CORPORATE GOVERNANCE ASSESSMENT TOOL

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PART 1: BACKGROUND AND INSTRUCTIONS

The USAID/Ukraine Support to Anti-Corruption Champion Institutions (SACCI) project, together with the Kyiv International Institute of Sociology (KIIS), conducted a survey to understand public perceptions of the impact of corruption on the Ukrainian economy and society and the most important measures to prevent corruption, as well as awareness and expectations regarding the activities of the National Agency for Prevention of Corruption (NAPC). The survey also examined the attitudes of the population towards whistleblowers and the factors that prevent citizens from reporting corruption.

The survey was conducted from April 9 to April 24, 2020 using the computer-assisted telephone interviewing (CATI) method based on a random sample of mobile phone numbers. The survey was conducted among a representative sample of 2,000 adults (18 years and older) in Ukraine.

BACKGROUND

This *Assessment Tool* and *Methodology* were developed for evaluating the corporate governance practices of state-owned enterprises (SOEs) and state-owned banks (SOBs). The *Assessment Tool* permits: a) analysis of individual company governance practices; b) comparison between different companies; c) tracking the evolution of governance practices (both for individual companies and for the country) over time; and d) making international comparisons. The components of the *Assessment Tool* and *Methodology* are:

Part I: Background and Instructions
Part II: Goals, Explanations and Tests
Part III: Report Structure and Sample Graphics

The *Assessment Tool* was designed to be as easy as possible to use while at the same time being sufficiently detailed to permit rigorous analysis of governance practices. The Assessment Tool is based upon 3 internationally recognised benchmarks:

- *G20/OECD Principles of Corporate Governance, 2015* (http://goo.gl/Oc3PTT)
- *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, 2015 (http://goo.gl/C3la35)
- *Basel Committee on Banking Supervision: Guidelines Corporate Governance Principles for Banks, Bank for International Settlements 2015* (https://www.bis.org/bcbs/publ/d328.htm)

The *OECD Guidelines* are directed exclusively at SOEs. The OECD considers the *Guidelines* to be a further elucidation of the *OECD Principles* below. SOEs are expected to comply with the OECD *Principles* in addition to the *Guidelines*. While the Assessment Tool does not focus on the issue of anti-corruption and integrity, the *OECD Guidelines on Anti-corruption and Integrity in State-owned Enterprises* (https://bit.ly/2QVMmyY) may serve as additional background reading.

The *G20/OECD Principles* are directed mainly at listed companies. Their broad principles are, nevertheless, considered relevant to a wider set of companies and even non-corporate entities including SOEs and even public administrations. So, when there is an issue that is not addressed in a standard (such as the *OECD Guidelines* for SOEs), then the OECD Principles serve as the appropriate benchmark. The OECD has produced further guidance on the *Principles* entitled *Using the OECD Principles of Corporate Governance: A Boardroom Perspective* (https://goo.gl/bpw5bS). This document provides additional detail on good practices and was used to provide additional guidance on practices during the development of the *Assessment Tool*.

The BIS Corporate Governance Principles for Banks are directed at banks including state-owned banks (SOBs). The *Principles for Banks* emphasise the importance of effective corporate governance for the safe and sound functioning of banks and for the stability of the banking system. They stress the importance of risk governance as part of a bank's overall corporate governance framework and promote the value of strong boards and board committees together with effective control functions.

GOVERNANCE CATEGORIES

The *Assessment Tool* groups corporate governance indicators into the following five broad categories:

1. Shareholder rights and protection
2. The board of directors
3. Transparency and reporting
4. The control environment
5. Stakeholders and the environment

These governance categories correspond roughly to the chapter headings found in the *OECD Principles* and the *OECD Guidelines* with some modification. Both the *Principles* and the *Guidelines* contain chapters on shareholder rights, boards, transparency and disclosure, and stakeholders. These governance categories have been used in the structure of the *Assessment Tool* in order to be able to relate the findings of the assessment to the benchmarks.

However, the issue of the control environment has been highlighted and developed further in the *Assessment Tool.* The reason is to permit a greater focus on the critical issues of monitoring and control. This is in keeping with the approach of the International Finance Corporation (IFC) Progression Matrices, which also highlight this aspect of governance.

GOVERNANCE SUB-CATEGORIES

Under these 5 governance categories, there are a number of sub-categories.

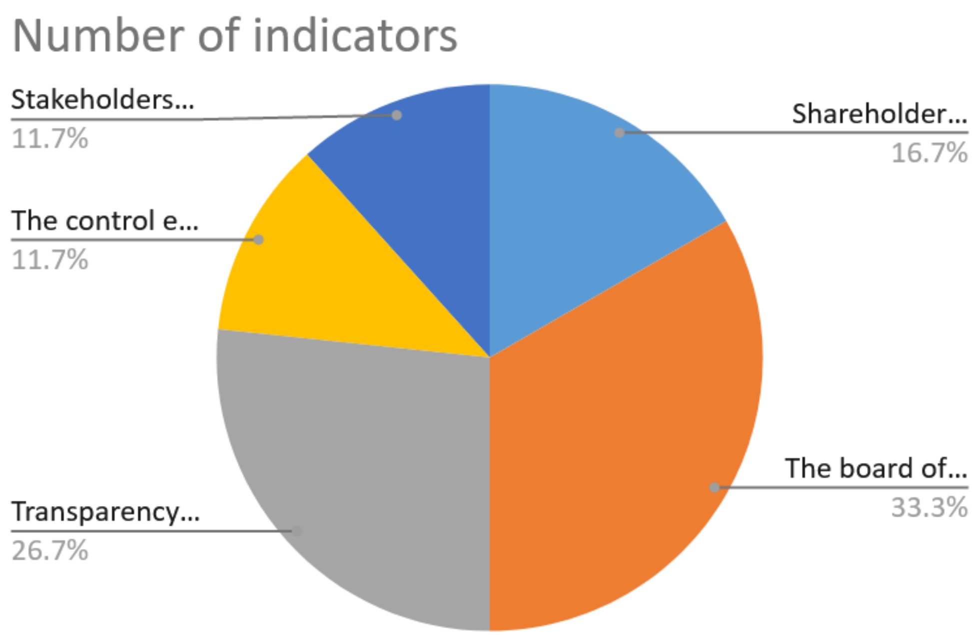
1. Shareholder rights and protection
    - 1.1 Shareholder rights
    - 1.2 Shareholder protection
2. The board of directors
    - 2.1 The role of the board
    - 2.2 Board responsibilities
    - 2.3 Board structure and processes
    - 2.4 Independence and objective judgment
3. Transparency and reporting
    - 3.1 Financial reporting and disclosure
    - 3.2 Non-financial reporting and disclosure
    - 3.3 Governance reporting and disclosure
4. The control environment
5. Stakeholders and the environment

These sub-categories permit a more granular analysis of the company’s governance practices.

NUMBER OF INDICATORS

A total of 60 indicators of practices that are widely considered crucial to good governance were extracted from the benchmarks and used to build the full *Assessment Tool.* Additional indicators could have been used.

However, the number of potential indicators runs into the hundreds and is thus impractical. The number of indicators chosen is considered sufficient to: a) conduct a reasonably complete inventory of governance practices; 2) go into sufficient depth for a rich statistical analysis; 3) educate companies on the essential elements of good governance; and 4) help companies define a well-rounded and complete agenda for potential improvements.



The indicators chosen for the *Assessment Tool* result in a heavier weighting of board and transparency practices. This weighting is the outcome of the number of recommendations that are found within the benchmarks themselves. The relative weighting of the different governance categories roughly reflects the importance attributed to different governance practices within the benchmarks themselves. As a consequence, the structure of the *Assessment Tool* allows users to determine their degree of compliance with the international benchmark.

SOURCES OF INFORMATION

The *Assessment Tool* allows for the use of both publicly available data and private data.

The advantage of using publicly available data is: 1) it allows for data collection from easily accessible sources; and 2) public data has a higher degree of veracity attached to it since it typically undergoes significant checking before disclosure. Using public data is extremely useful when trying to evaluate and improve a company's disclosure practices. The disadvantages are: 1) there may be insufficient data available; 2) limited qualitative analysis; and 3) the information may be insufficient to guide the company in improving its governance practices.

The advantage of private data is that it provides the possibility of a more informed analysis. As a result, the company can benefit from tailored and detailed remedial recommendations. The disadvantages are: 1) the collection of private data depends on the permission of the company and its active support; 2) some of the data may be subjective and will not have undergone any type verification or audit as would be the case with information that is formally disclosed.

In the event that an analysis is conducted using public data exclusively, then the absence of information is counted as non-compliance under the *Assessment Tool*—even if the best practice occurs within the company in fact. The reason is that one of the key goals of an external assessment based on publicly available data is to assess the quality of the company's transparency and disclosure.

METHODS OF ADMINISTERING

The Assessment Tool can be administered in 3 different ways:

- External assessment
- Self-assessment
- Assisted self-assessment

External assessments

An external assessment can mean two things: 1) an assessment based on publicly available data; and 2) an assessment made by an external expert.

- *An external assessment based on publicly available information* has the advantage that it requires less time and effort. There is no need to collect data from internal sources or conduct interviews. Nor is there the need to ask permission of the company or to enlist its collaboration in conducting the assessment.

  External assessments can emulate an investor's perspective, which means that the analyst is using information that would normally be available to the markets and investors. Furthermore, an external assessment allows the analyst to draw conclusions about the disclosure framework. External assessments can be well-suited to analysing listed companies.

  The disadvantage of using publicly available information is that it may be limited both in quantity and quality. It may not, for example, give good information on the actual function of the company board. Nor does it permit building a collaborative relationship with the company during the assessment process. External assessments are poorly suited to unlisted companies and SOEs since many make little information available to the public.

- *The use of an external expert* to assess the enterprise has the advantage that most companies do not have staff members with a deep knowledge of good governance practices who also have the skills to conduct a rigorous governance assessment. Furthermore, internal staff may find it difficult to exercise independent judgment of the company's governance practices. Outside experts have the advantage of bringing both expertise and independence.

  The disadvantage of using an outside expert is that many companies may be wary of permitting outsiders to have an insight into their internal affairs. This is understandable since the governance practices of a company could, in some cases, be compromising. Companies are particularly wary when the results of a study on their governance practices will be used by outsiders or disclosed to the public in the form of a report. Experience has shown that companies react negatively to external assessments that are done without their approval particularly when the findings are negative. This implies that whenever external assessments are being done, the company should at least be informed of the project in advance as a courtesy.

Self-assessments

In a self-assessment the company evaluates itself. Self-assessments are the form of scoring most easily accepted by companies since the information and conclusions remain under their control. Furthermore, they do not require many resources to complete.

In principle, self-assessments are attractive because companies know their own governance practices best. However, self-assessments are also vulnerable to bias. Experience has shown that companies significantly over-estimate the quality of their own governance. Unless the company is already highly committed to governance reform and has a strong capacity for self-analysis, it is often hard to generate useful information from self-assessments.

As such, self-assessments are only recommended as a means of gathering basic information and getting companies interested in a more tailored assessment with the involvement of an independent analyst. Self-assessments are also useful for companies who already have mature governance practices and who may already have undergone an assessment by an independent external expert in the past. If a self-assessment is to be conducted, then it is recommended to use the *Lite Tool* as it will be considerably easier to administer.

Assisted self-assessments

An assisted self-assessment uses the best parts of the two prior approaches. Typically, an assisted self-assessment would start with publicly available data that an external analyst fills into the *Assessment Tool*. This would be supplemented by the company which would be asked to contribute by filling in the blank parts of the assessment and verify existing information.

Any information that is provided by the company should be discussed with and verified by the external analyst. Otherwise, the danger is that the assisted assessment suffers from the same biases as a self-assessment. It is important that the analyst maintains full control over the actual spreadsheet and is the only party able to make changes. The assisted self-assessment derives much of its benefit from the capacity of the analyst to assess the company with an objective eye, and to act as an advisor to the company.

In summary, the trade-off between external assessments and self-assessments is a trade-off between objectivity and getting the buy-in and acceptance of companies. Self-assessments are often the best way to break the ice, get companies involved, and familiarise them with the issues. External assessments can be most objective. A mixed approach is often best suited to encourage reform at the company level, especially where assessments include an in-depth dialogue between the company and the external governance analyst. In general, an assisted self-assessment is the recommended approach.

WHO TO CONTACT AT THE COMPANY

In the event that an assisted self-assessment is conducted, the issue arises regarding the main contact point at the company. Generally, it is advisable to go as high within the company hierarchy as possible. The Chair of the board is often the optimal contact to start with. The Chair is necessary to give the corporate governance assessment authority and the support that it needs. The Chair is also the ultimate recipient of the final assessment and will be in charge of any future governance reforms.

It is crucial for the analyst to establish a main working contact point within the company with whom they may communicate and co-ordinate. The Chair should be asked to define the main contact point and instruct them and other individuals to co-operate in providing information for the assessment.

The main positions that should be interviewed are:

- Chair
- Chief Executive Officer
- Chief Financial Officer
- Chief Risk Officer
- Head of Investor Relations
- Corporate Secretary (or Chief Legal Counsel)
- Independent external auditors
- Internal Auditor (or Head of Control)
- Other board members (Independent board members where they exist)
- Representatives of holders of significant blocks of shares.

PREPARING FOR THE ASSESSMENT

Analysts need a reasonably strong understanding of corporate governance to conduct assessments. Analysts will need to read the benchmarks and assure themselves that they understand them. In the interest of efficiency, it is suggested that analysts first familiarise themselves with the "black line" principles, and then study the supporting text and annotations.

Ideally, analysts will have a background in corporate governance with some knowledge of related issues such as financial reporting and audit, business, law and possibly other specifics such as executive remuneration. Few individuals can be expected to have a strong background in all of these areas. It is sufficient that the knowledge be jointly available to a team which can then share its insights. Basic skills using a spreadsheet are necessary as are personal skills (the capacity to work with company staff and develop solutions in a team setting).

It is also necessary to prepare the company for the assessment. Companies need to understand the purpose, procedure and the output. It is useful to show companies how the process will help them identify strengths and weaknesses and how the assessment is designed to strengthen and benefit the company. Some of the concrete benefits are associated with better control and governance processes, reduced risks, and more rigorous and effective decision making. Companies generally require assurances regarding the confidentiality of information before they engage with analysts.

The company should be informed before the assessment that they are expected to provide documentation such as policies, reports, meeting minutes and so on to substantiate the assessment. The company should provide certain documents beforehand such as:

- Enterprise's charter
- Bylaws
- Statutes
- Annual financial reports
- Corporate governance code or reports
- List of affiliated persons

USING THE METHODOLOGY AND SUPPORTING TOOLS

As noted above, the Assessment Tool package includes a spreadsheet; Background and Instructions; Goals, Explanations and Tests; and Report Structure and Sample Graphics.

The use of the spreadsheet is reasonably self-explanatory. The spreadsheet is used to collect data. The spreadsheet will do the calculations automatically and assign the company an overall score which will represent the company's compliance with the benchmark. This score can be used to measure the company's own progress over time as well as compare it to other companies both nationally and internationally. The spreadsheet also generates some simple graphics that visually represent the company's compliance in the 5 corporate governance performance categories described above.

In order to use the spreadsheet correctly, an additional document is provided that includes Goals, Explanations and Tests. This document takes all of the indicators found in the spreadsheet and describes the goal of the governance practice on the simplest level. This establishes the outcome that the company should be aiming for and also establishes the ultimate performance benchmark for the analyst. The document also provides an explanation of the indicator and why it is important. Thereafter a series of tests are listed which the analyst can use to check compliance. These tests come with a series of boxes that can be ticked. In the end, the analyst should be able to see whether the company has room for improvement or not—the analyst will thus be in a position to assign a compliance rating in the spreadsheet as described immediately below.

USING THE SPREADSHEET AND ASSIGNING A PERFORMANCE RATING

The *Assessment Tool* uses letters to assess different levels of compliance. An A/B/C rating is used to remove the onus of a numerical rating.[1] Letters are entered into the *Assessment Tool* spreadsheet based on an assessment of whether there is any margin for improvement. After entering the letter into the *Assessment Tool*, the spreadsheet automatically converts it to a number as per the table below.

Level	Rating	Interpretation	Numerical Translation
Substantially compliant	A	There is no room or need for any further improvement in governance practice	1.0
Partially compliant	B	Areas have been identified where governance practices could/should be improved	0.5
Substantially non-compliant	C	There is an absence of practice, and significant attention must be devoted to this issue	0.0

In its essence, the tool aims at identifying weakness in corporate governance and identifying areas for future reform. The analyst is guided to assess compliance as follows:

Substantially compliant (A): If, at the end of the examination, the analyst can confidently say that…

- The goal has been fully met; and
- There is little or nothing that the company can do to enhance its practices

…then the company is substantially compliant.

[1] The alternative is to use a numerical score. However, analysts are inevitably tempted to introduce degrees of gradation in their valuations (for example, a percentage ranging from >0 to <100%). Such gradations: 1) are usually time consuming; 2) can be contestable; 3) are often based on partial information and on judgement; 4) give a false sense of accuracy; and 5) do not generally make any substantial difference in the final overall score. Above all, they are no better at signaling the attention of the company to the areas where attention and reform is needed.

Substantially non-compliant (B): If, at the end of the examination, the analyst can confidently say that…

- The goal is <u>partially</u> but not fully met; and
- There are some clearly identifiable steps that the company could take to enhance its governance practices

…then the company is partially compliant.

Partially compliant (C): If, at the end of the examination, the analyst can confidently say that…

- The goal has <u>not</u> been met; and
- There are fundamental steps that need to be taken to enhance governance practices

…then the company is substantially non-compliant.

CONSISTENCY IN ASSESSMENT

Potential errors can occur at various stages of the assessment. It is important to be aware of where they may occur and to have an approach for dealing with them.

- *People differences:* Different people will evaluate companies differently. Despite having objective indicators, judgement is always involved. The optimal way of reducing the differences that will naturally arise when different people conduct assessments is to have a single individual do all assessments. Where this is not possible, different members of a team will need to compare their assessments and discuss their approaches in an effort to have a consistent analysis. This means sharing spreadsheets between team members and discussing assessments as a team.
- *Time differences:* It is striking that even when the same individual conducts assessments, over time their judgments change. For example, it is possible that the assessment of an analyst becomes either more or less positive from the beginning to the end of a project. In order to address this issue, the analyst needs to compare and revise their assessments at the end of the project to ensure that all companies have been assessed in an equal manner. This means comparing the assessments of the same indicator across a group of companies to make sure the assessment has been done uniformly.
- *International differences:* Different countries have different legislation, regulation and corporate governance practices. The differences in law and regulation can make comparison difficult. In addition, different countries can have very different attitudes with respect to compliance with law and compliance with norms of best practice. In some countries, compliance is a matter of course while in other countries it is not. Addressing this issue requires that the analyst go beyond law and regulation and focus on actual practices and outcomes. This only applies when the goal is to conduct international comparisons.
- *Managing the spreadsheet:* Inconsistencies and errors may arise when different analysts alter the spreadsheet in order to add or remove indicators, change rows, columns, and so on. Once the spreadsheet has been altered it makes it extremely difficult to do a consolidated analysis of multiple companies. It is critical that different analysts only alter cells where input is allowed. Further, if there are multiple analysts, the layout of the spreadsheet should be under the responsibility of one individual.

DEVELOPING A REPORT FROM THE ASSESSMENT TOOL

Once the data has been collected into the spreadsheet, a report needs to be generated. Part III: Report Structure and Sample Graphics includes a simple report structure and shows the types of graphics and analyses that can be developed using the *Assessment Tool.*

JUDGEMENT AND LIMITATIONS

There are a series of limitations to quantitative assessment tools. The main limitation is that such tools are an attempt to measure an intangible value. Good corporate governance is increasingly being described as an intangible asset. The governance practices of a company are also increasingly referred to as the governance "culture" of the company. Obviously, there are difficulties in assigning a numerical value to a governance culture.

Still, some indicators are reasonably concrete and efforts need to be made to make the assessment process as objective as possible. Some indicators may be concrete and verifiable such as the presence or absence of IFRS financial statements. But most indicators require interpretation, for example, the degree to which the board takes into account stakeholder issues, or the degree to which the board treats different shareholder groups equitably.

Even objective indicators may cause the analyst to draw erroneous conclusions about a company's governance. For example, with respect to IFRS as noted above, the company may produce IFRS compliant statements, but the board may not be committed to presenting a true and fair view of the company through its financial reports. There are many ways in which management can manipulate the financial statements while, nevertheless, adhering to accounting rules.

THE BENEFITS OF GOVERNANCE ASSESSMENTS

Nevertheless, the *Assessment Tool*, when properly applied, is highly effective in: 1) helping companies identify areas where they have the potential to improve their governance practices; 2) track company progress over time; 3) show the degree of compliance with best practice standards of corporate governance; 4) make comparisons between companies; 5) assess the state of corporate governance within a region or country; 6) identify areas of weakness in a country's practices and governance framework; and 7) compare the evolution of governance practices within a company or within a country over time. Above all, the main value-added for companies is that they are positioned to develop remedial action plans and close gaps with best practice standards. This is hoped to eventually impact company performance and risk.

PART II: GOALS, EXPLANATIONS AND TESTS

Item	Governance categories and indicators	
1	**Shareholder rights and protection**	
1.1	*Shareholder rights*	
1.1.1	Clear roles of shareholders versus the board	*The goal:* There is a clear definition of and distinction between the roles of shareholders and the role of the board.
		Explanation: In widely-held listed companies there is usually a clear definition of and distinction between the shareholders and the board. This distinction is fundamental, but may break down under certain circumstances. In some cases, a dominant or controlling shareholder in a listed company may have the capacity to dominate board discussions (and possibly even exercise direct influence over management, see 2.1.1 role of board versus executives below). It is essential that shareholders not exceed their legally constituted rights which appear in company law. These are often transposed and elaborated upon in a company's articles of incorporation or other founding documents. They are: *A) Basic rights:* 1) proper ownership registration; 2) ability to transfer shares; 3) ability to obtain information on the company; 4) participate in voting; 5) election of board members; and 6) sharing in profits. *B) Right to decide upon:* 1) legal amendments; 2) new share issues; and 3) extraordinary transactions. *C) Participation in governance through GSMs:* 1) information; 2) fair process; 3) ability to question and influence key decisions; 4) ability to vote; and 5) voting in absentia. ***Shareholders have no rights to make decisions normally reserved to the board or executives***. The problem is particularly acute in SOEs. SOEs differ from listed companies in that there is a tendency for the state shareholder to become more involved in decision making than in a listed company. Such intervention may have a public policy or a political objective but often results in prejudicing the interests of the SOE and/or minority shareholders. It is critical for the state shareholder to not usurp the powers of the board.

		Tests: □ Articles of incorporation, bylaws, charters, policies and other documentation clearly identify the decision-making rights and responsibilities of the shareholders versus the board. □ The shareholders and the board understand their different roles and act in accord with these distinctions in practice. There are no current cases of shareholders exercising powers beyond those listed above in the *Explanation* or seeking to unduly influence the board or operational decisions. □ The government acknowledges that the board is an autonomous body with decision making rights that must follow a formal process. □ SOE boards are able to exercise their own decision making and are not merely conduits for instructions from the state. Boards have real decision making powers that they exercise in fact. (See Section 2.2 below.) □ The state as an owner does not circumvent the board and go directly to executives to dictate actions.
1.1.2	Formal documentation	*The goal:* Written policies and procedures are there to formalise the company's governance.
		Explanation: This indicator focuses on the presence of documentation such as articles of incorporation, bylaws, board and committee charters, governance codes, conflict of interest and related party transaction policies, ethics codes, responsible business conduct (RBC) codes, and so on. The objective is to ensure that practices are formalised and not informal. It also tests for the responsibility of the board and management for ensuring that proper documentation exists. Ideally, a Corporate Secretary under the direction of the CEO is tasked with making sure that documentation is compliant with law and best practice and up-to-date. The board should take it upon itself to ensure that up-to-date policies and procedures are in place and check annually.
		Tests: □ The company should have a full set of formal documentation, adapted to the size and needs of the company. □ The written documentation defines the distinct roles, responsibilities and decision-making rights of the government, ministers, boards and executives. (Documentation could be in SOE law, founding law of the SOE or a government ownership policy) □ The board recognises it has a responsibility for ensuring proper documentation and considers the issue formally on an annual basis. □ The board reviews its documentation in conjunction with the Corporate Secretary or a Compliance Officer (where such positions exist).
1.1.3	Effective shareholder meetings	*The goal:* GSM processes allow for the effective participation of all shareholders.

		Explanation: For many listed companies the only possibility for interaction with the shareholders and the only possibility for shareholders to hold the company, the board and executives to account is the GSM. The GSM should be organised in such as fashion as to permit easy and effective participation for those shareholders who wish to participate. Above all, the agenda should be made to reflect shareholder concerns and shareholders should be able to influence the agenda and the resolutions. The GSM should take place in an accessible locale at a convenient time. Documentation on the resolutions to be voted should be made available in advance. GSM processes and procedures should be transparent. Voting in absentia (by proxy) should be allowed and E-voting is increasingly considered a good practice, in particular where the company has foreign investors. Voting practices should be both fair and transparent. For SOEs owned 100% by the state, the GSM is usually only a legal formality. It is only when there are other stakeholders that the GSM takes on its full importance. Similarly, the GSM may only be a legal formality in single-shareholder unlisted companies. Again, once the ownership base is broadened, it is important to comply with best practices in GSM organisation.
		Tests: □ Shareholders, in particular, minority shareholders (where applicable) are able to participate effectively in GSMs. □ The GSM takes place annually in an easily accessible location. The meeting should occur according to national legislation, but no less than 4 months after the financial year ends. □ Meeting notice, and agenda including shareholder proposals are provided to all shareholders on a timely basis (21 days). □ The GSM permits the approval of the accounts, the approval of the auditor, approval of dividends, and the election of board members. Shareholders are able to vote to elect and remove members of the board. □ Voting by proxy (in absentia) is allowed. E-voting is an option. □ Shareholders should be able to put resolutions on the agenda subject to certain thresholds including the nomination of board members. □ The GSM should not be convened more than annually except under extraordinary circumstances and should not be used to make day-to-day operational decisions.
1.1.4	Transparent ownership and control	*The goal:* The company is transparent on its ownership and control, and ownership rights.
		The explanation: Shareholders and potential shareholders (the markets) must have sufficient information on the ownership structure and control rights of the enterprise in order to properly assess any potential governance risks and to make informed investment decisions. It is particularly important that they understand, for example, the powers that may accrue to controlling shareholders or any conditions which may prejudice their rights as shareholders. Capital structures, voting agreements, or other arrangements allowing disproportionate control of the company should be fully transparent both to shareholders and the markets. Disproportionate control can be special voting rights, any rule that is not strictly one-share-one vote, and/or decision making or control or pre-emptive rights that are

		established through contracts between the company and shareholders or between shareholders themselves. For SOEs, transparency with respect to ownership and control are important even when the SOE is wholly-owned by the state. The reason is that the public can be viewed as an ultimate owner who has information rights. In SOEs, transparency with respect to control rights take on greater importance when there are multiple owners.
		Tests: □ The ownership of the company is transparent. It is disclosed to the shareholders and the markets. □ The rights associated with different share classes should be transparent and disclosed. □ Capital structures and control arrangements should be transparent and disclosed. □ Special attention must be paid to the issue of control when there are minority shareholders since the decision-making powers and practices of the state may not be fully transparent to them. □ Special disclosure should describe decision making and ownership rights of the state that go beyond what is normally found in company law.
1.1.5	Dividend policy	*The goal:* The company has and discloses a dividend policy.
		Explanation: Dividend policy is the set of guidelines a company uses to decide how much of its earnings it will pay out to shareholders. It is considered good practice for a company to have a transparent dividend policy. A dividend policy can specify if, when and under what circumstances the company intends to pay dividends. Many companies fund capital expenditures before paying any dividends (a residual dividend policy). Some may opt for a fixed dividend pay-out (stable dividend policy) while others opt for a percentage of earnings (constant dividend policy). At a minimum, companies should have a formal policy for internal use. Best practice suggests that the dividend policy be transparent to other shareholders and the markets in order to communicate the board's understanding of the issue.
		Tests: □ The company has a written dividend policy for internal use. □ The company is transparent to its shareholders and the markets about its dividend policy and communicates the rationale for its policy. □ Disclosure includes what type of dividend strategy the company plans to pursue and whether a minimum, range or a target dividend is adopted. □ The issue of dividends is considered at each annual meeting and is voted upon.
1.2	*Shareholder protection*	
1.2.1	Equitable treatment of shareholders	*The goal:* Shareholders are protected and are treated equitably

		Explanation: No shareholder should exercise control to the detriment of other shareholders. Typically, shareholder protection is ensured by one-share-one vote. The OECD Principles permit other ownership structures as long as these are fully transparent. There are, however, several other circumstances under which abuses may occur: 1) *fragmented ownership* where executives wield significant power and where significant minority shareholders exercise disproportionate control over the company (more typical of the USA); and 2) *concentrated ownership* where controlling shareholders may act to the detriment of minority shareholders (more typical of Europe and Asian countries). While it may not be possible to act in the equal interest of all shareholders, the company should strive for "equitable" or fair treatment. Tools such as cumulative voting may permit small shareholders to at least have voice. In SOEs, where there are outside shareholders, such shareholders may be particularly vulnerable to decision making by fiat by the state. Companies that have a single shareholder are deemed to be fully compliant with this indicator.
		Tests: □ The board recognises that it has an obligation to treat all shareholders fairly even when there is a major controlling shareholder. □ The articles, governance or ethics code of the company or other policy have an explicit requirement that the board treat all shareholders in an equitable fashion. □ The board ensures that minority shareholder rights are respected and that decision making takes into account the interests of minority shareholders in an equitable fashion. □ There is no disadvantage to foreign shareholders. □ No legal action against the company for violation of shareholder rights succeeded in courts during the last 3 years.
1.2.2	Conflicts of interest	*The goal:* There are effective systems for controlling and monitoring conflicts of interest among executives, board members and employees including insider trading and abusive self-dealing.
		Explanation: A conflict of interest occurs when an individual or organisation has multiple interests, one of which could possibly corrupt their motivation in a transaction. Conflicts of interest commonly result from family interests, ownership of other companies, gifts from friends or business partners, and multiple places of employment or self-dealing (entering into a transaction with oneself to the detriment of the company). Self-dealing is a situation where action in an official capacity confers a benefit on oneself in a private capacity. Examples are using your official position to secure a contract for a private consulting company you own (this may not necessarily be an abusive transaction) or using your position to get a job for your daughter (nepotism). Insider trading (the illegal practice of trading on the stock exchange to one's own advantage through having access to confidential information) is a form of conflict of interest that is generally prohibited by law. SOEs are particularly vulnerable to abuse under conflict of interest conditions. They are vulnerable to abuse due to generally lower transparency requirements, less stringent governance practices, and their subjugation to political powers. Conflicts of interest are not generally prohibited and cannot be avoided completely. What is essential is that any decisions taken where a conflict of interest exists must be taken at arm's length. An arm's length

		transaction is a transaction in which parties (usually buyers and sellers) act independently and have no relationship to each other. State-owned banks can be particularly vulnerable to conflicts of interest since boards and executives can often direct lending decisions.
		Tests: □ The company has a written conflict of interest policy. It outlines how the company will monitor and resolve conflicts of interest. Such a policy might be found in an internal code of ethics or in a company governance or RBC code (See 4.3 ethics and responsible business conduct below). □ Systems are in place to ensure proper control and protection against conflicts of interest. Such systems are checked by the internal auditor. □ The board enforces its conflict of interest policy by monitoring potential conflicts of interest of the board and executives and related party transactions. (Annual declarations of board members and top executives are covered in 1.2.3 transparency regarding conflicts of interest.) □ There are regular communications on the issue of conflicts of interest and training is available on the issue to board members and top executives. □ The board requires approval of related party transactions, and/or recusal of board members and executives on decision making on related party transactions. Transactions must be required to occur at "arm's length". □ Consideration of conflicts of interest is conducted in the presence of independent members of the board. While the board, as a whole, has the responsibility to ensure that decision making is not conflicted, there is an expectation that independent board members are uniquely suited to provide an objective and independent perspective. It is for this reason that independent board members are often expected to participate in decisions in which there may be a conflict of interest such as audit and remuneration. This does not mean that the board, as a whole, in any way relinquishes any of its fiduciary duties or responsibilities. □ There are internal policies regarding insider trading and self-dealing and systems in place to encourage compliance such as annual declarations or signed acknowledgements. □ SOEs should not provide charity or public services that are better carried out by other institutions. Charitable giving by SOEs should not be seen by the state as a replacement for public support undertaken through the state budget. The criterion for assessing whether an SOE's contribution is appropriate is if it results in significant tangible benefits to the SOE—these may be reputational benefits. The OECD Guidelines suggest that SOEs should have a written mandate to provide any non-commercial services. By extension, charities or services that are not explicitly required by law or contract with the state should not be made. So, for example, an electricity generator sponsoring a conference on clean energy may be a legitimate expense, while the maintenance of a local football team, or provision of food or lodging to the poor would not generally be considered legitimate. □ The SOE has a clear policy on the types of non-commercial services it can provide, and the rationale for provision of services and how such services are compensated. Such policy is

		disclosed. □ SOEs should not finance political activities. □ SOEs should not make political campaign contributions. □ Nepotism or hiring of political or personal connections does not occur.
1.2.3	Transparency regarding conflicts of interest	*The goal:* Conflicts of interest of owners, board members, executives and staff are transparent as are the systems for controlling conflicts of interest.
		Explanation: Transparency creates disincentives for shareholders, boards and employees to act in a situation where they are conflicted. SOEs and SOBs are vulnerable to abuse in situations of conflict of interest because they are not generally subject to the same transparency requirements as listed firms.
		Tests: □ There is, at a minimum, full and formal *ex ante* disclosure of potential conflicts of interest <u>to the board</u>. □ There should be sufficient information made publicly available on executives and board members <u>to alert the public</u> to potential conflicts of interest. This requirement could be satisfied by disclosing CVs of executives and/or board members as well as any ownership they have in other organisations or posts or positions that they may hold. So, for example, other board posts, executive and or honorary positions, and political posts should be disclosed. □ There is a requirement that internal conflict of interest information be updated upon any change of status of the concerned individual.
1.2.4	Systems to control related party transactions	*The goal:* There are effective systems for controlling and monitoring related party transactions.
		Explanation: A related-party transaction is a business deal or arrangement between two parties who are joined by a special relationship prior to the deal. For example, a business transaction between a major shareholder and the corporation, such as a contract for the shareholder's company to perform renovations to the corporation's offices, would be deemed a related-party transaction. Not all related party transactions are bad. However, there is significant potential for abuse in related party transactions. IFRS contain precise definitions of related party transactions. SOEs and SOBs may, in some cases, be required to undertake related party transactions, or procure services from a pre-determined provider. Such related party transactions should be transparent and take place at arm's

		length.
		Tests: □ The company has a policy regarding related party transactions, which requires that such transactions take place at arm's length. (This policy may be part of a conflict of interest policy or ethics code or other company policy. See 4.3 below.) □ Systems are in place to ensure proper control and ensure that related party transactions are identified *ex ante* and occur in the interests of the company and shareholders. □ Material related party transactions must be approved by the board. □ Ensuring that RPTs occur at arm's length is the responsibility of the whole board. While the whole board has the responsibility to ensure that related party transactions occur at arm's length, there is an expectation that independent board members are uniquely suited to provide an objective and independent perspective on RPTs. So, for example, if the audit committee reviews an RPT, it would be best practice for the audit committee to be chaired by an independent board member. Or, if the board has both executive and independent directors, it is better for the discussion and consideration of an RPT to be led by an independent board member even if other board members or executives do not have a direct conflict of interest. □ The individuals participating in the related party transaction must recuse themselves from board deliberations on the issue and must abstain from voting.
1.2.5	Transparency in related party transactions	*The goal:* Related party transactions are transparent and disclosed.
		Explanation: Transparency creates disincentives for shareholders, boards and employees to engage in abusive related party transactions. Disclosure of related party transactions may also be required by law. IAS 24 Related Party Disclosures requires disclosures about transactions and outstanding balances with an entity's related parties. The standard defines various classes of entities and people as related parties and sets out the disclosures required in respect of those parties, including the compensation of key management personnel. SOEs and SOBs should comply with the same transparency requirements regarding related party transactions as listed companies.
		Tests: □ The company discloses a related party transaction <u>policy</u> which describes its approach to preventing abusive related party transactions. □ The company actually makes disclosures of material related party transactions <u>when these occur</u>.
2	**The board of directors**	
2.1	*The role of the board*	

2.1.1	Clear roles of board versus executives	*The goal:* There is a clear definition of and distinction between the roles of the board and executives.
		Explanation: The role of the board and the role of the executive are different. The board has a monitoring (oversight) and guiding function. Management has an executive (operational) function. There is a clear division of responsibilities within the company between the high-level decisions taken by the board and the operation of the business. In practice, different boards can be more or less "hands on" depending on the company and the circumstances. However, best practice boards do not become overly involved in operations or micro-manage decision making by managers. They should focus on high-level strategic issues and monitor outcomes and ensure that effective monitoring and control systems are in place. In the end, operations and operational outcomes must remain the responsibility of management. Boards need to rely on independent experts, such as internal and external auditors to provide assurances that systems for monitoring and control are functioning properly rather than conducting detailed checking themselves. In SOEs and SOBs, boards often have a tendency to either micro-manage the company by checking compliance while paying less attention to strategic issues. Alternatively, SOE/SOB boards may be passive and allow ministries to manage executives directly. Both practices diminish the value of the board.
		Tests: □ The articles of incorporation (or other policy such as a company governance code) explicitly state the roles and responsibilities and decision-making authorities of the board versus the executives. □ These roles, responsibilities and authorities clearly distinguish between the oversight and guiding role of the board versus the executive role of management. □ The board focuses on high-level outcomes and how to achieve these outcomes. Determining if the board focuses on high-level outcomes usually requires interviewing board members and assessing the degree to which they devote time to detailed issues versus high-level outcomes. It is useful to review and discuss what items appear on the agendas of typical board meetings. □ The board does not engage in micro-management—unless required by extraordinary circumstances. For example, the board does not engage in hiring/firing or remuneration decisions below the top executive level, or investments/expenditures/procurement below certain thresholds. □ Thresholds should be set for board approvals. Thresholds should be set sufficiently high so that the board does not make itself responsible for lower-level decisions that should occur under the authority of executives.
2.1.2	The duties of loyalty and care	*The goal:* Board members exercise their duties of loyalty and care to the company.
		Explanation: The precise definition of duties varies from country to country as does the exact number of duties. There are, however, two widely recognised duties of board members. The ***duty of loyalty*** requires board members to act free of conflict of interest and requires fiduciaries <u>to put the corporation's interests ahead of their own</u>. They may not use corporate assets, opportunities, or

		information for personal gain. The ***duty of care*** is an obligation imposed on the board that they <u>act on a fully-informed basis, in good faith, and with due diligence</u>. Board decisions must be taken based upon complete information. (The issue of board access to information is covered in 2.3.4 below). Decisions need to be founded upon informed, rigorous and open debate. The duties of loyalty and care are typically embedded in company law. SOE/SOB board members or often not as well informed of their fiduciary duties as board members in listed companies. Greater attention may need to be paid to their induction training, especially when board members are civil servants.
		Tests: □ Articles of incorporation, board charters, or other internal documents identify the duties of loyalty and care. □ Board members are conscious of these duties. □ Board members receive induction training that covers their duties. □ Board members act in accordance with these duties and fulfil the requirements as described in the explanation above. □ Boards assure themselves that they are fully informed of matters under board consideration and request and are given access to all relevant information. □ Boards take the time to read, understand and consider the information on hand in preparation for decision making. □ Board decisions are subject to rigorous examination and debate. □ There are no examples of board members acting in their own interest over the interest of the company (these are also covered under the conflict of interest and related party transaction indicators above).
2.1.3	The obligation to act in the interest of the company	*The goal:* Board members act in the interest of the company and its shareholders.
		Explanation: Most company laws, articles of incorporation and the OECD Principles require boards to act <u>exclusively in the interest of the company</u>. Though this obligation may be considered to be subsumed under the duties of loyalty and care, it can also be considered to go beyond them. It is especially important when considering what actions boards may take in the interests of stakeholders and is particularly relevant for SOE boards and even more so SOB boards. SOE board members often believe (incorrectly) that their duty is to the state as the owner of the SOE. In fact, board members (even when they are appointed by the state) are legally obliged to act in the interest of the SOE in their decision making when the SOE is established under company law. The requirement is particularly important when evaluating how boards take into account stakeholder interests and, in the case of SOEs, how boards should respond to the non-commercial policy objectives that the state may impose upon the SOE. Non-commercial objectives can be defined as those objectives that go beyond business objectives, usually assigned by the state for the purpose of providing a public service or good. For SOBs the primary objective of corporate governance should be safeguarding stakeholders' interest in conformity with public interest on a sustainable basis. Among bank stakeholders, shareholders' interest

		may be secondary to depositors' interest.
		Tests: ☐ The articles of incorporation and/or bylaws clearly state the obligation of the board to act in the best interests of the company. ☐ The board is fully cognisant of this obligation and acts upon it in practice. The board is willing and able to confront managers, other board members, or owners when decisions are potentially contrary to the interest of the company. ☐ It is important that contracts with the SOE either: 1) be on commercial grounds, or 2) that contracts that require the provision of services to the public secure fair compensation for the services provided to the public. ☐ Boards should be able to ensure that actions or obligations imposed by the state that incur costs or go against the interest of the SOE be fully compensated.
2.1.4	Leadership	*The goal:* The board exercises leadership by directing, guiding and monitoring executives.
		Explanation: Not only should there be a clear distinction between the roles of the board and executives (See 2.1.1 roles of the board versus executives), but the board should function as the thought leader and the highest decision-making authority in the company. The balance of powers between the board and the executive should underscore the authority of the board. The board needs to ensure that the company has a sound strategic vision, that management undertakes actions to achieve that vision, and that management is held accountable. It needs to direct management, establish goals, and monitor management's progress against the goals. For SOEs, the definition of final outcomes often comes from the state or an oversight ministry. However, it is not the role of the state to lead management. This remains the function of the board. In an SOE/SOB, the board must be seen as the body with the ultimate control and authority over management.
		Tests: ☐ The company does not have a weak or passive board. The board sets its own meeting agenda (in consultation with the executive function). ☐ The board discloses the company's vision and progress in achieving the vision in a directors' statement in a preface to the annual report. ☐ The board has authority over the executive function and ensures that the executive function is accountable to the board. ☐ The board is proactive in the sense that it has the capacity to make suggestions to management—without intruding on operational decisions or engaging in micromanagement. ☐ There is active and constructive dialogue between board members and the executive during board meetings. ☐ The board is perceived by executives as adding value and not just checking compliance. ☐ The state as an owner usually has the right to define the outcomes for the SOE that it wishes

		to achieve. However, the responsibility for devising strategies to achieve such outcomes remains with the board. □ The SOE board is seen as the ultimate authority for leading the SOE. The state, as the owner, is the body that establishes the ultimate outcome. The board is responsible for exercising leadership to achieve these outcomes. □ The board is able to introduce new concepts and ideas despite the fact that the state owner has significant authority in setting down the SOE's goals.
2.2	*Board responsibilities*	
2.2.1	Strategy	*The goal:* The board oversees the development of the company's strategy.
		Explanation: One of the most important functions of the board is to ensure that the company has a sound strategy. Strategy usually involves making fundamental choices about: a) the vision of the company and what clients the company will serve; b) how the company will serve its clients; c) how the company will achieve the vision through specific goals; and d) the resources needed to accomplish the vision. Boards typically formally approve the corporate strategy. For SOEs, the development of a strategy can be intimately linked to objectives set down in a national development plan. For example, there may be a national energy/electrification plan that requires the SOE to provide services to certain sectors and undertake certain investments. In such cases, the board may be implementing a larger vision championed by the state; it is important that the state only define the outcomes on the broadest level and allow the board to devise the strategies for achieving these outcomes. Furthermore, SOE board should be able to provide feedback to the state in the development of its plan in order to provide practical business-orientated insights. Many SOE/SOB boards get excessively involved in details of corporate performance (in particular monitoring budget variances) to the detriment of oversight of strategic performance.
		Tests: □ The board recognises that its key responsibility is ensuring that the company has a vision and a well-crafted strategy for achieving that vision. □ Some board members have experience in strategy development. □ There is a written company strategy. □ The strategy has been developed by management through a process of in-depth analysis and broad internal consultation, focusing on the value-added provided to the client, considering the competitive environment and the company's strengths and weaknesses, and taking into account the impact of the outside business environment and the roles of different stakeholders. □ The strategy has undergone rigorous review by the board and its assumptions and goals have been challenged. □ Performance against strategy is reviewed by the board at a minimum on a quarterly basis. There is no need to redo strategy on a quarterly basis—only to assess performance against strategy. Strategy should be checked and reconsidered on an annual basis. □ The board should devise a strategic plan along with management to achieve the outcomes

		specified by the state. □ The board should develop the strategies for achieving the non-commercial (public policy or social objectives) policy goals assigned by the state and ensure that such policy goals are made explicit in the SOE's strategy and business plans. Non-commercial objectives can be defined as those objectives that go beyond business objectives, usually assigned by the state for the purpose of providing a public service or good. It is typically the state's prerogative to assign non-commercial policy objectives. However, rather than the state determining how these objectives are to be achieved, the strategy for achieving the assigned objective is better left to the board and management.
2.2.2	Objective setting and performance monitoring	*The goal:* The board sets performance objectives and evaluates the performance of the company and management.
		Explanation: After establishing its strategy, the company needs to specify intermediate goals and objectives in support of the strategy. The strategy is operationalised by linking it to a more detailed business plan that contains specific objectives. The board regularly evaluates the performance of management in achieving objectives and adjusts goals based on circumstances and actual performance. Many companies use management by objectives (MBO) to develop objectives of ever greater detail in support of the strategy. The use of MBO is less common in SOEs/SOBs but can be helpful in guiding executives and staff.
		Tests: □ The board ensures that the company strategy is operationalised through the establishment of sub-goals, and benchmarks against which management's progress can be measured. (These goals may be found within the strategy or, alternatively, in a discrete business plan.) □ The goals have concrete measurable outcomes that are to be achieved within a specified time frame. □ The individuals or divisions responsible for achieving goals are clearly identified. □ The human, financial and other resources needed to achieve goals are clearly identified. □ Progress against key performance objectives are reviewed at every board meeting and there is an opportunity to hold management to account. □ Goals are re-assessed in response to actual performance. □ Any public policy objectives that SOE is required to achieve are clearly mandated by the relevant authorities. □ It is crucial that non-commercial objectives be made explicit in an SOE's strategy, business plans and MBOs (See 2.2.6 Incentives and remuneration) and that, where possible, plans specify the costs of achieving such non-commercial objectives. Non-commercial objectives can be defined as those objectives that go beyond business objectives, usually assigned by the state for the purpose of providing a public service or good.

2.2.3	Governance evaluations and action plans	*The goal:* The board conducts periodic appraisals of the company's governance practices that leads to the development of an action/improvement plan.
		Explanation: One of the roles of the board is to assess its own performance in governing the company. It should assess its own governance practices on an annual basis. Assessments may be self-assessments, external assessments conducted by independent experts, or a mix of the two (i.e. assisted self-assessments). An assessment should lead to an action plan. Progress against the action plan should, in turn, be reviewed by the board on an annual basis. Iterative assessments and action plans are necessary to raise awareness of the importance of governance, improve the governance culture of the company and to consistently and systematically enhance governance practices. Governance evaluations are considered good practice in listed and unlisted companies as well as SOEs and SOBs.
		Tests: □ The board has formally put the issue of corporate governance on its agenda as an item for discussion within the last year. □ The board is committed to improving the governance of the company. (In addition to checking if the issue has been discussed by the board, this could be assessed by testing to see if the issue of corporate governance is addressed in the annual report or on the company website.) □ The board is fully informed of best practices in governance and, in particular, the content of local and international codes of good governance. (Substantiating evidence may be company disclosures of a company governance code or disclosure making reference to the company's compliance with a code of corporate governance.) □ The board conducts an annual evaluation of the company's governance practices. Corporate governance evaluations can cover: a) the practices of the board; and b) the governance practices of the company more generally, which would include issues of disclosure, stakeholder relations, shareholder protection and so on. (The issues covered in this Assessment Tool go beyond board practices and include a broader assessment of corporate governance.) □ The annual evaluation has resulted in an action plan. □ Progress against the action plan is assessed on an annual basis.
2.2.4	Budgeting and investment	*The goal:* The board approves and oversees budgets and major capital expenditures.
		Explanation: The budgeting process forces the company to make informed decisions about investments and resource allocation and creates company-wide discipline around achieving goals. Most companies start with a static budget with projected amounts of what the company will take in and spend. Managers make use of economic forecasting methods to determine a realistic budget. At the end of a performance period (which could range anywhere from weekly to annual), actual data is used to calculate variances between what was budgeted and what actually occurred. Knowing where the company is falling short or exceeding the benchmark helps boards and managers to evaluate the company's performance and to adjust their plans. The board also has a special role in approving major capital expenditures and monitoring the effectiveness of such expenditures. For SOEs and SOBs, compliance with state budgeting and expenditure rules may at times generate inflexibility in the use of

		funds. The rules under which SOEs/SOBs operate can put them at a disadvantage compared to the private sector.
		Tests: □ Budgets and investments are formally reviewed and considered by the board before approval. □ The board oversees the budgeting process. It makes sure that the company budget is linked to the strategic and business plans. □ The board assesses actual performance against budget on a regular basis (no less than quarterly). □ The board understands that variances from the budget are normal and seeks to understand the reasons for variances. □ The board integrates feedback on budget performance into its future planning. □ The board does not use budgets to micro-manage specific line items. □ The budget process is not so inflexible that it hinders the achievement of the strategic objectives of the company (for example, an inability to reallocate funds from a line-item that is no longer needed to one that has suddenly become urgent).
2.2.5	Executive appointments	*The goal:* The board selects and replaces the CEO and oversees the selection of key executives and ensures succession planning.
		Explanation: Another one of the key roles of the board is to hire (and fire) the CEO and, in some cases, to vet (to check) the selection of other top executives. The capacity to hire and fire the CEO underscores that the board has the ultimate authority over the executive and also that the board is ultimately responsible for company performance. Though the board should be involved, typically, it is considered the prerogative of the CEO to appoint their own management team. It is considered best practice for boards to ensure that succession takes place in an orderly fashion in the interests of the company. As such, a company is expected to have a succession plan for the CEO and for critical executives. This plan should be reviewed by the board on a regular basis. For SOEs, it is common practice for the state to appoint CEOs. This is not good practice. As in listed companies, this should be the prerogative of the board.
		Tests: □ The board has the power to hire and fire the CEO. □ The board has the authority to vet the other members of the management team though its precise composition should either be the CEO's choice or the CEO should be able to influence the composition of their team. □ The board ensures that there is a succession plan in place for the CEO and for other critical executives. Typically, this succession plan is developed by the CEO and reviewed by the board. □ The board considers the succession plan on a regular basis (probably no less than annually). □ Political issues should not be allowed to influence the process of selecting the CEO or other key executives.

		□ Decisions on executive appointments should be based exclusively on merit i.e. the qualifications of the candidate.
2.2.6	Incentives and remuneration	*The goal:* The board ensures that incentives are in place for top executives and all other employees including remuneration policies.
		Explanation: An incentive program is a formal scheme used to promote or encourage specific actions or behaviours. Incentive programmes are used in businesses to motivate top executives and other employees to achieve corporate objectives. Incentive plans often focus on remuneration. However, there are other ways (arguably more effective) of generating incentives including through recognition for performance and promotion. Listed companies, SOEs and SOBs can all benefit from the introduction of incentive plans. In SOEs and SOBs the capacity to do so may be limited as employees may be considered civil servants and therefore subject to civil service remuneration policies.
		Tests: □ The company has a management by objective plan (MBO) that includes objectives for all levels of employees that support the achievement of the company's strategy and goals. (See 2.2.2 above.) □ The MBO plan is linked to the remuneration of top executives and other employees that are typically considered eligible for incentive compensation. □ The board or a remuneration committee formally evaluates the performance of the CEO and other top executives against Key Performance Indicators (KPIs) aligned with the MBO objectives. □ Non-executive board members have the opportunity to meet in private sessions to discuss and evaluate management performance. □ Remuneration practices within the company are broadly considered as fair. □ Non-financial methods of creating incentives such as recognition for performance and promotion are used to incentivise staff. □ The company does not act to demotivate staff or provide disincentives for performance. For example, actions or policies that may demotivate employees are: a) absence of recognition for achievement; b) micro-management; c) lack of opportunity for personal advancement; d) extreme job insecurity; e) unstructured or ad hoc decision making by top management; f) poor communications between top management and other employees; g) an unpleasant work culture; h) lack of interesting work or opportunities; h) lack of respect for employees or uncivil treatment thereof; i) absence of basic protections against improper treatment such as gender bias; j) non-enforcement of labour law and/or an internal code of responsible conduct; or k) toleration of corrupt practices. □ Public service objectives are formally included in the MBO plan. □ SOE employees are not limited by civil servant remuneration guidelines and are eligible to be recognised for performance through financial performance incentives. □ SOE employees are not limited by civil servant promotion guidelines and are recognised for

		performance through promotion. SOBs are expected to comply with the same requirements as SOEs and, in addition: □ SOBs should have incentives that take into account the special role of non-shareholder stakeholders (such as depositor protection and proper risk management). □ Incentive plans should not promote excessive risk taking that might endanger the financial stability of the SOB or stakeholder rights.
2.3	*Board structure and processes*	
2.3.1	Board composition	*The goal:* Board composition responds to the needs of the company.
		Explanation: The skills and experience of board members are appropriate to the requirements of the business. Boards will require different skill sets, experience and personalities to properly fulfil their roles. These should be adapted to the evolving needs of the company. The aim is to maintain an appropriate balance of skills and experience on the board. SOEs tend to have board compositions excessively skewed towards individuals with political backgrounds, who represent key constituencies, and who oftentimes have insufficient business experience. SOE and SOB boards also tend to underrepresent individuals with financial expertise and individuals who are independent.
		Tests: □ The current board composition corresponds to the needs of the company. The owners and board have staffed the board with skilled and experienced board members. □ The board has conducted a formal gap analysis of the skills it needs and has developed profiles for the board members that are needed. Such an analysis can be conducted once and then checked and updated (if required) in the context of an annual corporate governance review. □ The board monitors the skills that it needs, and puts in place an active search for the right skills and experience. Such an analysis and search are done regularly and systematically. □ No knowledge areas are missing such as financial, control, strategy, sectoral, good governance, etc. □ There is an appropriate diversity and gender balance on the board. □ The board has the capacity for objective (independent) judgment and no further independent board members are needed. □ The personalities on the board function well together as a team and there are no personality conflicts or conflicts over authority. □ Special attention is paid to avoiding political appointments. □ There are no ministers, vice ministers or high-level government officials on the board. It is particularly important that board members, irrespective of their official roles in government, are not politically engaged. □ Civil servants are kept at a minimum. □ The board has a strong presence of individuals with relevant business experience. □ Board members who represent constituencies are kept to a minimum. Representatives of constituencies might include representatives of political parties, a head of a chamber of

		commerce or a sectoral trade grouping such as the head of a chamber of construction companies, or an individual that represents regional interests in an area where the company is active. The reason is that board members are supposed to act in the interest of the company and this may conflict with a constituent board member's need to represent their constituency. □ The board has at least 1/2 independent members. □ The board benefits from the assistance of a Corporate Secretary who is well versed in good governance practices. SOBs are expected to comply with the same requirements as SOEs and, in addition: □ The majority of the board has some banking and/or financial experience. □ At least one member of the board should have a good understanding of controls and risk management. □ At least one member of the board should be able to represent the view of key stakeholders such as depositors and/or borrowers.
2.3.2	Formal merit-based selection	*The goal:* The company has a formal selection process that aims at having the best qualified board members with the skills, character and experience the company needs.
		Explanation: 'Merit" is the set of characteristics composed of the skills, abilities and knowledge of a potential board member. In a merit-based system for board member selection, potential board members compete for board posts. Character issues and personality traits enter into the assessment of who is best-suited to fill a position. This is often referred to as "fit and proper testing". Selection processes benefit from being open, transparent and competitive. In practice, in many companies the process for selecting board members is informal and therefore poorly suited to finding the most appropriate candidate. Informal board member selection processes are vulnerable to the influence of controlling or significant shareholders, the existing board and/or the management. This is particularly true in SOEs where political or personal connections may be considered by owners as the most important criterion for board membership. This generally works to the detriment of SOEs. In unlisted firms, the choice is more influenced by family relation or personal contacts. In all cases, the board can be made more effective by ensuring that members are selected purely based on what the board member can offer the company. (Section 3.3.4 transparent board member selection process deals with the issue of transparency of the selection process.)
		Tests: □ The company has a formal selection process designed to find individuals who have the skills, character and experience needed by the board (this may be under the control of the state owner). □ The sought-after profile was established as part of a board evaluation process (see 2.2.3 governance evaluations). □ There is a clear written policy for how to go about nominations and selection (this may be under the control of the state owner). □ The company has a nominations committee (or *ad hoc* working group) staffed mainly by

		independent board members and/or chaired by independent members of the board. □ Candidates undergo "fit and proper testing". Fit and proper testing goes beyond the content of a candidate's CV. Candidates are checked for a history of honesty, integrity, fairness, ethical behaviour and their financial soundness. Typically, a criminal act, bankruptcy, fraud or dishonest behaviour would disqualify candidates. □ Candidates are assessed for personality fit with the board, and their capacity to work on a team. □ The nominations process does not rely mainly on existing networks of contacts, friendships, or word-of-mouth recommendations. □ The company expands the pool of potential candidates by utilising the services of an independent search consultant or by making a public announcement to find suited candidates. □ The state as an owner recognises that both the SOE and the interests of the state are best protected by board members selected primarily based on merit. □ An SOE nominations committee or a public commission should exist to provide input into the selection process. Usually committees and/or commissions only have powers to make recommendations. A nominations committee or commission should ideally be staffed to the extent possible by independent board members whilst a public commission should be staffed to the extent possible by figures without any political affiliation. □ Board members are not selected based purely on political affiliation, because they represent a constituency, or because of political loyalty (patronage). □ The full board is not changed with every election cycle. At least a portion of board members stay on to provide some continuity after changes in administration.
2.3.3	Board size	*The goal:* The board size allows for the efficient dispatch of the board's functions.
		Explanation: There is no single optimal board size. The correct board size depends upon the sector, nature of the company and its needs. A typical range of board size for a listed company or SOE would be from 5 to 10 members with an average among large listed companies being about 8. Anecdotal evidence suggests that SOE boards tend to be somewhat larger. Excessively small boards may have insufficient manpower and skills, in particular for the staffing of committees. On the other hand, excessively large boards may find it more difficult to achieve consensus and act as a cohesive team. Excessive size may make decision making cumbersome and may also allow some board members to be less involved and contribute only marginally.
		Tests: □ The board has considered and discussed the issue of board size. The proper board size may have been considered in the context of a governance evaluation (2.2.3) or the deliberations of a nominations committee—where they exist. □ The board has satisfied itself that the size is effective and suited to help the company achieve its goals. □ SOEs have a tendency towards larger and sometimes unwieldy boards. Special attention needs

		to be paid to ensure that they do not become too large. □ For full compliance, the board has at least 5 members and does not exceed 12 members.
2.3.4	Access to information	*The goal:* The board has the information it needs to fulfil its responsibilities.
		Explanation: The board makes important decisions. Its decisions need to be founded upon the best possible available information, as well as informed, rigorous and open debate. The obligation to act on a fully informed basis is part of the board's "duty of care" (See 2.1.2 the duties of loyalty and care). Information should be complete and available to the board on a timely basis. The board should be able to request and receive all information that it considers necessary for it to fulfil its duties. An absence of good information leads to weak decision-making processes.
		Tests: □ The board is able to request and receive any information that it feels it needs to fulfil its duties. □ Management provides such information on a timely basis. What is timely is likely to be different in every company. However, it is not timely if the board feels that it does not have sufficient time to consider all of the information thoroughly before board meetings. □ Materials are provided to the board before meetings with sufficient time to read and digest their content. This would be one full week at a minimum. □ The board has the ability to consult with members of management (such as the internal auditor, the chief risk officer, the chief financial officer, the external auditor, legal counsel, etc.) directly and without the presence of the CEO or other management if it so desires. □ The board also has the ability to consult with outside experts (f.ex. remuneration consultants, lawyers, etc.) at company expense (within reason) if it deems necessary.
2.3.5	Training	*The goal:* Induction and ongoing training are available to board members.
		Explanation: New board members need to receive sufficient training and background information to fulfil their duties. Preparing a board member before starting their board duties is referred to as induction training. Induction training may include facilities visits and interviews with key staff, provision of key documentation from the company. In some cases, formal external training is provided by, for example, an institute of directors. Most board members learn how to fulfil their duties while on the job. In some cases, however, it may also be desirable for board members to receive ongoing training or attend conferences or seminars after they have served for some time. Such ongoing training may help inform board members of industry trends, and develop their understanding of other relevant issues. All board members, irrespective of the type of company, will likely benefit from training in good governance practices. Induction training is always paid by the company. Ongoing training is generally paid by the company, but is subject to prior approval by the board in order to verify the need and availability of funding.
		Tests: □ Induction is formalised with a package of all of the key information that might be useful for new board members to allow them to effectively step into their new role.

		□ Induction training covers the basic information on the company, its structure and business, financial history, strategic challenges, main future goals and projects, risks, risk appetite and so on. □ Induction training covers the issue of corporate governance and the responsibilities and expectations of board members. □ An individual (such as a Corporate Secretary or another board member who can serve as a mentor) is assigned to new board members to help them orientate themselves. □ New board members should have the ability to interview executives, staff and key functions such as the internal and external audit as part of their induction. □ The opportunity to have ongoing training (on topical issues) is provided to board members subject to the approval of the board. □ The induction training of SOEs should pay special attention to: a) how to deal with situations where a company has both commercial and policy objectives; b) the issue of loyalty to the SOE versus loyalty to the state; c) the special governance challenges associated with SOEs; d) the specific decision-making limits that apply to the state versus the board versus management. SOBs are expected to comply with the same requirements as SOEs and, in addition: □ The induction training of SOB board members should take account of the unique aspects of bank governance. It should pay special attention to: a) risk management; b) regulatory obligations; c) special obligations that bank board members may have under law; and d) obligations to depositors and borrowers.
2.3.6	Meeting frequency	*The goal:* Board meeting frequency is appropriate to the needs of the company.
		Explanation: Too few board meetings means work is not being done, or the board is uncommitted or does not take its functions seriously or that the role and responsibilities of the board is defined too narrowly. Too many board meetings can mean that the board is overly involved in management or is micro-checking management instead of providing strategic guidance and monitoring. Both are indications of a poor understanding of the board's proper function. Irrespective of the company type, a minimum of 4 board meetings per year can be used as a thumb rule. Infrequent board meetings can be an indication that a board is not truly operational. Listed company boards meet on average about 7 to 8 times per year (depending on the country). More than monthly meetings are generally considered excessive. Some committees, in particular audit committees, meet with greater frequency than the whole board, sometimes on a monthly basis.
		Tests: □ The board knows what appropriate meeting frequency is for the company. □ The board meets with sufficient frequency to ensure that business at hand is completed at the expected quality level. The board meets at a minimum of 4 times per year and no more frequently than monthly for full compliance with the test. Approximately 7 to 8 times per year is an average for listed companies and may serve as a reference point.

		☐ The length of board meetings is such that all issues are covered in appropriate detail. The board focuses on the big issues and does not get into excessive detail that results in "busy work" (work that keeps a person busy but has little value in itself). ☐ Meetings are regular and according to a predictable schedule. ☐ There are not excessive numbers of extraordinary meetings or emergency meetings—unless under exceptional circumstances—as these suggest poor planning.
2.4	*Independence and objective judgement*	
2.4.1	Capacity for objective judgement	*The goal:* The board has the capacity to exercise objective judgement and reason with independence.
		Explanation: One of the main ways to encourage objective judgment and reasoning on the board is through independent board members. Independent board members provide a balance to the views of insiders, owners, and board members who represent constituency interests. Independent board members are often seen as important defenders of minority shareholders. At the same time, one should not focus excessively on formal aspects of independence. It is increasingly agreed that formal independence is less important than board members who have an independent character and state of mind, and who are capable of objective reasoning. Nevertheless, formal definitions of independence remain popular because they provide easy-to-use criteria and can be implemented in an objective fashion. In some countries, best practice suggests that listed companies have boards composed of a majority of independent board members. However, empirical data on the optimal number is limited. Independent board members are less frequent on SOE boards though they are widely considered an essential tool to improve SOE governance.
		Tests: ☐ A listed company should have a minimum of 50% independent board members. Current law says ⅓ but no less than 2. There is no empirical evidence that a larger percentage of independent directors improves governance or performance in practice. ☐ The company is able to provide documentation with the definition of independence that it applies. Such definition is in addition to extant law. ☐ The independent board members have a significant voice on the board and are actively encouraged to express their views. ☐ The board as a whole is able to discuss issues and arrive at decisions in an open and objective fashion. ☐ The company has the explicit goal of achieving objective dialogue on its board as reflected in articles or bylaws. ☐ The company looks for independent and objective thinkers in its search process for new board members.
2.4.2	Separation of Chair and CEO	*The goal:* The distinction between oversight and management is unambiguous in the board's leadership.

		Explanation: In a two-tier board, the positions of Chair and CEO are separated by definition. Two-tier boards are usually fully compliant with this indicator. In a single-tier board it is more likely to have the roles of Chair and CEO exercised by the same person. While SOE boards are currently all two-tier in Ukraine, this may change in future. Best practice suggests that the roles of the Chair and the CEO be separated in order to create a clear distinction between the oversight role of the Chair and the executive role of management. Where this separation is not considered desirable, it may be a reasonable alternative to have a "lead independent director" to balance the powers of the Chair in the event that the roles of Chair and CEO are combined. For SOEs, the Chairman and CEO should not be the same person. This indicator does not apply to "management boards", which do not need to establish separate roles.
		Tests: □ The roles of the Chair and the CEO are separated. □ If the Board of Directors does not have an independent chairman, a lead independent director is appointed by the Board of Directors. The lead independent director will be responsible for calling separate meetings of the independent directors, determining the agenda, and serving as chair of meetings of independent directors, reporting to the Chairman of the Board of Directors regarding feedback from executive sessions, serving as spokesperson for the Company as requested, and performing such other responsibilities as may be designated. □ The Chair or the lead independent director (not the CEO) is in charge of setting the board's agenda, directing its discussions and directing decision making. □ The company has established a clear relationship of accountability of the CEO to the Chair (or the lead independent director) and this relationship is formally documented either in the articles of incorporation, by-laws, or governance code. □ The Chair does not spend too much time at SOE's office and should avoid involvement in discussions of day-to-day operations with management. The Chair should not have a "full-time function" at the SOE. (This indicates that the Chair is, in fact, exercising an executive function.)
2.4.3	The contribution of independent board members	*The goal:* Independent board members contribute an objective and independent view to areas where there is a potential risk of conflict of interest.
		Explanation: Independent board members have the same responsibilities under law as any other board member. However, there is an expectation under best practice that independent board members have a unique mind-set. It is precisely because of their independence of mind and objectivity that they are considered important contributors to a best practice board. Their independence of mind is considered particularly important where there are potential conflicts of interest. There are a number of areas that are particularly vulnerable to conflicts of interest: a) financial reporting and control; b) remuneration of executives; c) the nomination and selection of board members; d) related party transactions; e) procurement; and f) the distribution of profits and dividend payments amongst others. As a consequence, it is common under best practice to recommend that the audit, nominations and remuneration committees be staffed fully or predominantly by independent board members.

		Independent board members (a board member who has no financial relationship or other significant interest with the company or related parties) can make a special contribution to the company by reducing the potential for disagreements and abuse potentially resulting from conflicts of interest.
		Tests: □ The company understands the special contribution that independent board members can make and puts them in positions where they can be objective arbiters. □ Independent board members are in the majority on the audit, remuneration, and nominations committees. □ The key committees noted in the explanation section above are chaired by independent board members. □ Independent board members play an active role in the approval of related party transactions, oversight of ethics policy, and oversight of conflicts of interest.
2.4.4	Reporting on independence	*The goal:* The company reports on the degree of independence of board members and the board.
		Explanation: The capacity of a board to arrive at objective and fair decisions on the behalf of all shareholders is a fundamental goal of good governance. It is critical to demonstrate this capacity to the markets and existing shareholders. In order to do so, the company is expected to report on the independence of board members and of board processes and structures that encourage independent and objective judgement.
		Tests: □ The company reports on the capacity of the board to exercise independent and objective judgement in its annual report. □ The company identifies those board members whom it considers independent and discloses their identity. □ The company discloses its definition of board member independence. In the EU, non-binding recommendations suggest that a director "should be considered to be independent only if he is free of any business, family or other relationship, with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgment." In some countries, independence will be defined either in law or a local governance code or some other pronouncement. Sometimes companies develop their own definitions, or interpret existing definitions. Whatever approach is chosen, it is essential that the company disclose the definition of Board independence that it adheres to. □ Sufficient information on board members is disclosed in order to arrive at a reasonable assessment of their degree of independence. □ The special roles (if any) assigned to independent board members are disclosed (such as staffing of the audit or remuneration committee, or monitoring related party transactions). □ The requirements for committees to act independently and the number of independent board members on committees are disclosed.

3	**Transparency and reporting**	
3.1	*Financial reporting and disclosure*	
3.1.1	Board oversight of reporting	*The goal:* The board exercises oversight over financial reporting and the independent external audit and assures compliance with good financial reporting practices.
		Explanation: One of the key responsibilities of the board is to exercise oversight over financial reporting, and the external independent audit that provides assurances that the financial reports of the company give a true and fair view of its financial state. Typically, this function requires some level of expertise and experience in the preparation and/or use of financial reports. As a consequence, boards should have a sufficient number of members who are financially literate and understand both internal and external audit. It may be useful for boards to have members with backgrounds in banking and/or financial analysis in order to contribute the perspective of common users of financial reports. This can be considered essential for SOBs.
		Tests: □ The board's responsibility for overseeing financial reporting and external audit is described in the articles of incorporation or in the bylaws or in a board charter. □ The board is actively involved in overseeing the preparation of the company's annual financial reports and intermediate reports (where they exist). □ The board assures that the company complies with its financial reporting requirements under law. □ The board oversees the external audit process, in particular the process of hiring and firing the external independent auditor, the negotiation of the annual audit fees and ensuring that the external independent auditor retain their independence. □ In the event that the board does not have an audit committee (See 4.6 below), the board jointly fulfils the responsibilities and roles of a best practice audit committee. □ Board members are present at the GSM to help present the financial reports.
3.1.2	Disclosure of financial reports	*The goal:* The company discloses financial reports on a fair and timely basis.
		Explanation: Financial reporting includes the following: a) the external financial statements (balance sheet, income statement, sources and uses of funds (cash flow), and statement of shareholders' equity including the notes to the financial statements); b) press releases; and c) the content of analysts' meetings, conference calls regarding quarterly earnings and related information. Quarterly reporting is currently the norm for listed companies though it is usually not as detailed as annual reporting. Nor is it typically audited. It is essential that financial reports be disclosed on a timely basis (so that the information is relevant) and in a fair manner (so that investors are unable to take unfair advantage of privileged access to information). SOEs are expected to maintain the same standards as listed companies. SOBs should also follow the same standards of financial reporting as listed companies as they are considered Public Interest Entities (PIEs). PIEs are generally considered banking, insurance

		companies and company groups. Given the systemic nature of banking, bank disclosure is expected to lead other companies.
		Tests: □ The company discloses annual financial reports audited by a reputable independent external auditor. □ The auditor has not issued a repeated qualified statement on the financial reports over the past 3 years (or an adverse opinion or a disclaimer of opinion). □ Financial reports are provided on a timely basis. □ Where the SOE is listed, financial reports are provided to the markets and shareholders simultaneously (fair disclosure) so as not to give unfair advantage. □ The company discloses quarterly reports.
3.1.3	Financial reporting standards	*The goal:* The company uses a high-quality financial reporting standard (IFRS).
		Explanation: Financial reports of listed companies worldwide tend to be required to be prepared according to IFRS or an IFRS equivalent such as US GAAP. The use of a high quality internationally accepted standard is necessary to ensure confidence in financial reports and to permit for comparison between different reporting entities. For SOEs, the same requirement applies as for listed companies since the state deserves the same quality of information as the private sector. It is insufficient for SOEs to report according to national accounting standards or government accountings standards. The reporting requirement is even more important for banks which are Public Interest Entities.
		Tests: □ The SOE's audited financial reports contain a statement by the independent external auditor that the financial reports of the SOE have been prepared using IFRS. □ The financial reports of the SOE have not undergone repeated restatement over the past 3 years. □ The SOE does not limit its reporting standard to either national accounting or public sector standards.
3.1.4	Audit standards	*The goal:* The external auditor uses International Standards on Auditing (ISA).
		Explanation: The use of a high-quality standard for audit enhances the value of financial statements by providing assurances to users. International Standards for Auditing (ISA) are required in many countries for the statutory audits of listed companies. SOE audits should also be conducted in accordance with ISA. The same is true for banks and SOEBs which can be considered Public Interest Entities.
		Tests: □ The company's financial reports contain a statement by the independent external auditor that the financial reports of the company have been audited in accordance with ISA. □ Government audit standards are not a substitute for ISA—unless these are in full compliance

		with ISA and effectively equivalent.
3.1.5	External audit	*The goal:* An audit of the financial statements is conducted annually by an independent external auditor.
		Explanation: Listed companies are required to have an annual audit of their financial reports conducted by an independent external auditor. Such an audit provides assurances to the users of financial reports. The absence of an annual audit by an independent external auditor greatly reduces the value of financial reports for users. The expectations are the same for listed companies, SOEs and SOBs.
		Tests: □ The financial statements of the company are audited by an independent external auditor. □ The external auditor has a direct and unencumbered reporting relationship to the board (and ideally to an independent audit committee). □ The board of directors assesses the independence of the external auditor. □ The board of directors applies measures that ensure external auditor independence such as mandatory rotation of audit firms, or rotation of audit partners, or the non-provision by the auditor of non-audit services. The exact measures designed to ensure auditor independence may be found in legislation. For example, the EU requires PIEs to rotate audit firms every 10 years. □ The fees that the company pays to the independent external auditor are not a significant portion of the auditor's total revenues. If they were, this might endanger auditor independence. The company should be able to provide assurances that it complies with relevant legislation. (For example, EU legislation prohibits a statutory auditor of a PIE "directly or indirectly to provide any prohibited non-audit services to the audit entity, to its parent undertaking or to its controlled undertaking within the EU." EU legislation also defines permissible services.) Big 4 firms can usually be understood to be in compliance with best practice international standards and local legislation. □ The mandate to assure auditor independence is given to the audit committee of the board which is staffed in its majority by independent board members.
3.1.6	Audit quality	*The goal:* The external auditor is recognised, independent, and qualified.
		Explanation: Not all audits nor all audit firms are created equal. Some do not have the capacity to conduct a high-quality audit or deliver the necessary assurances. It is incumbent upon the board to assess the capacity of the external independent auditor to provide the needed assurances. The auditor's capacity to provide assurance services should be commensurate to the situation, size, complexity and sector of the company. The independent external auditor must have sufficient capacity and independence and the company must devote sufficient resources to pay for a high-quality audit. The governance of the audit by the board is essential. This means that the board must oversee the external auditor and the audit process and ensure that they are effective.

		Tests: □ The board has assured itself that the auditor has the capacity to conduct a high-quality audit and provide the necessary assurances. Boards regularly request proposals for audit services from different audit firms. Such proposals should describe the audit firm's capacity. Capacity can be demonstrated by the number of staff, level of training and certification levels of staff, and the independence of the auditor. □ The board has checked the reputation of the external auditor including its membership in local and international professional bodies (such as an institute of auditors and IFAC) and has checked to see if there have been any complaints to regulatory or professional bodies. □ The external auditor is a member of a larger network of internationally recognised audit firms. □ On occasion, the board opens the independent external audit up to tender in order to explore the possibility of a better service offering (audit firm rotation). □ The audit of a state authority is not used as a substitute for an independent external audit. □ The audit of an internal auditor is not used as a substitute for an independent external audit.
3.2	*Non-financial reporting and disclosure*	
3.2.1	Board oversight of non-financial reporting	*The goal:* The board oversees non-financial reporting and communications and assures compliance with good practice.
		Explanation: There are different definitions of non-financial reporting. From the perspective of the OECD, non-financial reporting is any form of reporting outside of traditional financial reports. This could include stakeholder, sustainability, governance, environmental, ethics, corruption, gender, human rights, social and employee, and other forms of reporting. IOSCO uses a narrower definition. It defines non-financial reporting as financial information not prepared according to a generally accepted accounting practice (GAAP). IOSCO refers to these as "non-GAAP financial measures" or "alternative performance measures". There are also initiatives that seek to integrate traditional reporting and internal management information systems with additional indicators on how the company creates value. This is referred to as "integrated reporting". For the purposes of this scorecard, the broader OECD definition is used. Irrespective of the content of non-financial reporting, the quality of non-financial reporting is improved when it adheres to a commonly accepted reporting standard. Commonly accepted reporting standards aim at raising the quality of non-financial reports and permitting comparability between reports. Boards are generally expected to oversee the communications of the company on major issues of interest to all stakeholders as these can have a significant reputational impact on the company.
		Tests: □ The board recognises that non-financial reporting is an important source of information that can help to better communicate the company's vision and performance. (This can be substantiated by looking at the actual non-financial disclosures that are made by the company--See 3.2.2-5 and 3.3).)

		☐ The board has considered what types of non-financial reporting may be important in helping it achieve its communications goals. ☐ The board oversees non-financial communications.
3.2.2	Company objectives	*The goal:* The company discloses its commercial objectives.
		Explanation: Communication of the company's commercial objectives is considered essential. Commercial objectives need not be only financial objectives. For example, commercial objectives include achieving a certain percent market share, or expanding into a new market or region, achieving a specified level of product quality, or a degree of customer service satisfaction and so on. Usually, disclosure of commercial objectives is fairly general. Disclosure should not reveal Confidential Business Information (CBI) that would compromise the competitive position of the company. CBI might include, for example, information on patents, processes, techniques, and strategic plans. Typically, SOEs and SOBs have both commercial and non-commercial objectives that go beyond commercial objectives. These are usually assigned by the state for the purpose of providing a public service or good.
		Tests: ☐ The company disclosed its objectives. (This may be found in the company's annual report, other periodic reporting or in the company's IPO documents if it is listed.) ☐ While a detailed strategy is typically considered confidential information, the company provides general indications on its strategy and how it will achieve its objectives. ☐ The company discusses its objectives in its annual report. ☐ In addition, SOEs are expected to discuss their non-commercial (public policy or social objectives) in their annual report. ☐ Any public policy objectives that the SOE is required to achieve and is mandated by the relevant authorities is disclosed.
3.2.3	Management's discussion and analysis	*The goal:* The annual report contains a Management's Discussion & Analysis (MD&A) or similar discussion of company situation and performance.
		Explanation: An MD&A is considered an essential part of an annual report. The MD&A provides an overview of the previous year's operations and how the company performed financially. The MD&A also discusses the upcoming year by outlining future goals and approaches to new projects. The MD&A is an important document for analysts and investors who want to review the company's financial fundamentals and management performance. SOEs and SOBs are generally expected to comply with best practice standards for listed companies.
		Tests: ☐ The annual report contains an MD&A section. ☐ This section includes a discussion of the past year's performance. ☐ The MD&A also discusses future performance prospects, challenges and risks. ☐ The MD&A of an SOE should also address the non-commercial (public policy or social objectives) of the SOE, its performance on such objectives and the costs of achieving them.

3.2.4	Transparent ethics and responsible business conduct	*The goal:* The company discloses its ethics code and policies to ensure Responsible Business Conduct (RBC).
		Explanation: (This indicator measures only the <u>disclosure</u> of the ethics and RBC code. The requirement to have such codes is found in 4.3 ethics and RBC below.) Ethics code set down a company's policy with respect to ethical conduct. Sometimes these are referred to as codes of conduct. These tend to specify the behaviour that is expected of individuals. Ethics codes are generally established voluntarily by companies, though adherence to the code is typically mandatory for employees. They may cover: relations with stakeholders, clients, bribery, harassment, race, religion, acceptance of gifts, conflicts of interest, employee relations. On the other hand, RBC codes tend to focus less on individual behaviour and more heavily on corporate actions and policies, in particular, compliance with laws, such as laws on human rights, environmental protection, labour relations and financial accountability. Ethics codes often contain elements of RBC. Having an ethics and/or RBC code, is considered best practice for listed companies, SOEs and unlisted companies alike.
		Tests: □ The company discloses its ethics and RBC code. □ The company discloses how it implements the ethics and RBC code. □ The company discloses that the board is responsible for ensuring that management develops and implements an ethics and RBC code and monitors their effectiveness (in all likelihood relying on the internal audit function). □ As an alternative to disclosure of an RBC code, the company discloses its endorsement of an international code of ethics or RBC (such as the UN Global Compact, or the OECD Guidelines for Multi-national Enterprises).
3.2.5	Transparent remuneration policy	*The goal:* The company remuneration and incentive compensation policy is disclosed.
		Explanation: Best practice suggests that remuneration policies and incentive compensation plans for both executives and board members be disclosed and transparent. In some cases, remuneration disclosure may occur for individuals or in the aggregate (e.g. total compensation for the 5 highest-paid executives). There is no general consensus that remuneration be disclosed below top management level. Arguably more important than the actual remuneration is the policies that are used to set remuneration levels and what if any plans exist to incentivise performance through remuneration practices. For listed companies, securities exchange regulation may require mandatory filings on remuneration. Furthermore, IFRS may require disclosure of the costs of share-based incentive compensation plans. SOEs and SOBs can be expected to have the same degree of transparency with respect to remuneration and remuneration/incentive compensation policies as listed companies.
		Tests: □ The company has a written remuneration/incentive compensation policy for executives, for board members and employees. □ The policy regarding board and executive compensation is disclosed either in the annual report or through some other channel such as a regulatory filing or on the company website. (The

		existence and/or details of employee compensation plans are not typically disclosed.) ☐ Executive remuneration and incentive compensation is disclosed individually (ideally) or in the aggregate for the group of top executives and board members.
3.2.6	Communications	*The goal:* The company has a communications policy that helps ensure its transparency to a full set of its stakeholders.
		Explanation: It's important for a company to have an external and publicly accessible communication policy that sets out procedures and helps plan how often is needed to communicate with the different stakeholder groups and decide which tools to use for each one.
		Tests: ☐ The company has a communications officer. ☐ The company has developed an external communications strategy and a communications policy which is designed to frame communications with key stakeholders to further the reputation and standing of the company.
3.3	*Governance reporting and disclosure*	
3.3.1	Board responsibility for governance reporting	*The goal:* The board oversees reporting on the company's corporate governance and assures compliance with good practice.
		Explanation: One of the key responsibilities of the board is to be accountable to shareholders for the company's governance. The main way to achieve accountability is through governance reporting. Some of the key elements of governance reporting are listed in 3.3.2-4 below. SOEs and SOBs often suffer from a lack of transparency in their governance making this a key area of concern.
		Tests: ☐ For listed companies, the board acknowledges that it has the responsibility for ensuring that the company's and the board's governance practices are fully transparent to shareholders and the markets. This may be substantiated either by the existence of a governance section in the annual report, or in a statement by the board on its roles and responsibilities that might be found either on a website or in an annual or governance report. The absence of formal reports or the absence of transparency on items 3.3.2-4 would indicate that the board does not recognise this responsibility. ☐ The issue of reporting on the company's corporate governance practices has been formally placed on the board agenda and is considered at least once a year. ☐ The board (with the assistance of the Corporate Secretary or chief legal counsel) has developed a list of key corporate governance disclosures that should occur.
3.3.2	Annual governance report	*The goal:* The company discloses an annual report on its governance.
		Explanation: The governance practices of a company are an essential element of corporate reporting. They provide valuable information that helps shareholders and the markets better understand the financial reports and the opportunities and risks associated with the company. Annual corporate governance reports are often legally required for listed companies. They are generally not legally

		required for SOEs or SOBs but are increasingly considered a good practice.
		Tests: □ The company issues an annual governance report. This could appear as a discrete disclosure (sometimes a filing with securities markets regulators or stock exchanges) or it could be part of the annual report. □ The annual governance report covers at a minimum, the identity and backgrounds of board members, board and committee structures, and board and committee membership. □ It is useful to have information on whether an annual evaluation of governance practices (See 2.2.3) has been done, board and committee meeting frequency and board member attendance at meetings. □ In addition, a special section of the annual governance report should be dedicated to how the SOE manages its relations with the state and what the limits of decision making are for both the company and the state. SOBs are expected to comply with the same requirements as SOEs and, in addition: □ The SOB annual governance report reflects the special accountability rights that bank stakeholders (e.g. borrowers and depositors) have in its governance reporting.
3.3.3	Transparent board composition and qualifications	*The goal:* The company reports on the composition of the board and board member qualifications.
		Explanation: The ultimate objective is for the board to have a diverse skill set designed to meet the needs of the board and the company and to ensure that the company has the best available talent. In order to achieve this ultimate objective, the company must be accountable for its decisions regarding board composition. Transparency with respect to board composition and board member qualifications are important to ensure accountability for board member selections.
		Tests: □ Summary background information on board member nominees is made available to shareholders before voting at the GSM. Sufficient information is made available for shareholders to assess the candidates' skills, experience, and potential conflicts of interest. The company should disclose that board nominees have undergone "fit and proper testing" (See 2.3.2 on merit-based selection for a discussion of fit and proper). Such information is typically provided to shareholders in a proxy package sent to them in advance of the GSM along with other meeting materials. It is increasingly common for such materials to be made available on the web in electronic form. □ More detailed information on board members should be made available, after the board members' confirmation, on the company's website and possibly elsewhere such as in a governance report or in the annual report. Such information is not expected to reveal personal information that can reasonably be expected to be held confidential.

		□ Mixed ownership SOEs should comply with the same requirements as listed companies. Wholly-owned SOEs that do not have multiple shareholders should make detailed information on board members public after confirmation.
3.3.4	Transparent board member selection process	*The goal:* The company reports on its board member selection process.
		Explanation: The board member selection process is of great interest to shareholders. It is critical that the selection process be transparent. (2.3.2 formal merit-based selection deals with the process. This indicator deals with the transparency of the process.) For SOEs and SOBs, board member selection is subject to political influence with the result that SOE boards may not be optimally staffed. The use of an independent search consultant can add to the credibility and transparency of the board member selection process. It is important to bear in mind that with respect to SOEs and SOBs that the state typically retains full control over the nominations process. Irrespective of who controls the process, there should be disclosure.
		Tests: □ The company has written policies and/or procedures that guide board member selection. These may be found in the articles of association, by-laws or other documentation. □ The basic parameters of the board member selection process are transparent to shareholders (and the markets). While the full selection policy may be publicly disclosed, this would likely be excessively detailed. At a minimum, the essential elements of the policy should be disclosed: objectives; process; general requirements of board members.
4	**The control environment**	
4.1	Board oversight of the control environment	*The goal:* The board assures itself of the integrity of the control environment.
		Explanation: The control environment is the foundation on which an effective system of internal control is built and operated in an organisation that strives to: a) achieve its strategic objectives; b) provide reliable financial reporting to internal and external stakeholders; c) operate its business efficiently and effectively; d) comply with all applicable laws and regulations; and e) safeguard its assets. The control environment refers to the overall culture of the organisation. This culture reflects the attitude, awareness, and actions of the board of directors, management, and owners who influence the staff. One of the key responsibilities of the board is to assure itself that the control environment of the company is sound, that the necessary systems of control are in place, and that they are functioning properly. The board is also responsible for communicating its responsibility for the control environment to the shareholders and the markets.
		Tests: □ The issue of the control environment appears formally on the board agenda and is considered at least annually by the board.

		□ The board discusses the effectiveness of the control environment with the internal auditor, compliance officers, and the Corporate Secretary (where such a position exists). The Corporate Secretary may not be formally part of the control environment but may be useful in determining the degree to which the company is compliant with legal requirements. □ The board discusses the control environment with the external auditor in order to gauge its effectiveness. □ In the event the external auditor issues an internal control letter or "management letter", the issues raised therein are considered immediately and are addressed. □ The board meets directly with the internal auditor in fulfilling its responsibility for oversight of the control environment. □ The board takes responsibility for internal control and relations with the internal auditor. □ Internal audit is not mainly the responsibility of an outside body such as a state auditor or controller. □ The board selects the internal auditor (the selection is not made mainly by a state auditor or controller).
4.2	Internal audit and control	*The goal:* The company has effective internal controls and an effective internal audit function.
		Explanation: Internal audit and internal control are distinct functions. Internal audit is an independent, objective auditing, assurance and consulting activity. It brings a systematic approach to improving the effectiveness of risk management, control, and governance processes. Internal control is different. It is generally an ongoing function and not an audit process. It provides daily controls and assures: operational effectiveness; reliable financial reporting; and compliance with laws, regulations and policies. Listed companies can expect to have an internal audit function in addition to internal control. SOEs are also expected to have distinct internal audit and control functions. Many unlisted companies will not have the resources to have two separate functions. In this case, the company usually has a single internal control function which may have some audit responsibilities.
		Tests: □ The company has an effective system of internal controls. □ There have not been significant failures of internal controls in the past 2 years. □ The company has an internal auditor. □ The internal auditor has an unfettered direct reporting relationship to the audit committee of the board (where one exists) which is staffed with independent directors some of whom have significant financial expertise (See audit committee under 4.6). □ The external auditor has not issued an "internal control letter" within the past 2 years that identifies material weaknesses and significant deficiencies in the entity's internal control.
4.3	Ethics and responsible business conduct	*The goal:* The company has and implements a code of ethics and a code of responsible business conduct.

		Explanation: This indicator measures the existence of an ethics and RBC code. For disclosure of the ethics and RBC codes see indicator 3.2.4 transparent ethics and RBC above. Boards and the company as a whole are expected to have a written ethics code and systems to ensure that the principles of the code are being followed. The company is also expected to have an RBC code. Sometimes the ethics code and RBC code are combined. The ethics and RBC codes should apply both to employees as well as to the board. Ethics and RBC codes can cover issues of conflict of interest, related party transactions, insider trading, self-dealing, relations with stakeholders, bribery, harassment, race, religion, acceptance of gifts, etc. (See 1.2.2 conflicts of interest above).
		Tests: □ The company has an ethics code (and an RBC code or a combined code) that applies to executives, staff and the board. □ The company actively enforces its code. □ Enforcement is verified by internal auditors and/or a compliance officer (where the position exists). □ The board annually reviews its code and compliance mechanisms to ensure that there is enforcement and that an ethical culture is implemented. □ The company has a strong ethics culture. Ethical behaviour is not achieved simply by having written codes. It is commonly understood that the board and executives set the tone for corporate behaviour and the corporate culture (irrespective of formal policies). The degree to which the company has a strong ethics culture may be indicated by the extent to which the board and executives make reference to ethics in their communications with stakeholders and the staff. The existence of an employee ethics committee may also provide substantiating evidence. The internal auditor and internal controller usually have a good idea of whether the company has a strong ethics culture or not.
4.4	Risk oversight	*The goal:* The company has a risk oversight policy and systems for risk management.
		Explanation: Enterprise risk management is: a) a process effected by the entity's board, management, and other personnel; b) applied in strategy setting and across the enterprise; c) designed to identify potential events that may affect the entity; d) manage risks to be within the risk appetite; and e) provide reasonable assurance regarding the achievement of objectives. Internationally, new risk oversight expectations are emerging for boards, with increasing pressure from regulators, banking supervisors, ratings agencies, directors' associations and shareholders. Listing rules generally require audit committees of listed corporations (See 4.6 on the audit committee) to conduct risk assessment and disclose risk management policies. In addition, credit rating agencies are increasingly assessing enterprise risk management processes as part of their corporate credit ratings analysis. The issue of risk oversight is of particular importance in the banking sector. The board is considered to be the main body with responsibility for ensuring that risk oversight and risk management is in place.
		Tests: □ The board acknowledges that it has the primary responsibility for risk oversight, and ensuring

		that risk management systems and policies are in place. □ The board understands the company's approach to risk and concurs with the company's risk appetite as set by management. □ The board verifies and knows the extent to which management has established effective systems for risk management. (It usually relies upon internal and/or external expertise--the external auditor--to verify.) □ The board is apprised of the company's most significant risks and checks to see whether management is responding correctly. □ There is a written risk oversight/risk management policy that the board reviews at least annually. □ There is a disclosure in the annual report regarding the company's risk management approach. □ The board does not see the responsibility of risk oversight/management as belonging to a state oversight body such as a state auditor or controller. □ The board acknowledges its responsibility for risk oversight in the annual report.
4.5	Compliance	*The goal:* The company has an effective system for ensuring compliance.
		Explanation: The compliance function is designed to protect the company from the risk of failure in processes and losses and fines from regulatory inspection. The compliance function ensures compliance both with external and internal rules. The compliance function also ensures that the legal rights of stakeholders are respected.
		Tests: □ The company has a compliance function. □ The company has a compliance officer or an employee assigned to the compliance function. □ The compliance function receives support from management. It is considered by management as a useful tool for the company to understand and manage risk. □ The board assures itself that the company has the capacity to ensure legal compliance. The efficacy of the compliance function is reviewed by the board annually. □ The company has a compliance manual/policy. □ There have been no significant breaches of compliance within the past 2 years.
4.6	Audit committee	*The goal:* The board has an effective audit committee or alternative structure for small and medium-sized companies.
		Explanation: Of all of the committees of the board, the audit committee is the most important. The audit committee has a special role, acting independently from the executive, to ensure that the interests of shareholders and other stakeholders are protected in relation to financial reporting, risk and internal control. Best practice suggests that audit committees be staffed 100% by independent board members. If this is not possible then the company should strive to have the highest possible number of independent board members on the committee. Members of audit committees should have a deep understanding of financial reporting and knowledge of risk and control. Audit committees are increasingly seen as best practice amongst SOEs and are generally considered mandatory amongst

		banks and SOBs. In some countries, there are structures that provide a type of audit function for the board that are composed of individuals who are <u>not</u> members of the board. These structures are not considered a substitute for a duly constituted audit committee of the board.
		Tests: □ The company has an audit committee of the board. The audit committee is not an operating committee staffed by management. The audit committee is staffed exclusively by board members. □ The audit committee has a formal charter. □ The charter of the audit committee describes its role in accordance with international best practice. (There are numerous national codes that describe best practice for audit committees. The UK Financial Reporting Council Guidance on Audit Committees is an excellent example. EU legislation specifies minimum statutory oversight responsibilities. See PWC publication: **<u>http://tinyurl.com/zwdaoz8</u>**.). □ The audit committee is staffed with financially literate individuals. □ At least one member of the audit committee has competence in accounting and audit. □ At least one member of the audit committee has competence in risk management and control. □ Ideally, all audit committee members should be independent.
4.7	Transparent control environment	*The goal:* There is disclosure on the control environment, including on internal control and audit, external audit, ethics standards, material foreseeable risks, risk oversight policy and systems for risk management.
		Explanation: In addition to having a sound control environment, the company is expected to communicate information on the control environment to its shareholders, stakeholders and the markets. It is not uncommon for companies to have systems in place but to fail to disclose such systems. Communications should be sufficient to allow shareholders, the markets and other stakeholders to form a view on the quality of the company's control environment.
		Tests: □ The company discloses the board's responsibility for the control environment. □ The company discloses governance structures and/or processes that it has put in place to ensure that the control environment is sound. For example, the company should disclose the existence of an audit committee and the responsibilities of the audit committee. □ Board charters, articles, and/or by-laws that describe the board's responsibility for the control environment should be disclosed. □ A separate section of the annual report describes the work of the audit committee, the risk management function, and the board's responsibility for the control environment.
5	**Stakeholders and the environment**	

5.1	Board considers stakeholder and environmental interests	*The goal:* The board takes into account the interests of stakeholders and the environment and assures compliance with the law.
		Explanation: The OECD Principles state that the governance rights in an enterprise accrue to the shareholders. Such rights are typically enumerated in company law. On the other hand, the rights of stakeholders (other than shareholders) are fixed in other laws (such as, for example, labour, consumer, credit and environmental legislation) and mutual agreements between the company and stakeholders (such as loan covenants with lenders). This may change in special situations, such as the insolvency of an enterprise where borrowers and other stakeholders may be given formal governance rights. But these situations are the exception. In general, the interests of stakeholders are provided by law and regulation and not through corporate governance rights. As such, the role of the company board is to ensure that all laws and regulation to which the company is subject are respected and complied with and that stakeholder views are taken into account when the board makes decisions. "Taking into account" means considering how stakeholders may impact the company in the achievement of its objectives. The obligation of the board, however, always remains to act in the best interest of the company. The single exception to this rule is for banks and SOBs who may have an equal obligation to stakeholders (specifically depositors and borrowers). For SOEs, the achievement of policy objectives that aim at stakeholders are often embedded directly in their founding legislation, their articles of incorporation or their by-laws. They are, as such, legal obligations.
		Tests: □ The board ensures that the compliance function (4.5 above) ensures observance of the law and other norms that apply to stakeholders. □ The board informs itself on stakeholder interests and environmental impacts and sustainability issues. □ The board has conducted a formal analysis of the stakeholders of the company and takes into account how the interests of different stakeholder groups impact the company's operations. □ The board's consideration of stakeholder issues can be substantiated by the existence of stakeholder reports (5.6 stakeholder reporting) and the quality of stakeholder communications. (For example, an electric or a transportation company may communicate with consumers and communities regarding shortages or problems in providing services. Or, a company can be proactive in managing a product recall. An airline might have policies in place to ensure assistance to clients in the case of flight delays, lost luggage or accidents.) □ There should be a formal Stakeholder Engagement Policy and a Sustainability Policy.
5.2	Equitable treatment of stakeholders	*The goal:* The company proactively engages with stakeholders and seeks to manage disputes with stakeholders equitably.
		Explanation: Simple compliance with the law could be interpreted as equivalent to the "equitable treatment" of stakeholders. However, the requirement that the company treat stakeholders in an equitable fashion leaves boards and companies with room for manoeuvre. It may, for example, be

		possible for the company and the board to take decisions that put stakeholders in a disadvantageous position. This may not only be legal, but required under the duty of board members to always act in the interest of the company. At the same time, the company must also consider a broader set of impacts of its actions, in particular, reputational effects. So, for example, strong action against labour during a strike may damage the company's reputation, impact labour productivity and reduce its capacity for hiring in future. Alternatively, providing better benefits for employees may enhance the company's reputation and the productivity of labour and reduce the costs and time lost as a result of labour conflicts. Another example might be the prompt recall of a defective product and replacement and/or compensation for damages or inconveniences caused to consumers. While actions in the interest of stakeholders may have negative cash flow consequences in the short term, they can reduce future risks and enhance corporate reputation in the longer term. Ultimately, it is the board that must judge what is equitable treatment and to calculate the impact of its decisions. With respect to banks and SOBs there is a stronger obligation to act taking into account stakeholder interests.
		Tests: □ The board understands how the equitable treatment of stakeholders can potentially affect company reputation and its operation, and acts in accordance with this understanding. □ Stakeholder relations are discussed at board level when they are relevant to the operations of the company. □ The company has done an analysis of its stakeholders and such analysis has become part of its risk assessment and risk management. □ The company has developed a Stakeholder Relations Policy. This can be a free-standing policy or may be part of an employee manual or ethics code or the company's code on responsible business conduct. □ There are no recent examples of stakeholder suits (by consumers, labour, or environmental interests) that have had significant effects on the company. □ Differences with stakeholders are generally resolved in an equitable fashion.
5.3	Employee participation	*The goal:* Constructive participation of employees in company affairs is encouraged.
		Explanation: In most companies, employees are the most important stakeholder. Human capital is increasingly considered the most essential asset of a company (even if it is not an asset in the financial reporting sense). Just as companies seek to preserve and enhance financial or physical assets, companies increasingly seek to enhance their human capital. For some companies, their competitiveness and survival depend on it. There are many ways in which companies seek to enhance the value of their human capital. One way is to improve good will towards the company from employees, which may lead to greater efficiency and productivity. This may mean providing fair compensation and attractive benefits. Another is to better utilise the skills and insights of employees by allowing them to participate in company affairs in a meaningful way. Such participation may be in the form of suggestions for improvements in safety and production processes. Or, it could be in the form of taking responsibility for enhancing the quality of the workplace environment. It has been empirically

		shown that employees who can contribute and those employees who have a sense of control over work issues are motivated to perform better. For banks, employees play a particularly important role in ensuring that there is a strong ethics and control culture.
		Tests: □ The company encourages employees to make constructive suggestions to improve the workplace environment and/or work processes. □ There is no impediment to unionisation or to the creation of workers' councils. □ The company implements a reward/recognition plan for employees who make outstanding suggestions. □ Employees are consulted on issues that may affect worker satisfaction. The conditions for SOBs are the same as for listed companies and SOEs and, in addition: □ All employees are responsible for helping the bank operate within the established risk appetite and risk limits. □ Bank employees are informed and know that they are expected to conduct themselves ethically and perform their job in compliance with laws, regulations and company policies.
5.4	Stakeholder access to information	*The goal:* Stakeholders are provided access to information they need to participate constructively on affairs relevant to their interests.
		Explanation: Some stakeholders have legal information rights or information rights that are contractually fixed. The company may, for example, be legally required to publish accident rates by law. Information rights that are contractually fixed include rights to information through loan covenants under which companies may be required to report on when they pass certain liquidity thresholds. In other cases, there is no legal or contractual obligation for a company to provide information but there may, nevertheless, be an interest in doing so. So, for example, plans of a company to build new facilities or to invest in or abandon certain product lines can be of significant interest both to employees and communities. As a consequence, it would be considered good practice to keep affected stakeholders informed. Not all information will be positive. However, companies that act transparently and in good faith are generally rewarded with stakeholder support.
		Tests: □ The company provides the same information that is made available to shareholders to other stakeholders. □ The company responds to reasonable requests for information from stakeholders. □ The board is proactive in informing stakeholders of matters that may impact stakeholder interests.
5.5	Whistle-blowing	*The goal:* Stakeholders should be able to communicate illegal and/or unethical practices anonymously without fear of retribution.
		Explanation: A whistle-blower (sometimes referred to as a "reporting party") is an individual who observes an improper action or practice and seeks to alert the company on its prejudicial effects.

		Whistleblowers can help alert the company to mismanagement and fraud and help internal auditors improve systems of control. Unfortunately, whistle-blowers are often subject to attempts of retribution. This discourages employees from stepping forward and reduces the positive impact that whistle-blowing can have. Companies are much better off if they are able to respond to whistle-blower complaints before problems escalate. Companies should have a whistle-blower programme in place that indicates where to log complaints and provides absolute anonymity and protection from retribution. Some companies use independent services that log whistle-blower complaints thus ensuring anonymity.
		Tests: □ The company has a formal whistle-blower policy. Such a policy need not be found in a separate document; it is possible for it to be found in an ethics or RBC code or other document. □ The policy allows for anonymous submission of comments. □ The whistle-blower policy foresees that some complaints may regard top executives and/or board members. (It should be possible for the board to receive complaints of serious misconduct amongst top executives.) □ The whistle-blower policy is made public and can be found on the company's web site. □ The whistle-blower function has sufficient capacity to respond to *internal* complaints. □ The whistle-blower function has the capacity to respond to *external* complaints. □ The company considers each and every submission and provides a formal response to submissions with a description of any actions taken to rectify the issue that was identified (if so desired by the whistle-blower). □ The board oversees the whistle-blower policy and systems, and reviews the efficacy of the function annually.
5.6	Stakeholder reporting	*The goal:* The company reports on employee, stakeholder, human rights, anti-corruption, board diversity, board gender balance, and environmental issues.
		Explanation: Different companies have different groups of stakeholders who are interested in information on how the company impacts their interests. Best practice suggests that companies issue regular reports that address the issues in which stakeholders are interested. It is understood that larger firms typically have greater capacity to provide stakeholder reports. For smaller companies, there may not be any formal reporting. However, good communications with stakeholders should be the goal.
		Tests: □ The company has identified its key stakeholder groups. □ Larger companies publish an annual report on their relations with key corporate stakeholders. □ Stakeholder reports are prepared according to a generally accepted standard or benchmark such as, for example, the GRI standards or ISO standards. □ SOEs are expected to provide additional stakeholder disclosure, in particular, the reporting of performance of the SOE against non-commercial (public policy or social) objectives.

		Stakeholder reporting can be seen as being of greater importance in SOEs than in other types of companies because of the SOE's non-commercial objectives. ☐ SOBs should pay particular attention to depositors, borrowers and other stakeholders in their reporting.
5.7	Environmental and social issues	*The goal:* The SOE integrates environmental and social issues into its strategy, planning and operations.
		Explanation: Attention to environmental and social issues is important since stakeholders increasingly expect businesses to operate sustainably.
		Tests: ☐ The board is knowledgeable of the impact of social and environmental issues on the SOE (including risks) and integrates these factors into its strategy and decision making as appropriate. ☐ At least one director has some level of expertise in environmental and social risks. ☐ The board ensures that systems are in place to identify and manage environmental and social risks and impacts. ☐ Environmental and social issues are recurring board agenda items. ☐ The board approves an environmental and social strategy and policies routinely. ☐ The board ensures the effectiveness of external communications on such issues. ☐ The SOE's environmental and social practices are consistent with international standards (e.g., ISO 14001).

PART III: REPORT STRUCTURE AND SAMPLE GRAPHICS

INTRODUCTION

Once data have been collected, the next step is to convert it into useful information. What is useful depends on the user. For companies, a simple gap analysis that shows where their governance falls short of the benchmark is often sufficient to develop a remedial action plan. If the user wants to analyse the state of governance within a country, then multiple companies need to be analysed and compared. This is a more complex process but may yield valuable information for governments or institutes of directors who aim at country-wide reforms.

SAMPLE SUMMARY REPORT AND ACTION PLAN

The following is suggested as a basic structure for a report resulting from the corporate governance assessment:

THE PURPOSE OF THE SCORING

Approximately 2-4 lines of text explaining what the company expects to see as a result of the scoring. Typically, the purposes would be to: better understand the state of the company's governance, identify gaps from best practice, identify weaknesses or risks in governance practices, the development of an action plan to close gaps, generate awareness of governance issues amongst supervisory board, executives and staff, and strengthen the good governance culture of the company. Ultimately, the purpose of improving the company's governance is to enhance its performance and better manage risks.

THE PROCESS THAT WAS UNDERTAKEN

Approximately 2 paragraphs on the process, what benchmarks the scoring uses (mainly OECD and the Basel Committee for banks), who was interviewed, what documents were examined, any efforts to make the analysis more objective, and what was the involvement of top executives and the supervisory board.

THE MAIN CONCLUSIONS

There should probably be no more than about 5 main conclusions. These should talk about high-level findings. This might be whether the company's governance practices are generally strong or weak, if there are major risks or not, and how much effort and investment might be needed to address problems.

Some high-level proposals could be made on what might be required to improve governance practices. It can be useful to describe how improvements can impact company performance and help address potential risks.

STRENGTHS AND WEAKNESSES

The chart that is automatically generated by the Excel spreadsheet can be inserted here. It would be useful to identify the large "indicator category" areas where the company is strong and weak. This should emanate directly from the chart. The section should also describe the total percentage of indicators with which the company complies. It may be useful to list the 5 strongest indicators and the 5 weakest individual indicators.

THE MAIN ACTIONS REQUIRED

This section should identify the top indicators that require improvement and remedial actions. This is, of course, a matter of judgement. Typically, the indicators that are identified as requiring urgent action are areas of particular weakness. It may be useful to present action indicators in two columns: a) the indicator that requires remedial action; b) basic steps required to close the gap with best practice.

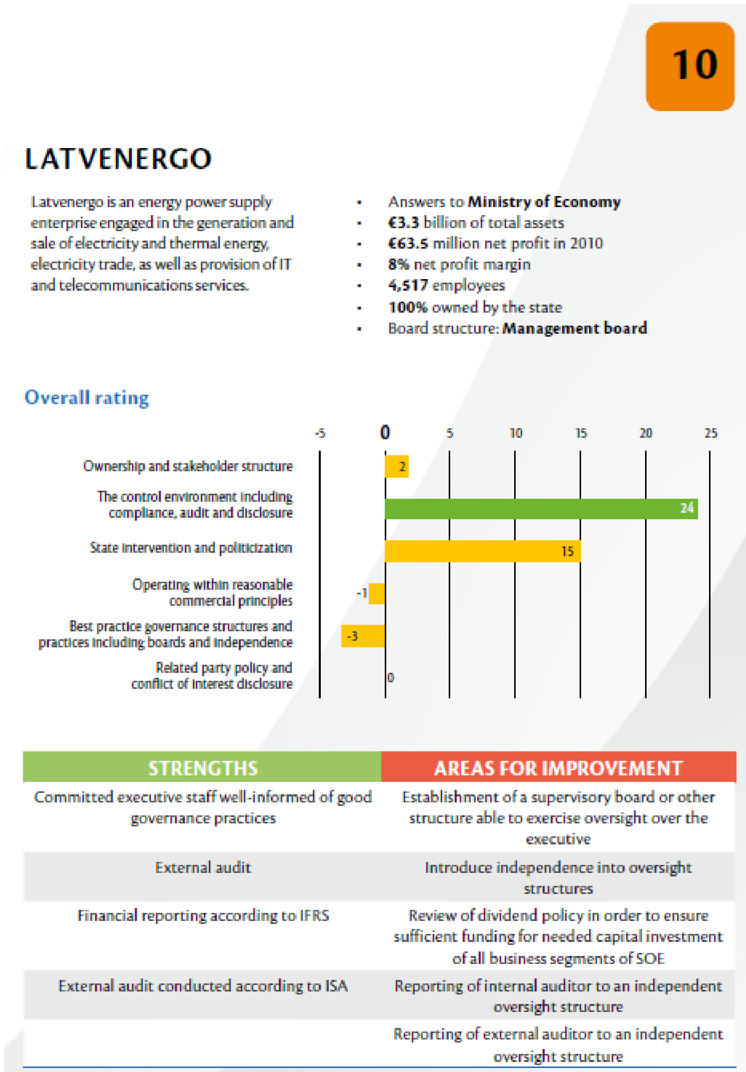
CLOSING COMMENTS

This may include 2-3 paragraphs on who is responsible for conducting remedial actions, by what time remedial actions are to be completed and to whom progress should be reported. Typically, progress should be reported to the supervisory board on no less than an annual basis—though immediately after doing the first scorecard analysis, progress should be reported on a quarterly basis. This section may also indicate when the company plans to conduct its next scorecard review.

Note: The report need not be long. There is generally no need to go beyond 2 to 4 pages though annexes may contain copies of the scorecard Excel spreadsheet and the Part II checklist.

SAMPLES OF REPORTING ON INDIVIDUAL COMPANIES AND SAMPLE GRAPHICS

The simplest form of reporting is an individual company report. A good company governance report should highlight the essential issues quickly and make constructive suggestions for improvement.



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LATVENERGO

Latvenergo is an energy power supply enterprise engaged in the generation and sale of electricity and thermal energy, electricity trade, as well as provision of IT and telecommunications services.

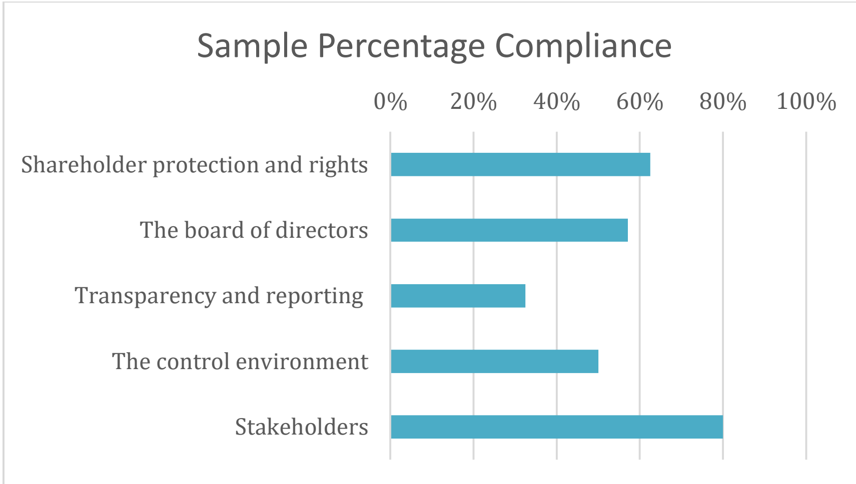
- Answers to **Ministry of Economy**
- **€3.3** billion of total assets
- **€63.5** million net profit in 2010
- **8%** net profit margin
- **4,517** employees
- **100%** owned by the state
- Board structure: **Management board**

Overall rating

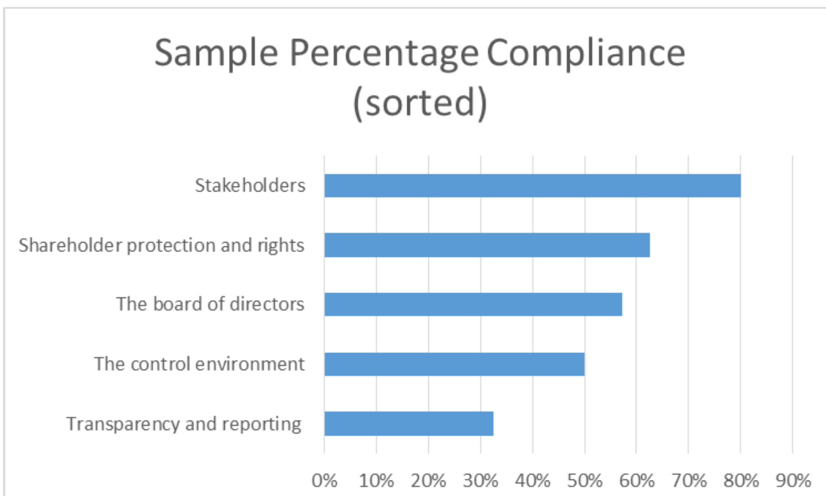
STRENGTHS	AREAS FOR IMPROVEMENT
Committed executive staff well-informed of good governance practices	Establishment of a supervisory board or other structure able to exercise oversight over the executive
External audit	Introduce independence into oversight structures
Financial reporting according to IFRS	Review of dividend policy in order to ensure sufficient funding for needed capital investment of all business segments of SOE
External audit conducted according to ISA	Reporting of internal auditor to an independent oversight structure
	Reporting of external auditor to an independent oversight structure

The above company report summarises the essential findings of a governance study on one page. This type of analysis is particularly well-suited for board members and high-level executives who want to have a summary of the state of governance in their enterprise. The report visually relates corporate governance performance into categories. It makes use of colour coding (green = good, yellow = neutral, red = bad) to make the message clear and easy to understand. Finally, it seeks to provide indications of where the company should focus future reform efforts by highlighting specific areas for improvement.

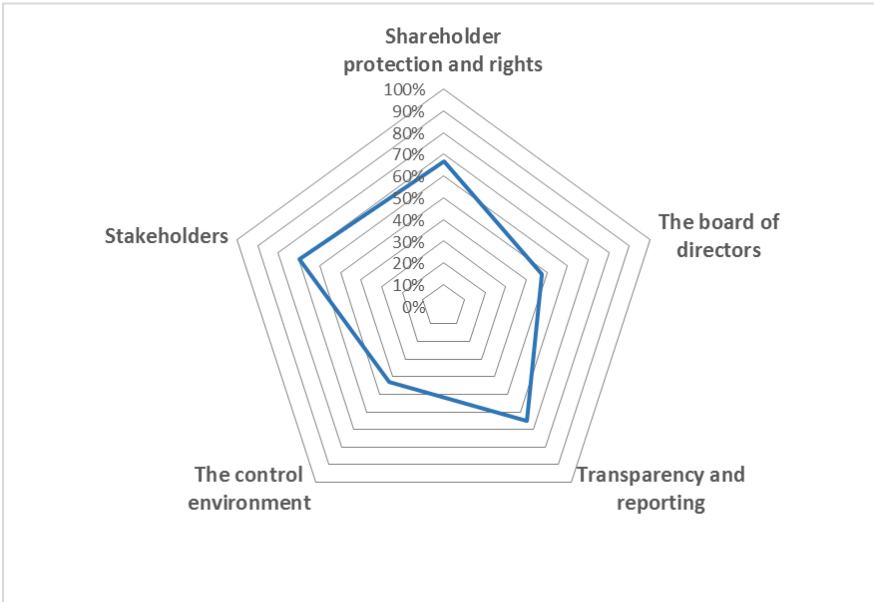
The *Assessment Tool* presents company performance using different categories than those above in the Latvenergo example. The following graphic shows compliance on indicator categories for a fictitious company. The graphic shows that compliance with stakeholder indicators is strongest while transparency is weakest.



The above chart does not focus the reader's attention on any particular category. In order to do so, the same categories can be sorted in order of performance to clearly show which categories are stronger and weaker. This is particularly helpful when trying to focus the attention of boards on where they need to dedicate their efforts.



Another way of illustrating a company's compliance by category is with a radar (or spider) chart. Radar charts allow for a quick visual assessment of the overall performance of the company by the size of the circumscribed area while simultaneously permitting assessment of performance by categories.



A further breakdown of company performance into sub-categories is useful. The following graphic summarises company performance by sub-indicator using colours and symbols to indicate areas of strength and weakness and where further work is required.

Performance by governance sub-indicator

CG Category	Governance sub-indicator	Evaluation
The state's role as an owner	Undue interference by the state into SOE and SOE autonomy	?
	Board nominations processes	✗
The marketplace	No undue advantage or disadvantage versus private sector	=
	Distinction and separation of state functions from SOE functions	?
Stakeholders and responsible business	Stakeholders and responsible business conduct	=
	Board responsibility for controls	✗
	Use of SOE for political purposes	?
Transparency and disclosure	Financial reporting	=
	Disclosure on public interest commitments	=
	Governance	✗
	Risk	=
	Related parties	=
	Audit	✓
The responsibilities of the board	Role and powers	=
	Nominations	✗
	Composition	✗
	Independence	✗
	Conflict of interest	✗
	Structure and processes	=

The categories and sub-categories of the *Assessment Tool* are represented in the sample chart below. Different symbols and colours could be used to illustrate governance performance going from a simple good/bad 2-point scale to a slightly more nuanced 3-point scale.

Category and Sub-category Performance	Performance (2 scale)	Performance (3 scale)	Performance (color scale)
Shareholder protection and rights	✓	☺	
• Shareholder rights	✓	☺	
• Shareholder protection	✓	☺	
The board of directors	✓	☺	
• The role of the board	✓	☺	
• Board responsibilities	✓	☺	
• Board structure and processes	✓	😐	
• Independence and objective judgement	💣	☹	
Transparency and reporting	✓	☺	
• Financial reporting	✓	😐	
• Non-financial reporting	✓	😐	
• Governance reporting	💣	☹	
The control environment	💣	😐	
Stakeholders	✓	☺	

It should be noted that the above sub-category summary tables do not present numerical percentages. A performance summary using symbols can be useful in avoiding disputes with companies who may contest numerical scores. The use of symbols to categorise performance into good/bad/neutral is also in keeping with idea that good corporate governance is an intangible value that defies perfect quantification.

A qualitative section of a report can serve to interpret findings. An extract from a real corporate governance analysis is provide below.

Main governance challenges

ENA neither stands out positively nor negatively according to publicly available information. On the other hand, information gathered through interviews sheds a more positive light. Recent changes in government led to a new more professional board of directors and CEO and have moved ENA towards more economically sound decision making. Its board now includes individuals with business experience and ENA is reportedly able to operate free from political influence with no interference in hiring, firing or contracting. Greater transparency has been introduced into contracting processes and a motivated staff with private sector experience have been hired.

But, there is more to be done. The essential challenges are: 1) a complete lack of transparency with respect to governance practices (whether good or bad); and 2) corporate governance that is vulnerable to changes in political administrations. Better and more stable practices and systems need to be put in place to professionalize and stabilize ENA's corporate governance and board. ENA needs to compare itself to best practice and develop a remedial action plan to close gaps, in particular, on the roles and responsibilities of its board. A board action plan has, reportedly, been introduced recently and is being implemented.

The above text has the same function as the "areas for improvement" section of the aforementioned Latvenergo report, but goes into somewhat greater detail. These qualitative/interpretive sections typically draw upon the insights gathered from interviews with board members and executives. They are difficult to complete when drawing exclusively on publicly available data.

SAMPLES OF REPORTING ON MULTIPLE COMPANIES AND SAMPLE GRAPHICS

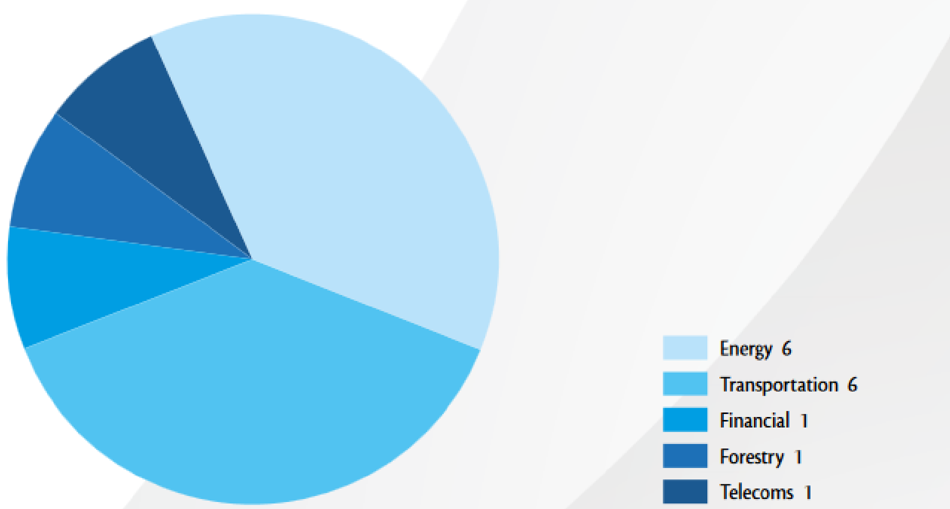
A comparative report is a compendium of individual reports. In addition to allowing an assessment of the performance of individual companies, it allows for the drawing of conclusions about governance practices on a country level. Typically, the first part of a comparative report lists the companies that are reviewed. In most cases, the companies will be from the same country but one can also do international comparisons as in the example from below which covers SOEs in Estonia, Latvia and Lithuania.

The 5 Largest SOEs (in alphabetical order)

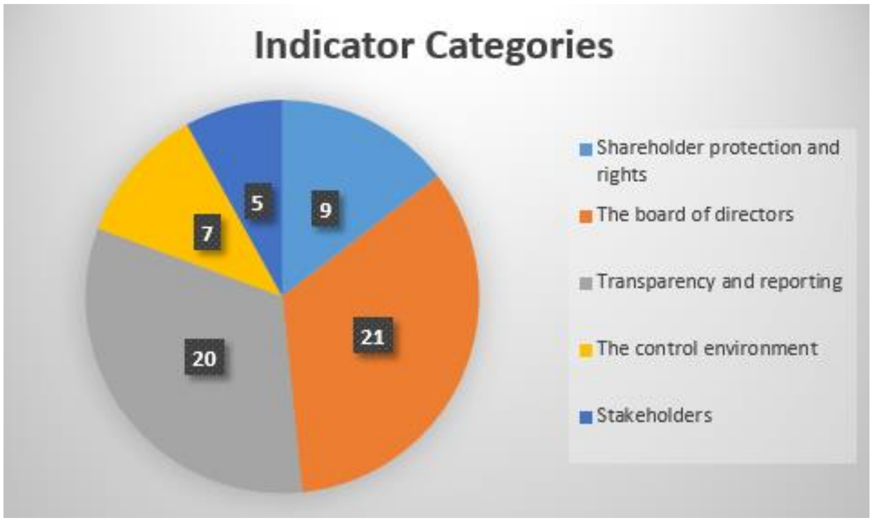
Estonia	Latvia	Lithuania
Eesti Energia	Citadele Bank	Klaipeda State Seaport Authority
Elering	Lattelecom	LESTO
Estonian Railways	Latvenergo	Lietuvos Energija
Port of Tallinn	Latvian Railways	Lithuanian Railways
Tallinn Airport	Latvian State Forestry	Litgrid

The study group is concentrated in the energy and transportation sectors as illustrated below.

Industrial Sectors Represented in Study Group



A comparative report should also illustrate what indicators are being used to evaluate the companies. It is not necessary to list all of the indicators because there are many. It is usually sufficient to show the indicator categories. The following categories correspond to those found in the *Assessment Tool*.

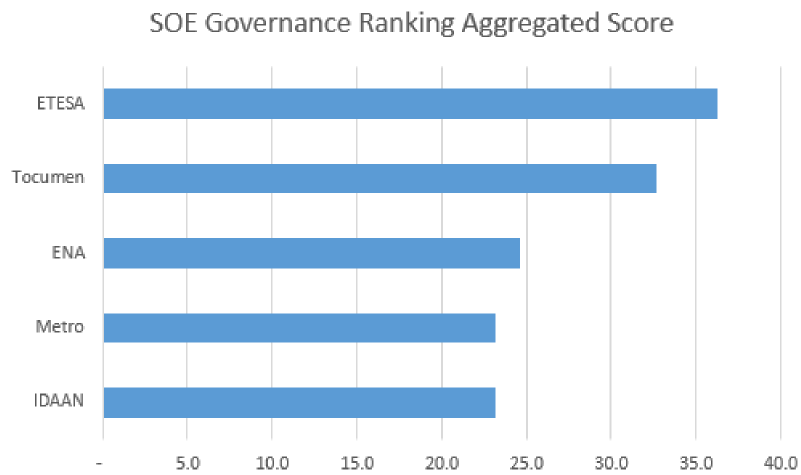


Governance assessment can then be used to generate rankings. The table below orders companies in Azerbaijan by aggregate governance score showing best and worst performers.

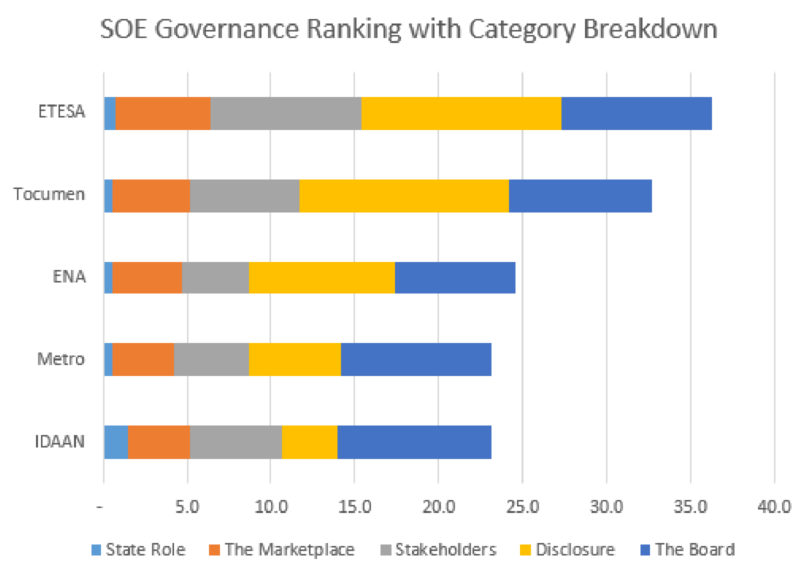
Ranking	Company	% Score
1	DemirBank	99
2	Azerbaijan Leasing Company	93
3	Ismayilli Gushchuluq	90
4	Sumgait Technology Park	89
5	Azerigasbank	88
6	Gilan Gabala Food Production	88
7	Azmark Dısh Tıcaret	86
8	Azerbaijan Investment Company	82
9	The International Bank of Azerbaijan	82
10	Metanet A	81

The ranking shows that DemirBank has the highest overall compliance score and Metanet the lowest among the top 10.

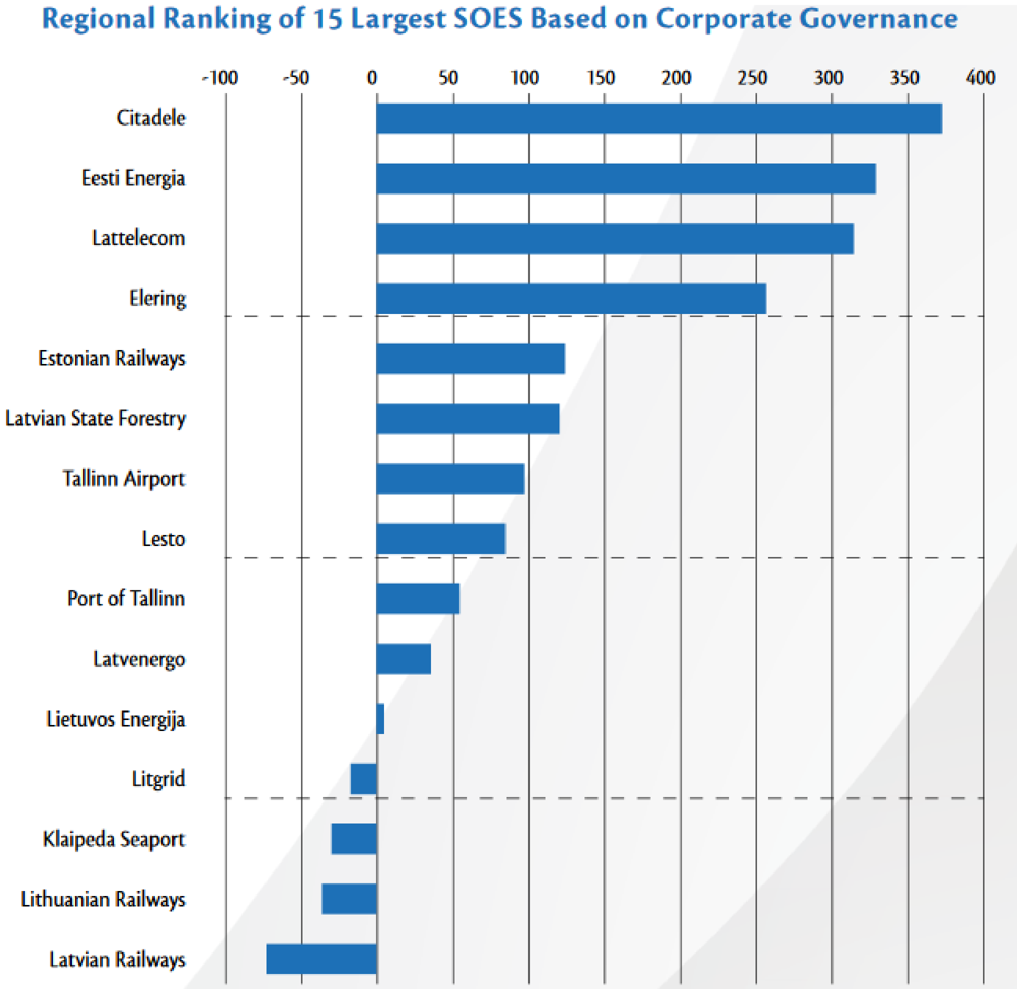
The same information can be communicated in graphic form, which is easier to understand and delivers a more compelling message. The graphic below shows a 2016 ranking of SOEs in Panama.



Rankings can be enhanced to show performance by governance category. The graphic below is the same as the prior graphic except that it also shows compliance on different governance categories. The category breakdown below permits drawing conclusions such as, for example, that performance in the "disclosure" category is better than in the other categories for most companies. This type of chart should only be used for larger categories. Using sub-categories makes the chart too difficult to interpret.

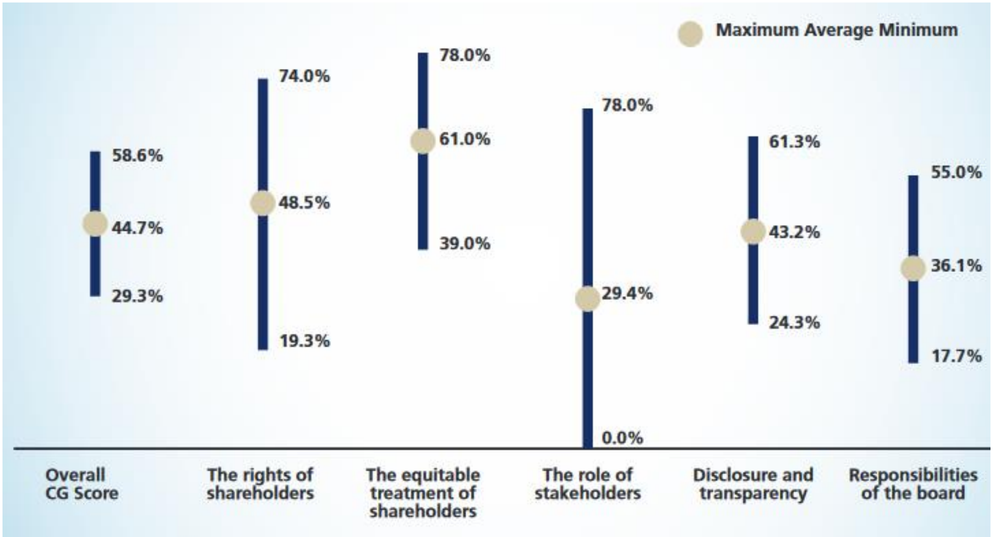


Another form of ranking organises companies into performance groups. In the graphic below, no colour symbol is used, however, there are 4 groups of companies ranked from best to worst performance. The groups are then separated into categories by the dotted lines. The top group can be described as "top performers" whilst the bottom group might be described as "laggards".



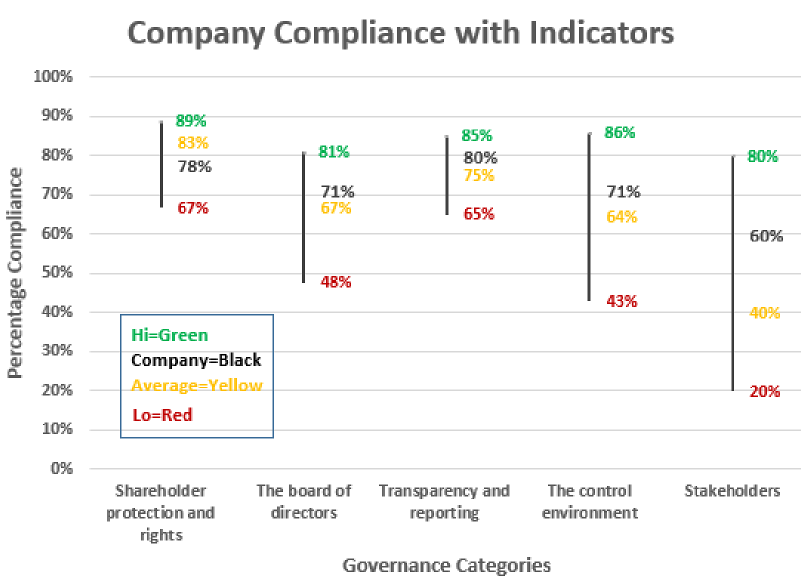
Putting companies into groups draws away the attention from the exact numerical score of the company and focuses on the relative (comparative) performance of the companies. As with the individual reports, this approach serves to avoid potential disputes regarding specific point scorings by focusing on the larger conclusions and implications.

When information on multiple companies is available, it allows for sophisticated comparative analysis. In the graphic below, the variability of performance within each category amongst a number of companies is illustrated. The bottom point of each bar is defined by the lowest performing company, while the highest point is defined by the best performing company. The dot in the centre is an average.

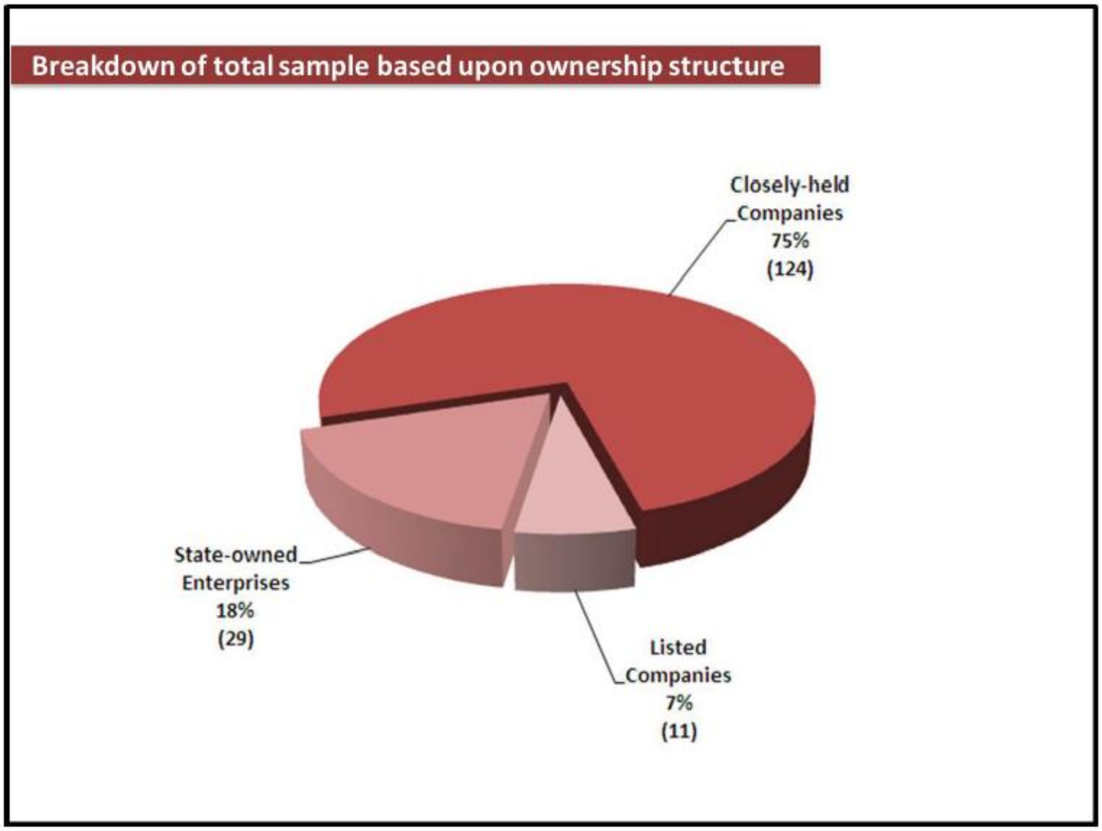


The graphic shows far greater variability in stakeholder performance compared to other categories such as disclosure. This has an interesting explanation in practice. The reason is that stakeholder governance practices are usually voluntary whereas disclosure is typically regulated by law (at least for listed companies). Variability in this case serves as a proxy for the degree of implementation of rules and regulation. Such information is valuable for governments and regulators who wish to know the degree to which hard laws and soft recommendations are implemented in fact.

The prior chart can be supplemented by adding a dot for the compliance level of an individual company. This allows for a rapid assessment of the company's practices compared to a peer group.

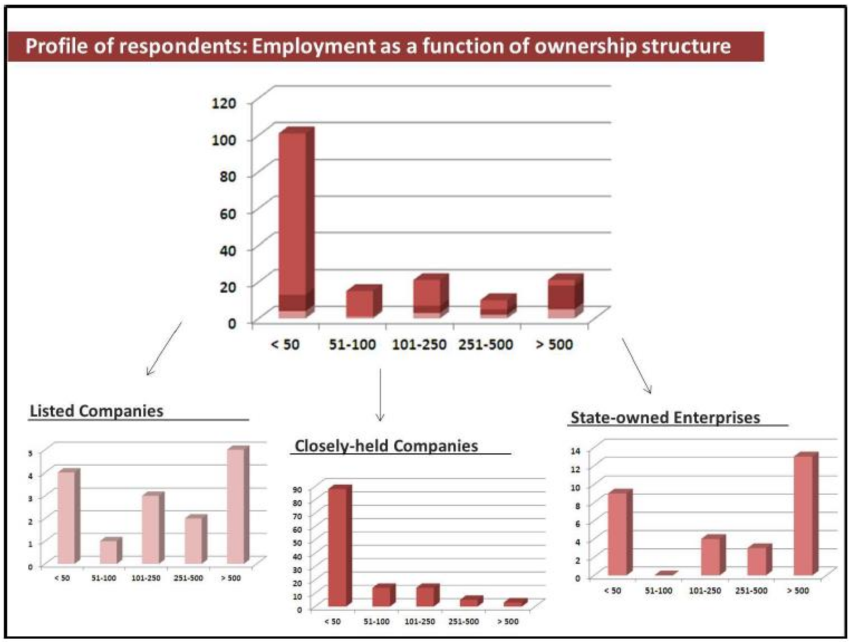


Comparative reports should also include basic background information both on the group of companies analysed and on individual companies themselves. The graphic below shows that most of the companies in a sample were unlisted/closely held companies and that the lowest number of firms in the sample were listed.



The *Assessment Tool* permits an analysis of governance practices as a function of any other data variable that is collected. For example, it makes it possible to draw conclusions about the governance of different companies based on ownership structure (listed, SOE, companies with foreign ownership); size (employees, assets, or turnover); industry (finance, manufacturing, etc.); funding sources (equity, bond, bank) and so on. Governance assessment tools have been used to assess the differences between financial and non-financial companies, the impact of bond offerings, and also the impact of foreign ownership on corporate governance practices and financial performance.

Illustration of employment by ownership structure



The *Assessment Tool* can also be used to collect information on whether the financial statements are prepared under IFRS and the auditor's opinion on the company's financial reports. This can be information of critical importance to regulators such as banking sector supervisors.

	IFRS Statements	ISA Audit	Unqualified Opinion (positive)	Qualified Opinion (negative)	No Statement
Non-financial SOEs	33%	78%	22%	56%	22%
Financial SOEs	100%	NA	100%	0%	0%

In the case above, it is clear that financial SOEs have better financial reporting practices than non-financial SOEs.