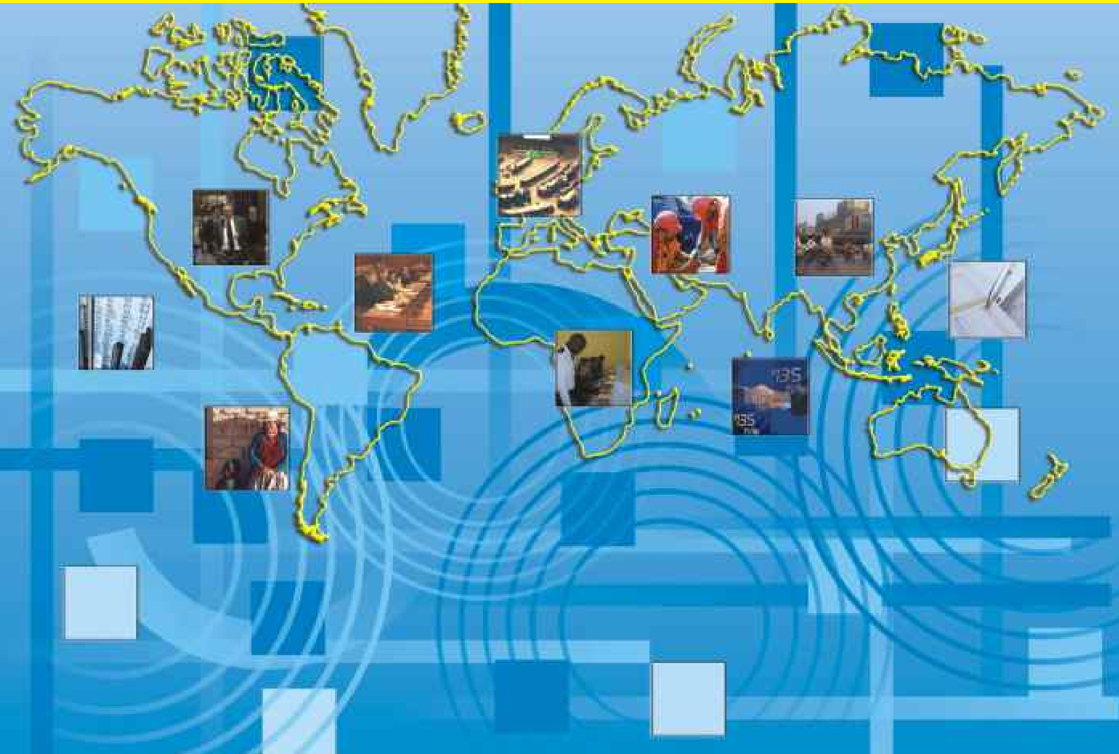
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

GUIDANCE ON GOOD PRACTICES IN CORPORATE GOVERNANCE DISCLOSURE



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United Nations

New York and Geneva, 2006

NOTES

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PREFACE

The issue of corporate governance continues to receive a high level of attention. Valuable lessons have been learned from the series of corporate collapses that occurred in different parts of the world in the early part of this decade. Since then, UN member States have undertaken various actions to strengthen their regulatory frameworks in this area in order to restore investor confidence, and enhance corporate transparency and accountability.

At UNCTAD's 10th quadrennial conference, which was held in Bangkok in February 2000, member States requested it to promote increased transparency and improved corporate governance. In response, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) at UNCTAD conducted a series of consultations and deliberations on corporate governance disclosure during its annual sessions with a view to assisting developing countries and countries with economies in transition in identifying and implementing good corporate governance practices.

This was undertaken as part of the larger goal of achieving better corporate transparency and accountability in order to facilitate investment flows and mobilize financial resources for economic development.

At its 21st session in 2004, the Group of Experts agreed to consider further developments in the area of disclosures and to update its earlier work as needed. Accordingly, the updating work was conducted and reviewed at the 22nd session of the Group of Experts in 2005, where it was decided to prepare this guidance for publication and disseminate it as widely as possible. ISAR's decision was welcomed by delegates during the 10th session of the Commission on Investment, Technology and Related Financial Issues in 2006, where delegates commended the report for its usefulness and recognized the need for tools to promote good practices in corporate transparency and reporting.

This document is therefore expected to serve as a useful tool for drawing attention to good corporate governance disclosure practices that enterprises in different parts of the world might wish to emulate.

Supachai Panitchpakdi
Secretary-General of UNCTAD

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INTRODUCTION

This guidance is a voluntary technical aid for, among others, regulators and companies in developing countries and transition economies. What and how organisations disclose will depend considerably on local laws and customs. In addition, particular industries may have some industry-specific disclosure requirements. In order to facilitate the general usefulness of this document, the focus is placed on widely applicable disclosure issues that should be relevant to most enterprises.

The purpose of this guidance is to assist the preparers of enterprise reporting in producing disclosures on corporate governance which will address the major concerns of investors and other stakeholders. This work would be relevant to enterprises eager to attract investment regardless of their legal form or size. This guidance would also be useful for promoting awareness in countries and companies that are not sufficiently adhering to international good practices and are consequently failing to satisfy investors' expectations regarding corporate governance disclosures.

This document draws upon recommendations for disclosure relevant to corporate governance contained in such widely recognized documents as the revised OECD Principles of Corporate Governance (OECD Principles), the International Corporate Governance Network (ICGN) Corporate Governance Principles, past ISAR conclusions on this matter, the Commonwealth Association for Corporate Governance Guidelines (CACG Guidelines), the pronouncements of the European Association of Securities Dealers (EASD), the EU Transparency Directive, the King II Report on Corporate Governance for South Africa, the Report of the Cadbury Committee on the Financial Aspects of Corporate Governance (Cadbury Report), the Combined Code of the UK, the United States Sarbanes-Oxley Act, and many others (see Annex I). References to codes in this report are provided by way of example only, and for every individual code highlighted, there may exist other codes that address the same issue in a similar way.

Reference is made to the recommendations contained in the foregoing documents, since one objective of this guidance is to illustrate the convergence of opinion on the content of corporate governance disclosures. Another objective of this guidance is to encourage countries and/or companies to implement best international practices in a way tailored to their particular legal requirements and local traditions by giving various examples of existing best practices.

The guidance revisits the content of major corporate governance codes and regulations with a focus on financial disclosures, a range of non-financial disclosures, disclosures in relation to general meetings, the timing and means of disclosures and the disclosure of the degree of compliance with local or other codes of corporate governance. The following sections present the main recommendations on these issues.

I. FINANCIAL DISCLOSURES

***Enterprises should disclose their financial and operating results*.**

One of the major responsibilities of the board of directors is to ensure that shareholders and other stakeholders are provided with high-quality disclosures on the financial and operating results of the entity that the board of directors have been entrusted with governing. Almost all corporate governance codes around the world, including the OECD and the ICGN Principles, the CACG Guidelines, the Cadbury Report, and the King II, specifically require the board of directors to provide shareholders and other stakeholders with information on the financial and operating results of a company to enable them to properly understand the nature of its business, its current state of affairs and how it is being developed for the future.

The quality of financial disclosure depends significantly on the robustness of the financial reporting standards on the basis of which the financial information is prepared and reported. In most circumstances, the financial reporting standards required for corporate reporting are contained in the generally accepted accounting principles recognized in the country where the entity is domiciled. Over the last few decades, there has been increasing convergence towards a set of non-jurisdiction specific, widely recognized financial reporting-standards. The International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board provide a widely recognized benchmark in this respect.

Furthermore, the board of directors could enrich the usefulness of the disclosures on the financial and operating results of a company by providing further explanation, for example in the Management's Discussion and Analysis section of the annual report, on critical accounting estimates[1] of the company in addition to the disclosure required by the applicable financial reporting standards.

The board could clearly identify inherent risks and estimates used in the preparation and reporting of the financial and operational results of the company in order to give investors a better understanding of the risks they are taking in relying on the judgement of management. For example, in some cases, financial reporting measurement requirements call for the valuation of certain assets on a fair value basis. However, while for certain assets deep markets might exist and fair value could be obtained with reasonable objectivity, that might not be the case for others. Situations of the latter kind may invite management to exercise great latitude and influence the direction of earnings in its favour by resorting to less objective estimates based on modelling hypothetical markets. In addition to the disclosure required by the applicable financial reporting standards, the board of directors may provide further comfort to shareholders and other stakeholders by disclosing that the board or its audit committee has reviewed fair value computations, if any, and that the computations were conducted in an objective manner.

The board's responsibilities regarding financial communications should be disclosed.

[1] An example of a definition of critical accounting can be found in the United States Securities and Exchange Commission Release number 33-8098, according to which an accounting estimate would be considered critical when it requires management to make significant judgement in making assumptions about matters that were highly uncertain at the time the estimate was made; and when alternative estimates that management could have reasonably used, or changes in the accounting estimate that are likely to occur from period to period, have material impact on the financial and operating results of the company.

A description of the board's duties in overseeing the process of producing the financial statements should be provided. This is useful for supporting the notion that the board is responsible for creating an overall context of transparency. It is generally accepted that the board has responsibility for reporting on the financial and operating results of the corporation. Almost all corporate governance codes describe the basic responsibility of the board for reviewing financial statements, approving them, and then submitting them to shareholders. When the duties of the board in this area are clearly disclosed, shareholders and other stakeholders could find it useful in providing an additional level of comfort regarding the fact that the financial statements accurately represent the situation of the company.

The quality of financial disclosure could be undermined when consolidation requirements on financial reporting are not followed appropriately. In this respect, the board of directors could provide additional comfort to users of its financial reports. For example, the board of directors could state that it had ascertained that all subsidiaries and affiliated entities, including special-purpose ones, which are subject to consolidation as per the financial reporting standards applicable to the entity, have been properly consolidated and presented.

Enterprises should fully disclose significant transactions with related parties.

Many shareholders and stakeholders would be interested in information that would help them determine that management is running the enterprise with the best interest of all shareholders and stakeholders in mind and not to unduly benefit any related parties (see also section II.E.6 below on conflict of interest). Most national financial reporting standards, and IFRS, require extensive disclosure on this matter. However, in circumstances where the financial reporting requirements are less stringent, as a minimum, the board of directors should provide the following disclosures that are generally considered best-practice: significant related-party transactions and any related-party relationships where control exists; disclosure of the nature, type and elements of the related-party transactions; and related-party relationships where control exists (irrespective of whether there have been transactions with parties under common control). The decision-making process for approving related-party transactions should also be disclosed. Members of the board and managers should disclose any material interests in transactions or other matters affecting the company.

II. NON-FINANCIAL DISCLOSURES

A. Company Objectives

***The objectives of the enterprise should be disclosed*.**

There are two general categories of company objectives: the first is commercial objectives, such as increasing productivity or identifying a sector focus; the second is much more fundamental and relates to governance objectives: it seeks to answer the basic question, "why does the company exist?" This section refers to these governance objectives. The objectives of enterprises may vary according to the values of society. In many countries, but by no means all, the primary corporate objective is to maximize the long-term return to shareholders (shareholder value). This objective appears in many codes throughout the world.

However, despite an increasing awareness throughout the world that shareholder requirements must be met in order to attract and retain long-term, low-cost capital, the emphasis on shareholder value maximization has not precluded a growing emphasis on other corporate objectives. Many codes now include social, environmental and economic objectives as part of the fundamental objectives of an enterprise. In particular, the codes emphasize the need for enterprises to address the interests of a range of stakeholders in order to promote the long-term sustainability of the enterprise. If an enterprise knowingly damages the interests of its stakeholders, it can risk negatively affecting its own ability to produce long-term shareholder value. This suggests that rather than viewing shareholder value and stakeholder value as mutually exclusive objectives, there are indications that the opposite is true, and that the two objectives are probably interdependent in the long run. This emphasis on a broader set of objectives can be found in the Revised OECD Guidelines on Multinational Enterprises, the 2004 edition of the OECD Principles of Corporate Governance, proposed revisions of the UK Companies Act, and the King II Report.

B. Ownership and Shareholder Rights

***The beneficiary ownership structure should be fully disclosed to all interested parties. Changes in the shareholdings of substantial investors should be disclosed to the market as soon as a company becomes aware of them*.**

The beneficiary ownership structure of an enterprise is of great importance in an investment decision, especially with regard to the equitable treatment of shareholders. In order to make an informed decision about the company, investors need access to information regarding its ownership structure.

It is recommended that this disclosure includes the concentration of shareholdings, for example the holdings of the top twenty largest shareholders. This information is of particular interest to minority shareholders. In some countries (e.g. Germany) disclosure is required when certain thresholds of ownership are passed.

Disclosure should be made of the control structure and of how shareholders or other members of the organisation can exercise their control rights through voting or other means. Any arrangement under which some shareholders may have a degree of control disproportionate to their equity ownership, whether through differential voting rights, appointment of directors or other mechanisms, should be disclosed. Any specific structures or procedures which are in place to protect the interests of minority shareholders should be disclosed.

In certain cases, control is exercised indirectly via the ownership of one or several entities that in turn (collectively) control a corporation (i.e. a pyramid structure). In such cases, the disclosure of ultimate control is considered best practice.

As noted in the OECD Principles, information about record ownership may need to be complemented with information about beneficial ownership, in order to identify potential conflicts of interest, related-party transactions and insider trading. In disclosing beneficial (or ultimate) ownership, information should also be provided about shareholder agreements, voting caps and cross-shareholdings, as well as the rights of different classes of shares that the company may have issued.

A company might have a single shareholder or group of shareholders with majority control of the company, either through holding the majority of the company's outstanding equity or through holding shares with superior voting rights. In this situation, without safeguards for minority shareholders, the latter group may be adversely affected. This issue is emphasized by a number of codes, including the OECD Principles.

A number of international statements advocate a "one share one vote" approach. Although the OECD Principles do not advocate any particular view on the "one share one vote" approach, the Principles include examples of other international statements that do advocate a "one share one vote" approach. The International Corporate Governance Network, among others, is a strong supporter of this approach. Advocates of the "one share one vote" approach view any deviation from this approach as an undesirable distortion of the connection between investment risk and the decision-making process. However, actual practice might be different. For example, in the European Union, many member States do allow shares with multiple or no voting rights. While this practice remains controversial, it may be tolerated by investors as long as differentials in voting rights are disclosed. The European Association of Securities Dealers does not support such differentials but allows flexibility, noting that if they cannot be avoided they should at least be indicated by a different share class (EASD Principles, Recommendation II.2).

C. Changes in Control and Transactions Involving Significant Assets

***Rules and procedures governing the acquisition of corporate control in the capital markets and extraordinary transactions such as mergers and sales of substantial portions of corporate assets should be disclosed*.**

Best practice suggests a substantial amount of pre-control transaction disclosure, including the disclosure of the intention to acquire control, and to take the company private, and of associated squeeze-out/sell-out rights relevant for minority shareholders. Other typical disclosures include the identity of the bidder, past contacts, transactions and agreements between the merging entities (or acquirer and target, as the case may be), and a discussion of the consequences of the control transaction for the shareholders of the companies involved, as well as disclosure of the financial situation of the bidder and its source of funds for the control transaction.

This disclosure should include any anti-takeover measures established by the enterprise. It should also cover the compensation policy for senior executives leaving the firm as a result of a merger or acquisition.

Best practice disclosure for sales of substantial portions of corporate assets include a notice to all shareholders (usually at the annual general meeting), accompanied by an independent evaluation report. In the Republic of Korea, for example, the Corporations Code requires a special resolution for a transaction that may result in the sale of a substantial part of the enterprise. For such transactions involving listed companies, additional disclosure and substantive requirements are imposed. In South Africa, the Companies Act requires approval of the shareholder meeting for sales of the whole or the greater part of the company's assets, and for listed companies such approval is required for any transaction over 30% of assets. In most governance systems, it is generally considered good practice to submit questions of extraordinary transactions (including mergers, acquisitions and takeovers) to a general meeting for shareholder approval.

In the interest of protecting minority shareholders, the principle of "equality of disclosure" should be practised, such that all shareholders receive information equally.

Any information disclosed to one shareholder should also be equally available to all shareholders (FEE, 2003a). This reflects the view that all shareholders should have a right to be equally informed, and complements the issue of simultaneous disclosure of information discussed in section IV below. Major shareholders such as institutional investors should not have privileged access to information that is unavailable to minority shareholders.

D. Governance Structures and Policies

The structure, role and functions of the board

The term "board" has different meanings in unitary and two-tier systems. A unitary board is composed of executive and non-executive directors. In a two-tier system the term "board" is distinguished between the management board, whose members have executive responsibilities, and the supervisory board, responsible for the monitoring and supervision of the company's management. Variations exist among the two-tier systems, and the responsibilities of the supervisory board could in some countries include responsibilities for the strategic direction of the company. While the two-tier system is not as widely utilized as the one-tier system, it is nevertheless prevalent in several large economies such as Austria, Germany and the Netherlands. In this document, the term "board" is used to refer to the highest governing and monitoring body or bodies of an enterprise on which executive and non-executive or supervisory board members sit. The recommendations contained herein typically apply to both one-tier and two-tier systems.

The composition of the board should be disclosed, in particular the balance of executives and non-executive directors, and whether any of the non-executives have any affiliations (direct or indirect) with the company. Where there might be issues that stakeholders might perceive as challenging the independence of non-executive directors, companies should disclose why those issues do not impinge on the governance role of the non-executive directors as a group.

One of the main issues in relation to the board structure and its disclosure is that, regardless of which structure exists in the company, independent leadership within the board is ensured. Some countries would give more emphasis to the need for a clear division of responsibilities between the chairman and the chief executive officer (CEO) (Cadbury Report, para. 4.9) Increasingly, codes mention that while a combined CEO/Chair is tolerable (in a one-tier system), the separation of the two is desirable and considered best practice, as it helps to promote a balance of power within the leadership structure. There is also increasing debate on the need for an independent Chair of the board. Even within economies where a combined role is still common, the accepted view is that measures are called for to balance the power at the head of the corporation such that no single individual has unfettered control of the company (FEE, 2003a).

If the roles of chairman and CEO are combined, the proportion of independent directors within the board structure assumes greater importance. For example, the Cadbury Report recommended that where the roles were combined, there should be a strong independent element on the board and that there should be a lead non-executive director to whom issues regarding the executive management could be addressed. This idea is followed by the Indian code and was also addressed in the 2002 Report of the Kumar Mangalam Birla Committee on Corporate Governance. The idea is also expressed in the Malaysian Code on Corporate Governance (2000). However, the definition of an independent director varies in different countries. Therefore, a reference to a particular approach used in defining director independence might be useful in disclosing and discussing the board structure. FEE (2003a), for example, recommends that a principles-based approach used for assessing the independence of external auditors (see section H below) can also be usefully applied to the assessment of independence among non-executive (supervisory) directors. A crucial general principle in this respect is the principle of self-interest threat; a self-interest threat occurs when a director could benefit from a financial or other interest in the enterprise, as a result of unethical behaviour or lack of independence (FEE, 2003b). FEE further recommends that the board should disclose its reasons for considering a non-executive (or supervisory) director to be independent.

It is recognized that not all non-executive directors can be considered independent directors. The Narayan Murty Committee Report in India, for instance, makes a clear distinction between non-executive and independent directors. For example, non-executive directors who are employees of banks and other financial institutions with which the enterprise has a business relationship cannot be considered independent. Similarly, for the boards of subsidiary companies, it is not uncommon for non-executive directors to be employees of the parent firm or some other subsidiary related to the parent firm. Any relationship of directors to the parent firm or its subsidiaries should therefore be disclosed. Such a relationship could be considered in assessing the ability of the non-executive director to fulfil his or her duties.

***The board's role and functions must be fully disclosed*.**

Most guidelines and codes of best practice emphasize the stewardship and supervision functions of the board and distinguish its responsibilities from those of management. It is important that directors disclose what their functions and retained powers are, otherwise they may be considered accountable for all matters connected with the enterprise. In many Commonwealth countries, for example, the Companies Act makes the directors accountable for the "management" of the company, but also allows them to delegate; hence the importance of recording and disclosing the retained powers of the directors, along with a clear statement about which powers are delegated to the CEO. However, there are differences in the specificity with which the board's role is explained. For example, the Dey Report (Canada), the Vienot Report (France), the Korean Stock Exchange Code, Malaysia's Report on Corporate Governance, Mexico's Code of Corporate Governance and the King II Report (South Africa) specify board functions as strategic planning, risk identification and management selection, oversight and compensation of senior management, succession planning, communications with shareholders, integrity of financial controls and general legal compliance. In India, for example, a director's responsibility statement outlining the board's responsibilities on compliance with standards, internal controls, risk management, fraud detection and other matters, is a disclosure requirement under both the law and stock exchange rules. The degree of differences between codes may reflect the degree to which company law or listing standards specify board responsibilities.

Board committees

It has become a common practice for boards to establish board committees to facilitate fulfilment of certain of the board's functions and address some potential conflicts of interest. The use of board committees is, among other things, intended to enhance independent judgement on matters in which there is potential for conflict of interest, and to bring special expertise in areas such as audit, risk management, election of board members and executive remuneration. While it may be advisable for the preparatory work of certain key board functions to be assigned to separate committees, there is an international consensus that the full board holds collective and final responsibility (FEE, 2003a).

Governance structures should be disclosed. In particular, the board should disclose structures put in place to prevent conflicts between the interests of the directors and management on the one side, and those of shareholders and other stakeholders on the other.

These structures may include committees or groups to which the board has assigned duties regarding the oversight of executive remuneration, audit matters, appointments to the board, and the evaluation of management performance.

The composition and functions of any such groups or committees should be fully disclosed. Committee charters, terms of reference or other company documents outlining the duties and powers of the committee or its members should also be disclosed, including whether or not the committee is empowered to make decisions which bind the board, or whether the committee can only make recommendations to the board. Where any director has taken on a specific role for the board or within one of these structures, this should be disclosed.

Internationally, there has been consensus that although a board has collective and final responsibility, the use of committees for the preparatory work of certain key board functions is advisable. This is especially true where executives may find themselves facing conflicts of interest, for example in the areas of audits, remuneration and director nomination. A number of codes address this issue, also outlining the need for clear terms of reference for such committees (e.g. Australia, India, Malaysia, South Africa).

As a general rule, codes have recommended, and in some cases stock exchange regulations require, that some board committees be substantially or exclusively staffed by non-executive or outside directors, particularly independent directors, and especially with regard to the committee chairpersons. Disclosures that are becoming increasingly common include the disclosure of committee charters or terms of reference, committee chairs, reports on activities (in particular those of the audit committee), composition, nominations committee disclosure on whether use is made of external advisers/advertising to find new directors (as opposed to potentially conflicting informal connections), and the effectiveness of executive remuneration in providing incentives for executives.

Ethics policy and support structure

The existence of an enterprise code of ethics and any governance structure put in place to support that code of ethics should be disclosed. Any waivers to the code of ethics or the rules governing ethics procedures should also be disclosed.

Ethics management is important for the promotion of good business practices, transparency and risk reduction. As ethics management becomes more common in enterprises, the existence of its key structural features is an important area of disclosure. It is noted that, with the exception of some countries such as the United States, no general or international best practice has yet been established in this area. Nevertheless, some possible features subject to disclosure might include: the existence of a senior ethics officer and that person's responsibilities; the existence of an ethics committee and its relationship to the board; policies for breaches of the ethics code, including reporting mechanisms and "whistleblower" protection mechanisms; and policies on the dissemination and promotion of the ethics code.

E. Members of the Board and Key Executives

1. Duties and qualifications

The number, type and duties of board positions held by an individual director should be disclosed. An enterprise should also disclose the actual board positions held, and whether or not the enterprise has a policy limiting the number of board positions any one director can hold.

Shareholders need to be aware of the number, type and duties of outside board and management positions that any individual director holds. Information on outside board and management positions should be disclosed for key executives as well. The purpose of this information is to make a judgement on the ability of directors and key executives to meet all of their commitments; thus the number as well as the type and duties of the position (which gives some indication of the commitment involved) should be disclosed.

Many codes and institutional investors have specified disclosure requirements (and/or actual limitations) on the number and type of positions held by directors. Among others, such disclosure requirements can be found in the positions of the FEE and the Winter Group Report, the Dey Report, the Indian Code, the Malaysian Code, the King II Report and the National Association of Pension Funds in the UK. Some guidance, such as the report of the FEE, also recommends disclosure of positions held in public or not-for-profit organisations.

There should be sufficient disclosure of the qualifications and biographical information of all board members to assure shareholders and other stakeholders that the members can effectively fulfil their responsibilities. There should also be disclosure of the mechanisms which are in place to act as "checks and balances" on key individuals in the enterprise**.**

Most governance guidelines and codes of best practice address topics related to directors' qualifications and board membership criteria. These may include experience, personal characteristics, core competencies, availability, diversity, age, specific skills (e.g. the understanding of particular technologies), international background, and so on. The CACG, for example, indicates that the director has to have integrity, common sense, business acumen and leadership. Some codes specifically require financial literacy (e.g. the National Association of Corporate Directors in the United States) or knowledge of business and financial technology (e.g. the Brazilian Institute of Corporate Governance).

There should be disclosure of the types of development and training that directors undergo at induction as well as the actual training directors received during the reporting period**.**

Recently, some countries have started to require specific training for directors. For example, in India, the Companies (Amendment) Bill 2003 makes director training mandatory. The Naresh Chandra Committee on Corporate Audit and Governance, also of India, recommends training for independent directors and disclosure thereof.

***The board should disclose facilities which may exist to provide members with professional advice. The board should also disclose whether that facility has been used during the reporting period*.**

On certain legal and financial matters, directors might discharge their duties more effectively if allowed access to independent external advisers, for example legal and financial experts. If used correctly, access to external expertise can enhance the ability of directors to fulfil their duties properly. In New Zealand, for example, it is considered vital for directors to have access to independent advice, and therefore this principle is stated in that country's Companies Act. The Merged Code in Belgium also points out the need for an agreed procedure for using external expertise, a point also mentioned in the Dey Report (Canada), and the Vienot (France), Mertanzis (Greece) and Olivencia (Spain) reports. Best practice suggests that whatever approach is used, the approach should be disclosed.

2. Evaluation mechanism

***The board should disclose whether it has a performance evaluation process in place, either for the board as a whole or for individual members. Disclosure should be made of how the board has evaluated its performance and how the results of the appraisal are being used*.**

Along with the duties and responsibilities of directors, shareholders will need to know how directors were evaluated, what criteria were used and how they were applied in practice, particularly with reference to remuneration.

CACG Guidelines stress that evaluations should be based on objective criteria. The IAIM Guidelines (Ireland) and Preda Code (Italy) leave to the remuneration committee the selection of appropriate criteria and the establishment of whether these criteria have been met.

An important aspect of performance is the attendance of directors at board and committee meetings. Specific requirements regarding disclosure of the frequency and procedures of board meetings can be found, for example, in the Indian Code, the King II Report and the Combined Code of the United Kingdom.

3. Directors' remuneration

***Directors should disclose the mechanism for setting directors' remuneration and its structure. A clear distinction should be made between remuneration mechanisms for executive directors and non-executive directors. Disclosure should be comprehensive to demonstrate to shareholders and other stakeholders whether remuneration is tied to the company's long-term performance as measured by recognized criteria. Information regarding compensation packages should include salary, bonuses, pensions, share payments and all other benefits, financial or otherwise, as well as reimbursed expenses. Where share options for directors are used as incentives but are not disclosed as disaggregated expenses in the accounts, their cost should be fully disclosed using a widely accepted pricing model*.**

The current level of disclosure relating to directors' remuneration varies widely. However, the trend appears to be towards greater levels of disclosure in this area, especially in Europe: France, Germany, Luxembourg, the Netherlands, Switzerland and the United Kingdom have all introduced laws to enforce the disclosure of directors' individual remuneration. In the United Kingdom, for example, the report of the company's remuneration committee must identify each director and specify his or her total compensation package, including share options. Recently added regulations also require companies to put their remuneration report to a shareholder vote at each annual general meeting. Elsewhere in the world there are other examples of this practice. The Indian Code, for instance, requires disclosure about remuneration in a section of the annual report on corporate governance, in addition to suitable disclosure on directors' remuneration in the profit and loss statement.

The length of directors' contracts and the termination of service notice requirements, as well as the nature of compensation payable to any director for cancellation of service contract, should be disclosed. A specific reference should be made to any special arrangement relating to severance payments to directors in the event of a takeover.

4. Succession planning

The board should disclose whether it has established a succession plan for key executives and other board members to ensure that there is a strategy for continuity of operations.

OECD Principle IV.D.2 stresses that overseeing succession planning is a key function of the board, while the Dey Report (Canada) considers it an important stewardship duty of the company, and the Vienot Report I (France) recommends that the selection committee be prepared to propose successors at short notice. While specific details regarding potential successors might be the subject of confidentiality, the existence of a procedure and a preparedness to appoint successors as necessary is not confidential, and should be the subject of disclosure.

5. Conflict of interest

***Conflicts of interest affecting members of the board should, if they are not avoidable, at least be disclosed. The board of directors should disclose whether it has a formal procedure for addressing such situations, as well as the hierarchy of obligations to which directors are subject*.**

Conflicts of interest are required to be disclosed by law in many countries. The critical issue is that all conflicts of interest should be disclosed, along with what the board decided to do regarding the specific situation and the relevant director involved.

F. Material Issues Regarding Stakeholders, and Environmental and Social Stewardship

***The board should disclose whether there is a mechanism protecting the rights of other stakeholders in a business*.**

OECD Principle IV concerns itself with ensuring that the rights of stakeholders protected by law are respected. Even where no legislation exists, it is considered good practice to make additional commitments, as corporate reputation and performance may require recognition of broader interests. For example, the CACG Guidelines require that a board identify the corporation's internal and external stakeholders and agree on a policy for how the corporation should relate to them.

The role of employees in corporate governance should be disclosed.

Among member States of the European Union, for example, various practices exist where employees elect some of the supervisory directors, can be given a right to nominate one or more directors or can have an advisory voice on certain issues discussed by the board. This practice is considered by some to dilute the influence of shareholders, and to be a distortion of the connection between investment risk and the decision-making process. Others consider the strong interest of employees in the enterprise to warrant their special status in the governance process, and view employee involvement as having a beneficial effect on the overall sustainability of the firm. Regardless of one's views, any mechanisms for employee involvement in the governance of the enterprise should be clearly disclosed.

***The board should disclose its policy and performance in connection with environmental and social responsibility and the impact of this policy and performance on the firm's sustainability*.**

The environmental dimension of this issue was addressed by ISAR in its agreed conclusions on Accounting and Financial Reporting for Environmental Costs and Liabilities. ISAR noted that an enterprise's environmental performance could affect its financial health and hence its sustainability. At its twentieth session, ISAR concluded that the pressure for better reporting on social issues was increasing and that enterprises were producing more information on this topic. Among others, the King II Report (South Africa), the Association of British Insurers (UK) in its Disclosure Guidelines on Socially Responsible Investment, and the guidelines of the Global Reporting Initiative encourage disclosure of governance mechanisms in place to support improvement of social and environmental performance. Such governance disclosure is also relevant for creators of "socially responsible investing" indexes, such as the Domini 400 Social Index produced by KLD Research & Analystics in the United States, the FTSE4GOOD produced by FTSE in the United Kingdom, or the Dow Jones Sustainability Worlds Indexes (DJSI) produced by the SAM Group of Switzerland in conjunction with Dow Jones Ltd and STOXXX Ltd.

G. Material Foreseeable Risk Factors

The board should give appropriate disclosures and assurance regarding its risk management objectives, systems and activities. The board should disclose existing provisions for identifying and managing the effects of risk-bearing activities. The board should report on internal control systems designed to mitigate risks. Such reporting should include risk identification mechanisms.

In recent years, much attention has been paid to the role of the board in risk assessment or management and internal controls designed to mitigate risk. This issue is emphasized in most codes and principles, including the OECD Principles, the CACG Guidelines, King II and the United Kingdom's Combined Code.

Users of financial information and participants in the marketplace need information on foreseeable material risks, including risks specific to industries or geographical areas, dependence on certain commodities, financial market risk and derivative risks. The corporate governance structures in place to assess, manage and report on these types of risks should be the subject of corporate governance disclosure.

H. Independence of External Auditors

The board should disclose that it has confidence that the external auditors are independent and their competency and integrity have not been compromised in any way. The process for the appointment of and interaction with external auditors should be disclosed.

Independent external audits should provide an objective assurance that the financial statements present a true and fair view (or are presented fairly in all material respects) of the financial condition and performance of the audited entity. Therefore, most governance codes and guidelines define procedures for enhancing the independence, objectivity and professionalism of the external audit. A number of approaches regarding the external audit, such as the need for audit partner rotation and the avoidance of possible conflicts of interest involved in providing non-audit services, can be considered to ensure that external audits serve shareholder and other stakeholder interests in the intended manner.

Auditor independence is a prerequisite for the reliability and credibility of the audit of financial statements. Adopting a principles-based approach to auditor independence (as set out in the EC's 2002 recommendation on auditor independence and in the IFAC Code of Ethics) is valued for its adaptability to new practices. The principles-based approach sets out the fundamental principles which must always be observed by the auditor and considers the threats and safeguards (including restrictions and prohibitions) to be in place to ensure the auditors' independence and objectivity. However, it could be useful for enterprises to disclose a substantial definition of those activities that would be regarded as non-audit-related, especially in those cases where audit and non-audit-related fees are not subject to mandatory disclosure.

Disclosures should cover the selection and approval process for the external auditor, any prescriptive requirements of audit partner rotation, the duration of the current auditor (e.g. whether the same auditor has been engaged for more than five years and whether there is a rotation of audit partners), who governs the relationship with the auditor, whether auditors do any non-audit work and what percentage of the total fees paid to the auditor involves non-audit work.

The audit committee should play a role in establishing a policy on purchasing non-audit services from the external auditor; this policy should be disclosed along with an explanation or assessment of how this policy sufficiently ensures the independence of the external auditor (FEE, 2003a).

I. Internal Audit Function

Enterprises should disclose the scope of work and responsibilities of the internal audit function and the highest level within the leadership of the enterprise to which the internal audit function reports. Enterprises with no internal audit function should disclose the reasons for its absence.

An effective internal audit function plays a significant role within the corporate governance framework of a company. The scope of work and responsibilities of an internal audit function are often determined by the board (or management board in a two-tier system), typically in conjunction with the audit committee, and can vary significantly depending on the size, structure and complexity of the company and the resources allocated. Given the potential variation in the internal audit function among enterprises, it is recommended that details of this function be disclosed.

III. GENERAL MEETINGS

Disclosure should be made of the process for holding and voting at annual general meetings and extraordinary general meetings, as well as all other information necessary for shareholders to participate effectively in such meetings. Notification of the agenda and proposed resolutions should be made in a timely fashion, and be made available in the national language (or one of the official languages) of the enterprise as well as, if appropriate, an internationally used business language. The results of a general meeting should be communicated to all shareholders as soon as possible.

The OECD Principles outline a general consensus as to the nature of shareholder meetings and the requirement to make shareholder participation as simple and effective as possible and ensure the equitable treatment of all shareholders. The Principles state that shareholders should be informed of the rules and be furnished with information regarding the date, location and agenda of the meeting as well as the issues to be decided. Sufficient information should be provided so that shareholders can make fully informed decisions. Enterprises should do everything possible to facilitate the effective participation of all (including foreign) shareholders in general meetings.

In most governance systems, it is either required or considered good practice to put certain issues to shareholder approval at a general meeting. Best practice in this area entails that issues subject to shareholder approval be presented individually and unbundled, allowing shareholders to accurately exercise their voting rights. These rules can vary across different countries, and therefore disclosing information on the subject would be useful, especially for foreign investors.

In some countries, for some enterprises, new types of voting technology are being employed, for example Internet voting. The enterprise should, when issuing notice of the meeting, disclose the relevant details of voting technologies employed.

The enterprise should disclose all relevant information on the process by which shareholders can submit agenda items, and should disclose which shareholder proposals (if any) were excluded from the agenda and why.

It is considered good practice in most governance systems to allow shareholders to include items on the agenda of a general meeting.

IV. TIMING AND MEANS OF DISCLOSURE

All material issues relating to corporate governance of the enterprise should be disclosed in a timely fashion. The disclosure should be clear, concise, precise and governed by the "substance over form" principle.

Some issues may require continuous disclosure. Relevant information should be available for users in a cost-effective way, preferably through the websites of the relevant government authority, the stock exchange on which the enterprise is listed (if applicable) and the enterprise itself.

The location of corporate governance disclosures within the annual report is not generally defined and can vary substantially in practice. Some degree of harmonization of the location of corporate governance disclosures would be desirable to make the relevant data more accessible. Two possible approaches include putting all corporate governance disclosures in a separate section of the annual report, or in a stand-alone corporate governance report. Examples of the former approach are found in the recommendations of the Hong Kong Society of Accountants and the listing requirements in India and Switzerland, which provide for corporate governance disclosures to appear in a separate section of the annual report and in a prescribed format. Where corporate governance disclosures are not consolidated, there should be sufficient cross-referencing to different disclosures to improve access to the information.

Some information related to corporate governance may require immediate disclosure, and some codes and listing requirements address this issue. For example, in Malaysia listing requirements call for immediate disclosure of a change in the management, external auditor or board structure.

Traditional channels of communication with stakeholders, such as annual reports, should be supported by other channels of communication, taking into account the complexity and globalization of financial markets and the impact of technology.

The OECD Principles state that the Internet and other information technologies provide the opportunity for improving information dissemination. In some countries (e.g. the United States), Internet disclosure is now accepted as legal disclosure and annual reports must indicate where company information can be found on the Internet. The King II Report also emphasizes the need for critical financial information to be made available to shareholders simultaneously and supports the idea that traditional channels of communication be complemented by new means, such as the Internet.

Whatever disclosures are made and whatever channels used, a clear distinction should be made between audited and unaudited financial information, and means of validation of other non-financial information should be provided.

V. GOOD PRACTICES FOR COMPLIANCE

Where there is a local code on corporate governance, enterprises should follow a "comply or explain" rule whereby they disclose the extent to which they followed the local code's recommendations and explain any deviations. Where there is no local code on corporate governance, companies should follow recognized international good practices.

The use of "comply or explain" mechanisms in many countries allows investors and other stakeholders greater access to information about the corporation and is to be encouraged. In relation to this "comply or explain" rule, some countries now require companies with foreign listings to disclose the extent to which the local governance practices differ from the foreign listing standards.

The enterprise should disclose awards or accolades for its good corporate governance practices.

It is recognized that there is an increase in the number of corporate governance accolades, awards, ratings, rankings and even corporate governance stock market indexes where constituents are selected on the basis of exhibiting good practices in corporate governance. Especially where such awards or recognitions come from major rating agencies, stock exchanges or other significant financial institutions, disclosure would prove useful since it provides independent evidence of the state of a company's corporate governance.

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