Corporate Governance Glossary

List of Key Corporate Governance Terms

BOARD COMMITTEES (e.g., Audit, Risk, Governance and Nomination)

Companies feature a variety of approaches to their boards of directors. Many closely held companies see management effectively functioning at the board level and some boards are formulated solely to meet legal requirements and play no serious role in the life of the company.

In contrast, other boards strive to fulfill the strategic and oversight roles dictated by good corporate governance practices.

These boards…	meet regularly
	hold focused discussions
	make decisions within the scope of their responsibilities with some independence from executive management
	usually feature at least two or three committees usually consisting of at least three board members.

Board committees allow a subset of directors with appropriate skills to spend additional time focusing attention on their assigned subject matter. These committees, however, do not relieve the full board of its responsibility for these matters, they merely allow for specialization and help streamline the operations (and the meetings) of the full board. The committee chairs typically present a report to the full board with the committees' recommendations on how the board can best fulfill its responsibilities.

Good practice dictates a majority of independent directors on the most important committees to ensure that executive management does not have undue influence over their handling of matters which require decision making at the board level. Also, best practice requires that the board's chairperson does not chair any of the committees.

The most common committees are as follows:

Audit Committee:	The audit committee of the board of directors is primarily concerned with ensuring that the company's financial statements are timely, relevant and reliable; that financial controls are adequate; that the company complies with relevant regulation and that the internal and external auditors are fulfilling their proper roles. They are commonly responsible for recommending the selection and compensation of the external auditors
Corporate Governance and Nominations Committee:	This committee is responsible for assessing the performance and staffing needs of the board of directors and supplying the full board with recommendations on candidates. This committee also identifies the definition of and need for independent directors on the board.
Remuneration Committee:	The remuneration committee is charged with recommending the overall salary structure including any incentive programs for the executive management of the company and the board of directors.
Other Committees:	A company can add additional standing committees or use ad hoc committees to address additional matters such as **risk management**, ethics, crisis management, environmental policies, labor issues, technology and others.

CONTROL / CONTROLLING SHAREHOLDERS / CHANGES OF CONTROL

Control refers to the ability of an individual, a group or a legal entity, acting alone or in concert, to predetermine a company's decisions, its oversight and its management bodies.

Control can be exercised through a variety of ways including:	Voting at the shareholders' meeting
	Electing/appointing the majority of members of the board of directors
	Electing/appointing key management personnel

The term "controlling shareholder" refers to a shareholder or a group of shareholders acting in concert who have the ability to control the company. The size of the ownership stake that will confer such controlling ability will vary depending on the ownership structure of a company (dispersed vs. concentrated) and the voting rights attached to each class of shares. Changes of control refer to any transfer of control.

Examples of such transactions include but are not limited to:	Sale by an existing controlling shareholder of its controlling stake in a company
	Acquisitions of a significantly large equity stake in a company, on the market or through block purchases from several non-controlling shareholders
	Hostile takeovers
	Nationalization by the state
	Mergers and consolidations
	Conclusion of a shareholders' agreement between several relatively large but non-controlling shareholders, as a result of which the group acquires control over the company

CODE OF ETHICS

A code of ethics (also called a code of conduct) is a guide of behavior and values that imposes duties and responsibilities on a firm's directors, managers and employees towards its stakeholders, including colleagues, customers, business partners, government and society.

This code usually serves to:	emphasize the firms' commitment to ethics and compliance with the law
	set forth basic standards or principles of ethical and legal behavior
	provide reporting mechanisms for known or suspected ethical or legal violations
	indicate penalties for code violations (in spirit or in letter)
	help prevent and detect wrongdoing

The particular issues covered by a code will vary with the business culture, values and industry in which the firm operates.

The **issues typically covered by the guiding principles** in a code of ethics **include:**	Avoiding and disclosing conflicts of interest
	Use of corporate property, information or position for personal gain
	Fair dealing including theft of competitors' proprietary information
	Guidance on acceptance of business entertainment and gifts
	Prohibition the acceptance of bribes and kick-backs
	Prohibition of insider trading

	Protection and proper use of corporate assets include the firm's trade secrets
	Compliance with the law and regulations
	Full, fair, truthful and timely disclosure of information to the market, auditors and regulators
	Reporting of significant accounting deficiencies to the board

In addition to a code of conduct, many firms signal their commitment to the highest ethical and legal standards by becoming signatories to national and international initiatives to **combat corruption**, environmental degradation, and child labour and support other protocols of good corporate citizenship. Examples of such initiatives include the Principles for Countering Bribery and the Equator Principles.

A firm adopts ethics and/or **anti-corruption codes because** they**:**	enhance a company's reputation/image
	form a part of its risk and crisis management
	help build a corporate culture around enunciated values
	communicate its commitment to ethical behavior to its stakeholders

CONFLICT OF INTEREST

The term "conflict of interest" refers to any situation in which an individual or corporation (either private or government) is in a position to exploit a professional or official capacity in some way for their (or that of a related party) personal or corporate benefit.

In short, it is a conflict between a person's private interests and public or professional obligations.

Depending upon the law or rules related to a particular organization, the existence of a conflict of interest may not, in and of itself, be evidence of wrongdoing. In fact, for many professionals, it is virtually impossible to avoid having conflicts of interest from time to time. A conflict of interest can, however, become a legal and ethical problem if an individual tries (and/or succeeds in) to influence the outcome of a corporate decision for personal benefit. A director or executive of a corporation can be subject to legal liability if a conflict of interest results in a breach their fiduciary duty of loyalty.

Corporate codes of ethics often provide procedures for managing conflicts of interest. Commonly, the individual is required, in good faith, to disclose any material transaction or relationship that can reasonably be expected to give rise to such a conflict to the board (or to the board's ethics, governance or audit committee). Directors are expected to recuse themselves from voting on any issue before the board in which they have a conflict of interest.

"conflict of interest" ≠ conflicting interests	Conflict of interest is not the appropriate term to use if two or more persons have differing opinions or conflicting interests. A conflict of interest arises when one person has a "conflict of roles' and is serving two or more competing interests.

An appearance of or a perceived conflict of interest can cause a loss of public confidence and directors and managers should avoid such situations.

CORPORATE GOVERNANCE

There several definitions of corporate governance, including the following:

- Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. *(OECD Corporate Governance Principles, 2004)*
- Corporate governance relates to the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. *(Shleifer & Vishny (1997) The Journal of Finance, Vol. 52, No.2, 737-783. June 1997)*
- Corporate governance is the system by which companies are directed and controled. *(Cadberry Report, 1992)*

The IFC's definition is: **"Corporate governance refers to the structures and processes for the direction and control of companies."**

Thus, corporate governance **covers**:	Financial Stakeholders (Shareholders)
	Boards of Directors (Checks and Balances)
	Control Environment (Accounting, Controls, Internal and External Audit)
	Transparency and Disclosure

At the same time, it does **not include**, although it may reinforce, the following:	Corporate Social Responsibility / Corporate Citizenship
	Socially Responsible Investing
	Other Elements of Sustainability
	Political Governance
	Business Ethics
	Anti-Corruption / Anti-Money Laundering

CORPORATE GOVERNANCE CODE

The corporate governance code of **a company:**	a document developed and approved by the board of directors which stipulates the company's governance policies as regards the shareholders rights, functioning of the board of directors and management, control environment, information disclosure and transparency.
The corporate governance **country** code[1]:	developed and approved by national regulators or civil society, giving non-binding guidance to all companies on similar topics as a typical company code as well as in other areas such as anti-takeover defenses and executive compensation.

CUMULATIVE VOTING

Cumulative voting is a system for electing members of the board of directors that allows each shareholder to cast all his votes to a single nominee director **and** where the total number of votes he has is equal to the number of his voting shares multiplied by the number of directors put up for election.

[1] A Collection of corporate governance country codes can be found at:
https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/topics/codes+and+scorecards
https://ecgi.global/content/codes

Example:

If the election is for 5 directors and your equity stake is 1000 shares (each with a vote per share) under the regular voting system you could vote a maximum of 1000 shares for any single candidate. This would give you 5000 votes in total – 1000 for each of five potential directors. With cumulative voting, you could decide to vote all 5000 votes for a single candidate, 2500 each to of two candidates or allocate your total 5000 votes in anyway as you wish.

Cumulative voting makes electing a director to the board much easier for holders (i.e., voters) of small equity stakes. Under the regular or statutory voting system the impact of their votes is less than under the cumulative system.

DIRECTORS

Persons serving as members of the company's board are directors. They are usually elected by voting the company's shares under rules established in the firm's organic documents. Directors have formal fiduciary duties established under relevant company and other law. If the firm is publicly listed, directors may also have additional accountability under applicable securities legislation.

Directors can be classified as follows:

Executive Directors:	members of the board who are employed by the company in an executive position. Executive directors are "**insiders**" of the firm.
Non-executive Directors:	members of the board who do not occupy an executive position in the company. Not all non-executive directors meet the definition of *independent directors*. For example, persons who were recently in employ of the firm are not considered independent.
Independent Directors:	see definition "independent directors"

DIRECTOR AND BOARD EVALUATION

The board of directors should periodically assess its performance as a collegial body as well as the performance of its individual directors. Many boards undertake this evaluation exercise annually.

If done well, appraisals help boards:	become more effective by clarifying the individual and collective responsibilities
	improve the working relationship with managers
	keep an appropriate balance of power between the board and the CEO
	take a developmental perspective

Several elements contribute to an effective evaluation process.

They include:	**Arriving at a consensus** on the need for and the benefits of an evaluation. All the directors should buy into the process to avoid it becoming divisive.
	Selecting a leader to champion the process. In general, the responsibility for the evaluation process rests with the governance committee.
	Benchmarking the evaluation process to that of other firms and distributing readings to the directors on evaluation current best practices.
	Ensuring all the directors have input on what and how to evaluate the board collectively and the directors individually. Many firms also invite input from the CEO and the senior managers. This process is set up at the beginning of the period to be covered in the evaluation with agreeing and focusing on the five or six things at which the board needs to excel. These factors will form the core on which the end-of-period evaluation will build. Many boards include matters such as boardroom dynamics, quality of the chairmanship, attendance, fee structure, relations with CEO and senior management, board resources and information and committees. Some boards evaluate different aspects an alternate years.
	Starting with the evaluation of the board as a whole and then extending the evaluation to individual directors. Typically the board evaluation starts with informal discussions followed by a written feedback from directors and senior management (usually by a confidential survey document). The individual evaluation includes a self-evaluation as well as

	confidential peer feedback. Many boards also review the minutes for the period under evaluation and a few get input from outsiders such as market analysts, regulators and institutional investors.
	Considering starting with an outside facilitator (with some experience in such processes) for the first year or two before embarking on an independent self-evaluation process.
	Ensuring that the evaluation process end in some specified action. Many boards disclose the process without the making the results public; a few firms disclose the results. The evaluation process should lead to a specific action plans for the next year. This may include changes to the mix of directors. For the individual directors, some firms use the process to prompt resignations and retirements by poor performers.

INDEPENDENT DIRECTOR (definition)

The purpose of identifying and appointing independent directors is to ensure that the board includes directors who can effectively exercise their best judgment for the exclusive benefit of the Company, judgment that is not clouded by real or perceived conflicts of interest. It is expected that in each case where a director is identified as "independent", the board of directors will affirmatively determine that such director meets the requirements established by the board and is otherwise free of material relations with the Company's management, controllers, or others that might reasonably be expected to interfere with the independent exercise of his/her best judgment for the exclusive interest of the Company. An indicative definition from IFC follows[2]. In each case, the Company and the investing DFI should consider changes tailored to those sorts of relationships that would impair a director's independence, taking into account the circumstances of the particular Company.

<table>
<tr><td rowspan="9">"Independent Director" means a director who is a person who:</td><td>has not been employed by the Company or its Related Parties in the past five years</td></tr>
<tr><td>is not, and is not affiliated with a company that is an advisor or consultant to the Company or its Related Parties</td></tr>
<tr><td>is not affiliated with a significant customer or supplier of the Company or its Related Parties</td></tr>
<tr><td>has no personal service contracts with the Company, its Related Parties, or its senior management</td></tr>
<tr><td>is not affiliated with a non-profit organization that receives significant funding from the Company or its Related Parties</td></tr>
<tr><td>is not employed as an executive of another company where any of the Company's executives serve on that company's board of directors</td></tr>
<tr><td>is not a member of the immediate family of an individual who is, or has been during the past five years, employed by the Company or its Related Parties as an executive officer</td></tr>
<tr><td>is not, nor in the past five years has been, affiliated with or employed by a present or former auditor of the Company or of a Related Party</td></tr>
<tr><td>is not a controlling person of the Company (or member of a group of individuals and/or entities that collectively exercise effective control over the Company) or such person's brother, sister, parent, grandparent, child, cousin, aunt, uncle, nephew or niece or a spouse, widow, in-law, heir, legatee and successor of any of the foregoing (or any trust or similar arrangement of which any such persons or a combination thereof are the sole beneficiaries) or the executor, administrator or personal representative of any Person described in this sub-paragraph who is deceased or legally incompetent</td></tr>
</table>

and for the purposes of this definition:

<table>
<tr><td rowspan="2">a person shall be deemed to be "affiliated" with a party if such person:</td><td>has a direct or indirect ownership interest in</td></tr>
<tr><td>is employed by such party</td></tr>
<tr><td>Related Party" shall mean:</td><td>with respect to the Company, any person or entity that controls, is controlled by or is under common control with the Company.</td></tr>
</table>

[2] Please also see the EC Commission Recommendation dated 15 February 2005 on the role of non- executive or supervisory directors of listed companies and on the committees of the supervisory board - http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:052:0051:0063:EN:PDF

INTERNAL AUDITING

Internal auditing:	is an organizational control that functions by measuring the effectiveness of other controls.
	is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.
	helps an organization accomplish its objectives by bringing systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. *(The Institute of Internal Auditors)*

INTERNAL CONTROLS

Internal control is 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**	**Reliability of financial reporting**

Committee of Sponsoring Organizations of the Treadway Commission (COSO I)

Examples of internal control activities:	Monthly statements sent to customers
	Use of cash register tapes
	Use of numbered checks v
	Sales orders and invoices are pre-numbered and controlled
	Bank reconciliations prepared by a person independent of cash receipts recordkeeping
	Debt and equity transactions are properly approved by the board
	Cancelled share certificates are defaced to prevent reissuance
	Periodic internal audits

The Basle Committee on Banking Supervision has issued special guidelines for internal controls in financial institutions. For details on internal controls system in listed financial institutions, see *Framework for Internal Control Systems in Banking Organisations*, Basle, September 1998.

NON-FINANCIAL DISCLOSURE

The purpose of the disclosing non-financial in addition to financial information is to provide context necessary to the understanding of the firm's financial condition, changes in financial condition, and results of operations.

Management has a responsibility to communicate with shareholders in a clear and straightforward manner.

These non-financial disclosures should satisfy three major objectives: **To provide…**	narrative explanations of the company's financial statements that enables investors to see the companies through the eyes of the management;
	context within which financial statements can be analyzed;
	provide information about the quality, and the potential variability, of a company's earnings and cash position so investors can judge if past performance is indicative of future performance.

The appropriate content of the non-financial disclosure will vary with the particular firm and from year to year. However, the information should be salient, concise and clear.

Generally, **non-financial disclosure**…	covers discussions of critical accounting estimates
	material changes in revenue
	discontinued operations
	extraordinary items
	liquidity and capital resources
Other companies include **more diverse issues** including…	management of intellectual capital
	executive remuneration
	occupational health and safety practices
	research and development
	corporate governance
	compliance with anti-corruption protocols
	the firm's code of conduct
	reputation risk
	and the environmental and social impact of corporate activity

The regulations for Management Discussion and Analysis (MD&A) established by the US Securities and Exchange Commission provide extensive guidance on the appropriate content of non-financial disclosure. Comparable guidance can be obtained from the U.K.'s practices for the Operational and Financial Review (OFR).

annual report:	As a part of their investor communications programs, many firms combine the publication of their audited, statutory financial statements with their non-financial disclosures (both mandatory and voluntary) to produce an annual report.

RECOGNIZED INDEPENDENT EXTERNAL AUDITING FIRM

Each element in this clause directs attention to a **specific requirement**:	**recognized** focuses on technical proficiency and reputation;
	independent refers to ability to exercise objective, neutral and disinterested judgment;
	external auditing firm alludes to the conduct of the audit by an outside entity which is separate (i.e., not a related party) from the company, its management, its board and its shareholders.

Generally, a **recognized auditing firm** should **have** the following **characteristics:**	be legally registered and authorized under applicable company law, tax law, securities regulations, banking laws and other legal frameworks to audit and attest financial statements
	work is conducted under the supervision of persons licensed by internationally recognized professional accounting and auditing bodies
	the work is conducted consistent with international accounting and auditing standards such as the IFRS and ISA
	the firm's work is subject to peer review or regulatory inspection

Independence refers to a mental attitude which ensures freedom from control by or influence of others. Auditors should be independent in fact and in appearance. In assessing auditor independence reliance is usually placed on indicators or existence of actual or perceived factors that could impair independence rather than guessing mental states.

The US's Sarbanes-Oxley Act provides excellent guidance on activities and conditions in which auditor independence should be considered impaired.

The Act provides for:	Limitations on the non-audit services that an external auditor can provide (for e.g., bookkeeping services, IT design and implementation, valuation, internal audit services, HR services, investment banking services are prohibited)
	Audit committee's pre-approval of non-audit services bought from the external auditors
	External auditors reporting to the audit committees
	External audit partner rotation at a minimum of every five years

Please refer to the Act for other provisions. Note that other laws and regulations may apply in different countries.

In many countries, the financial statements of state-owned enterprises are audited by state auditors that report to the parliamentary bodies or congress. These are not considered external and these firms must use professional firms (i.e., chartered accountants, certified public accountants) instead of or in addition to these internal examinations.

RELATED PARTIES

Parties are considered to be related if one party has the ability to control the other party or to exercise significant influence or joint control over the other party in making financial and operating decisions.

A party is related to an entity if:	(a) Directly, or indirectly through one or more intermediaries, the party: • Controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries); • Has an interest in the entity that gives it significant influence over the entity; or • Has joint control over the entity
	(b) The party is an associated entity (See relevant accounting standards on associated companies)
	(c) The party is a joint venture in which the entity is the venturer
	(d) The part is a member of the key management personnel of the entity or its parent
	(e) The party is a close member of the family of any individual referred to in (a) or (d)
	(f) The party is an entity that is controlled, jointly or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e)
	(g) The party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

Close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealing with the entity.

They may include:	the individual's domestic partner and children
	children of the individual's domestic partner
	dependants of the individual or the individual's domestic partner

The following are deemed not to be related:	two enterprises simply because they have a director or key manager in common
	two venturers who share joint control over a joint venture
	providers of finance, trade unions, public utilities, government departments in the course of their normal dealings with an enterprise
	a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence

A related party transaction is a transfer of resources, services or obligation between related parties, regardless of whether a price is charged.

Please see IFRS 24 and International Public Sector Accounting Standard 20 and both titled "Related Party Disclosures" for technical guidance on related party transactions and their disclosure. For listed financial institutions, see also *Guidelines on Disclosure of Related Party Transactions (with Focus on Financial Institutions) - Suggested Outline for RPT Disclosure on the CCGCP's website.*

REGULATORY COMPLIANCE

Regulatory compliance refers to systems or departments at corporations and public agencies to ensure that personnel are aware of and take steps to comply with relevant laws and regulations.