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A Guide to Corporate Governance

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Foreword

How businesses are managed and controlled has become a major contemporary issue following the collapse of many major companies and the unacceptable practices which these revealed. Shareholders, employees, suppliers, customers, auditors all suffered. There was growing concern that similar examples of this happening in the banking and financial institutions sector and also in the other industrial and trading sectors could have a very damaging effect on the economy. This accelerated the provision of legislation in many parts for the world designed to provide a framework for the provision of corporate governance and the responsibilities of directors to the various stakeholders. It was hoped that this would minimize the likelihood of similar types of events occurring. In addition it was felt that this would also create a market which would result in greater capital investment.

The Arab region has seen the introduction in many member countries of such requirements for banks, other financial institutions, and listed companies. Without question this will extend to other countries and other institutions .Indeed even in the absence of legislation many companies are taking the initiative and putting corporate governance practices into practice of their own accord.

In my own firm, we obviously had to prepare appropriate audit and advisory procedures for these developments .The Arab Society of Certified Accountants (ASCA) was also concerned that its members and their clients should have available a general guide to these developments and I was delighted when they asked my firm Talal Abu-Ghazaleh & Co. International (TAGI) to do this Guide to Corporate Governance for them.

The "General Guide to Corporate Governance" is available in both Arabic and English and as part of both ASCA's and TAGI's obligations to the profession is available free of charge.

I hope you find this guide useful.

Talal Abu-Ghazaleh,
Chairman of TAGI and President of ASCA

Introduction

The collapse of major Companies/Corporations and the revelations as to how they were directed / managed and the public scandals, which followed, have led to the demands that how Companies are managed should be based on a code of good practice. A code which lays down procedures designed to try to ensure that the interests of all stakeholders (directors, managers, employees, suppliers, customers, and the public) are taken into consideration and that the decision making process has sufficient checks and balances to allow this. The concept of corporate governance has evolved to regulate many different aspects of organization structure and processes, especially the relationship of ownership and management. Corporate governance is meant to establish a balance of power between management and control bodies within the entity. Although the corporate governance concept is aimed to Corporations (listed shareholding Companies), the general principles apply to almost any organization.

Definition of Corporate Governance:

Corporate Governance is the system by which business entities are managed and controlled. It is a means to promote transparency and accountability. Thus, the cornerstones of having an effective system of corporate governance are described as follows:

- *Fiduciary Responsibility:* The Board of Directors has fiduciary responsibility towards the shareholders. The Board is supposed to act as a trustee to protect and enhance the shareholders' value and to ensure that the business entity fulfils its obligations and responsibilities to its other stakeholders.

- *Transparency:* The transparency involves disclosing sufficient and appropriate information about the entity's actions and policies without jeopardizing its strategic interests. In other words, it is the entity's openness in its actions and relations with internal as well as external stakeholders.

- *Accountability:* The Board of Directors shall be accountable to the shareholders and management shall be accountable to the Board of Directors. By having this bidirectional system of accountability effective performance is generated and shareholders value is enhanced accordingly.

- *Control:* No effective corporate governance is expected to exist without an appropriate system of internal controls. Control provides reasonable assurance that the entity's objectives are met in terms of effective and sufficient reporting, compliance of laws and regulations, and safeguarding of the entity's assets and resources.

- *Ethical Atmosphere:* Business entities have responsibility toward the society as well as their stakeholders to maintain ethical standards of behavior. The Board of Directors is responsible for setting the tone at the top. Unethical behavior promotes corruption, which ultimately contradicts the core corporate governance purpose, which is, to protect/enhance the shareholders' as well as other stakeholders' values.

1 BOARD OF DIRECTORS

1-1 BOD Roles (Functions)

Corporations shall be led by an effective Board which exercises leadership, endeavor, integrity and judgment in directing the Corporation in a transparent, accountable and responsible manner. The Board of Directors (BOD), as the heart of corporate operations, holds comprehensive power over the corporate management. The Board, therefore, must perform all its duties not only to protect minority shareholders and other stakeholders but to prevent corporate insolvency. The Board shall perform the following functions of decision-making and management supervision:

» Setting business goals and strategies, and major corporate actions, as well as monitoring their progress .The Board shall establish and evaluate longer-term objectives so as not to overly emphasize short term performance.

» Approving business plans and budgets. The Board shall review and approve the operating plan and its specific goals at the start of the year. The plan will contain quarterly financial performance that will be reviewed several times per year versus results.

» Supervising management and evaluating management performance. The Board shall make the key management policy decisions in the best interests of the Corporation and its shareholders taking into consideration other interested parties, and shall perform effective supervision of the management.

» Replacing the management and also reviewing the remuneration. The Board is solely authorized to grant waivers regarding the remuneration policy.

» Monitoring major capital expenditures and corporate takeover as well as approving significant business acquisitions and divestitures.

» Mediating the conflicting interests among directors, management and shareholders

» Ensuring integrity of the accounting and financial reporting systems. The Board shall review, with the assistance of the Audit Committee, the financial, legal and ethical controls of the Corporation and ensure that appropriate compliance processes are in place.

» Supervising risk management, contingencies management and financial control.

» Supervising the compliance of statutory and ethics-related regulations. The Board shall approve and ensure the implementation of written codes of best practices for the Corporation.

» Monitoring the effectiveness of governance practices.

» Overseeing the affairs of the Corporation in the best interests of the stockholders, while day-to-day operation of the Corporation is the responsibility of management.

» Mandating, as long as no violation is made on the statutes and laws or the articles of incorporation, a portion of the Board's authority to its respective internal committees or the representative director. The Board shall concentrate on key management decision-makings and mandate relatively less important matters to the representative director or the management; or that the Board shall establish internal committees within itself to which a portion of the authority can be delegated.

» Nominating candidates for election by the General Meeting of Shareholders to membership on the Board.

» Ensuring that financial reports follow the relevant Accounting Standards promulgated by bodies, whose promulgations are applicable in the country where the Corporation operates, and that there is an effective communication of all operational reports to the various supervisory agents and various stakeholders.

1-2 BOD Composition

The Board shall be composed so as to allow effective decision-making and supervision of the management.

The number of directors shall be such that it allows the Board to have fruitful discussions and to make appropriate, swift and prudent decisions. For large public Corporations, it is highly advised that the number of directors on the Board be appropriate for effectively managing internal committees. Normally, the size of the Board will be increased or decreased to reflect the workload of the Board and the availability of qualified directors.

There is no perfect number of directors appropriate for all the different circumstances of Corporations. The reason lies with the many different factors that may influence the Board's size, e.g., the Corporation's size, the business environment, and special characteristics.

The Board shall consist of a significant majority of independent directors. Independent director means a director who:

- Is not a member of management or an employee.
- Has no close family or similar relationship with a member of key management.
- Is not a lawyer, advisor or consultant to the Corporation or its subsidiaries and does not have any personal service contracts with the Corporation or its subsidiaries;
- Does not have any other relationship with the Corporation or its subsidiaries either personally or through his employer which, in the opinion of the Board, would adversely affect the director's ability to exercise his or her independent judgment as a director.
- Is not a current or former employee of the independent auditor.
- Is not an immediate family member of a current or a former employee of the independent auditor.

The Independent directors shall be capable of performing their duties independently from the management, controlling shareholders and the Corporation.

The most important role of independent directors is to enable the Board to perform its management supervisory functions effectively. Such directors hold an independent position from the Corporation, management and controlling shareholders when compared to other non-independent directors, thereby making possible effective management supervision and objective management counseling.

For independent directors to perform their functions properly, it is important that the number of independent directors appointed is adequate for them to exercise actual influence in the Board's decision-making process. Therefore, the proportion of independent directors shall be decided at the level where the Board would be able to maintain actual independence from the management and the controlling shareholders while exercising influential authority over management decisions.

Corporations shall ensure that majority of independent, non executive directors who possess the mix of skills and competencies are appointed to the Board .The non-executive directors do not, normally, have the administrative or management responsibilities in a Corporation, that is, he/she does not participate in the routine operation of the Corporation; nor does he/she participate in the management. Such directors are not necessarily independent. The Board shall strive to achieve balance and mix of skills without compromising quality.

1-3 Appointment of Directors

The Board shall make actual contribution to the corporate management by appointing directors, who have been associated with institutions noted for excellence, and who are possessing the following qualities: a vision for and a strategic perception of the corporate management; a sound managerial judgment; an ability for managing and supervising the organization; a knowledge of law and finance; and some experience suitable for the Corporation concerned.

Directors appointed by the controlling shareholders or management are much influenced by them in performing their duties. To maintain independence of directors, there shall be a procedure for appointing directors that broadly reflects the expectations of shareholders. For this purpose, there is a need to thoroughly examine the adoption of a committee system that allows recommendations of director nominees to be seen to be fairly made.

It is advised that a committee be established and managed for fair nomination of directors. The committee shall be organized such that the fairness and independence of the nomination process are ensured. Normally a Nominating/Corporate Governance Committee, consisting entirely of independent directors is established for that purpose.

Board selections shall reflect sensitivity to diversity. Directors who change their primary job responsibilities are required to offer to resign from the Board, but shall not necessarily be required to resign. Such an offer of resignation will be reviewed by the Nominating/Corporate Governance committee, with a recommendation from the Chief Executive Officer.

The Corporation shall disclose, in advance of the general shareholder meetings, adequate information and details of all nominated directors.

The term of office for the director, once appointed through due process, shall be respected so that his functions as managing with responsibility for all shareholders may be performed dutifully. The exceptions are the following: the director is found liable for any illegal act; gross violation is made of statutes or the Article of Incorporation; or the director is deemed quite inept for office.

The positions of Chairman of the Board of Directors and that of Chief Executive Officer are often combined and held by the same person. However, there is a strong and growing view that these positions should be held by different people in order to have a proper balance of power. In the absence of any statutory or regulatory requirement for this separation then it should be explained to all shareholders why the Corporation has chosen not to do so.

In order to ensure continuity of the Board, the appointment of the members of the Board shall be staggered and the practice of rotation of directors be applied.

1-4 BOD Meetings

The Board shall meet frequently, given the size and complexity of the business, regulatory mandates for director review of various matters, and the changing industry environment. The number of scheduled Board meetings shall vary with circumstances and that special meetings shall be called as necessary. While the Board recognizes that directors discharge their duties in a variety of ways, including personal meetings and telephone contact with management and others regarding the business and affairs of the Corporation, it is the responsibility of individual directors to make themselves available to attend both schedule and special Board and committee meetings on a consistent basis.

There are significant differences in the issues and the actual role that the Board meeting plays in each Corporation; therefore, it is difficult to decide on a uniform standard for the frequency of such meetings. But since the Board itself must vote on important matters concerning corporate management, Board meetings shall be held regularly, and special meetings held whenever necessary.

Long-range strategic issues shall be discussed as a matter of course at regular Board meetings, but that, given the complexity of the Corporation and the level of change in the industry, it is important to hold periodic multi-day meetings devoted solely to discussion of strategic issues. The frequency of such meetings will vary with changes in the business environment and the organization, but it is the current view of the Board that such meetings shall be held approximately every two years, subject to the needs of management or the Board.

The Chairman shall establish the agenda for each Board and Committee meeting, taking into account suggestions of Board members. Board members have the right to suggest the inclusion of particular items on such agendas, and the Chief Executive Officer, from time to time, shall ask directors for their suggestions or opinions on possible agenda items. As with the agenda, the Chief Executive Officer shall determine the form of each presentation to the Board and the person to make such presentation. However, it is important that line and support unit managers make presentations to the Board from time to time, to permit the Board to meet these officers in person.

It is advised that meetings of the Board shall, in principle, be held regularly, at least once every quarter.

To convene a Board meeting, prior notification of its date and time shall be made to each director.

The Board must receive information that would be important to understanding presentations, discussions and issues covered at each meeting, in writing and sufficiently in advance of the meeting to permit appropriate review.

For efficient running of Board meetings, each Corporation is advised to draft a Board Operating Regulation that comprehensively regulates matters related to the steering of Board meetings. The Regulations shall state the rights and authority, composition, and operational procedures for Board meetings, all of which shall be observed.

The Board shall approve minutes of the meeting each time. The minutes shall state important discussion topics and resolutions as detailed and clearly as possible. The minutes of the Board meetings shall be maintained and stored, serving later as important pieces of evidence, should the occasion demand. For example, when problems concerning directors' accountability arise.

1-5 Duties/Responsibilities of Directors

Directors shall perform their duties fairly, with prudence and faithfulness, in the best interests of the Corporation and its stakeholders. Directors shall not exercise their authority for their own benefit or that of a third party, and shall place the interests of the Corporation and shareholders before themselves.

Additionally, the directors shall be sensitive to the needs of stakeholders such as employees, customers, creditors, suppliers and the community in evaluating the affairs of the Corporation.

In order to bring effectiveness in the governance of Corporations as business enterprises, the directors shall devote their times and resourcefulness to their Corporations by meeting as regularly as dictated by the needs of each Corporation.

Directors shall continuously review and determine the purpose and strategic plans and shape the values of their Corporations, devise appropriate strategies to achieve these in order to ensure that the Corporations succeed and strive.

Directors shall review various materials with care and shall attend all Board and committees' meetings on which they serve, and if needed, receive the advice of specialists before attending. Directors are expected to undertake any additional tasks assigned to them by the Board, as recommended by the Nominating and Governance Committee. They are expected to review all materials distributed to them in advance of the meetings, to periodically review materials posted on the Board website between meetings to keep them informed about the Company's business and performance, and to spend the time necessary to prepare for meetings. Directors must be contactable by the Chairman and the Secretary at short notice and be available for special meetings of the Board when necessary.

The Chief Executive Officer's senior team will be present and participate as required in all Board meetings. The Chief Executive Officer shall have discretion to invite members of management to the meetings of the Board but the Board has the right to insist that specific members of management must attend if it feels this is necessary

A newly elected director shall meet with the Chief Executive Officer, the Chairman, the Chief Financial Officer, and the Nominating/Corporate Governance Committee and selected senior managers to obtain information about the Corporation and to review carefully all relevant public information about the Corporation.

An independent director shall be given easy access to information necessary for reviewing opinions on the management's objectives or the Corporation's strategic decisions. For this purpose, the independent director shall be able to request information from anyone in the Corporation. If the CEO feels this is not appropriate to disclose it should then go to the independent directors to vote.

Independent directors shall allot sufficient time towards performing their duties, and shall review all related information before attending a Board meeting.

Independent directors shall listen to shareholders and shall make every effort to acquire information from various sources within and outside the Corporation, including shareholders, to minimize the risk of management failure.

Independent directors shall, in performing their duties, collect and review sufficient information on the agenda up for decision-making and shall make every effort to make the best decision in the interests of the Corporation.

The independent director shall, if necessary, be able to seek, through due process, the support or advice of executives, employees or outside professionals like external auditors, legal advisors and others. Any such expense incurred within reasonable limits shall be borne by the Corporation.

The independent director system is normally adopted to raise transparency in corporate management. Therefore, a system of cooperation must first be established among independent directors.

To raise the independent director's management supervision and supporting functions, a regular meeting, participated by independent directors only, is recommended. Independent directors and the management shall put every effort to make opportunities for regular discussions on managerial issues.

1-6 Compensation (Remuneration) of Directors

The Compensation and Organization Committee considers various factors in determining the form and amount of director compensation to recommend to the Board, including, for example, alignment of incentives with the interests of a majority of members of the Board, consideration of the work load, time commitment and responsibilities involved in Board and Committee meeting participation, and comparison with the compensation practices of comparable Companies.

To the extent permitted by law, the Compensation and Organization Committee establishes amends modifies and administers compensation and benefit plans for Corporation. It also sets general parameters of compensation levels and benefits for all employees and recommends compensation and benefits for officers on the Chief Executive Officer's senior management team to the Board, which approves it. Shareholders must have an opportunity to vote on all equity compensation plans.

The level of director compensation shall generally be competitive with that paid to directors similar sized and situated local Corporations. The Compensation and Organization Committee is responsible for making recommendations to the full Board with respect to director compensation. The full Board approves director compensation and benefits programs.

The activities of an independent director shall be evaluated and disclosed fairly, with the remuneration being commensurate to the evaluation results.

1-7 Directors' Qualifications

The individual qualifications sought in potential director nominees identified by the Nomination and Governance Committee for consideration by the Board shall be set forth in the Charter of that Committee. The following are the traits/qualifications to be considered in the Board members:

Independence:

At least a majority of the Board shall consist of independent directors who the Board has determined do not have any material relationships, directly or indirectly, with the Corporation and meet the local jurisdictions of Stock Exchange and Governmental Authorities.

The materiality of the relationships and the director's own ability to exercise independent judgment shall be evaluated, and external criteria for independence, such as those promulgated by the USA Securities and Exchange Commission, shall be considered.

To help maintain the independence of the Board, all directors are expected to deal at arm's length basis with the Corporation and its subsidiaries and to disclose circumstances material to the director which might be perceived as a conflict of interest. The Corporation shall disclose publicly compliance with the requirement that a majority of its Board is comprised of independent directors.

Each director is expected to be familiar with and follow the Corporation's Code of Ethics and Conflicts of Interest Policy. If an actual or potential conflict of interest develops, or a situation arises which might give the appearance of such a conflict, the director shall immediately report the matter to the Secretary and to the Chair of the Nominating and Governance Committee. If a director has a personal, business or professional interest in a matter before the Board, the director shall disclose the interest to the Board, excuse himself or herself from discussions on the matter and not vote on the matter.

On appointment and on continuous basis all directors shall, in good faith disclose to the Board for recording any business or other interest that is likely to create a potential conflict of interest.

Due Care:

The long-term success of the corporate governance is dependent upon the maintenance of an ethical business environment that focuses on adherence to both the letter and the spirit of regulatory and legal mandates.

The directors of the Corporation must exercise the highest degree of care and diligence in the discharge of their duties and shall be held jointly and severally liable for all acts and omissions.

The director shall make active business judgments concerning operations of the Corporation, and he/she shall not have any interests on matters needing business judgment. He/She shall, in the process of making a business judgment, make decisions only after collecting and reviewing, sufficiently and carefully, a significant amount of reasonably reliable data and information. Also, the director shall rationally believe that such business judgment is of benefit to the Corporation.

If the director, in the process of making a managerial decision, has collected and sufficiently reviewed with care a significant amount of reliable material and information, and has then performed his/her duties, according to his/her faithful and reasonable judgment, using means deemed to be in the best interests of the Corporation, then such decision shall be respected.

In order to ensure that directors can dedicate an appropriate amount of time toward their responsibilities as directors, directors should only serve on limited number of additional Boards.

The Board of Directors shall constantly monitor and satisfy themselves that the Corporation is constantly meeting their social responsibilities.

The Board shall adopt a code of business conduct and ethics as well as procedures for monitoring compliance with the code and granting waivers form the code.

Retired officers of the Corporation shall not, normally, serve on its Board. However, upon immediate retirement from the Corporation, the Board may defer any management resignation from the Board for a period of time as it deems appropriate.

Corporations shall make every effort to maintain and improve labor conditions by faithfully observing labor-related statutes.

Corporations shall not be negligent in their social responsibilities, such as consumer protection and environmental protection.

The Corporation holds diverse relations with stakeholders, those being employees, creditors, suppliers, consumers and community. Also, the roles played by the stakeholders are very important to the continuance of the Corporation. Therefore, the Corporation shall realize that mutual cooperation with stakeholders is, in the long term, to its own benefit, and shall respect and protect rights of stakeholder, as determined by statutes and contracts.

Accountability:

The director shall observe the law and the articles of incorporation in performing his/her duties, and shall not be negligent in his/her duties. If a director does not perform his/her duties properly, he/she may not be reappointed or may even be dismissed.

Managing a Corporation is very complicated, requiring technical knowledge. Therefore, it is almost impossible, and inappropriate, to hold one accountable for damages by determining any existence of negligence based on examination of ex post results. Directors may perform their duty with conviction only if actions made within their capacity, based on reasonable judgment, are respected.

The Corporation, to ensure effectiveness of holding directors accountable and to attract competent persons as directors, may purchase, at its own expense, coverage for the directors with liability insurance.

When a director has violated the law or the articles of incorporation, or has neglected his duties, he may be liable for damages to the Corporation. If there was malicious intent or gross negligence on the part of the director, he may also be liable for damages to a third party.

Confidentiality:

A director must keep secret any confidential matter of the Corporation that he/she has acquired in the process of performing his/her duties. He/She shall not openly discuss the confidential matters, and he/she shall ensure that a third party does not reveal such information. Also, the director shall not use corporate secrets for his/her own gain or that of a third party. The use of corporate secrets by a director, even it bears no financial harm to the Corporation, may erode confidence in the Corporation or may incur losses on the part of shareholders and creditors; therefore, it shall be prohibited.

Continuance Education and Training:

Each Director is encouraged to participate in relevant training programs, which may include training in topics related to corporate governance or in topics that are otherwise relevant to the Corporation's business.

The Board shall put in place an effective induction program for new directors and, that training and development programs shall be continuously mounted in order to provide the directors with newer and emerging skills in good corporate governance.

The Board shall develop an orientation program for new directors and provide continuing education for all directors.

1-8 BOD Relation with Management

In order to ensure that the Board is adding value, the Board shall monitor its collective performance, the performance of individual directors and the performance of the management.

The Board and its Committees have full and free access to officers and employees of the Corporation, and are free to retain independent legal, financial or other advisors, as they deem necessary. For purposes of preparing the agenda for Board and Committee meetings, the Chairman and Committee Chairs regularly solicit suggestions from the Directors for presentations by executive officers and other senior managers at Board and Committee meetings. Any additional meetings or contacts that a director wishes to initiate may be arranged through the Chairman, the Secretary, or any Committee Chair.

Board members provide advice to management on matters relating to the Corporation's business at Board meetings and in other less formal settings, such as telephone calls and small meetings.

The culture and environment within which the Board and the management operate shall provide an enabling and effective atmosphere within which good governance and efficient management can thrive.

The Board shall develop a process for assessing the integrity of the Chief Executive Officer and other executive officers and determining whether these officers are creating a culture of integrity throughout the company.

The Board shall appoint the Chief Executive Officer and participate in the appointment of all senior management and ensure that there are adequate development programs for the management and other employees, and putting in place management succession planning for senior management.

Business activities of the management shall be evaluated fairly, and the evaluation results shall be reflected appropriately in the remuneration. Remuneration for the management shall be decided by the Compensation and Organization Committee of the Board.

1-9 Directors' Evaluation:

Activities of the Board shall be evaluated fairly in terms of effectiveness and corporate governance, the results of which shall be disclosed. Therefore, activities and the evaluation results of the Board shall, through disclosure, assist in the decision-making by shareholders. Such disclosures presented in the annual report are also advisable.

It is recommended that the evaluation process to be led by the Chairman of the Nominating and Governance Committee who solicits information from all directors.

The Nominating and Governance Committee shall conduct an annual self-evaluation by the directors of the Board's performance, and the full Board shall discuss the results and consider ways to improve Board practices. The Committee shall review the Corporate Governance Guidelines on the basis of that evaluation and discussion, as well as developments in law, listing standards, and governance best practices, and recommend any appropriate changes to the Board for its consideration.

Evaluations of independent directors shall be based on their contributions, and such results shall be used as grounds for deciding the remuneration and reappointment of independent directors.

The Chief Executive Officer performance shall be evaluated annually. The evaluation of the Chief Executive Officer shall be a comprehensive process, based on both qualitative and quantitative factors, including actual performance of the business, accomplishment of long-term business and financial goals, positioning of the Corporation for the future, development of management, stewardship of the enterprise and effective Board communication and interaction.

1-10 Management Remuneration:

The ultimate goal of evaluating the management's activities lies in enhancing the Corporation's business results by increasing their rate of contribution to the Corporation. Therefore, the management's activates shall be evaluated under objective standards, including business results, achievement of business strategy goals, and others. The evaluation results shall be used as the basis for determining remuneration and reappointment for management.

Remuneration for the management shall be decided by the Board. If an internal committee exists within the Board, it would be best for that committee to propose the remuneration for the management and to gain the Board's approval.

When management's remuneration involves granting stock/share options, the calculation criteria for stock options shall always be disclosed in detail prior to any decision regarding it; such criteria shall in general be justified to accurately reflect results achieved through the management's efforts.

2 Board Committees

2-1 Types of committees

It is unreasonable for the full Board to convene on all occasions for handling corporate matters. Particularly with the sharp increase in the number of independent directors, it has become more difficult to convene a Board meeting frequently. Also, considering the size of the Board or the short length of meetings, it is not easy to achieve sufficient discussion or to arrive at a satisfactory resolution during meetings. Therefore, the Board may, if necessary, establish internal committees that perform specific functions and roles. The directors having expertise or those interested shall be placed on those committees; the committees shall then focus on studying the important issues that occur periodically or that need closer review. Through operating of internal committees, the Board shall be able to raise professionalism and efficiency as well as effectiveness and expertness in their performance of duties through division of labor, thereby creating an overall effective control over the management.

The Board of Directors will often delegate a number of its functions to committees which will have the right to act or to recommend to the Board on what is required. When the Board mandates matters within its jurisdiction to the internal committee, the committee's resolutions shall hold the same effect as the Board's resolutions, allowing their actual functions to be performed. Also, the committee's resolutions shall be reported to the Board so that all its members are aware of the committee's activities.

All of the committees may meet in executive session, as circumstances warrant. At the committee's discretion, the Chief Executive Officer or other members of management may be requested to meet with the committee during these executive sessions.

A report of each committee meeting shall be presented to the full Board at the Board meeting subsequent to each committee meeting.

The Chairman of the Board or the Chairman of the Board in consultation with the Chief Executive Officer will recommend a yearly committee meeting schedule for all standing committees and agendas for each meeting. The schedule and meeting content are expected to assure that the committees meet regularly and as needed to accomplish their responsibilities.

2-2 Roles (Functions) of Board's Committees

Committees shall be created and disbanded depending on the particular needs of the Board, issues facing the Corporation, and regulatory/legal requirements. Normally the standing committees of the Board are:

Finance Committee

The Finance Committee, among other things, shall be comprised of independent directors and shall be responsible for approving and monitoring return on invested capital, monitoring the Corporation's liquidity, evaluating dividends policy, assessing long-term as well as short-term debt status, and monitoring interest rates and currency exposure.

Compensation and Organization Committee

The Compensation and Organization Committee shall be comprised of independent directors and shall be responsible for developing a scheme of compensation for directors and management. The Committee may hire consultants to aid in setting the compensation scheme.

Nominating/Corporate Governance Committee

The Board shall be comprised of independent directors and shall expect the Nominating/Corporate Governance Committee to consider the views of the Chief Executive Officer in making appointments. However, it is the Nominating/Corporate Governance Committee responsibility to make director recommendations to the full Board for submission to the shareholders at the annual meeting.

Periodically the Nominating/Corporate Governance Committee shall review the retirement policy to help assure that it remains appropriate in light of the Corporation's needs. The Nominating/Corporate Governance Committee shall regularly review incumbent directors and the strengths and weaknesses of the Board as a whole.

The Chief Executive Officer shall be responsible for making recommendations to the Nominating/Corporate Governance regarding the committee structure, but directors shall be free to make suggestions of committees at any time and are encouraged to do so. The Board also shall expect that the committee structure would be one of the matters considered by the Nominating/Corporate Governance from time to time as part of its review of overall Board effectiveness.

2-3 Audit Committee

An audit committee is expected, through checks and balances, to bring positive results in supervising and supporting the management of Corporations whose business activities have become complex, and the financial institutions whose stakeholders are diverse. This is so that they may ultimately maximize the Corporation's value. Therefore, Corporations, government-invested institutions, financial institutions and other Corporations whose goals reflect strong public interest shall establish audit committees within the Board.

» Matters concerning the authority, qualifications, rights, duties, responsibilities and operations of the audit committee or auditors shall be stated in the Corporation's bylaws.

» Audit committees, to maintain objectivity and independence, shall be composed substantially of independent, financially literate directors, charged with a number of specific responsibilities and authorities.

» Replace any audit committee members that are not "independent", as defined in the audit committee rule.

» Replace any audit committee members who are not financially literate unless they agree to become financially literate within a reasonable period of time.

» Adopt an audit committee charter that meets the requirements set out in the audit committee rule.

» Adopt a policy for the pre-approval of all non-audit services to be provided by the external auditor unless the audit committee will specifically pre-approve every engagement to be carried out by the auditor.

» Develop whistleblower procedures for the (a) receipt, retention and treatment of complaints about accounting, internal control or auditing matters; and (b) confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

» Develop procedures for the review of corporate disclosure that is derived or extracted from the financial statements, and periodically assess those procedures.

» Adopt a policy regarding the hiring of current and former partners and employees of the current and former external auditors.

» Audit Committee members shall assume their responsibilities faithfully by maintaining independence from the management and controlling shareholders.

- Audit Committee members may receive only director fees as compensation. Board members associated with major shareholders may not chair or be a member of the Audit Committee.

Auditing requires expertise. While holding a professional audit license is not a requirement for membership of the audit committee, at least one member shall be a person with a professional knowledge of auditing with an understanding of accounting standards, financial reporting, and the internal control systems.

Designing and running the internal control system is the responsibility of the management, but evaluating its appropriateness and seeking points for improvement is the duty of the audit committee and the external auditors. The audit committee or auditors shall check the existence and efficiency of a management system for protecting corporate assets, and also shall evaluate whether auditors shall, on the basis of these evaluations, seek means of maintaining the appropriateness of internal control systems.

Audit committees and auditors shall at least perform the following functions:

- Audit the appropriateness of the manager's execution of operations
- Review the soundness and reasonableness of financial activities and the accuracy of the Corporation's financial reports
- Review the adequacy of major accounting standards and changes in accounting estimates as well as appropriateness of the accounting changes
- Evaluate internal control systems
- Approve the appointment or dismissal of persons heading internal auditing divisions (for only audit committees)
- Evaluate the auditing activities of external auditors
- Recommend nominees for external auditors (for only audit committees)
- Check measures on those matters corrected as a result of auditing

The audit committee shall decide regularly the question of re-appointing external auditors by evaluating whether they have invested sufficient time and effort in performing auditing operations, and also by evaluating the independence of external auditors. Also, when the external auditors give advice on a management besides that of performing accounting audit, measures shall be taken so that the independence of external auditors is not affected.

To maintain objectivity and independence, local laws and regulations may mandate rotation of external auditors and lead auditor, who are performing audit and other assurance services to the Corporation, every certain period of time. The Audit Committee shall verify compliance with such laws and assess the independence and objectivity of the external auditors.

As the audit committee cannot supervise all operations on its own, it shall receive much support from employees performing internal auditing operations. Therefore, the independence of these employees is a prerequisite to assuring efficiency of auditing operations. If an audit committee exists, it shall be mandated, at the very least, with the authority to approve or dismiss persons heading internal auditing divisions, thereby ensuring their independence.

In the case of material conflict of opinion between the management and external auditors, audit committee shall propose a solution and check thereafter its performance. Furthermore, internal auditors shall check whether major corrective measures indicated by external auditors have been reflected in the execution of operations.

The audit committee shall hold meetings at least once each quarter, and if need arises, may allow the attendance of the management, financial officers, chair of an internal audit division or external auditors. If the agenda of the audit committee meeting includes the performance evaluation of the management, then the management shall not be allowed to attend. Also, members of the audit committee shall try to collect information and exchange opinions through individual contact, separate from official meetings, with the management, employees of internal auditing divisions, and external auditors.

To ensure the effectiveness of quarterly reporting, the audit committee shall review the quarterly reporting process.

The audit committee shall draft minutes of proceedings each time a meeting is convened, and the minutes shall state in detail and clearly the major discussion topics and resolutions and shareholders, under the law, shall be allowed to read them. The audit committee and auditors shall compose audit records that give detailed results of audits.

Members of the audit committee and auditors shall be allowed full access to information necessary for audits, and if need arises, may receive the advice of external experts. Full access to necessary information is a prerequisite for audit committees and auditors to perform their duties faithfully.

Other than cooperation from officers and employees or external auditors, audit committees and auditors may need the advice of external experts, such as accountants and lawyers, to perform their duties. Therefore, the Audit Committee Charter shall provide the basis for enabling the audit committee or auditor to receive advice from external experts. In particular, when the audit committee utilizes external experts, it shall be made mandatory for the chair of the audit committee to report to the Board a statement on the background, contents, expenses attached to the advice, follow-up measures, and its results.

The audit committee shall report to the general shareholders meeting matters concerning the personal history of its members, numbers of meetings held, and its major activities; the representative director shall disclose the information in the annual report. The Corporation without an audit committee shall report major activities of auditors to the general shareholders meeting and shall disclose such activities in the annual report.

Personal profile of audit committee members, members' existing important transactions with the Corporation, and other interests in the Corporation that may influence their independence shall all be disclosed in the annual report.

The Audit Committee shall receive reports from management, as appropriate. The Board shall receive reports from the Audit Committee and from management periodically. The Board shall expect that Board and committee agendas and materials and other information will flow to the Board and will be established with legal/regulatory requirements in mind.

3 Shareholders

3-1 Shareholder Rights

As owners of the Corporation, the basic rights of shareholders cannot be taken away or restricted even through the articles of incorporation, the general shareholder meetings, or the decision of the Board of directors. Therefore, shareholders possess basic rights including the following:

» A right to participate in profit sharing when dividends are declared by the Board;

» A right both to attend and to vote at general shareholder meetings;

» A right to obtain relevant corporate information in a timely and regular manner.

Resolutions from the general shareholder meeting shall be made through transparent and fair proceedings. Also, shareholders shall receive sufficient prior notice including the time, location and agenda of the meeting; such time and location shall be set so as to allow maximum number of shareholder participation.

It is highly desirable that shareholders be allowed to make decisions directly on issues which carry weighty influence on the Corporation's existence, such as corporate mergers and replacements, and the rights of shareholders.

The shareholders may exercise their voting rights, either through direct or indirect means. The shareholder may exercise his/her voting rights by participating, in person, in the general shareholder meeting, or he/she may exercise his/her voting right indirectly through a proxy. Further, the shareholder may participate in the general shareholder meeting and exercise his/her voting right through a ballot that is of written or electronic means.

The Corporation shall establish a method for receiving feedback from shareholders (e.g., a process whereby shareholders can contact the independent directors directly).

Aside from any intention to disrupt the order of the general shareholder meetings or from asking repetitious or unjustified questions, the shareholder shall be given the full capacity to sufficiently question and gain explanations prior to resolution of the agenda.

3-2 Treatment of Shareholders

Shareholders shall be provided all necessary information, both sufficiently and impartially, from the Corporation in a timely manner and the Corporation shall not show partiality to certain shareholders by providing undisclosed information only to them.

Shareholders need to be informed periodically of information, aside from those matters disclosed regularly, on the Corporation which may have influence on its stock value. The Corporation, therefore, shall make every effort to provide as much information to all shareholders impartially.

Rights of shareholders according to the law shall be protected from unfair conducts of insider trading and self-dealing. The following matters, which cause fundamental corporate changes and shareholder rights, shall be decided at the general shareholder meetings:

- » Amendments to the articles of incorporation
- » Mergers & acquisitions, business transfer, capital decrease and split mergers
- » Corporate disbanding and dissolution
- » Capital reduction and others

The management or shareholders must not engage in insider trading or self-dealing with the intent of personal gains. Particularly, self-dealing must be dealt within reasonable bounds away from any breach of moral obligation by the management. For such, the Corporation shall be equipped with an internal control mechanism to handle insider trading and self-dealing, and the details of such transactions shall be disclosed through a fair means.

When stakeholders hold the dual position of a shareholder, for example, a supplier, each of the rights pertaining to stakeholder and shareholder is protected independently.

3-3 Shareholders Responsibilities

Shareholders, understanding that the exercise of their voting rights has bearing on the corporate management, shall be encouraged to make every effort to exercise their voting rights for the Corporation's best interests.

It is important that controlling shareholders appreciate that significant influence also implies significant responsibility.

3-4 Shareholders Participation in Management

The form and level of monitoring on management by shareholders shall be determined separately for each Corporation, considering the characteristics of shareholders and the incentive for management monitoring. Shareholders shall have access to relevant information to protect their rights.

Due to the popularization of non-guaranteed corporate bonds and credit extensions, shareholders have been exposed to the Corporation's risk. Therefore, a growing need arises for shareholders to perform appropriate monitoring of corporate management. From this perspective, the shareholders' role in monitoring management and participating in corporate governance is necessary but it would be inappropriate to decide for all interests of shareholders. Therefore, the form and level of shareholders' participation in corporate governance shall be determined according to the Corporation's bylaws.

4 External Auditors

4-1 External Auditors Roles/Functions

The prime role of the external auditor is perform audit procedures in order to be satisfied that the financial statement have been prepared in accordance with relevant statutory requirements and applicable accounting standards and to certify them accordingly. During this process the auditor may discover many matters which need to be brought to the attention of the Audit Committee and the Board of Directors.

The external auditors shall attend the general shareholder meeting and answer any question posed by shareholders related to the submitted audit reports.

External auditors shall consider the possibility of going concern of the audited Corporation as specified in statutes related to external auditors.

The fact that auditors express opinion on the matter of going concern for an audited Corporation means that their responsibility becomes just as great. Therefore, adverse affects are possible: for example, external auditors may evade accounting audits on insolvent Corporations or may give excessively conservative audit opinions to evade responsibility.

The opinions of external auditors on the going concern issue of the audited Corporation will help determine the actual state of the Corporation. The external auditors shall be able to easily access information needed to assess the possibility of going concern of the Corporation.

The BOD and the external auditors shall report, in the Corporation's annual report, on: (a) the status of any material transactions during previous year concerning acquisition, sale, lease, exchange or otherwise disposal of the Corporation's assets or assets to be held by the Corporation which would change the essential nature of business, (b) the status of any material transactions during previous year concerning related party transactions, and (c) that the corporate governance disclosures are consistent with the audited financial statements.

Related Parties are those parties who: (a) are, directly or indirectly, having control, are controlled by, or are under common control with the Corporation, (b) have interests in the Corporation that give them significant influence over the Corporation, (c) Have joint control over the Corporation, (d) are members of key management, (e) are close members of the family of any individual having direct or indirect control over the Corporation or participating in management, and/or (f) are post-employment benefit plan of the Corporation.

One of the most important roles of both the audit committee and the external auditor is that the latter is required to present to the audit committee a full and frank report on the audit and the annual accounts before these accounts are submitted to the Board of Directors for approval.

4-2 External Auditors' Independence

External auditors shall maintain independence in reality and in appearance from the Corporation subject to audit, its management, and controlling shareholders.

Statutes related to external auditors state regulations on the independence of external auditors. But it is, above all, most important that external auditors themselves, backed by work ethics, do not enter into an accounting audit contract whereby it is judged that they hold interests, in reality or in appearance, with the management or controlling shareholders of the Corporation.

External auditors may not be independent, in principle, if they perform non-audit services such as: (a) bookkeeping or other services related to accounting records, (b) financial information systems design and implementation services, (c) internal audit services, Appraisal or valuation services, (d) management functions or human resources services, (e) broker dealer, investment advisor of investment banking services. Generally, the external auditors' independence is impaired when: (a) they perform management functions, (b) audit their own work, and/or (c) act as an advocate for their audit clients. However, exceptions are made for management consulting or tax advice if accounting Corporation concerned clearly separates its accounting audit divisions from the concerned divisions.

In some jurisdictions and especially for banks and other financial institutions a change of Audit Firm, or at least change in the Lead Auditor, is periodically required.

4-3 External Auditors' Responsibility toward the Corporation

External auditors shall notify the BOD of all material breaches detected or suspected.

External auditors are liable to pay for damages incurred from negligent accounting audit to the Corporation concerned and to other information users. External auditors shall check whether any fact conflicts with the audit results in the information disclosed regularly with the audited financial statements.

Also, external auditors shall demand correction of corporate information included in regularly disclosed business reports with audit reports and audited financial statements. This may include information that conflicts with audit results or that may cause misunderstanding on audited financial statements.

5 Internal Control System

5-1 Overview & Objectives of Controls

Internal control is broadly defined as a process, affected by an entity's Board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

The first category addresses an entity's basic business objectives, including performance and profitability goals and safeguarding of resources. The second relates to the preparation of reliable published financial statements, including interim and condensed financial statements and selected financial data derived from such statements, such as earnings releases, reported publicly. The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs.

Internal control systems operate at different levels of effectiveness. Internal control can be judged effective in each of the three categories, respectively, if the Board of directors and management have reasonable assurance that:

- They understand the extent to which the Corporation's operations objectives are being achieved.
- Published financial statements are being prepared reliably.
- Applicable laws and regulations are being complied with.

While internal control is a process, its effectiveness is a state or condition of the process at one or more points in time. The Board and executive director share the responsibility for setting a tone and standard of accountability and conscientiousness regarding the Corporation's assets and responsibilities. The Board, usually through the work of the Audit Committee, fulfills that responsibility in part by approving many aspects of the internal control system.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

5-2 Components of Internal Control System

Internal control consists of five interrelated components. These are derived from the way management runs a business, and are integrated with the management process. Although the components apply to all entities, small and mid-size Companies may implement them differently than large ones. Its controls may be less formal and less structured, yet a small company can still have effective internal control. The components are:

Control Environment

The control environment sets the tone of a Corporation, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the Board of directors.

Risk Assessment

Every Corporation faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks shall be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Control Activities

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the

organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Information and Communication

Pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to informed business decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators and shareholders.

Monitoring

Internal control systems need to be monitored, a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies shall be reported upstream, with serious matters reported to top management and the Board.

There is synergy and linkage among these components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the entity's operating activities and exists for fundamental business reasons. Internal control is most effective when controls are built into the Corporation's infrastructure and are a part of the essence of the enterprise. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs and enable quick response to changing conditions. All five components must be present and functioning effectively to conclude that internal control over operations is effective.

The internal control definition, with its underlying fundamental concepts of a process, affected by people, providing reasonable assurance, together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

5-3 Risk Assessment

Risk is the probability that unfavorable event could occur and lead to failure in achieving the Corporation's objectives. Therefore, risks have to be assessed through identification, measurement and prioritization of risks in order to manage those risks.

Risk is assessed at three levels:

- Strategic level
- Program level
- Operational level

Once risks are assessed, management of risks becomes vital to obtain a reasonable assurance that the Corporation's objectives are met. Risk management constitutes three scenarios: (a) Avoid the risk, (b) Control the risk, and/or (c) Share the risk.

Risk assessment refers to the process of analyzing potential losses from a given hazard using a combination of known information about the situation, knowledge about the underlying process, and judgment about the information that is not known or well understood.
The Board shall establish a process of identifying, analyzing and managing risks.

5-4 Internal Controls over Financial Reporting

The Chief Executive Officer and the Chief Financial Officer shall acknowledge responsibility for establishing internal control over financial reporting and shall certify that: (a) they have designed the internal controls to provide reasonable assurance that financial reporting is accurate and that the external financial statements are prepared in accordance with applicable framework; and (b) all changes in internal controls that materially affect, or are reasonable likely to materially affect, internal controls are publicly disclosed.

It is recommended that management of a public Corporation files an internal control report in which it (a) accepts responsibility for establishing and maintaining an adequate system of internal controls over financial reporting; (b) states its conclusion about the effectiveness of the internal controls; and (c) discloses any material weakness in the internal controls. Thus, the external auditor will be required to attest to management's assessment of the effectiveness of the internal controls.

6 Internal Auditing Function

Introduction:

Many companies, particularly large corporations, have found it necessary to have an internal audit department specifically tasked with internal control responsibilities to assist the Board of Directors in discharging their responsibilities and promoting good corporate governance.

6-1 Definition of Internal Auditing

The Institute of Internal Auditors (IIA) defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The internal Audit purpose, authority and responsibility are often defined in a Charter approved by the Board of Directors and governed with the Standards issued by the IIA.

The Internal Audit Department is usually headed up by a Chief Internal Auditor who is functionally responsible to the Audit Committee in relation to all internal auditing matters. The Chief Internal auditor must be independent and irrespective of the line management system in operation must have the right to approach directly the Chairman and/or the CEO and or the Chairman of the Audit Committee about any matter which concerns him/her.

6-2 Responsibilities of Chief Internal Auditor:

- Effectively manage the internal audit activity.
- Establish a risk-based audit plan perform the audit activity and meet the Corporation's objectives.
- Communicate the audit plan and resource requirements to the Audit Committee for review and approval.
- Work closely and coordinate with External Auditors but independent of them. Audit programs and working papers shall be mutually accessed by the internal and external auditors.

- Report periodically to the Audit Committee and senior management on the current state of the Internal control system and significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the Board of Directors and senior management.
- Contribute to the improvement of the risk management function, corporate governance and internal control system.
- Develop retention requirements for the audit activity.
- Properly supervise the audit activity to ensure objectives are met, quality is maintained and internal audit staff is developed.
- Monitor disposition of audit results to the management and follow up corrective actions by management.
- Establish and maintain effective quality assurance program for the internal audit activity.
- Chief Internal Auditor is a senior position in the Corporation and would attend ex-officio all meetings of the Audit Committee.

6-3 Code of Ethics

The Code of Ethics, as set by the IIA, is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about risk management, control, and governance to promote an ethical culture in the profession of internal auditing.

Objectivity:

The internal auditors:

- Shall maintain independence in fact and in appearance, and avoid conflict of interests to effectively run the internal audit activity.
- Shall be independent of the activities they audit and should refrain performing administrative functions in the Corporation.
- Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.
- Shall not accept anything that may impair or be presumed to impair their professional judgment.

Confidentiality:

The internal auditors:

- Shall be prudent in the use and protection of information acquired in the course of their duties.
- Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

Competency:

The internal auditors:

- Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- Shall perform internal auditing services in accordance with the International Standards for the Professional Practice of Internal Auditing.
- Shall continually improve their proficiency and the effectiveness and quality of their services.

Integrity:

The internal auditors:

- Shall perform their work with honesty, diligence, and responsibility.
- Shall observe the law and make disclosures expected by the law and the profession.
- Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
- Shall respect and contribute to the legitimate and ethical objectives of the organization.
- Shall have the same personal skills and characteristics of an independent external auditor.

6-4 Outsourcing of Internal Audit Function

The skills required in an Internal Audit department are such that many Corporations have found it to be more economic and effective to outsource this function to outside specialists e.g. independent audit firms. So doing does not absolve the Board of directors from their internal control obligations and responsibilities. The principles and procedures described above are applicable equally well to outside internal auditors.

objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

5-3 Risk Assessment

Risk is the probability that unfavorable event could occur and lead to failure in achieving the Corporation's objectives. Therefore, risks have to be assessed through identification, measurement and prioritization of risks in order to manage those risks.

Risk is assessed at three levels:

» Strategic level

» Program level

» Operational level

Once risks are assessed, management of risks becomes vital to obtain a reasonable assurance that the Corporation's objectives are met. Risk management constitutes three scenarios: (a) Avoid the risk, (b) Control the risk, and/or (c) Share the risk.

Risk assessment refers to the process of analyzing potential losses from a given hazard using a combination of known information about the situation, knowledge about the underlying process, and judgment about the information that is not known or well understood.
The Board shall establish a process of identifying, analyzing and managing risks.

5-4 Internal Controls over Financial Reporting

The Chief Executive Officer and the Chief Financial Officer shall acknowledge responsibility for establishing internal control over financial reporting and shall certify that: (a) they have designed the internal controls to provide reasonable assurance that financial reporting is accurate and that the external financial statements are prepared in accordance with applicable framework; and (b) all changes in internal controls that materially affect, or are reasonable likely to materially affect, internal controls are publicly disclosed.

It is recommended that management of a public Corporation files an internal control report in which it (a) accepts responsibility for establishing and maintaining an adequate system of internal controls over financial reporting; (b) states its conclusion about the effectiveness of the internal controls; and (c) discloses any material weakness in the internal controls. Thus, the external auditor will be required to attest to management's assessment of the effectiveness of the internal controls.

7 General Disclosures

Active and appropriate disclosure, as the Corporation's obligation to shareholders and other stakeholders, of corporate information will raise their confidence and will give equal opportunity to market participants, while preventing unfair practices using undisclosed information.

Disclosure of Controls and Procedures: The Chief Executive Officer and Chief Financial Officer shall acknowledge responsibility for establishing disclosure controls and procedures, and must certify that (a) they have designed the controls to provide reasonable assurance that material information is made known to them and others, particularly during the period in which the interim and annual financial statements are being prepared; (b) they have evaluated the effectiveness of the disclosure controls; and (c) the Corporation has publicly disclosed their conclusions about the effectiveness of the controls.

Disclosure of Corporate Governance Practices: Disclosure of Corporate Governance Practices shall require the Corporation to describe certain key elements of its governance practices. Specifically, the Corporation shall be required to disclose the procedures implemented to meet the governance objective keeping in mind that the market will expect more meaningful disclosure than that often disclosed in the past. Major items concerning governance for disclosure are: 1) the voting system; 2) information on the composition of the Board, along with independent directors and their independence; 3) the composition, rights, and activities of the Board's internal committees, and 4) activities of directors and the Board.

Disclosure of Material Information: Corporations shall disclose material information that may influence the decision-making of shareholders and other stakeholders, in a timely and accurate manner even if the disclosure is not mandatory by related statutes. Disclosures shall cover, among other things, the following:

» Matters that may have material influence on the financial structure or business operation of the Corporation.

» Matters concerning the issue of shares.

» Matters entailing material changes in the assets, operations, and business climate of the Corporation.

» Matters entailing major changes in debt and credit relations.

- Matters concerning important investments and financing.
- Matters entailing material change in the profit and loss structure as well as business performance.
- Matters that bring changes to the corporate control and management structure.
- Matters concerning dividend.
- General business conditions.

Disclosures in the Annual Report: The annual report shall include the following information:

- Business goals and strategies.
- Financial condition and business performance.
- Status of shareholders and statistics on exercise of shareholder rights.
- Cross-shareholdings and cross-debt guarantees.
- Capital increase and capital expenditure for the fiscal year.
- Business climate and risk factors.
- Information on executives and employees.
- Remuneration system for directors, auditors and executives.
- Evaluation of external auditors, credit rating agencies and others.
- Disclosure rule violation and subsequent sanction.
- Disclosure of any plans to make future changes.

Disclosures of Financial Information: Corporations shall prepare and disclose semi-annual reports, apart from annual reports. If one Corporation is in fact under a control and subordinate relationship to another Corporation, consolidated financial statements and combined financial statements, as determined by law, shall be additionally disclosed.

The range of items for inclusion in the consolidated financial statements, aside from share ownership criteria, shall be determined considering the existence of a control and subordinate relationship that may actually govern business operations, investment, and financial activities.
The disclosure of corporate information is not limited to facts that have already occurred, but also include forecasts on future business performance and financial condition.

Disclosure in General:

Corporations shall prepare items for disclosure that may easily be understood, and shall assist so that access to them is possible at minimal cost.

Due to diversification, high technology orientation, and specialization of industries, comprehension would be difficult if corporate information is provided in technical terms. Therefore, such information shall be prepared in the simplest terms possible; and when using technical terms, explanations shall be attached so that the general public may easily understand the contents. Also, ambiguous terms shall be avoided. The means for disseminating information shall be what the Corporation finds convenient to use and what is determined the fast mode of transmission.

The Corporation shall designate a person to oversee disclosure matters, and an internal information control system shall be established so that important corporate information may be quickly transmitted to such person.

Selecting information that needs to be disclosed and also announcing such information effectively are an important part of operations that requires specializations. Therefore, each Corporation shall assign a person with specialized knowledge to oversee disclosure.

Also, to disclose corporate information in a timely and accurate manner, persons overseeing disclosure shall be given the right to access to major corporate decisions; a system shall be established which will immediately notify them shall any new information arise.