Society and Economy 27 (2005) 2, pp. 195–211

THE ETHICAL PRINCIPLES DETERMINING THE CONTENTS OF CORPORATE GOVERNANCE RULES AND SYSTEMS

MICHEL DION

The basic ethical values enhancing good corporate governance – as they are internationally recognised in national and international reports about corporate governance from the Cadbury report (1992) to the OECD Principles (2004) – are the following ones: fairness, accountability, transparency. Such values are required to achieve the desired confidence of shareholders and other stakeholders. Three main ultimate values constitute the basis of every corporate governance system: (a) an orientation towards Justice-itself through the actualisation of the following values: fairness, integrity, and objectivity; (b) an orientation towards Truth-itself through the actualisation of values of openness, trustfulness, and transparency; (c) the orientation towards Harmony through attitudes of collaboration, care and diligence.

Keywords: ethical principles, corporate governance, accountability

1. INTRODUCTION

The basic ethical values enhancing good corporate governance as they are internationally recognised are the following ones: fairness, accountability, transparency. Such values are required to achieve the desired confidence of shareholders and other stakeholders (Kumar Mangalam Report 2002, art. 4.4). Three main values constitute the basis of every corporate governance system: (a) an orientation towards Justice-itself through the actualisation of the following values: fairness, integrity and objectivity; (b) an orientation towards Truth-itself through the actualisation of values of openness, trustfulness, and transparency; (c) the orientation towards Harmony through attitudes of collaboration, care and diligence. We shall discuss the way such values are enhanced in various corporate governance issues.

This article will build on the main national reports (published in the United Kingdom, Canada, USA, India, Malaysia, and South Africa) and international re-

Michel Dion, professor, Département de management, Faculté d'administration, Université de Sherbrooke, 2500 boul. Université, Sherbrooke (Québec) J1K 2R1, Canada.

1588-9726/$20.00 © 2005 Akadémiai Kiadó, Budapest

المنارة للاستشارات
www.manaraa.com

ports (OECD, Asian Development Bank, World Bank, and Commonwealth Corporate Governance Association). Insofar as such national and international reports dealt with listed business corporations, we shall not discuss the application of the main values to non-listed companies and non-profit organisations either. However, we must say that values and attitudes closely linked to corporate governance rules and systems could easily be applied to non-listed companies (Cadbury 2002), although Stock Exchanges cannot require such companies to conform themselves to such values and attitudes. In the case of non-profit organisations, we should admit that those values and attitudes which are closely connected with corporate governance could also be applied within them, *"mutatis mutandis"*. Some governance rules would then become irrelevant or useless, because they are not focusing on profit-making activities. In this article, we would like to draw the set of "areas of meaning" (Cassirer 1970: 234) we could find in every ethical principle determining the contents of corporate governance rules and systems. Areas of meaning reveal a part of business activities, structures and operations that can produce a given meaning for the value, although that meaning is not explicitly defined.

2. ACCOUNTABILITY AS THE GROUNDING PRINCIPLE FOR A VALUE-ORIENTED CORPORATE GOVERNANCE SYSTEM

There are three areas of meaning in which we could understand accountability as it is described in the main national and international reports on corporate governance: (a) the scope of accountability; (b) the balance of purposes in corporate governance rules; and (c) the requirement of disclosure.

The scope of accountability

The Dey Report (1994, art. 3.2) said that "we are in an era of openness and accountability". Indeed, the corporate governance process implies decision-making processes that make decision-makers accountable for the way they managed the business enterprise (*ibid.,* art. 5.56), that is, the way they enhanced shareholder value. *Good corporate governance systems reflect the accountability of management to the board, and of the board to the shareholders* (Cadbury Report 1992, art. 3.4, 6.1, 6.6, 7.5; Dey Report 1994, art. 2.2, 5.34; Greenbury Report 1995, art. 4.3; Hampel Report 1998, art. 1.21; Blue Ribbon Report 1999: 20, 22; CACG Guidelines 1999: 14; Kumar Mangalam Birla Report 2002, art. 6.1, 9.1; OECD Principles 2004, VI: 24). The board is accountable to shareholders for creating, protecting and enhancing corporate wealth and resources, and for disclosing to them on the performance in a transparent fashion (Kumar Mangalam Birla Report 2002,

المنارة للاستشارات
www.manaraa.com

art. 6.2). Two limitations could influence the way the board is fulfilling its duties: (1) the existence of executive committees tend to set up a double set of directors (internal and outside directors), so that outside directors could feel little sense of accountability for corporate decisions (Dey Report 1994, art. 6.22); (2) the board should not be too big since in that case individual directors could lose their sense of personal accountability for board decisions (Dey Report 1994, art. 5.39).

The balance of purposes in corporate governance rules

The essence of any good corporate governance system is that boards "must be free to drive their companies forward, but exercise that freedom within a framework of effective accountability" (Cadbury Report 1992, art. 1.1). In strengthening their control over their businesses and their public accountability, listed corporations will realise a right balance between meeting the existing standards of corporate governance and actualising the spirit of free enterprise (*ibid.,* art. 1.5). The World Bank Framework (1999: 1, 3–4) has a similar objective to balance the promotion of enterprise with greater accountability. Some directors could have specific responsibilities for which they are accountable to the board. But the principle remains that all directors are "equally responsible" for board decisions (Cadbury Report 1992, art. 4.3).

The requirement of disclosure

Accountability presupposes disclosure (Hampel Report 1998, art. 1.2). The Cadbury Report (1992, art. 5.2, 7.2) said that the most direct way to ensure that business corporations are accountable for their decisions is through open disclosure by their boards and through audits realised in accordance with strict accounting standards. The risks of fraud and incompetence are quite reduced when we make people as effectively accountable as possible. As said the Blue Ribbon Report (1999: 21), directors should share some personal characteristics such as integrity and a sense of accountability. Shareholders, however, should hold the board accountable for their governance practices (Hampel Report 1998, art. 1.19).

Outside auditors are accountable to shareholders, to the board, and to the audit committee (the board and the audit committee representing shareholders' interests). They are not accountable to management (Saucier Report 2001: 30). In order to ensure the integrity and effectiveness of the audit committee process, all parties should recognise that the audit committee and the board (as representatives of shareholders' interests) are the entities auditors are accountable to (Blue Ribbon Report 1999: 30). The audit committee can ensure that procedures of account-

www.manaraa.com

ability are an integral part of the roles played by all "relevant social actors" (*ibid.,* 34). Audit committees should encourage procedures of accountability ensuring that management properly develops and adheres to sound internal control systems (*ibid.,* 38).

According to the Greenbury Report, the key to strengthening accountability implies three steps: (1) having appropriate systems (and responsibility) for determining directors' remuneration; (2) rightly reporting such systems, responsibilities and remuneration packages to shareholders; (3) always being transparent (Greenbury Report 1995, art. 1.14). The remuneration committee is also accountable to shareholders and reports to them for its decisions (*ibid.,* art. 4.4). The full disclosure of directors' remuneration packages tend to ensure accountability to shareholders and to guarantee the public confidence. Remuneration committees constitute the main body through which a given business corporation discloses and accounts to shareholders for directors' remuneration packages (*ibid.,* art. 5.4).

3. THE ETHICAL PRINCIPLES OF A VALUE-ORIENTED CORPORATE GOVERNANCE SYSTEM

Justice-itself

Integrity and fairness

In the national and international reports on corporate governance, there seems to be only one "area of meaning" for values of integrity and fairness: presenting a balanced picture of company's affairs.

All directors have a duty to act honestly (CACG Guidelines 1999: 10). The Dey Report (1994) focused on the integrity of corporate internal controls. The board must ensure that the corporation has an audit system guaranteeing the integrity of data (Combined Code 2003, A.1, C.3) and the compliance of financial information with "appropriate accounting principles" (Dey Report 1994, art. 4.6; TSX Guideline 2002, 1E; OECD Principles 2004, VI.D-E: 25). According to the Cadbury Report, integrity implies "straightforward dealing and completeness". Financial reporting must then be honest and mirror a balanced picture of the company's affairs. But indeed, what is a balanced picture of company's affairs? It is certainly not the assets *versus* debts and liabilities since it is the nature of accounting to present such components of company's affairs. Using the word "balanced picture" could be related to the intent to disclose and the need to protect confidentiality. If it were not the case, the "balanced picture" would imply to reveal something and to hide something else to investors. Although we could easily under-

www.manaraa.com

stand the need to protect confidential (corporate) information because of its importance from the competitors' viewpoint, we cannot accept an ethical principle that could veil the real motive of its existence. Of course, honest reporting requires honest people who prepare and present the financial statements (Cadbury Report 1992, art. 3.3, 4.51). Audit committees must ensure the transparency and integrity of financial reporting (Blue Ribbon Report 1999: 19). As the OECD Principles (2004, art. 16) said, audit committees play a vital role in ensuring the integrity of business corporations.

External auditors have the responsibility to audit and attest to the fair presentation of the company's financial statements, and to evaluate the company's system of internal controls (Cadbury Report 1992, art. 4.51). That is why their reputation for objectivity must never be compromised (Blue Ribbon Report 1999: 30). But what does a "fair presentation" of the company's financial statements mean? What could be an unfair presentation? Would it be equivalent to a falsified presentation of financial statements? If it is the case, why is it so important to avoid any terms like "falsifying" or "untrue" when dealing with financial statements? On the other hand, if a "fair presentation" implies that the same data are made available to all investors, then we could accept this way to express ethical concerns. According to Section 302 of the Sarbanes-Oxley Act of 2002, the principal executive officer(s) and the principal financial officer(s), or persons performing similar functions must certify in each annual or quarterly report filed or submitted that: (a) the signing officer has reviewed the report; (b) based on the officer's knowledge, the report does not contain any untrue statements of a material fact or omit to reflect a material fact that is necessary; (c) based on such officer's knowledge the financial statements and other financial information included in the report fairly present all material aspects; (d) the signing officers are responsible for establishing and maintaining internal controls, and have evaluated the effectiveness of such internal controls; (e) the signing officers have disclosed to the internal auditors and the audit committee all significant deficiencies in the design or operation of internal controls as well as any fraud; (f) the signing officers have indicated whether or not there were significant changes in internal controls or other actions that could significantly affect internal controls. According to the Hampel Report (1998, art. 6.5), the basic duty of auditors is to report to shareholders on whether annual financial statements give a true and fair view of the company.

Minority shareholders must receive equal consideration to dominant shareholders (King Report 2002, art. 18.6). According to the Dey Report, a "significant shareholder" is one who can exercise a majority of the votes for the election of directors. When a given corporation has a significant shareholder and a majority of unrelated directors, the board should include a number of directors who have neither interests, nor relationships with the corporation, or the significant share-

المنارة للاستشارات
www.manaraa.com

holder; that number of directors should fairly reflect the investment made by shareholders other than the significant shareholder (Dey Report 1994, art. 5.14; Saucier Report 2001: 24; TSX Guideline 2, 2002). But about the composition of the Board of Directors, the Dey Report concluded that only the market will finally judge the composition and effectiveness of the board, since the board will annually disclose whether the corporation actually satisfies the requirement of fairly reflecting the investment made by minority shareholders (Dey Report 1994, art. 5.14, 5.18, 8.1; Malaysian Code 2000, Part 2, AA VI). According to the OECD Principles, in cases where board decisions affect various shareholder groups quite differently, the board should treat all shareholders fairly (OECD Principles 2004, Part 1, VI.B: 24). More generally, there should be a simultaneous reporting of information to all stakeholders in order to guarantee their equitable treatment (*ibid.,* Part 2, V: 50). The audit committee must ensure that there is a fair and true disclosure of the affairs of the company (ADB 2003, art. 16). Financial reporting practices must be fair for individual (minority) shareholders (Cadbury Report 1992, art. 4.54). The fact that such national and international reports refer to a "fair and true" disclosure of company's affairs reveals that a fair disclosure would not give birth to the same result as a true disclosure. Finally, all shareholders should be fairly treated so that they are provided with the same appropriate information, regardless of their interests in the company (CACG Guidelines 1999: 10). The OECD Principles strongly criticises the practices of off-balance sheet transactions and special purpose entities, since they could veil an important part of the whole corporate picture to the shareholders (OECD Principles 2004, Part 2, V: 50). Such SPEs were an integral part of the Enron case. But we must admit that they are technically defined through some "Financial Accounting Standards" (no. 140, September 2000; no. 57, March 1982).

As to the remuneration of directors, they should be fair and competitive (Cadbury Report 1992, art. 4.44) and be seen as such (Greenbury Report 1995, art. 6.13). Executive directors should be fairly and responsibly rewarded for their individual contributions to the board. The CACG Guidelines (1999: 9) widen the scope of such "fair rewards" in emphasising the role of the board to promote a "culture of innovation", with short and long-term performance-related rewards that are fair and achievable in motivating management and employees as well.

Objectivity

In the national and international reports on corporate governance, there are three areas of meaning for the value of objectivity: (a) the nature of the board's judgment; (b) the attitude of internal auditors; and (c) the attitude of external auditors.

المنارة للاستشارات
www.manaraa.com

The nature of the Board's judgment. According to the Hampel Report (1998, art. 2.5), directors should be able to demonstrate objectivity and independence of judgment, "when necessary". According to the Malaysian Code, independent directors should cooperate with executives and be able to practise objectivity and "robust independent judgment when necessary" (Malaysian Code 2000, Part 4, A 4.2). But what are the conditions that would make necessary to take a "robust independent judgment"? They are not clearly established. However, we could believe that in some situations where a CEO is exerting a strong pressure on directors, they should actively resist in order to safeguard their independence. An independent director is more likely to be able to objectively assess the propriety of management's practices (Blue Ribbon Report 1999: 22). The board should be able to exercise objective judgment when assessing the performance of management and the merits of their initiatives (Dey Report 1994, art. 5.9–5.10). According to the Hampel Report, the audit committee must safeguard the objectivity and independence of auditors (Hampel Report 1998, art. 2.21, 6.9; Combined Code 2003, C 3.2). According to the CACG Guidelines (1999: 9 and 13), the board should be able to exercise objective judgment, independent of management. It must have access to all reliable information that makes possible to produce an objective assessment of the affairs of the company. The Combined Code rather said that directors must take decisions objectively in the interests of the company (Combined Code 2003, A.1). Appointments to the board should be made on merit and against objective criteria (*ibid.,* A.4). According to the ADB, directors should be recruited because they have a good record of diligence, integrity, and ability to be independent and objective (ADB 2003, art. 9). But are those (relevant) traits of personality objectively definable? They are rather highly subjective. Directors must always act with independent judgment, objectivity and impartiality (*ibid.,* art. 48, 50). More specifically, the board should annually disclose, through the company's annual report, a rational and objective remuneration policy (Malaysian Code 2000, Part 4, B 4.10).

The attitude of internal auditors. The Blue Ribbon Committee enhanced a culture of disclosure (internal auditors disclosing any relevant information to the audit committee) and of objectivity (implying a critical analysis of management and of the internal auditors) (Blue Ribbon Report 1999: 39–41). The audit committee should ensure that "management properly develops and adheres to a sound system of internal control, that the internal auditor objectively assesses management's accounting practices and internal controls, and that the outside auditors, through their own review, assess management and the internal auditors' practices" (*ibid.,* 38). Outside and internal auditors should speak regularly and confidentially with the members of the audit committee (*ibid.,* 7, 29–31). According to the ADB

www.manaraa.com

(2003, art. 17), the audit committee must ensure that external auditors have objectively realised their audit. The annual audit process should ensure its objectivity and effectiveness (Cadbury Report 1992, art. 5.1). Shareholders (and the public in general) expect auditors to be objective in the way they will make their audit (*ibid.,* art. 5.3).

The attitude of external auditors. According to the OECD Principles (2004), external auditors will give an objective assurance to the board and the shareholders that financial statements fairly mirror the performance of the company in all material aspects (OECD 2004, Part 1, V C: 22). Shareholders expect auditors to work with management, while remaining objective so that they are still aware of their accountability to those who appoint them. Maintaining such impartial relationships is a duty of the board and of the auditors themselves (Cadbury Report 1992, art. 5.7). Auditors must always be able to give their opinion, even if their opinion could contradict management's viewpoint (*ibid.,* art. 5.9). According to the Hampel Report (1998, art. 6.2), auditors should provide shareholders with independent and objective assurance on the reliability of financial statements and other corporate information. According to the Turnbull Report (1999, art. 44), the board must assess whether given monitoring processes actually provide sufficient and objective assurance that the internal control systems are functioning as intended. As said the Blue Ribbon Report, audit committees must be engaged in a dialogue with auditors as to any disclosed relationships or services which may negatively affect the objectivity and independence of auditors (Blue Ribbon Report 1999: 31). The audit committee should encourage procedures of accountability ensuring that internal auditors objectively assess management's accounting practices and internal control systems (*ibid.,* 38). The independence of the internal auditors (from management) is required for the auditors to objectively assess management's actions (p. 39). External auditors must perform their role without being influenced by any interest that could question their objectivity, and thus the reliability of their attestation (*ibid.,* 40). Audit committees should promote an organisational culture that enhances an objective analysis of management's and internal auditors' practices (*ibid.,* 41). As the Malaysian Code (2000, Part 2, BB VIII) claimed, internal auditors should perform their duties with impartiality and due care.

The audit committee has to ensure that internal controls and independent and objective outside auditors can deter fraud, anticipate financial risks and promote high quality disclosure of financial (and non-financial) information to the Board, to public markets and to shareholders (Blue Ribbon Report 1999: 20). Auditors

المنارة للاستشارات
www.manaraa.com

must provide the shareholders with independent and objective assurance on the reliability of the financial statements and other information provided by the company (Hampel Report 1998, art. 6.2, 6.8). The board should adopt an objective viewpoint as to the corporate strategic planning process (Dey Report 1992, art. 4.6; Malaysian Code 2000, Part 4, AA 4.17). When auditors supply an important volume of non-audit services to the company, the Hampel Report said that the audit committee should review the nature of such services in order to balance the maintenance of objectivity with value and money. The annual report should explain to shareholders how the objectivity and independence of auditors are then maintained (Combined Code 2003, C 3).

Truth-itself

Openness

There are three areas of meaning for the value of openness: (a) the management–directors relationships; (b) the nature of financial reporting; and (c) corporate strategy and risk management.

The management–directors relationships. Management and directors should understand their respective tasks and enter in an open and continuous dialogue with one each other (Saucier Report 2001: 12). In spite of their competitive position, business corporations have to actualise an attitude of openness as real basis for the confidence required between business and all stakeholders (Cadbury Report 1992, art. 3.2).

The nature of financial reporting. The guiding principle for financial reporting practices is openness (Cadbury Report 1992, art. 4.54). It is particularly true about the disclosure of remuneration packages (*ibid.,* 1992, art. 4.40). Openness implies that substance (of information and communication processes) will prevail over form (CACG Guidelines 1999: 10).

Corporate strategy and risk management. An open approach to the way responsibilities have been discharged will assist boards in winning support for corporate strategies (Cadbury Report 1992, art. 3.5). As said the Turnbull Report (1999, art. 30), management should adopt an attitude of openness with the board on risk and control issues. Such openness could even be applied to institutional shareholder activism (King Report 2002, art. 41).

المنارة للاستشارات
www.manaraa.com

Trustfulness

There are four areas of meaning for the value of trustfulness: (a) the nature of auditing; (b) relationships with stakeholders; (c) relationships with shareholders; and (d) managing remuneration packages.

The nature of auditing. According to the Saucier Report (2001: 29–31), the audit committee should explicitly define its role and responsibilities: (1) its relation with external auditors (who are accountable to the shareholders, to the Board and to the audit committee, but never to the top management, since they represent the interests of shareholders): a full, trustful and timing discussion, in the presence or absence of top managers, depending on circumstances; (2) its relations with internal auditors: ensuring that internal auditors have required resources to fulfil their responsibilities; (3) its monitoring of internal control systems; (4) the publication of financial information; and (5) any other question that the audit committee considers important or that is imposed to the committee by the Board. As said the Blue Ribbon Report (1999: 40–41), only through open, frank and confidential dialogue will the audit committee be able to use the knowledge of outside auditors in assessing internal controls, the knowledge of management and of the internal auditors, as well as the impact of each of them on the quality and reliability of financial statements.

Relationships with stakeholders. According to the OECD Principles (2004: 47), when stakeholders actually participate in the corporate governance process, they should have direct access to relevant and reliable information on a timely and regular basis. According to the Turnbull Report, effective financial controls can ensure that financial information used and disclosed is reliable (Turnbull Report 1999, art. 12, 20), so that confidence in the corporation will be safeguarded (CACG Guidelines 1999: 10).

Relationships with shareholders. Insofar as actual and potential shareholders have access to reliable detailed information, they can assess the way the company is managed and judge the value of their shares (OECD 2004, Part 2, V: 49). According to the CACG Guidelines, corporate governance needs leadership of probity. Investors need to have the assurance that managers will behave honestly (CACG Guidelines 1999: 3; King Report 2002, art. 39). The Dey Report said that the information given to shareholders must be reliable (Dey Report 1994, art. 3.9). The decision as to the timing of release of corporate (especially financial) information is extremely important to build shareholders' confidence in management (*ibid.,* art. 7.12). According to the Cadbury Report, corporations having high standards

www.manaraa.com

of corporate governance are the more likely to get the confidence of investors (Cadbury Report 1992, art. 1.6, 3.5), and of the public in general, especially as to the audit process and systems (*ibid.,* art. 5.6). Indeed, the information must be trustworthy before investors will decide to actually invest (King Report 2002, art. 21.2). External directors should be free to meet in the absence of management; such meetings and discussions will contribute to strengthen their mutual confidence and sense of solidarity (Saucier Report 2001: 14 and 19). Indeed, the board must be confident that the management will implement its strategies, plans and policies (CACG Guidelines 1999: 14).

Remuneration packages. Even the remuneration committee needs to have access to reliable information about remuneration packages that are provided by other business corporations (Greenbury Report 1995, art. 4.16).

Transparency

There are five areas of meaning for the value of transparency: (a) the attitude of directors; (b) the attitude of auditors; (c) enhancing stakeholders' interests; (d) enhancing shareholders' interests; and (e) managing remuneration packages.

The attitude of directors. The CACG Guidelines said the board should exercise leadership, integrity and judgement in directing business, so as to achieve continuing wealth for the corporation and to act in the best interests of the enterprise, in a manner based on transparency and accountability (CACG Guidelines 1999: 8). Indeed, transparency as a duty fulfilled by the board is a basic social expectation in many Western and Eastern societies (*ibid.,* 11). The King Report (2002, art. 18.2) has a very relevant definition of transparency: "Transparency is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business". According to the ADB, transparency implies that annual reports actually disclose true and fair accounting information that is suitable to "applicable standards" (ADB 2003, art. 13). But what do "applicable standards" mean? The term is so unclear that it could reinforce any unethical corporate operation. However, it is said that the board should provide periodically with all relevant information about corporate operations, in a very transparent fashion. On the other hand, the management must provide all relevant information to the board in a transparent way, so that the board could monitor the accountability of management to it (Kumar Mangalam Birla Report 2002, art. 2.8).

المنارة للاستشارات
www.manaraa.com

The attitude of auditors. According to the Malaysian Code (2000, Part 1, D.III), the board sbould set up transparent procedures for maintaining appropriate relationships with the company's auditors. The Combined Code (2003, C.3) asserted that the board should have formal and transparent procedures regarding the way financial reporting and internal control principles will be applied and the way "appropriate relationships" with auditors will be maintained. But what do "appropriate relationships" exactly mean? If it is a way to talk about the need to keep objectivity and independence of judgement, why is it so important to make such an unclear statement? According to the Combined Code, there should be a transparent procedure for the appointment of new directors to the board (Combined Code 2003, A.4; Hampel Report 1998, art. 3.19; Malaysian Code 2000, Part 1, A.IV; OECD 2004, VI.D: 24).

Enhancing stakeholders' interests. According to the Blue Ribbon Report (1999: 8), the financial viability of a given corporation is closely linked to practices of disclosure and transparence about financial performance and governance practices. According to the World Bank Framework, in running companies with transparency, directors should maximise their companies' value and take stakeholders' interests into account. Such behaviour is believed to enhance corporate image (World Bank 1999: 12). Transparency should actually be applied to financial and non-financial corporate information as well (*ibid.,* 16). Audit committees could help ensure the transparency and integrity of financial reports and then maintain investors' confidence (*ibid.,* 19). The Blue Ribbon Report said that a more transparent and reliable financial reporting process will result in a more efficient allocation and lower costs of capital (Blue Ribbon Report 1999: 19). Moreover, audit committees should disclose their role, structure and practices, so that investors be well informed (*ibid.,* 27).

Enhancing shareholders' interests. Transparency enables shareholders to take informed decisions about their investments and to know the real performance of management and directors (Blue Ribbon Report 1999: 33). According to the Cadbury Report (1992, art. 4.48), the more the activities of the company are transparent, the more accurately will their securities be valued. As said the OECD Principles, a strong disclosure system promoting transparency is crucial for the shareholders' ability to exercise their rights on an informed basis. The OECD Principles even asserted that a weak disclosure system (non-transparent practices) can contribute to unethical behaviour and having negative effects on the markets as such, and even on the whole economy (OECD 2004, Part 2, V: 49). As said the CACG Guidelines, transparency and accountability are required for developing

المنارة للاستشارات
www.manaraa.com

good leadership and a basic trust that is necessary to the economic growth of any country (CACG Guidelines 1999: 3; see also King Report 2002, art. 39).

Managing remuneration packages. The Kumar Mangalam Birla Report asserted that a company must have a credible and transparent process to determine remuneration packages for directors, so that shareholders clearly know the benefits given to all directors (Kumar Mangalam Birla Report 2002, art. 10.1–10.2). It added that the board should decide the remuneration packages for non-executive directors (*ibid.,* art. 10.7). Companies should set up a formal and transparent procedure for developing corporate policy about executive remuneration and for fixing the remuneration packages of their directors (Malaysian Code 2000, Part 1, B-II). The company's annual report should reveal details of such remuneration packages (*ibid.,* Part 1, B-III). According to the Combined Code, there should be a formal and transparent procedure for developing a policy about remuneration packages for executives and for fixing the remuneration packages of non-executive directors (Combined Code 2003, B.2; Hampel Report 1998, B.II). The Hampel Report (1998, art. 4.17) said that shareholders have an equal interest in the disclosure of directors' remuneration packages, regardless of nationality or residence.

Harmony

Collaboration

There are two areas of meaning for the attitude of collaboration: (a) the attitude of directors; and (b) enhancing stakeholders' interests.

The attitude of directors. Non-executive directors should be able to work with executive directors in a cohesive team (function of collaboration) (Hampel Report 1998, art. 3.8, 3.11). Directors should be able to work cooperatively with their executive colleagues (*ibid.,* art. 2.5). The board assesses the CEO's performance against objectives that the board has set in cooperation with the CEO (Dey Report 1994, art. 4.6; Malaysian Code 2000, Part 4, AA 4.17). As to some key positions within the company, there should be real collaboration between the board and the present CEO in order to define the requirements for such positions and the persons who could get them in urgent situations and in the long run (Saucier Report 2001: 20).

www.manaraa.com

Enhancing stakeholders' interests. According to the Blue Ribbon Report (1999: 36), outside auditors should be able to fulfil their role of monitoring the internal reporting process if financial managers and the audit committee adopt an attitude of cooperation. Our world reveals the interdependence of nations, but profit maximisation and attitude of greed negate such deep links between countries. Indeed, the value of business corporations itself is created through the cooperation of various stakeholders (employees, customers, suppliers, distributors, communities, and Governments). In an interdependent world, such cooperation between all stakeholders actually gives a value to any business corporation. That is why the final aim of any business can no longer be profit maximisation, and must include the *maximisation of stakeholders' interests* – taking for granted that such interests can be conflictual so that we must prioritise them (Ohmae 1990). According the the World Bank Framework, there should be an active cooperation between companies and stakeholders in creating wealth, jobs, and financially viable enterprises (World Bank 1999: 11–12; see also OECD Principles 2004, IV: 21).

Care and diligence

There are three areas of meaning for the attitude of care and diligence: (a) the attitude of directors; (b) the attitude of auditors; and (c) managing remuneration packages.

The attitude of directors. Directors must act in "good faith", that is, in the interests of the company and for a proper purpose (Hampel Report 1998, art. 3.2). But what does a "proper purpose" mean? Is it a purpose that is directly linked to the mission statement of the company? It surely reflects something else than the "best interests of the company". According to the OECD Principles (2004, VI.A: 24), directors should act in good faith, with due diligence and care, and in the best interests of both the company and the shareholders. But is "good faith" equivalent to "acting in the best interests of the company"? Or is "good faith" a wider concept than a notion focusing on the financial aspects of the organisation? Effective governance systems facilitate the discharge of duties to exercise due care and diligence, and to act honestly and in good faith (Dey Report 1994, art. 4.14, 5.60). Here, "good faith" seems to refer to honest behaviours. It is self-evident that corporations cannot indemnify directors against costs incurred because they acted without any sense of honesty and without good faith (Dey Report 1994, art. 5.66). There is a basic expectation that non-executive directors (particularly in the audit committee) will exercise their role with care, skill and diligence (Combined Code 2003, Schedule B.1; Blue Ribbon Report 1999: 43). That is why non-executive directors

المنارة للاستشارات
www.manaraa.com

should be selected with the same impartiality and care as it is the case for senior executives (Cadbury Report 1992, art. 4.15).

Directors should exercise care and diligence (CACG Guidelines 1999: 6, 10). The ADB implies that directors should limit their board memberships consistent with their duty to discharge their responsibilities with due diligence (ADB 2003, art. 44). They must always remind their duty of care (*ibid.,* art. 56). Their duties are owed to the (present and future) shareholders collectively, and not to the shareholders at a given point in time (Hampel Report 1998, art. 3.2). Board members should be let free to warn of potential risks and more generally to express views to the board which are different from those of the CEO (without any fear of retiliation) (Hampel Report 1998, art. 3.6). The Dey Report (1994, art. 5.62) said that the imposition of absolute liability on directors (denying to them any "due diligence defense") is unfair and counter-productive to good corporate governance systems. The possibility to use a due diligence defense in a claim against directors will be an incentive to implement an effective risk management system within the company. However, said the Saucier Report (2001), directors have a limited right to a due diligence defense, so that such regulation has side- (negative) effects: discouraging competent persons to become directors, for instance. The corporation is liable for the timing of releases concerning material changes in its operations and financial affairs. We should carefully consider any potential liability of the board in the context of the objective of timely and accurate disclosure of information (Dey Report 1994, art. 7.18). Business corporations should precisely identify theirs risks within their annual report. However, because most of those risks are constituted mainly by confidential information, disclosing them would be equivalent to give a competitive advantage to competitors. That is why such disclosure must always be actualised very cautiously. Business corporations should disclose their environmental and social performance in a very precise way that excludes the attitude of "window-dressing" and "public relations game". According to the Turnbull Report (1999, art. 2.5), the board has to elaborate its own view on the effectiveness of internal control systems, after having realised a careful inquiry based on corporate information. As said the Combined Code (2003, art. A.1), the board must provide prudent and effective controls in order to assess and manage risks.

The attitude of directors. The Blue Ribbon Report (1999: 32) asserted that auditors must report to the audit committee "reportable conditions", which are conditions that could negatively affect the company's ability to produce reliable financial statements. The Asian Development Bank Report (2003) said that the audit committee has the following functions: (1) communicating with and providing oversight to external auditors; (2) ensuring the adequacy and effectiveness of in-

المنارة للاستشارات
www.manaraa.com

ternal controls; (3) ensuring that there is a proper disclosure of the accounts that gives a true and fair view; and (4) communicating with internal auditors. According to the OECD Principles (2004, V.D: 22), outside auditors must exercise due care in the conduct of their audit.

Managing remuneration packages. Even the remuneration committee should carefully assess the information about remuneration packages given in other business corporations, the corporate strategies for executives' remuneration packages and any other relevant information (Greenbury Report 1995, art. 4.16, 6.8).

4. CONCLUSION

Out of the analysis of the main national and international reports on corporate governance, we could make two basic remarks. (1) Values and attitudes that are connected with corporate governance rules are not defined: what we have found is rather a set of "areas of meaning" in which they are involved, but their meaning remains a deep mystery. (2) Because of the fact that those values and attitudes themselves are not clearly defined, stock exchanges that have usually adopted those national reports on corporate governance will find very hard to make listed companies conforming themselves to such values and attitudes. The result will probably be the following one: insofar as corporate governance rules do not refer to a specific meaning for given values and attitudes, there could be more "opportunities" for some listed companies not to conform themselves to the spirit of such rules, although it was not what stock exchanges expected.

Although values that are closely linked to corporate governance rules are suitable to the objectives of any corporate governance system, it could be easier for directors and management to have clear definitions of such values and attitudes, so that they could assess the scope of their actualisation in the organisational life. If we liked to enhance ethical behaviour in the board of directors, we should at least be attentive to the meaning we want to give to such values and attitudes that will determine the way corporate governance rules and systems will be applied.

REFERENCES

Asian Development Bank (2003): *Corporate Governance Principles for Business Enterprises- Private Sector Development* ("ADB Principles"). Manila: ADB.

Cadbury, A. (2002): *Corporate Governance and Chairmanship. A Personal View*. Oxford: Oxford University Press.

Cassirer, E. (1970): *An Essay on Man*. New York: Bantam Books.

للاستشارات المنارة

www.manaraa.com

Commonwealth Association for Corporate Governance (1999): *Principles for Corporate Governance in the Commonwealth* ("CACG Principles"). Havelock (New-Zealand): CACG.

OECD (2004): *Principles of Corporate Governance* ("The OECD Principles"). Paris: OECD.

Ohmae, K. (1990): *The Borderless World: Power and Strategy in the Interlinked Economy*. New York: Harper Business.

Study Group on Directors' Remuneration (1995): *Directors' Remuneration* ("The Greenbury Report"). London: GEE.

The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (1999): *Report and Recommendations* ("The Blue Ribbon Report"). New York: NYSE.

The Combined Code on Corporate Governance (2003).

The Committee on Corporate Governance (1998): *Final Report* ("The Hampel Report"). London: GEE.

The Committee on the Financial Aspects of Corporate Governance (1992): *The Financial Report of Corporate Governance* ("The Cadbury Report"). London: Burgess Science Press.

The Finance Committee on Corporate Governance (2000): *The Malaysian Code on Corporate Governance*. Kuala Lumpur: Securities Commission.

The Joint Committee on Corporate Governance (2001): *Beyond Compliance. Building a Governance Culture* ("Saucier Report"). Toronto: TSE.

The King Committee on Corporate Governance (2002): *Report* ("The King Report"). Parktown: Institute of Directors in Southern Africa.

The Kumar Mangalam Birla Committee on Corporate Governance (2002): *Report* ("The Kumar Mangalam Birla Report"). New Delhi: Securities and Exchange Board of India.

The National Commission of Fraudulent Financial Reporting (1987): *Report* ("The Treadway Commission").

The Toronto Stock Exchange Committee on Corporate Governance in Canada (1994): *Where Were the Directors? Guidelines for Improved Corporate Governance in Canada* ("The Dey Report"). Toronto: TSE.

The Toronto Stock Exchange and the Institute of Corporate Directors (1999): *Five Years to the Dey* ("The 1999 Report on corporate governance"). Toronto: TSE–ICD.

The Toronto Stock Exchange (2002): *Corporate Governance. A guide to good disclosure* ("TSX Guidelines"). Toronto: TSX.

World Bank (1999): *Corporate Governance: A Framework for Implementation* ("World Bank Framework"). World Bank.

المنارة للاستشارات

www.manaraa.com

المنارة للاستشارات
www.manaraa.com

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

المنارة للاستشارات

www.manaraa.com