- Recognize all proxy votes
- Chairs of nomination, remuneration & audit committees should be available to answer questions
- Notice & related papers to be sent >20 days

# Accountant's Response

- International Federation of Accountants (IFAC) Task Force

*Rebuilding Public Confidence in Financial Reporting*

- Crow Report issued in 2003

# Crow Recommendations

- Effective Ethics Code for companies
- Greater emphasis on effective financial management and control
- Improved board oversight of management
- Reduced threats to auditor independence
- Improved audit effectiveness
- Adoption of international auditing and accounting standards

# GUYANA'S CHALLENGES

# The Guyana Scenario

## Applicable legislation

- Companies Act 1991
- Securities Industry Act 1998
- Labour, contract & environment laws

## Applicable regulation

- GSC “regulations”
- GASCI rules

# Companies Act 1991

## Relevant Public Companies Provisions:

- S36: company could require a member to disclose capacity shares held. Also could require information of agreements.
- S55: prohibits loans to directors unless part of ordinary course of business
- S59(2): directors should ensure that secretary has requisite knowledge and experience.

# Companies Act 1991

- S60: Must have a minimum of two directors
- S68: Appointment of directors by ordinary resolution & for a period not exceeding 5 years but may be reappointed for not more than 5-year periods.
- S126 & S127: Substantial shareholder (>10%) must give notice of becoming or ceasing.

# Companies Act 1991

Other provisions applicable to all companies:

- S33: Pre-emptive right to shareholders once articles contains such a clause.
- S90: Director party to material contract – disclose in writing or request be part of minutes. Allowed to vote but 2/3 majority.
- S93: If not disclose, court could set aside contract on decided terms.

# Companies Act 1991

- S104: No director's remuneration paid unless specified in articles, by-laws, service contract and authorized at general meeting.
- S136: Court could call general meeting on application of shareholder.
- S142: Proxy votes are allowed.
- S163: Director's emoluments disclosed.

# Securities Industry Act 1998

Created Guyana Securities Council to:

- Advise Minister
- Maintain surveillance
- Register, authorize and regulate
- Protect integrity of securities markets from insider trading
- Create and promote conducive conditions

# Securities Industry Act 1998

Regulation 8 “Disclosure by Reporting Issuers” requires:

- Enhanced director’s report to include director’s interests, accounting departures, director’s interests in contracts, provision of services to controlling shareholder.
- Interim reports
- Disclosure re: S126 & S127 CA 1991

# Securities Industry Act 1998

- Disclosure of certain transactions:
  - a) Transactions with related parties for loans or financial assistance, guarantees & any of “out of the ordinary” transactions.
  - b) Acquisition or disposal of assets when it is significant or to a related party.
- Notification of certain important meetings and decisions.

# Sanctions of GSC: Reg 8

- For the issuer:
  - censure
  - publish fact of censure
  - suspend trading or stop listing
- For the directors:
  - privately censure
  - publish fact
  - “prejudicial” announcement
  - \$250,000 fine & 2 years imprisonment

# GSC Governance “Regs”

- Directors re-election at no more than 3 year intervals.
- Sufficient bio data on directors for re-election
- Training to be provided to new directors.
- Access to independent advice.
- NEDs  $>1/3$  of board

# GSC Governance “Regs”

- Execs should only take NED in other cos.
- Encourages separation of chair and CEO. Where necessary, publicly justify
- NEDs should be free from any business relationship with company
- At least 3 sub- committees: Audit ( >3 NEDs), Governance, & Remuneration (all NEDs)

# GSC Governance “Regs”

- Executive remuneration should be based on corporate and individual performance
- Annual report should contain details of remuneration
- Chairs of committees available to answer questions
- Directors should make a statement in accounts on internal control

# GSC Governance “Regs”

- Companies should have an effective internal audit regime.
- IFRS should be followed.
- AC should maintain record of non-audit services.

# GASCI Rules

- No companies on Official List
- No corporate governance rules anyway.

# NEXT STEPS