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ACC112 PRELIMS

Understanding Concepts of Governance

Governance

- Refers to a process whereby elements in society wield power, authority, and influence and enact policies and decisions concerning public life and social uplift.
- Means the process of decision-making and the process by which decisions are implemented (or not implemented) through the exercise of power or authority by leaders of the country and/or organization.

Corporate Governance

- System of rules, practices, and processes by which business corporations are directed and controlled.
- Corporate governance is of paramount importance to a company and is almost as important as its primary business plan. It enhances a company's image in the public eye as a self-policing company that is responsible and worthy of shareholder and debtholder capital. It dictates the shared philosophy, practices, and culture of an organization and its employees. A corporation without a system of corporate governance is often regarded as a body without a soul or conscience.

Characteristics of Good Corporate Governance

The major characteristics of good governance are as follows:

1. **Participation:** It could be either direct or through legitimate institutions or representatives. It needs to be informed and organized. This means freedom of association and expression on one hand and an organized civil society on the other hand.
2. **Rule of Law:** Good governance requires fair legal frameworks that are enforced impartially and requires full protection of human rights.
3. **Transparency:** Decisions taken and their enforcement are done in a manner that follows rules and regulations. Information is freely available and directly accessible to those who will be affected by such decisions and their enforcement.
4. **Responsiveness:** Good governance requires that institutions and processes try to serve the needs of all stakeholders within a reasonable timeframe.
5. **Consensus Oriented:** Mediation of different interests in society is required. It also requires a broad and long-term perspective on what is needed for sustainable human development and on how to achieve the goals of such development.
6. **Equity & Inclusiveness:** Ensures that all its members feel that they have a stake in it and have opportunities to improve or maintain their well-being.
7. **Effectiveness & Efficiency:** The processes and institutions produce results that meet the needs of society while making the best use of resources at its disposal.
8. **Accountability:** The key requirement of good governance. An organization or institution

is accountable to those who will be affected by its decisions or actions. Accountability cannot be enforced without transparency and the rule of law.

Relevance of Good Governance to SMEs and Publicly Listed Companies

- **Small Medium Enterprise (SME):**
  - Businesses that maintain revenues, assets, or a number of employees below a certain threshold.
  - Each country has its own definition of what constitutes an SME.
  - Example (Philippines): Businesses with not more than 100M assets and not more than 199 employees (e.g., Marikina shoemakers).
- **Publicly-Listed Companies:**
  - A company that has held an initial public offering (IPO) and whose shares are traded on a stock exchange or in the over-the-counter market.
  - Examples: ABS-CBN, PHINMA Corp., Ayala Corp., etc.

Regardless of size and type, the issue of good governance has become increasingly important. Note that there is no single universal formula for good corporate governance. All organizations are encouraged to give appropriate attention to the principles and adopt approaches that are tailored to the specific needs of the organization at a given point in time. The essence of any good corporate governance system is to allow the board and management the freedom to drive their organization forward and exercise it within the framework of effective accountability.

Relationship of Shareholders and Other Stakeholders

Framework of Corporate Governance

- **Public Corporation Structure:** Shareholders/Owners $\rightarrow$ Delegate Responsibilities to $\rightarrow$ Board of Directors, Executive Management, Operational Management (which have Accountabilities), and Internal Auditors.
- **Stakeholders:**
  - Shareholders/Owners
  - External Auditors
  - Regulators
  - Society and Others

There is a clear-cut distinction between ownership and professional management of the company, and all stakeholders are informed about day-to-day operations through various reports and data.

LO3: Responsibilities of Members of Corporate Governance

Party	Overview of Responsibilities

Shareholders	a. Provide effective oversight through the election of board members. b. Approval of major initiatives such as buying and selling stocks, annual reports on management compensation.
Board of Directors	**1) Overall Operations:** • Establishing organization mission, vision, and ethical standards. • Delegating an appropriate level of authority to management. • Demonstrating leadership. • Assuming responsibility for the business relationship with the CEO including his or her appointment, succession, performance, remuneration, and dismissal. • Overseeing aspects of the employment of the management team. • Recommending auditors and new directors to shareholders. • Ensuring effective communication with shareholders and other stakeholders. • Crisis Management. • Appointment of the CEO and corporate secretary. • Ensuring long-term viability and enhancing financial position. • Formulate and oversee implementation of corporate strategy.

	2) Performance: • Approving the plan, budget, and corporate policies. • Agreeing on Key Performance Indicators (KPIs). • Monitoring/assessing the performance of the organization, the board itself, management, and major projects. • Overseeing the risk management framework and monitoring business risk. • Monitoring developments in the industry and the operating environment. • Oversight of the organization, including its control and accountability systems. • Approving and monitoring the progress of major capital expenditure, capital management, and acquisition and divestitures. **3) Compliance:** • Understanding and protecting the organization's financial position. • Requiring and monitoring legal and regulatory compliance. • Approving annual financial reports, annual reports, and other public documents/sensitive reports.
Independent Directors	• Ensuring an effective system of internal controls.

	• To understand that his role is not to act as an auditor, nor as a member of the management team. • To understand the organization, its business, its operating environment, and financial position. • To apply expertise and skills in the organization's best interest. • To assist management in keeping performance objectives at the top of the agenda. • To respect the collective, cabinet nature of the board's decisions. • To prepare for and attend board meetings. • To seek information on a timely basis to ensure that he is in a position to contribute to the discussion when a matter comes before the board or alert the chairman in advance to the need for further information. • To ask appropriate questions relative to operations.
Management	**Board Role:** Manage the organization effectively, provide accurate and timely reports to the shareholders and other stakeholders. • Recommend the strategic direction and translate the strategic plan into the operation of the business. • To run the business.

	• Assume day-to-day responsibility for the organization's conformance with relevant laws and regulations and its compliance framework. • Develop, implement, and manage the organization's risk management and internal control framework. • Develop, implement, and update policies and procedures. • Be alert to relevant trends in the industry. • Provide information to the board. • Act as a conduit between the board and the organization. • Develop financial and other reports to meet public, stakeholder, and regulatory requirements.
Audit Committee of Board of Directors	**Broad Role:** Provide oversight of the internal and external audit functions and the process of preparing annual financial statements as well as public reports on internal control. • Selecting the external audit firm. • Approving any non-audit work performed by the audit firm. • Selecting or approving the Chief Audit Executive. • Reviewing and approving the scope and budget of the internal audit function. • Discussing audit findings with internal auditors and external auditors and advising

	the board.
Regulators A. **Board of Accountancy** B. **Securities and Exchange Commission (SEC)**	**A. Board Role:** Set accounting and auditing standards dictating underlying financial reporting and auditing concepts; set expectations of audit quality and accounting quality. • Conducting CPA Licensure Board Examinations. • Approving accounting principles. • Approving auditing standards. • Interpreting previously issued standards. • Implementing quality control processes to ensure audit quality. • Educating members on audit and accounting requirements. **B. Board Role:** Ensure the accuracy, timeliness, and fairness of public reporting of financial and other information for public companies. • Reviewing filings with the SEC. • Interacting with FRSC in setting accounting standards. • Specifying independence standards required of auditors that report on public financial statements. • Identify corporate frauds, investigate causes, and suggest remedial actions.
External Auditors	**Board Role:** Performs audit of company

	financial statements to ensure that the statements are free of material misstatements including misstatements that may be due to fraud. • Audit of public company financial statements. • Audit of non-public company financial statements. • Other services such as tax or consulting.
Internal Auditors	**Board Role:** Perform audit of companies for compliance with company policies and laws, audit to evaluate efficiency of operations, and periodic evaluation and test of controls. • Reporting results and analysis to management and audit committee. • Evaluating internal control.

Main Lesson

LO1: Understanding Code of Governance and Need for Publicly Listed Companies

- **What is the name of the code?** Code of Corporate Governance.
- **When was it approved?** The SEC Code of Governance was released on November 10, 2016, during the 3rd Annual SEC-PSE Corporate Governance Forum.
- **What is the purpose of its release?** To raise the corporate governance standards of Philippine corporations to a level at par with regional and global counterparts.
- **How is the arrangement of the Code?** It is arranged into: 1) Principle, 2) Recommendation, 3) Explanation.
- **What companies are covered by the Code?** All registered companies and branches or subsidiaries of foreign corporations operating in the Philippines that:
  a) Sell equity and/or debt securities to the public that are required to be registered with the commission.
  b) Have assets in excess of 50M and at least 200 stockholders who own at least 100

shares of equity securities.
c) Whose equities are listed on an Exchange.
d) Grantees of a secondary license from the commission.

- **What is an Exchange?** An organized marketplace or facility that brings together buyers and sellers and executes trades of securities and/or commodities. An example is the Philippine Stock Exchange (PSE).
- **What are publicly-listed companies?** Those companies whose securities are listed and traded at an Exchange (e.g., ABS-CBN, PHINMA Corp., Ayala Corp.).

LO2: Understanding the Three Aspects of the Code and its Feature ("Comply or Explain" Approach)

The Code of Corporate Governance is arranged as follows:

1. **Principles:** High-level statements of corporate governance good practices and are applicable to all companies.
2. **Recommendations:** Objective criteria that are intended to identify the specific features of corporate practice that are recommended for companies operating according to the Code. Alternatives to the recommendation may be justified in a particular circumstance if good governance can be achieved by other means.
3. **Explanations:** Strive to provide companies with additional information on the recommended best practice.

- **Comply or Explain Approach:** Combines voluntary compliance with mandatory disclosure. Companies do not strictly have to comply with every recommendation, but they must state in their annual corporate governance reports whether they comply with the Code provisions, identify any areas of non-compliance, and explain the reasons for non-compliance.

LO3: 16 Principles of Code of Corporate Governance

The Code of Corporate Governance has 16 principles distributed among 5 main sections:

- **Board's Governance Responsibilities** – Principles 1–7
- **Disclosure and Transparency** – Principles 8–11
- **Internal Control and Risk Management Framework** – Principle 12
- **Cultivating a Synergic Relationship with Shareholders** – Principle 13
- **Duties to Stakeholders** – Principles 14–16

Detailed Matrix of Principles, Recommendations, and Explanations

Section	Principle	Recommendation	Explanation
Board's Governance Responsibilities (Principle 1–7)	**Principle 1:** Establishing a competent board.	1.1 Board should always ensure that it has an appropriate mix of	1.1 Competence enables the company to properly perform its

	A company should be headed by a competent, working board to foster the long-term success of the corporation, and to sustain its competitiveness and profitability in a manner consistent with its corporate objectives and the long-term best interest of its shareholders and other stockholders.	expertise relevant to the company's industry/sector. 1.2 Should be composed of a majority of non-executive directors who possess the necessary qualifications to effectively participate and help secure objective, independent judgment on corporate affairs and to substantiate proper checks and balances. 1.3 Should have a policy on the training of its directors, including an orientation program for first-time directors and relevant annual continuing training for all directors. 1.4 Should have a policy on board diversity. 1.5 Should have a	task of overseeing management and governance of the corporation, formulating vision, mission, strategic objectives, policies, and procedures. 1.2 Right combination ensures that no director or small group of directors can dominate the decision-making process. 1.3 Orientation program for first-time directors aims to promote effective board performance and continuing qualification of the directors in carrying out their duties and responsibilities. 1.4 This is a move to avoid groupthink and ensure that optimal decision-making is achieved. 1.5 Assist the board

		Corporate Secretary, who is: a) separate individual from compliance officer; b) not a member of BOD; c) annually attend training on corporate governance. 1.6 Should have a Compliance Officer who is: a) of the rank of Senior Vice President or an equivalent position with adequate stature and authority; b) not a member of BOD; c) annually attend training on corporate governance.	and board committees in the conduct of their meetings, safekeeps and preserves integrity of minutes of meeting, keeps abreast of relevant laws and regulations, works fairly and objectively with the board, advises on the establishment of board committees, informs members of the board of meeting agenda 5 days in advance, attends all discussions on key issues, and makes sure that board performance is evaluated at least once a year. 1.6 Ensures proper onboarding of new directors, monitors, reviews, evaluates compliance with this Code and other regulations, reports violations, recommends appropriate disciplinary actions, ensures integrity of

			all documents, appears before SEC when summoned in relation to compliance of the Code, ensures attendance of board key officers in relevant possible trainings, collaborates with other departments, and identifies areas of compliance.
	Principle 2: Establishing Clear Roles and Responsibilities of the Board. *The fiduciary roles, responsibilities, and accountabilities of the Board as provided under the law, the company's articles and by-laws, and other legal pronouncements and guidelines should be clearly made known to all directors as well as to shareholders and other stakeholders.*	2.1 The Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and all shareholders. 2.2 Should oversee the development of and approve the company's business objectives and strategy, and monitor their implementation, in order to sustain the company's long-term viability and strength. 2.3 Should be	2.1 Fiduciary duties of board members are duty of care and duty of loyalty. 2.2 Sound strategic policies and objectives translate to the company's proper identification and prioritization of its goals and guidance on how best to achieve them. 2.3 Chairman makes certain the meeting agenda focuses on strategic matters, guarantees accurate, timely, relevant, insightful information, and

		headed by a competent and qualified Chairperson. 2.4 Should be responsible for ensuring and adopting an effective succession planning program for directors, key officers, and management. 2.5 Should align the remuneration of key officers and board members with the long-term interests of the company. 2.6 Should have a formal and transparent board nomination and election policy. 2.7 Should have the overall responsibility in ensuring that there is a group-wide policy and system governing Related Party Transactions	facilitates board meetings except for a justifiable cause, oversees drafting of by-laws, and performs other duties provided by the SEC. 2.4 The goal of succession planning is the transfer of company leadership to highly competent and qualified individuals, and a good succession plan is linked to documented rules and responsibilities for each position. 2.5 To attract and retain the services of qualified and competent individuals.

		(RPTs) and other unusual or infrequently occurring transactions. 2.8 Should be primarily responsible for approving the selection and assessing the performance of Management. 2.9 Should establish an effective performance management framework that will ensure that Management, including the Chief Executive Officer, and personnel's performance is at par with the standards set by the Board and Senior Management. 2.10 Should oversee that an appropriate internal control system is in place. 2.11 Should oversee	

		that a sound Enterprise Risk Management (ERM) framework is in place. 2.12 Should have a Board Charter that formalizes and clearly states its roles, responsibilities, and accountabilities in carrying out its fiduciary duties.	
	Principle 3: Establishing Board Committees. *Board committees should be set up to the extent possible to support the effective performance of the Board's functions, particularly with respect to audit, risk management, related party transactions, and other key functions and responsibilities of all committees established should be contained in a publicly available Committee Charter.*	3.1 The Board should establish board committees that focus on specific board functions to aid in the optimal performance of its roles and responsibilities. 3.2 The Board should establish an Audit Committee. 3.3 Should establish a Corporate Governance Committee. 3.4 Subject to a corporation's size,	

		risk profile, and complexity of operations, the Board should establish a separate Board Risk Oversight Committee (BROC). 3.5 Subject to a corporation's size, risk profile, and complexity of operations, the Board should establish a Related Party Transaction (RPT) Committee. 3.6 All established committees should have Committee Charters.	
	Principle 4: Fostering Commitment. *To show full commitment to the company, the directors should devote the time and attention necessary to properly and effectively perform their duties and*	4.1 The directors should attend and actively participate in all meetings of the Board, Committees, and Shareholders in person or through tele/videoconferencing conducted in accordance with the rules and regulations of the Commission.	

	responsibilities, including sufficient time to be familiar with the corporation's business.	4.2 Non-executive directors of the Board should concurrently serve as directors to a maximum of five publicly listed companies. 4.3 A director should notify the Board where he/she is an incumbent director before accepting a directorship in another company.	
	Principle 5: Reinforcing Board Independence. *The board should endeavor to exercise an objective and independent judgment on all corporate affairs.*	5.1 The Board should have at least three independent directors, or such number as to constitute at least one-third of the members of the Board, whichever is higher. 5.2 Should ensure that its independent directors possess the necessary qualifications and none of the disqualifications for an independent director to hold the position.	

		5.3 The Board's independent directors should serve for a maximum cumulative term of nine years. 5.4 The positions of Chairman of the Board and Chief Executive Officer should be held by separate individuals and each should have clearly defined responsibilities. 5.5 The Board should designate a lead director among the independent directors if the Chairman of the Board is not independent. 5.6 A director with a material interest in any transaction affecting the corporation should abstain from taking part in the deliberations for the same.	

		5.7 The non-executive directors (NEDs) should have separate periodic meetings with the external auditor and heads of the internal audit, compliance, and risk functions, without any executive directors present to ensure that proper checks and balances are in place within the corporation.	
	Principle 6: Assessing Board Performance. *The best measure of the Board's effectiveness is through an assessment process. The Board should regularly carry out evaluations to appraise its performance as a body, and assess whether it possesses the right mix of backgrounds*	6.1 The Board should conduct an annual self-assessment of its performance, including the performance of the Chairman, individual members, and committees. Every three years, the assessment should be supported by an external facilitator. 6.2 The Board should have in place a system that provides, at the	

	and competencies.	minimum, criteria and process to determine the performance of the Board, the individual directors, committees, and such system should allow for a feedback mechanism from shareholders.	
	Principle 7: Strengthening Board Ethics. *Members of the Board are duty-bound to apply high ethical standards, taking into account the interests of all stakeholders.*	7.1 The Board should adopt a Code of Business Conduct and Ethics. 7.2 The Board should ensure the proper and efficient implementation and monitoring of compliance with the Code of Business Conduct and Ethics and internal policies.	

Disclosure and Transparency (Principles 8–11)

Section	Principle	Recommendation	Explanation
Disclosure and Transparency (Principle 8–11)	**Principle 8:** Enhancing Company Disclosure Policies	8.1 The Board should establish corporate disclosure policies and procedures.	*(Note: For a complete copy of this code, follow the link: http://www.sec.gov.*

	and Procedures.	8.2 The Company should have a policy requiring all directors and officers to disclose/report any dealings in the company's shares within 3 business days. 8.3 The board should fully disclose all relevant and material information on individual board members and key executives. 8.4 Company should provide clear disclosure of its policies and procedures for setting board and executive remuneration as well as the level and mix of the same in the Annual Corporate Governance Report. 8.5 The company should disclose its	*ph/wp-content/uploads/2016/12/2016-memo-circular-no.19.pdf)*

		policies governing Related Party Transactions and other unusual or infrequently occurring transactions in their manual on corporate governance. 8.6 The company should make full, fair, accurate, and timely disclosure to the public of every material fact or event that occurs. 8.7 The company's corporate governance policies, programs, and procedures should be contained in its Manual on Corporate Governance.	
	Principle 9: Strengthening the External Auditor's Independence and Improving Audit Quality.	9.1 The Audit Committee should have a robust process for approving and recommending the appointment, reappointment, removal, and fees of the external	

		auditor. 9.2 The Charter should include Audit Committee's responsibility on assessing the integrity and independence of external auditors and exercising effective oversight to review and monitor their independence and objectivity taking in consideration the Philippine professional and regulatory requirements. 9.3 The company should disclose the nature of non-audit services performed by its external auditor in the Annual Report to deal with potential conflicts of interest.	
	Principle 10: Increasing Focus on Non-Financial and Sustainability Reporting.	10.1 The board should have a clear and focused policy on the disclosure of non-financial information, with emphasis on the management of	Disclosure is required to respond to sustainability challenges to determine their long-term viability and competitiveness.

		economic, environmental, social, and governance (EESG) issues of its business.	
	Principle 11: Promoting Comprehensive and Cost-Efficient Access to Relevant Information.	11.1 The company should include media and analyst briefings as channels of communication to ensure the timely and accurate dissemination of public, material, and relevant information to its shareholders and other investors.	Communication channels can provide timely and up-to-date information relevant to investors' decision-making, as well as to other interested stakeholders.

Internal Control and Risk Management Framework

Section	**Principle**	**Recommendation**	**Explanation**
Internal Control System and Risk Management Framework	**Principle 12:** Strengthening the Internal Control System and Enterprise Risk Management Framework.	12.1 The company should have an adequate and effective internal control system and enterprise risk management framework in the conduct of its business taking into account its size, risk profile, and complexity of operations.	12.1 Help sustain safe and sound operations as well as implement management policies to attain corporate goals. 12.2 Essential to monitor and guide the implementation of the company's policies. Systematic and disciplined evaluation

		12.2 Company should have in place an independent internal audit function that provides independent and objective assurance, and consulting services designed to add value and improve the company's operations. 12.3 Subject to company's size, risk profile, and complexity of operations, it should have a qualified Certified Audit Executive appointed by the board. 12.4 Subject to company's size, risk profile, and complexity of operations, the company should have a separate risk management function to identify, assess, and monitor key risk exposures.	approach improves the effectiveness of the company's governance, risk management, and control functions. 12.3 CAE directly reports functionally to the Audit Committee and administratively to the CEO. 12.4 Risk management function defines risk management strategy, identifies and analyzes risk, evaluates and categorizes, establishes risk register, develops risk mitigation, communicates and reports significant risks, monitors and evaluates the effectiveness of the organization's risk management process. 12.5 CRO supervises the entire ERM process and spearheads development,

		12.5 The Company should have a Risk Management System where the CRO is the ultimate champion of Enterprise Risk Management.	implementation, maintenance, and continuous improvement, communicates top risks to Board Risk Oversight Committee, collaborates with CEO in updating and making recommendations, suggests ERM policies, and provides insight on risk management and measures.

Cultivating Synergic Relationship with Shareholders

Section	Principle	Recommendation	Explanation
Cultivating Synergic Relationship with Shareholders	**Principle 13:** Promoting Shareholder Rights.	13.1 The board should ensure that basic shareholder rights are disclosed in the Manual of Corporate Governance and on the company's website. 13.2 Board should encourage active shareholder participation by sending Notice of Annual and Special Shareholders' Meetings at least 28	13.1 It is the board's responsibility to adopt a policy informing shareholders of their rights. 13.2 It allows shareholders to plan their participation in meetings. 13.3 Substantial number of votes against a proposal made by

		days before the meeting. 13.3 Board should encourage active shareholder participation by making results of the votes taken during the most recent Annual or Special Shareholder's meeting publicly available on the next working day. 13.4 The board should make available, at the option of a shareholder, an alternative dispute mechanism to resolve intra-corporate disputes in an amicable and effective manner. 13.5 Board should establish an Investor Relations Officer to ensure constant engagement with its shareholders. IRO should be present at every	management may prompt analysis of reasons and consideration of having dialogue with its shareholders. 13.4 Ensures suitable remedies for the infringement of shareholders' rights and prevents excessive litigation. 13.5 Ensures that all information regarding the activities of a company are properly and timely communicated to shareholders.

		stockholder's meeting.	

Duties to Stakeholders (Principles 14–16)

Section	**Principle**	**Recommendation**	**Explanation**
Duties to Stakeholders (Principles 14–16)	**Principle 14:** Respecting Rights of Stakeholders and Effective Redress for Violation of Stakeholder's Rights.	14.1 The Board should identify the various stakeholders and promote cooperation between them and the company in creating wealth, growth, and sustainability. 14.2 The Board should establish clear policies and programs to provide mechanisms on the fair treatment and protection of stakeholders. 14.3 The Board should adopt a transparent framework and process that allow stakeholders to communicate with the company and to obtain redress for the violation of their	14.1 Due consideration is given to those who have an interest in the company and are directly affected by its operations. 14.2 The company's code of conduct ideally includes provisions on the company's policies and procedures on dealing with various stockholders. 14.3 Company's stakeholders play an important role in its growth and long-term viability hence it is crucial to maintain open and easy communication with its stakeholders.

		rights.	
	Principle 15: Encouraging Employee Participation.	15.1 The Board should establish policies, programs, and procedures that encourage employees to actively participate in the realization of the company's goals and its governance. 15.2 The Board should set the tone and make a stand against corrupt practices by adopting an anti-corruption policy and program in its Code of Conduct. 15.3 The Board should establish a suitable framework for whistleblowing that allows employees to freely communicate their concerns about illegal practices, without fear of retaliation.	15.1 Policies and programs on: 1) health, safety, and welfare; 2) training and development; 3) rewards/compensation encourages employees to perform better and motivates them to take a more dynamic role. 15.2 Endeavors to mitigate corrupt practices such as but not limited to bribery, fraud, extortion, and the like. 15.3 Sets up the procedures and safe-harbors for complaints of employees, either personally or through their representative bodies, concerning illegal and unethical behavior.
	Principle 16: Encouraging	16.1 The company should recognize and place an	16.1 Sustainable development means that the

	Sustainability and Social Responsibility.	importance on the interdependence between business and society, and promote mutually beneficial relationships that allow the company to grow its business, while contributing to the advancement of the society where it operates.	company not only complies with existing regulations, but also voluntarily employs value chain processes that take into consideration economic, environmental, social, and governance issues and concerns.