

CHAPTER-9 CORPORATE GOVERNANCE CODES ACROSS GLOBE

Cadbury Committee Report (UK), 1992

Title of Report- **Financial Aspects of Corporate Governance**

Chairman of Committee- **Sir Adrian Cadbury**

Importance- To restore back the confidence of investors which shook the world after the collapse of giants like Polly Peck, Maxwell Group etc. 1st Corporate Governance Code in the world. Also known as Cadbury Code of Best Practices. The principles in the Code were incorporated into the London Stock Exchange's Listing Rules and were introduced on the basis of 'comply or explain' principle.

Major Aspects (ABCDEF)

Audit (Auditors and Audit Committee)

- Auditors should be rotated
- Auditors have duty to report fraud to appropriate authorities
- Auditors to review compliance to the Code of Corporate governance
- Each listed company to constitute Audit Committee comprising of minimum three non-executive directors.
- Audit Committee to meet auditor atleast once without executive directors and discuss important issues

Board (Board of Directors)

- The Board to meet regularly and retain full and effective control over the company.
- Board to include adequate number of qualified and experienced non-executive directors whose views should be given due weightage
- Board should have access to the advice and services of the experts including the Company Secretary

CEO/CFO/Chairman

- Single person should not have decision-making power and so the roles of chairman and chief executive should be separate

Directors (Executive and Non-executive Directors)

- Executive directors service contracts should not exceed 3 years without shareholders approval
- Full disclosure of director's total emoluments in Company's Annual Report
- Remuneration Committee consisting majorly of non-executive directors to recommend the pay for executive directors.
- Non-executive directors should be independent of management and have no conflict of interest with the company
- Non-executive directors should be appointed for specific terms and reappointment should not be automatic
- Non-executive directors should be selected through a formal process

Establishment of Control Mechanisms

- Directors should report on the effectiveness of the company's system of internal control
- Board to present an assessment of company's position in easy understandable form
- Directors to report whether the assumption of going concern holds for the company.

Financial Disclosures

- Timely and accurate financial disclosures.

The Sarbanes Oxley Act of 2002 (USA)

Members of Drafting Committee- US Senator **Paul Sarbanes** and US Congressman **Michael Oxley**.

Importance -To restore back the confidence of investors after the collapse of giants like Enron, Worldcom etc.

Major Aspects

PCAOB-Public Company Accounting Oversight Board

- Setting up of PCAOB to oversee the audit of public companies and to register the accounting firms that audit public companies
- To investigate the audit firms and impose sanctions on them if they violate the rules
- To replace the Auditing Standards Board of AICPA and set standards for auditing, quality control, ethics and independence

Whistle Blowing

- Companies are required to establish procedures such as so that employees can report potential frauds confidentially and without fear of reprisal eg. anonymous hotlines
- Employees who report fraudulent activities to be protected from retaliation by their employers.
- Employees can seek reinstatement, back pay and compensatory damages incase they face harassment, demotion or termination for whistleblowing.

Audit

- Restrictions on non-audit services- Specified non-audit services (such as book keeping, actuarial services, internal audit, financial information system design etc) for the client cannot be provided by the auditor
- Other non-audit services (like . tax consultancy) which are not prescribed in the specified list, are not banned but must be pre-approved by the audit committee.
- Audit partner rotation- To maintain objectivity and prevent excessive familiarity between the auditors and their clients, the external auditors must be rotated every 5 years.
- Working papers must be retained by auditors for atleast 5 years.
- Independence and effectiveness of Audit Committee- The audit committee to be composed entirely of independent directors and **at least one member should have financial expertise.**
- The AC can even hire independent advisors or experts, at company's expense to assist them in fulfilling their oversight functions.
- Increased role of AC-The audit committee, not management, should be responsible for appointing, compensating, and overseeing the external auditors.
- Further, auditors are required to directly report to audit committee and disclose them the critical accounting policies, alternative accounting treatments, and other significant audit matters

Board

- CEO/CFO/Chairman
 - Personal loans from a company to its CEO/CFOs are prohibited
 - CEO/CFO to personally certify the accuracy and completeness of financial reports filed with authorities and will be responsible for any material misstatements or omissions in them.

Directors

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Establishment of internal controls

- Management to be responsible for establishing internal controls
- Management to perform annual assessments of internal controls which are to be attested by the external auditors.
- Management to provide a detailed internal control report on the effectiveness of these controls as part of each annual report

Financial Disclosures

- All off-balance sheet transactions that may affect financial status must be disclosed in periodic reports
- Information that may have a material effect on current and future financial conditions of a company must also be disclosed .eg. information on results of operations, liquidity, capital expenditures, conflict of interest etc.
- Criminal penalties for manipulation, destruction or alteration of financial records or other interference with investigations.

OECD PRINCIPLES OF CORPORATE GOVERNANCE

The 2023 G20/OECD Principles of Corporate Governance provide a comprehensive framework to enhance corporate governance globally. These were first published in 1999 and were revised in 2004, 2015, and 2023. These principles are non-binding and provide recommendations majorly across six key areas.

Evolution of OECD Principles on Corporate Governance

Year	Reason for revision	Key Developments and focus
1999	Response to Asian Crises in 1997.	Establish a global benchmark for corporate governance. Focus on transparency, accountability, and shareholder rights.
2004	Response to corporate scandals (e.g., Enron, WorldCom).	Revised principles emphasizing board responsibilities, risk management and rights of minority shareholders.
2015	Address global financial crisis of 2008	Focus on institutional investors, stakeholder engagement, and environment and social concerns.
2023	Adapt to ESG challenges, technological	Latest revision integrating sustainability, digitalization, and ESG concerns while maintaining

	advancements, and emerging risks.	focus on traditional aspects of corporate governance like transparency, accountability and risk management.
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KEY AREAS OF OECD PRINCIPLES ON CORPORATE GOVERNANCE

1. Ensuring the Basis for an Effective Corporate Governance Framework

- **Rule of Law:** Ensure that corporate governance framework should promote transparency and efficiency in markets and be consistent with the rule of law. This implies corporate governance framework must be established keeping in mind the prevailing legal and regulatory requirements.
- **Clear Division of Responsibilities:** Clear division of responsibilities among regulatory and enforcement authorities to serve the public interest effectively.
- **Digital Governance:** Encourage the use of digital technologies in corporate governance practices and supervision, while managing digital risks effectively.

2. The Rights and Equitable Treatment of Shareholders and Key Ownership Functions

- **Protection of Shareholder Rights:** Basic shareholders rights should include securing ownership registration, share transfer, timely information, participation in meetings, right to vote in shareholder meetings, right to dividends, electing directors, and appointing external auditors.
- **Equitable Treatment:** No discrimination amongst the shareholders of the same class. Ensure all shareholders, including minority and foreign shareholders, are treated equitably, and protect them from abusive actions by insiders.
- **Effective Redress:** Provide shareholders with effective means of redressal for violations of their rights.

3. Institutional Investors, Stock Markets, and Other Intermediaries

- **Active Engagement and Ownership:** Facilitate and support institutional investors' engagement with the investee company. Institutional investors should disclose policies for corporate governance, voting and how they manage managerial conflicts of interest.
- **Transparency and Integrity:** Corporate governance framework should promote transparency, fairness and integrity of stock markets. Insider trading and market manipulations should be prohibited and rules to prevent such malpractices be enforced. Stock markets should provide fair and efficient price discovery.
- **Disclosure of Conflicts:** Intermediaries such as proxy advisors, analysts, and ESG rating providers, should provide transparent and sound advice to investors. They should disclose and minimise conflicts of interest to maintain market confidence.

4. Disclosure and Transparency

- **Timely and accurate disclosures:** Ensure timely and accurate disclosure of all material matters regarding the corporation, including financial performance, operating results, sustainability related information, information on ownership structure, information on remuneration of board members and key executives, related party transactions, foreseeable risk factors and governance structures.
- **High Quality Reporting Standards:** Information should be prepared and disclosed in accordance with high quality accounting and financial /non-financial reporting standards.
- **Independent External Audit:** Independent auditors should conduct an annual external audit of the companies to provide assurance on the financial statements.

5. The Responsibilities of the Board

- **Strategic Guidance:** Provide strategic guidance for the company, ensure effective monitoring of management, and be accountable to the company and shareholders. Their key functions include- formulating major plans and performance objectives; selecting, compensating and monitoring key executives; overseeing capital expenditures, acquisitions and divestitures; ensure integrity of accounting and financial reporting systems; implementing and overseeing risk management systems.
- **Managing conflict of interest-** Non-executive board members should be assigned to tasks where there is potential for conflict of interests.
- **Regular performance appraisal-** Board should carry out evaluations to appraise the performance of its members on a regular basis.

6. The Role of Stakeholders and importance of sustainability in Corporate Governance

- **Sustainability and Resilience:** Incentivise companies and investors to make decisions promoting sustainability, consider sustainability-related risks in governance and provide reliable sustainability -related disclosures.
- **Risk Management:** Implement robust risk management systems, including those addressing environmental, social, and governance (ESG) factors, to enhance the company's resilience.
- **Stakeholder Rights:** Consider stakeholder interests and contributions to long term success of the company. Recognize their rights, encourage their active involvement, seek their cooperation, freely communicate with them , address the concerns raised by them and provide them timely access to relevant information.

These principles collectively aim to strengthen corporate governance practices, ensuring that companies operate transparently, responsibly, and sustainably, thereby contributing to overall market confidence and economic health.