

**THE
CODE
OF
CORPORATE GOVERNANCE
FOR
BANGLADESH**

PRINCIPLES & GUIDELINES FOR BEST PRACTICES IN THE PRIVATE SECTOR, FINANCIAL INSTITUTIONS,
STATE-OWNED ENTERPRISES & NON-GOVERNMENTAL ORGANISATIONS

THIS DOCUMENT WAS PREPARED BY THE
TASKFORCE ON CORPORATE GOVERNANCE
CONVENED AND SUPPORTED BY
BANGLADESH ENTERPRISE INSTITUTE

MARCH 2004

TABLE OF CONTENTS

Acknowledgements	3
Preamble	4
Members of the Taskforce on Corporate Governance	8
Code of Corporate Governance	10
Board Issues	11
Role of Shareholders	21
Financial Reporting, Auditing and Non-Financial Disclosures	25
Sector-Specific Provisions: Financial Institutions and SOEs	30
Financial Institutions	31
State-Owned Enterprises.....	36
Exhortations to Other Entities.....	40
Basic Checklist for Implementation of the Code of Corporate Governance	42
NGO Governance Principles	44
Resources	77
Appendices.....	78
Cumulative Voting: A Brief Description.....	79
Sample Shareholders' Handbook.....	81
Sample Contents of an Annual Report.....	85

ACKNOWLEDGEMENTS

In August 2003, Bangladesh Enterprise Institute (BEI) invited a number of prominent individuals from the private sector, the government, NGOs and other relevant bodies to begin the process of formulating a Code of Corporate Governance for Bangladesh. Convening this Taskforce on Corporate Governance was an outcome of BEI's ongoing research and advocacy work on strengthening corporate governance in Bangladesh. Members of the Taskforce provided essential guidance and direction to the development of the Code. In addition, distinguished guest experts invited to certain Taskforce meetings provided invaluable input and expertise on specific aspects and sections of the Code. Also, greatly appreciated for lending their valuable time and encouragement to the project are Dr. Fakhruddin Ahmed, Governor of the Bangladesh Bank, Mr. Muhammed Ali Rume, Deputy Governor of Bangladesh Bank, and Dr. Mirza Azizul Islam, Chairman of the Securities and Exchange Commission, all of whom offered significant insight and comments to the Code.

Many thanks are also due to the international donors that assisted in organising the Taskforce on Corporate Governance and supported its work: namely, the Department for International Development (DFID), the Commonwealth Secretariat and the Global Corporate Governance Forum (GCGF).

Finally, the Taskforce was assisted and supported in every way by the Bangladesh Enterprise Institute Working Group in the drafting of the Code, which could not have been completed within such a short time-frame, if not for the hard work of this dedicated group. The Working Group was chaired by Farooq Sobhan, President of BEI. The primary drafter of the Code was Wendy Werner, while Josephine Oguta led the effort to formulate the section of the Code on NGO Governance. Other members of the Working Group were Sheela Rahman, Yawer Sayeed, Nihad Kabir, Rashida Ahmad and Adeeb Khan. The group also received advice from Adnan Wahed and Abdullah Al Mamun on Financial Institutions. Anya Rahman and Rashida Ahmad spent many hours proofreading to help finalize the document. Finally, Michael Gillibrand served as international consultant to the project and provided unfailing feedback, resources, and assistance on international best practices of corporate governance.

PREAMBLE

Before turning to the specific provisions of the present Code of Corporate Governance, three fundamental questions should be examined regarding Codes of Corporate Governance in general and the Bangladesh Code in particular. First, what is the function of a Code of Corporate Governance? Second, how can such a Code be implemented? Third, what is to be gained from the implementation of a Code of Corporate Governance?

The obvious function of a Code of Corporate Governance for Bangladesh is to improve the general quality of corporate governance practices. The Code does this by defining best practices of corporate governance and specific steps that organisations can take to improve corporate governance. The Code, thereby, begins to raise the quality and level of corporate governance to be expected from organisations; in some areas the Code specifies more stringent practices than is required by Bangladeshi law, but it should be emphasised that these additional requirements are in keeping with international best practices. Even if small organisations do not feel they can meet all the requirements immediately, the Code provides a standard that can be used to measure progress towards the goal of best practices.

The Code of Corporate Governance, therefore, prescribes the principles, procedures and process through which better corporate governance practices may gradually be introduced. As such, the Code is organised into Principles and Guidelines. Organisations can start on the path to better corporate governance first by acknowledging the Principles of Corporate Governance and then by incorporating them through their own initial implementation strategies, which they must nevertheless justify and explain. The next step would be to begin complying fully with the Guidelines for implementation, as set out in the Code, which represent an appropriate synthesis of international and indigenous best practices that are wholly applicable to the Bangladeshi context.

Many of the best organisations in Bangladesh already have practices and procedures in keeping with the provisions of the Code. However, the Code is also a mechanism to disseminate these best practices to all organisations nationwide. Moreover, the best corporate governance practices, as enshrined in the Code, can improve overall accountability and performance throughout the private sector as well as the NGO and SOE sectors. Finally, the spirit of the Code seeks to enable organisations to grow and attract greater investment, rather than being a hindrance to growth.

The second question to consider is how the Code of Corporate Governance can be implemented. Full implementation of the Code – meaning full compliance throughout the private, NGO and SOE sectors – will undoubtedly take a number of years and will require the cooperation of a vast number of relevant stakeholders. However, a number of the Code's Principles, Guidelines and provisions can be incorporated into the decision-making process of key institutions and in framing new policies immediately.

A vital example: since banks are the primary source of capital in Bangladesh, a most effective way to begin applying the Code is for banks to ask client firms to explain their

compliance with the Code of Corporate Governance. Companies that can demonstrate sound corporate governance practices, as enshrined in the Code, should receive preferential borrowing facilities, among other possible benefits. A favourable interest rate is justified for companies with strong corporate governance since these organisations are liable to carry lower levels of business risk. Furthermore, credit rating agencies should include corporate governance in their ratings and could, in future, produce stand-alone corporate governance ratings.

Individual organisations can comply with the Code by writing the provisions into their Articles of Association and incorporating the Code into company procedures and reporting practices. Management and the Board of Directors should use the Code of Corporate Governance as a guideline to develop procedures for evaluation and accountability within the organisation. All organisations should develop a Code of Conduct for their employees. All employees should read, understand, and sign the Code of Conduct; thereafter, violations of this Code of Conduct should be penalised.

The most effective regulatory step to implement the Code of Corporate Governance could be its adoption by the Securities and Exchange Commission. Such a step could begin with a ‘comply or explain’ phase, which requires an organisation to comply with the Code’s provisions, but if there are aspects in which the organisation does not comply the reason for such non-compliance must be explained. As has been the case in many other countries, the Code could also be incorporated into the listing requirements of the Dhaka and the Chittagong Stock Exchanges. A complimentary requirement would be compulsory director training for the Board of Directors of all listed companies. BEI’s Working Group for the Taskforce on Corporate Governance has simultaneously been working on an Agenda for Reform of Corporate Governance, targeting policies, institutional and legal reforms that can enable the growth of a more transparent and accountable corporate sector. However, the first step can and should be the initiative of corporations and organisations themselves, through the implementation of this Code.

The final question is one of reward and benefit from implementation of the Code. Using the Code to strengthen corporate governance practices can not only benefit individual organisations, but also the specific sectors addressed by this Code, as well as the nation as a whole. Companies that demonstrate international standard corporate governance practices are better able to attract greater capital from banks and equity investors. Such companies will also attract the best-qualified professionals to work in their organisations. These implicit rewards will lead in turn to more explicit benefits: a successful organisation with higher profits.

As for the country context, there are numerous potential benefits and rewards for Bangladesh by improving corporate governance practices. The primary and most important benefit from implementing the Code of Corporate Governance, however, probably lies in attaining and sustaining development goals; strengthening corporate governance could, at the national level, lead to a process of revitalisation of the Bangladeshi economy. If the Code can be fully implemented, in public corporations, joint stock (private) companies, state-owned enterprises (SOEs), and non-governmental

organisations (NGOs), the reputation of Bangladesh as a destination for investment and aid will be greatly enhanced. Producing a national Code sends a message to investors and observers that Bangladesh has recognised the importance of corporate governance and is taking definite steps to improve its corporate governance performance. As such, implementation of a programme of corporate governance can make significant contributions to economic growth.

First, an economy with sound systems of corporate governance will be rewarded with more investment and higher quality investors. Quite simply, improving corporate governance will improve the overall reputation of Bangladesh as a place to do business. This in turn will improve the investment climate and the prospects for economic growth. Good corporate governance practices, as enshrined in this Code, will lead to well-governed, more profitable companies that are candidates for both foreign and domestic investment. It is well established that international investors, especially portfolio investors, consider corporate governance a necessary prerequisite for investment.

Second, corporate governance systems can better enable the capital market, private investors, international donors and financial institutions to identify and fund successful enterprises. Through full and transparent disclosures such enterprises can better be identified, and by applying the concepts of accountability their performance can be more accurately measured. This can but result in a more efficient allocation of capital to profitable enterprises.

Third, by identification of better performing enterprises, and thereby more efficient allocation of capital, corporate governance can lead to greater economic growth by enabling the country to maximise the resources it has. Corporate governance can therefore lead to higher levels of efficiency, quality, and competitiveness throughout the national economy, which in turn will enable Bangladesh to reach its goals for poverty alleviation.

Fourth, a culture of corporate governance will begin to address the pervasive corruption that is crippling the Bangladeshi economy and development as a whole. The Principles, Guidelines and practices prescribed in the Code of Corporate Governance and the NGO Code of Governance are absolutely incompatible with any systematic practice of corruption, bribes and kickbacks. By application of the Code, both the instigators and recipients of corruption will be targeted. This is not to suggest that the Code of Corporate Governance can simply eliminate a deep-rooted culture of corruption – many other complementary reforms are necessary, of course. However, corporate governance can begin the reform process.

In short, corporate governance can be a catalyst for change, for higher economic growth, for a more efficient use of resources, for a private sector that is accountable to investors and society, for a reduction in corruption, and for a healthy inflow of funds from domestic and foreign investors.

A final note goes to the form and structure of the Code of Corporate Governance. The Code was developed, as has been mentioned, with the contribution of the Taskforce on Corporate Governance, and with intensive consultation with other Codes of Corporate Governance and international experts on corporate governance. Other international and national Codes and Principles of Corporate Governance which have been consulted include: the Combined Code (UK), the OECD Corporate Governance Principles, the Commonwealth Association for Corporate Governance Guidelines, the King Report (South Africa), the Sri Lanka Central Bank Code, the CII Code of Desirable Corporate Governance (India), the Pakistan Code of Corporate Governance, the Myners Report (UK), the Malaysian Code of Corporate Governance, and a variety of institutional investor codes from the United States. The Code of Corporate Governance for Bangladesh attempts to draw on international best practices, as enshrined in the above-mentioned documents, combined however with the situation and country specifics of Bangladesh in order to define corporate governance as far as possible in an indigenous context.

The Code is organised into sections on specific topics (Role of Shareholders, Board Issues, etc.). Within each section, the Code sets out a number of Principles and Guidelines. Each Principle explains the underlying value or tenant of corporate governance practices. These Principles of Corporate Governance may be applied in different organisations by various different methods. Thus, while the Guidelines suggest specific methods for application, the Code as a whole allows for each organisation to apply the Principles in their own way. Organisations solely implementing the Corporate Governance Principles by their own method, nevertheless, should provide explanations to shareholders and the public as to how exactly these are applied in their practices, policies, regulations and procedures. To fully comply with the Code, however, organisations should implement both the Principles and Guidelines.

Corporate governance is a journey, not a destination and it is hoped that this document will provide guidance for beginning that journey in Bangladesh. However, as the corporate environment develops in Bangladesh, the Code of Corporate Governance will need to be adapted to address new developments. Therefore, the Code of Corporate Governance will be reviewed and revised following the first two to three years of implementation and application, and thereafter as the need arises.

MEMBERS OF THE TASKFORCE ON CORPORATE GOVERNANCE

Prof. Abu Ahmed
Chairman
Bangladesh Shilpa Bank

Mr. Muzaffar Ahmed
President and CEO
Credit Rating Information and Services
Limited

Mr. Shah Md. Nurul Alam
Managing Director
Prime Bank Limited

Mr. C. M. Alam
Managing Director
Industrial Promotion and Development
Company of Bangladesh Limited

Mr. Wali ur Rahman Bhuiyan
Managing Director
BOC

Dr. Toufiq Ahmed Choudhury
Professor and Director
Bangladesh Institute of Bank Management

Mr. A. Quadir Choudhury
Managing Director
Phoenix Leasing Company

Mr. Abdul Mueyed Chowdhury
Executive Director
BRAC

Mr. Samson H. Chowdhury
Chairman
Square Group of Companies

Mr. Monzurul Haque
Chairman
AIMS of Bangladesh

Mr. A. H. M. Moazzem Hossain
Editor
Financial Express

Dr. Shamsul Huq
Vice Chancellor
City University

Mr. Syed Yousuf Hussain
Former Comptroller and Auditor General

Dr. Mirza Azizul Islam
Chairman
Securities and Exchange Commission

Mr. Mahbubul Karim
Senior Vice President
Proshika

Mr. Anis A. Khan
CEO & Managing Director
Industrial Development Leasing Company of
Bangladesh Limited

Mr. M. Hafiz Uddin Khan
Former Comptroller and Auditor General
Chair, Public Expenditure Review
Commission

Mr. Dhiraj Malakar
Joint Secretary
Ministry of Industries

Mr. M.A. Malik
Former High Commissioner

Mr. Wali-ul Maroof Matin
Chief Executive Officer
Chittagong Stock Exchange

Mr. A. S. M. Mainuddin Monem
Director Finance
Abdul Monem Ltd. (Igloo and Milk Unit)

Mr. Siraj Ullah
Controller
Bangladesh Chemical Industries
Corporation

Mr. A. K. M. Muktadir
Senior Vice President
Institute of Chartered Secretaries and
Managers of Bangladesh

Mr. Tapan K. Podder
Managing Director
Prime Finance and Investment Limited

Mr. Aminur Rahman
Additional Director General
Directorate of Inspection (Taxes)

Mr. Abdur Rashid
President
Institute of Cost and Management
Accountants of Bangladesh

Dr. Haroon-ur Rashid
Former SEC Chair

Mr. M. Syeduzzaman
Chairman
Bank Asia Ltd.

Dr. Hamid Uddin
Associate Professor
Institute of Business Administration

Mr. Mohammad Yousuf
Additional Director General
Monitoring Cell, Ministry of Finance

Dr. M. Zahir
Senior Advocate
Supreme Court

Mr. Mohammad Abdul Hannan Zoarder
Executive Director
Securities and Exchange Commission

Mr. Mahbub Jamil
President
Foreign Investors' Chamber of Commerce

Mr. Fasih Uddin
First Secretary (Income Tax)
National Board of Revenue

Mr. A. K. Gulam Kibria
Kibria & Co.
(immediate past ICAB President)

MEMBERS OF THE WORKING GROUP

Mr. Farooq Sobhan (Chair)
President
Bangladesh Enterprise Institute

Ms. Wendy Werner
Senior Research Associate &
Project Coordinator
Bangladesh Enterprise Institute

Ms. Rashida Ahmad
Research Associate &
Assistant Project Coordinator
Bangladesh Enterprise Institute

Ms. Nihad Kabir
Advocate
Supreme Court of Bangladesh

Mr. Adeeb H. Khan
Partner
Rahman Rahman Huq

Ms. Josephine Oguta
Corporate Governance Specialist
Boards' Consult

Ms. Sheela R. Rahman
Advocate
Supreme Court of Bangladesh

Mr. Yawer Sayeed
Managing Director & CEO
AIMS of Bangladesh

Advisors

Mr. Adnan Wahed
COO
&
Mr. Abdullah Al-Mamun
Manager, Compliance and Control
Hongkong and Shanghai Banking
Corporation (HSBC)

**THE
CODE OF CORPORATE GOVERNANCE
FOR
BANGLADESH**

March 2004

BOARD ISSUES

The Board of Directors is the central entity in a functioning corporate governance system, since it is the governing body of any organisation. The board is accountable to the shareholders and/or stakeholders of the organisation. To meet its organisational objectives the board must provide strategic policy and direction to the management, but should not be involved in day-to-day operational decisions. Management is accountable to the board, and therefore information systems that provide relevant, transparent, and material information to the board are imperative.

Individual boards must find the best way to adapt the guidelines and requirements of the Code to their organisations. The provisions of the Code may be incorporated into a Board Charter that defines the objectives, roles, and responsibilities of the board. To evaluate the board's own progress towards its goals, a board appraisal system could be implemented. The provisions of the Code encourage boards to become more proactive and effective by training directors in corporate governance and their responsibilities.

I. Mission of the Board of Directors

Principle:

The Board of Directors should lead and oversee strategy and policy of the company and provide direction to the management. Board actions should be in the best interests of the company and shareholders.

II. Duties of the Board

Principles:

The Board of Directors should define its role and job responsibilities. The following include the major responsibilities of the board:

- A. Serve the legitimate interests of the shareholders and/or owners and account to them fully. All directors represent all shareholders – diversity should not be misinterpreted as representing constituencies. Directors should ensure that the company communicates effectively with shareholders, potential shareholders, and other stakeholders.
 1. Any communication of material information should be made public rapidly or simultaneously to all shareholders and investors, so that all current and potential investors have an equal opportunity to act on such information.
- B. Ensure that the company complies with all relevant laws and regulations, including the current Code of Corporate Governance, and other codes of best business practice.
- C. Determine, monitor, and evaluate strategies, policies, management performance criteria, and business plans.
- D. Identify and monitor key risk areas and performance indicators of the enterprise.
- E. Ensure that technology and information systems used in the organisation are sufficient to operate the organisation effectively and maintain competitiveness.

- F. Review and monitor risk management systems and internal control mechanisms to enable decision making and maintain the accuracy of financial results.
- G. The Board of Directors should appoint the Managing Director/ Chief Executive Officer and participate in the appointment of senior management. The board should establish performance criteria and evaluate the performance of the MD/CEO. The board should also ensure that there is a succession plan for senior management and the MD/CEO.

III. Board Membership Criteria

Principles:

- A. Each director should be well-qualified to carry out their duties. Each director should be able and prepared to devote sufficient time and effort to his or her duties as a director.
- B. Directors should each add value to the board and bring independent judgement to bear on their duties.

Guidelines:

- C. To ensure a director has sufficient time to undertake his or her duties, an individual director should not hold directorships in more than 6 boards.¹
- D. Directors who have not attended at least 50% of the board meetings (without a leave of absence) during the last year should not be eligible for re-election to the board.

IV. Nomination of New Board Members

Principle:

- A. When nominating new directors, shareholders and the board should consider the mix of director characteristics, experiences, diverse perspectives and skills that is most appropriate for the organisation.

Guidelines:

- B. A Nomination Committee of the Board is not required to carry out the nomination process, but may be one method to seek out and nominate qualified persons for directorships. A nomination committee, however, should not preclude shareholders from being active participants in the nomination process.
- C. Shareholders should have an opportunity to nominate board candidates before the Notice of the Annual Meeting. Sufficient time (at least 21 days) should be provided in a general notice to shareholders to allow them to organise their nomination of directors.
 - 1. The board or nomination committee should release a list of required information that must be submitted with a director nomination. The required information should include qualifications, education,

¹ An institution or institutional investor (government, provident fund, etc.) can be represented on numerous boards, far in excess to 6. However, a single individual (as nominee of the institution) should not hold more than 6 directorships, so that they have sufficient time to devote to their individual duties as director.

experience, current directorships, and any interests in the company. The required information can be used to compare director candidates.

2. Candidates nominated by both the shareholders and the board, along with the required information on each candidate, should be put before the AGM for election.
3. By enabling shareholder nomination of director candidates, directors can become more directly the representatives of shareholders.

V. Training

Principle:

- A. Companies should recognise that a directorship is a professional appointment and therefore they should provide opportunities and funds for training of individual directors and the development of the board.

Guidelines:

- B. New and continuing directors would benefit from director training programmes that increase their skills and knowledge on directors' liabilities, best board practices, and strategic planning. New directors should be required to attend a corporate governance orientation or training offered by a reputed institution or trainer.

VI. Separation of Chairman and CEO

Principle:

The positions of Chairman of the Board and CEO should be filled by different individuals since their functions are necessarily separate. A strong, independent chairman provides the appropriate counterbalance and check to the power of the Managing Director/ CEO.

VII. Board Composition

Principles:

- A. To ensure a well-functioning and involved board, the size of the board should be large enough to include directors with diverse expertise and experience, but should not be too large to enable involvement by all directors. The board should periodically review its size and composition.
- B. An important way for the board to provide active, unbiased, and diverse advice to senior management is to have a diverse group of directors, including executive directors, non-executive directors, and outside/independent directors.²

Guidelines:

- C. Internationally, successful corporate boards have membership of 7 to 15 directors.
- D. Companies should articulate and implement a nomination programme to enable a majority of board members to be non-executive and independent directors.

² Executive directors are those that concurrently hold a senior management position in the company. Non-executive directors are simply directors that do not currently hold a position with the organisation for which they serve on the board. Independent or outside directors are those who do not have employment, familial, financial, or other ties to the company.

- E. Non-executive directors should be included in any committees and tasked with any decisions that might involve a conflict of interest.
- F. For the Board of Directors to reach a quorum, a majority of non-executive or independent directors must be present.
- G. There should be mandatory retirement by rotation of 20% of the board of public companies; the vacancies to be filled at the AGM.
- H. The term limit for directors of banks and other financial institutions should be a maximum of 12 years. This would apply equally to sponsor directors.³

VIII. Board Compensation

Principle:

Board compensation⁴ should be sufficient to compensate directors for the time and effort required to complete their duties well. This is especially important to nurture professional directors.

IX. Board Agenda

Principles:

- A. The agenda and materials for each board meeting should be provided to directors sufficiently in advance of the board meeting to allow them to prepare and provided substantial input and comments on agenda items.
- B. The Board Agenda should be prepared by the Chairman of the Board, who should also determine the materials for the board meetings, and all board papers to be organised and circulated by the Company Secretary.

Guidelines:

- C. The following information should be reported to, and placed before, the board:
 1. Annual operating plans and budgets, together with updated long term plans.
 2. Capital budgets, manpower, and overhead budgets.
 3. Quarterly results for the company as a whole and its operating divisions or business segments.
 4. Internal audit reports, including specific, material cases of theft and misconduct.
 5. Show cause, demand, and prosecution notices received from revenue authorities which are materially important.⁵
 6. Fatal or serious accidents and any effluent or pollution problems.
 7. Default in payment of interest or principal on any public deposit, secured creditor, or financial institution.

³ Directors that provide an extraordinary service to the company may be granted an extended term beyond 12 years, but an explanation for non-compliance with the Code would need to be provided.

⁴ Board compensation is used to refer to any and all fees paid to directors. This includes sitting fees, professional fees, reimbursement, and any other benefits provided to directors individually or the board as a whole.

⁵ Generally, any exposure greater than 1% of net worth should be considered material.

8. Any possible public or product liability which is material and estimable.
9. Details of any joint venture or collaboration agreement.
10. Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the Company Secretary and most senior financial officer.
11. Any labour issues and their proposed resolution.

X. Committees (Type, Structure, Responsibilities)

Principles:

- A. Committees in which conflicts of interest are more likely to occur (i.e. Audit, Nomination, etc.) should be made up of a majority of non-executive directors, or at least should be headed by a non-executive director.
- B. Companies with greater than Tk 30 crore (Tk 300 million) turnover should have an Audit Committee of the Board.

Guidelines:

- C. Audit Committees: Though audit committee arrangements will vary according to the size and complexity of the company, the audit committee's basic structure and responsibilities should include:
 1. Structure/Membership. The audit committee should be composed of at least three members appointed by the board. The audit committee chairman must be, and the majority of members should be, non-executive directors; the chairman of the audit committee should have a professional qualification and recent and relevant financial experience. The Chairman of the Board shall not be a member of the committee.
 2. Meetings/Reporting. Meetings must be held quarterly, to monitor internal and external audits. The committee must prepare reports on all meetings for the board, and report annually to shareholders. The MD, CEO, or chairman of the board may be invited to attend committee meetings as and when required;
 3. The responsibilities of the audit committee should be established in the Terms of Reference for the committee. They should include:
 - a. to review effectiveness of company's internal risk controls and risk management systems;
 - b. to monitor the integrity of annual and interim financial statements of the company, the clarity of disclosure and the context in which statements are made;
 - c. to review and challenge where necessary the consistency of, and any changes to, accounting policies;
 - d. to approve the appointment and removal of the internal auditor, ensure adequate resources, appropriate access to information and independence so that internal audits can be effectively performed to high standards; review all internal audit reports and plans, and monitor management's responsiveness; meet the internal auditor/head of internal audit at least once a year without

- management being present to discuss any issues arising from internal audits;
- e. to assess the independence and objectivity of external auditors; assess annually their qualifications, expertise, resources and the effectiveness of the external audit; review and approve the annual audit plan; meet regularly with the external auditor, including at least once a year without management being present to discuss any issues arising from the external audit.
- D. Other Board Committees: Companies could also consider forming other board committees as is deemed necessary. Other committees might include:
 1. A Remuneration Committee that deals with the compensation to the Board of Directors.
 2. A Nomination Committee that oversees the process for nomination to the board and to other committees.
- E. All board committees should be given clear Terms of Reference including:
 1. Structure
 2. Role, responsibility and authority delegated to it by the board
 3. Frequency, length and agenda of committee meetings
 4. The above information on board committees should be made available by the company on request (and/or placed on the company's website).
- F. The committee should have access to adequate resources, including the services of the Company Secretary who should:
 1. Act as secretary to, or at least attend, the committee meetings;
 2. Co-ordinate between the board and its committees;
 3. Ensure that the board and its committees are properly constituted and advised.

XI. Directors' Report

Principle:

- A. The annual Directors' Report, usually included in the organisation's Annual Report, is an important document for communication between shareholders and the Board of Directors. It should be a strategic document that explains both past results, board decisions, and the future direction of the organisation. The guideline for inclusion of items in the Directors' Report should be materiality⁶ to the company's operations and results.

Guidelines:

- B. The Directors' Report should include⁷:
 1. Explanation of results
 2. Explain compliance and/or non-compliance with the Code of Corporate Governance
 3. Explain deviations from IAS
 4. Sales and market share for domestic and foreign markets

⁶ Generally, any exposure greater than 1% of net worth or 10% of profits should be considered material.

⁷ Disclosures may appear elsewhere in the Annual Report as deemed appropriate.

5. Current market value of the company (if listed)
6. Strategy and future prospects
7. Material risk factors and uncertainties which could effect the quality of earnings
8. Ownership structure including disclosure of shareholders owning more than 5% of shares
9. Details of loans to directors
10. Details of any investments, including shares, government bonds, and other securities
11. Directors' shareholding and any changes therein
12. Report on the relatives of directors as employees or members of the board and their shareholdings
13. Details of director compensation and remuneration (both direct and indirect)
14. Persons who have attended board meetings in the last year, including attendance of directors and any substitute directors.
15. Key results information for divisions or business segments
16. Report on the end use of funds raised from the public by issuing shares or debentures
17. Ongoing or likely legal actions against or by the company that could have a material impact
18. The total amount of political donations and charity donations made throughout the year. (Recipients need not be identified.)
19. Details of new material loans and creditors
20. Critical accounting policies used in preparation of the financial statements.
21. Disclosure of the basis of estimates used in financial reporting. The presentation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and reported amount of revenue and expenses during the reported period. For example, allowances for doubtful accounts, inventory obsolescence, intangible asset valuation and useful life, employees' benefit plans, contingencies, etc. The basis of such estimates should be disclosed for their proper evaluation by the users of the financial statements.
22. Compliance Certificate (see Financial Reporting section for details).
23. Statement of a Going Concern (see Financial Reporting section for details).

XII. Code of Conduct

Principle:

- A. Boards should create a Code of Conduct for Directors detailing directors' roles, responsibilities, and duties.

Guidelines:

- B. Every year, directors should review and agree to abide by this Code of Conduct.

- C. The Code of Conduct should be included in the orientation for all new directors.
- D. The board should also create Codes of Conduct for Management and Employees, which should be signed and agreed as a condition of the contract of employment.

XIII. Company Secretary/Compliance Officer

Principle:

- A. Companies should employ a qualified Company Secretary or other qualified Compliance Officer to advise senior management and the board on their responsibilities and liability with regard to legal and regulatory requirements and compliance with the Code of Corporate Governance.⁸

Guidelines:

- B. The Company Secretary or Compliance Officer should provide advice both on issues of internal controls as well as requirements due to external entities.
- C. The Company Secretary or Compliance Officer should keep an annual record of the company's compliance/non-compliance with the Code of Corporate Governance, and in the event of non-compliance an explanation should be sought for the record from the board.
- D. In the event that the board cannot justify the cost of a full time in-house Company Secretary, the functions may be performed by external advisers provided that these advisers are not also the auditor, company lawyer, or other adviser to the board.

XIV. Access to Senior Management, Outside/Professional Advice

Principles:

- A. The board may seek out or invite those in senior management positions, employees, other non-directors or outside professionals to board meetings, as required, for access to any information deemed appropriate or necessary in order to effectively deliberate on decisions and perform its duties.

Guidelines:

- B. The board can obtain, at the company's expense, outside legal or other professional advice on any matter deemed necessary for it to effectively perform its duties.
- C. The MD/CEO shall be informed of all requests for information put to management.

XV. Evaluation of Board Performance

Principle:

- A. The board should evaluate its own performance, both collectively and individually including the performance of the chairman, at least once a year, to

⁸ Qualified should be taken to mean one certified by a reputable institute of Chartered Secretaries or one having equivalent legal, financial, and business training.

ensure it is operating effectively and adjust its constitution and policies accordingly

Guidelines:

- B. Boards may also consider using an independent outsider to conduct an external evaluation of the board and its performance, who shall make recommendations based on its evaluation.

Commentary

The provisions of the Code of Corporate Governance on Board Issues can begin to be implemented by their incorporation into a company's Memorandum and Articles of Association, as well as any internal Board Charter. A Board Charter can be a useful document to incorporate the duties, rights and responsibilities of the board, as well as the Vision and Mission Statements. The board should annually create a work plan and strategy for its role in guiding the organisation. The plan, however, should include benchmarks to develop board capacity as well as specific goals in the context of the organisation's activities.

Questions have often been raised about how to change the composition of the board, since the board is elected by shareholders. Key to transforming the composition of the board is to provide choices to shareholders. In most organisations, a slate of board candidates is offered to shareholders which corresponds with the seats up for election. This traditional method of board election leaves the shareholders few choices.

To begin to emphasise the importance of the shareholders' decisions regarding the board, shareholders should be presented with multiple nominees for each board seat and shareholders themselves allowed to nominate candidates. In addition, the board must include non-executives and independent candidates as nominees to the board. In this way, the board can achieve the goal of a majority of non-executive directors.

International best practice now focuses on independent directors who are not current or former employees and who do not have significant financial, commercial, familial, or other ties to the company. The Code has not emphasised independent directors, but for the present recommends a majority of the board be non-executive directors. The requirement focuses on non-executive directors due to the perception that Bangladesh currently lacks a sufficient number of persons who are qualified and willing to serve as independent directors. However, this may change in the future, and later versions of the Code may reflect such a change.

All board members, whether executive, non-executive or independent, have an individual legal responsibility to act in the best interests of the shareholders and the company. To ensure that directors have sufficient information to carry out their duties properly, section XIV asserts the right of directors to call on management, non-directors, and outside professionals to advise and provide information deemed relevant to their role on the

board. Other Codes of Corporate Governance also emphasise the right of employees to have access to the board to report complaints and wrongdoing; this access to the board can be facilitated by assigning one director, usually the Company Secretary, as the board contact for any employee. Individual boards may consider such a provision to improve access by concerned employees.

The Code puts the onus on the board itself to begin to define its roles more clearly and serve the interests of the shareholders. Stronger, more proactive boards will lead to organisations that have better long term strategic management and are able to better face the challenges of competitive markets.

ROLE OF SHAREHOLDERS

This section of the Code of Corporate Governance applies primarily to public companies; however many of the same principles of transparency and accountability are relevant to private companies that have minority shareholders. Public listed companies should comply with all legal and regulatory requirements; some, but not all, of those requirements are highlighted within this Code. Other provisions of the Code suggest that companies go beyond the legal requirements to further empower their shareholders. Existing regulatory bodies also have a mandate to uphold the rights of shareholders, while shareholders themselves, in turn, have a responsibility to advocate good corporate governance practices in accordance with international best practice.

Legal provisions for shareholders rights are, for the most part, adequate in Bangladesh. However, most shareholders are not aware of their rights or how to exercise them. In addition, they often misunderstand their function as shareholders, focusing instead on the corollary benefits of share ownership (such as attending the AGM in a nice location) rather than the substance of company management. By becoming empowered and understanding their rights, shareholders themselves will force company boards to become more accountable for their actions and company performance.

As the main arena for communication between shareholders, management and the Board of Directors, the AGM is a very important element of corporate governance. AGMs should provide an opportunity for some discussion of substance and allow for the shareholders to assert their rights regarding the agenda items they are asked to approve. There are, of course, limits to the ability of a large meeting of diverse shareholders to provide specific feedback to the board, but the format of the meeting should establish the fact that the Board of Directors is accountable to the shareholders and that important items for shareholder consideration should be explained clearly.

At the present time, in Bangladesh, a major problem affecting relations between shareholders, boards, and management is the disruption and control of AGMs by a few, organised individuals. All shareholders have the right to question the Board of Directors regarding the board's actions and responsibilities, but the current climate allows few shareholders to express their opinions. If, however, the majority of shareholders understand their rights and understand the key aspects of company strategy and performance, they can distinguish legitimate complaints and questions from those that are designed to disrupt; they can participate more fully in the AGM and can maintain the focus on company performance, transparency and board accountability. More educated shareholders will, with time, lead to a more viable, active capital market.

Probably the most important right of a shareholder is the right to vote for directors and on items put before general meetings. Voting rights and procedures should be clearly explained to shareholders so they may fully assert their rights in general meetings. Voting procedures that are difficult to follow or do not account for multiple shareholdings result in disenfranchisement of shareholders. Shareholders should be able

to exercise their voting rights through a proxy if they cannot attend a general meeting themselves.

I. Shareholders' Handbook

Principle:

- A. Educating and informing shareholders should be a basic requirement for listed companies.

Guidelines:

- B. A primary concern in Bangladesh is that shareholders do not know or understand their rights and responsibilities. To address this problem, listed companies together with the Securities and Exchange Commission and/or stock exchanges should describe and explain those rights and responsibilities in a Shareholders' Handbook that should be available to all shareholders with the notice for the AGM.
- C. The Shareholders' Handbook should also be accessible to shareholders by making it available on the websites of the SEC, stock exchanges, and individual company's website and at the company's offices.
- D. See appendix for a sample outline of a Shareholders' Handbook

II. General Meetings⁹

Principles:

- A. The general meetings, in particular the AGM, are the primary fora for communication between shareholders, management and the Board of Directors. Shareholders should be well-informed regarding general meetings and the meeting should be organised in a manner that allows for maximum shareholder participation, subject to reasonable limitations, and equitable treatment of shareholders.
- B. The outcome and proceedings of general meetings should be recorded and be verifiable.
- C. Shareholders have the right to receive information about company resolutions, decisions, and operations described in a manner that can be understood by a layperson. Companies should explain disclosures in detail and provide information about the effect of such.

Guidelines:

- D. A notice to shareholders regarding the date, time and location of the Annual General Meeting should be given in sufficient time for it to be received by shareholders through a standard and reasonable means of communication at least 21 days before the meeting¹⁰. The notice of the AGM should include information about the agenda items to be discussed, including a description of auditor

⁹ A 'general meeting' can refer to either an annual general meeting (AGM) or an extraordinary general meeting (EGM).

¹⁰ Note that the Code goes beyond what is provided in the Companies Act, to give shareholders more time to prepare for the AGM.

candidates, director candidates, and the text of proposed resolutions. The information provided about the agenda items for any general meeting should be detailed enough to allow shareholders to make an informed decision. The agenda should be presented in the order items will be addressed in the meeting.

1. The AGM notice should inform shareholders of the register of directors' interests in contracts or arrangements of the company and their right to inspect such a register.
- E. An AGM should be scheduled so as not to conflict with major events which may hinder the participation of most shareholders and should be held in a convenient location in the vicinity of the company's registered office.
- F. Agenda of an AGM
1. An AGM should ordinarily discuss the following agenda items:
 - a. Approval of Minutes of the previous meeting
 - b. Adoption of the Directors' Report
 - c. Adoption of the Auditors' Report
 - d. Approval of Dividends
 - e. Appointment of Auditors
 - f. Election of Directors
 2. Shareholders should have an opportunity to place additional relevant items on the agenda for the AGM prior to the AGM meeting.
 3. During the AGM, there should be an opportunity for shareholders to question the Board of Directors, subject to reasonable limitations. The Board of Directors should respond to shareholder questions.
 4. Agenda items should be completed in a timely manner to ensure that a quorum of shareholders is present for the entire meeting.

III. Voting Rights and Duties

Principles:

- A. In establishing the voting procedures and rights for public companies, the principle of one share, one vote should guide every public company. Within a class of shares, all shareholders should have the same voting rights. Information regarding the voting rights of all classes of shares should be available to potential shareholders.
- B. To enfranchise and facilitate voting by shareholders, proxy voting rules should be simple and easy to follow. Restrictions on appointing proxies should be withdrawn or reduced to widen the participation at AGMs.
- C. Regardless of the method of voting (proxy or at a meeting), all votes should be counted and the results declared.
- D. Share ownership carries duties as well as rights, and it is expected that all shareholders should exercise their right to vote. The decision not to vote should be recognised as an endorsement of the actions of the board and management. Shareholders should also exercise their rights in a considered and appropriate manner.

Guidelines:

- E. A ballot procedure rather than a poll (hand count) more accurately accounts for multiple shareholdings.
- F. Companies may wish to consider alternative forms of voting that permit an organised group of minority shareholders to elect a director. This could include cumulative voting (see Appendix for an explanation of cumulative voting).

Commentary

Although protection for minority shareholders are judged to be adequate in Bangladesh, more could be done to allow minority shareholders to place a director on the board to serve as an independent voice representing minority shareholders. For this reason, cumulative voting is mentioned as a possible alternative voting method. Cumulative voting would not guarantee that a minority group could elect a director, but it allows for an organised group of shareholders to do so.

Voting by show of hands could affect the independence of voters as minority shareholders may feel intimidated by powerful nominees/shareholders. Ballots may ensure free and fair voting as well as accurately reflect multiple shareholdings.

FINANCIAL REPORTING, AUDITING AND NON-FINANCIAL DISCLOSURES

Financial reporting and disclosures provide the tools by which stakeholders can monitor and evaluate an organisation's corporate governance practices. In Bangladesh, the first hurdle that must be overcome is to improve the quality and reputability of financial statements and disclosures. This process must be a joint undertaking of the regulators, self-regulatory organisations (primarily the Institute of Chartered Accountants of Bangladesh – ICAB), and organisations themselves. If companies begin to demand more from their own accounting personnel and their auditors, the quality of accounts and audits will improve. Simultaneously, the accounting profession must focus on ensuring compliance with audit standards, enforcing self-regulation, and increasing the number of qualified Chartered Accountants. These two movements can be further complimented by supporting actions on the part of regulators. Such a combination of reforms will create a virtuous circle of quality disclosures and increase demand from investors for more transparent financial statements. Accounting and auditing scandals around the world in recent years have shown how important this profession is to safeguard investor funds and ensure transparency. Without reform, the corporate sector in Bangladesh may be heading towards such disasters as we've seen in other regions; at the very least, the accounting and auditing profession will lose all credibility and prestige.

I. Accounting Standards

Principle:

- A. Companies should ensure that their accounts conform with all Bangladesh Accounting Standards (BAS) as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB) and the implementation time frame given by ICAB.

Guidelines:

- B. Companies that are striving to conform to international standards should prepare and have their accounts audited to conform with full International Accounting Standards (IAS). A company that is working to comply with IAS should establish a timeline by which time compliance will be achieved.
- C. Among the IASs that have been adopted by ICAB, those listed below are particularly important to ensure accurate and reliable financial reporting, but the level of compliance with them is low. Companies should comply with the following standards:
 - 1. IAS 12 – Deferred Tax, etc.
 - 2. IAS 18 – Revenue
 - 3. IAS 21 – Effects of changes in foreign exchange rates
 - 4. IAS 23 – Borrowing Costs
 - 5. IAS 25 – Accounting for Investment
 - 6. IAS 27 – Consolidated Financial Statements
 - 7. IAS 30 – Disclosures in financial statements of banks
 - 8. IAS 34 – Interim Financial Reporting

II. Preparation of Accounts

Principle:

- A. Companies must employ qualified personnel with professional accounting qualifications to prepare financial statements and accounts.

Guidelines:

- B. Listed companies with turnover of at least Tk. 20 crore (Tk. 200 million) must employ qualified personnel with professional accounting qualifications with at least five years of experience in preparation of accounts and/or a Chartered Accountant, Cost and Management Accountant, or one having at least a masters degree or MBA in Commerce or Finance.
- C. The Balance Sheet and Profit and Loss Statement should be reviewed and signed off by the Chairman of the Board, MD/CEO¹¹ and Chief Financial Officer (CFO)¹² and the Chairman of the Audit Committee (if one exists) to certify that:
 - 1. The accounts reflect a true and fair picture of the company,
 - 2. The accounts conform with BAS or, if they do not, disclosure has been made of material differences, and
 - 3. There are no post balance sheet events or off-balance sheet items, non-disclosure of which can affect the ability of the users of the financial statements to evaluate the company or make decisions.
 - 4. Assets are safeguarded against unauthorised use by the employees and/or management and/or third parties.
 - 5. Expenses incurred are for the purposes of the company's business.
 - 6. No material information has been omitted.
- D. The Chairman of the Board, CEO and CFO should supply two additional statements:
 - 1. That they are satisfied the company is a going concern.
 - 2. On the effectiveness of the company's internal control system and internal audit department. This should include any irregularities involving management or employees who have significant roles in the system of internal control. This statement should also be signed by the Chairman of the Audit Committee (if one exists).

III. External Auditors

Principles:

- A. External auditors should be independent, well-qualified to carry out their duties, and free of conflicts of interest.
- B. Auditors should be appointed by the shareholders. Shareholders should be provided an opportunity to nominate audit firms prior to the Notice for the AGM.

¹¹ Section 189 of The Companies Act, 1994 clearly states that the financial statements have to be authenticated by not less than two directors one of whom shall be the managing director where there is one.

¹² CFO is used to refer to the senior most financial officer of the company, regardless of the title.

Guidelines:

- C. A shareholder nominating an audit firm should be required to provide standardised information about the firm, so that nominated firms can be compared. The information should include: partners, staff; qualifications and experience; and the number, type, and identity of clients.
- D. Audit firms or partners are to be rotated at least every three years.
- E. Audit firms should not be engaged in accounting or non-audit consulting in enterprises in which they have been appointed as the statutory auditors. The exception is tax work, which may be undertaken by the statutory auditors of a firm. If, however, any non-audit work is performed by the statutory auditor, both audit and non-audit fees paid to the audit firm should be disclosed to shareholders.
- F. Auditors should not hold shares in companies they audit. If auditors do hold shares in a company for which they are appointed as the statutory auditor, the shareholding amount should be disclosed. A statutory auditor must not hold more than 1% of the shares of a company.

IV. Internal Audit**Principles:**

- A. All listed companies must have an internal audit function within the organisation. Private companies should consider establishing a system of internal controls if they do not have an internal audit department.
- B. The internal audit department should have a broad scope of work to investigate all levels of the organisation and be independent from management, with direct access to the Board of Directors and the Audit Committee.
- C. Directors must take adequate action to protect the company and shareholders based on internal audit reports.

Guidelines:

- D. The internal audit department should have a letter from the board or chairman of the audit committee giving it the authority to access any records in any location at any time.
- E. The internal audit function should have the authority to propose initiatives and changes directly to the board.

V. Disclosures**Principles:**

- A. The Board of Directors should present a balanced assessment of the company's position and prospects that may be understood by shareholders.
- B. All disclosures listed in this section should be disclosed in a public announcement and made available to the public and to shareholders.

Guidelines:

- C. Quarterly unaudited results. Within 30 days after the end of the quarter, companies should provide unaudited quarterly results to include:
 - 1. Sales and sales growth

2. Profit and profit growth
 3. Reserves
- D. Interim announcements should be made available to shareholders when a material event occurs. In addition to the material events required to be disclosed by the Companies Act, Dhaka Stock Exchange, Chittagong Stock Exchange, and SEC notifications, the following material events should be disclosed:
1. Signing or termination of a material contract¹³
 2. Loss of a materially important customer
 3. International or domestic regulatory approval or denial
- E. Half-yearly Balance Sheet and Profit and Loss Statement
- F. Audited Annual Balance Sheet and Profit and Loss Statement
- G. Annual Directors' Report should include the following items presented in a narrative format:
1. General Company
 - a. Corporate Governance Statement, which explains compliance and/or non-compliance with the Code of Corporate Governance.
 - b. Statement of the company's policy and practice on Corporate Social Responsibility, Corporate Environmental Responsibility, and compliance with Bangladesh environmental standards.
 - c. Quantitative disclosure of sales and market share, local and foreign (if applicable)
 - d. Future business strategy
 - e. Material risk factors and uncertainties
 - f. Explanation of results, including key results for divisions or business segments
 - g. Compliance Certificate, provided and signed off by the Company Secretary or other compliance officer or external auditor, and also signed off by the CEO, Chairman of the Board, and the chairman of each board committee dealing with compliance matters, attesting that:
 - i. the company has duly filled all statutory returns during the year
 - ii. the company has maintained all statutory books and registers, and in such order, as required by the Companies Act
 - iii. the company has duly paid all applicable duties, levies and taxes to the exchequer during the year
 - iv. the company has not paid or offered any gratification to any quarter
 - v. the company has practiced all corporate norms, rules and regulations, and standards of good conduct, especially in relation to money-laundering, insider-dealing, restrictive trade practices, quality and representation of goods and services, and anti-competitive behaviour, as required by other regulatory authorities during the year under report.

¹³ Generally, any exposure greater than 1% of net worth or 10% of profits should be considered material.

2. Ownership
 - a. Ownership structure including disclosure of shareholders owning more than 10% of shares
3. Board of Directors
 - a. Directors' shareholding and any changes therein
 - b. Report on the relatives of directors as employees or members of the board and their shareholdings
 - c. Details of directors' remuneration
 - d. Persons who have attended board meetings in the last year, included attendance of directors and any substitute directors
 - e. Details of loans to directors and related parties
 - f. Information on related party transactions, such as the purchase or sale of shares in associated companies where the company itself has a shareholding, or where the other company has a shareholding in the company, or where members of the board jointly or severally have a significant shareholding equivalent to 5% or more of the total share, and also on operational links and trading transactions with related parties.
4. Accounting and Financial
 - a. Report on the end use of funds raised from the public when issuing shares or debentures
 - b. Contractual agreements, if any, that would have a material effect¹⁴ on the accounts in the event of non-compliance
 - c. Contingent liabilities and ongoing, pending, or likely legal actions against or by the company which may result in significant gain or loss to the company
 - d. New creditors and details of material loans
 - e. Credit rating, if any
 - f. Details of investments, including market valuation, in equities, government bonds, and other securities
 - g. Critical accounting policies, namely those accounting policies to which the financial results are particularly sensitive (e.g. depreciation and tax policy)
 - h. Basis of estimates used in financial reporting (e.g. allowances for doubtful accounts, inventory obsolescence, intangible asset valuation and useful life, employees' benefit plans, etc.)
 - i. Depreciation and tax policy

¹⁴ Generally, any exposure greater than 1% of net worth or 10% of profits should be considered material.

SECTOR-SPECIFIC PROVISIONS: FINANCIAL INSTITUTIONS AND SOES

The following two sections detail corporate governance provisions that should be followed by specific types of organisations, namely, financial institutions (FIs) and state-owned enterprises (SOEs). These sections address issues that are unique to each sector, but are to be considered *in addition* to the provisions outlined in the previous sections of the Code of Corporate Governance. To achieve full compliance with the Code of Corporate Governance, FIs and SOEs should follow the provisions of the general Code as well as the sector specific provisions that follow.

FINANCIAL INSTITUTIONS

This section of the Code can be applied to all banks, including Nationalised Commercial Banks (NCBs), and non-bank financial institutions.¹⁵ Financial Institutions (FIs) should follow the provisions laid out in the previous sections of the Code on Corporate Governance but this section provides guidelines particularly relevant to corporate governance in Financial Institutions.

Financial Institutions are specifically addressed here due to their unique position as the lifeblood of any economy. The health of banks and public confidence in them are necessary to sustain and expand economic activity, as financial institutions form an essential link in the chain of national economic development. The Bangladesh Bank has the statutory power to regulate commercial banks to reduce systemic risk and the moral suasion to encourage high standards of probity and competitiveness among them, while commercial banks in turn can require their corporate customers to follow good risk management systems and encourage them to achieve high standards of corporate governance, in particular through the application of differential banking facilities. FIs are particularly powerful in an economy like Bangladesh where the capital market is small and FIs are the main source of capital for both public and private companies. Evidence of the importance of FIs is demonstrated by the fact that the financial sector is regulated by the government, through the Bangladesh Bank, and therefore has access to the government safety net. FIs are beneficiaries, fiduciaries, and managers of “other people’s money” in a number of ways and as such have a unique responsibility to uphold the highest standards of corporate governance.

I. Duties to Depositors and Customers

Principles:

- A. As the institutions that safeguard depositors’ funds and invest it with borrowers, FIs have an obligation to observe the highest standards of care and due diligence in assessing and monitoring risk, including credit risk, interest rate risk, operational risk, political risk, etc.
- B. As the institutions that provide essential financial services to families, public institutions, and business companies, FIs have an essential social as well as economic function in national life. Hence they have an obligation to observe the highest standards of customer care and efficiency while ensuring their own commercial competitiveness.

Guidelines:

- C. Information should be provided to depositors, customers, and the public to enable them to adequately judge the strength and health of the bank and whether its

¹⁵ This section on Financial Institutions does not apply to Microfinance Institutions (MFIs) which are covered in the section on NGOs.

- directors and managers are adequately safeguarding depositors' funds. (see Disclosures below)
- D. Financial institutions should publish a Code of Best Practice for Customers (as described below in II.C.7) and a Code of Corporate Social and Environmental Responsibility.
 - E. The system for handling complaints should be disclosed to customers and potential customers.

II. Disclosures

Principle:

- A. Financial institutions must provide transparent, comprehensive disclosures to the public, depositors, and shareholders.

Guidelines:

- B. Disclosure information should be made available to shareholders, depositors, and the public in a standardised format:
 - 1. On the company's website
 - 2. Displayed at branches and the head office
 - 3. Available to those who request upon payment of fee for posting.
- C. The following disclosures should be provided by financial institutions:
 - 1. Type of capital and percent of capital relative to credit exposures, as per Basel Capital Accord or guidelines from Bangladesh Bank.
 - 2. Institutions' credit rating, if any. If there is no credit rating, an explanation as to why the rating has not been completed should be provided.
 - 3. Exposure concentration relative to institution's capital, including exposure to individual counterparties, groups of associated counterparties, particular economic sectors, or industries.
 - 4. Maturity grouping of assets and liabilities based on the remaining period, at the balance sheet date to the maturity date
 - 5. Information on market risk (interest rate risk, exchange rate risk, equity risk) using the Basel Committee's market risk methodology or a similar alternative.
 - 6. Nature and extent of exposures to and transactions with related parties and affiliates
 - 7. Publication of a Code of Best Practice for Customers, describing the services and consideration customers should expect from the institution, as well as the responsibilities of the customer. This code should include lending guidelines and internal corporate policies.
 - 8. Publication of a Code of Corporate Social and Environmental Responsibility.
 - 9. Disclosure of the systems for handling complaints, from both internal and external parties.
 - 10. Nature of any conflicts of interest with directors or senior managers and the rules for handling such conflicts.
 - 11. Board structure (size, membership, qualifications and committees)

12. Senior management structure (responsibilities, reporting lines, qualifications and experience)
13. Basic organisational structure (lines of business, legal entity structures, etc.)
14. Information about the incentive structure of the bank (remuneration policies, executive compensation, bonuses, stock options)

III. Board of Directors

Principles:

- A. The function of the Board of Directors is to set policy and strategic direction for the financial institution. Committees and senior management should then carry out these policies and monitor their implementation.
- B. Directors must be fit, proper, and competent to carry out their duties.
- C. Boards of FIs must have an Audit Committee, which oversees the internal and external audit process.

Guidelines:

- D. All bank directors should have essential financial competency and recognised professional or management experience in banking, finance, law, marketing, operations, human resources management, or general management.
- E. Any directors appointed to the board for their non-financial specialist knowledge should undergo intensive training in financial analysis for non-financial directors.
- F. FIs must have an Audit Committee of the Board, which oversees the internal and external audit process. The audit committee must include members with adequate financial and banking expertise to carry out their duties properly. The audit committee will also report to the Board of Directors on risk management unless there is another committee that does so. The chairman of the audit committee must be a financial specialist and a non-executive director.
- G. Boards of FIs should have an Asset-Liability Committee (ALCO) which examines the overall position and risk level of the asset and liabilities held by the FI.
- H. Either the ALCO or an Executive Committee, including Chairman of the Board, CEO and at least one non-executive director should meet at least monthly to review:
 1. Major loan approvals
 2. Debt restructuring
 3. Risk management
- I. All boards should have a Company Secretary or Compliance Officer as the adviser to the board and responsible to the board as a whole.
- J. Board meetings must be fully and properly recorded in minutes so that decisions taken can be adequately carried out.¹⁶

¹⁶ The Bangladesh Bank has issued a standard format that must be followed in recording the minutes of board meetings.

IV. Credit Assessment and Asset Monitoring

Principles:

- A. Good business practices with regard to credit assessment and asset monitoring should be observed by FIs.
 - 1. Borrowers should be required to have a business plan and strategy for use of funds borrowed.
 - 2. The credit assessment and loan approval process should be isolated from personal conflicts of interest and political influence.
 - 3. Risk assessment for groups of companies should use a total risk assessment of the whole company.
- B. FIs should use their position and influence as suppliers of financing to actively encourage their customers to conform to the Code of Corporate Governance by using the Code in credit decisions, since better corporate governance in borrowing customers' organisations will improve performance and accountability, as well as reduce risk.
- C. FIs should consider the application of advantageous banking facilities to their corporate customers who maintain high standards of corporate governance, risk management, and business strategy and management.

Guidelines:

- D. Personnel assigned to Credit Risk Management functions should have training prerequisites and ongoing requirements.
- E. To avoid personal conflicts of interest and political influence:
 - 1. Employees and board members should not be involved in matters in which they have a personal interest.
 - 2. Methods of loan authorisation and lending limits should be clearly spelled out and complied with.
- F. Large borrowers¹⁷ should be required to show compliance with the Code or progress towards that end. Any credit rating agencies used by the FI for assessing creditworthiness will be required to use corporate governance as a major factor in assessing risk.
- G. FIs should require financial statements that comply fully with Bangladesh Accounting Standards.

V. Debt Recovery

Principle:

There should be a separation of personnel and reporting responsibility between loan origination/ marketing, credit approval, transaction processing, and loan recovery.

¹⁷ As per Bangladesh Bank's definition a large borrower comprises at least 15% of total capital.

VI. Risk Management

Principle:

- A. Corporate Governance arrangements in FIs should include systems and procedures that identify, monitor, and manage business risks.¹⁸

Guidelines:

- B. Staff should be assigned responsibility for risk management systems, and training should be provided to enable them to understand and manage risks.
- C. Risk management should be part of the responsibilities of all senior management and directors. Training should be provided that will give senior management and directors the background and knowledge to carry out this responsibility.
- D. Management systems which require regular reporting to senior management on the nature and magnitude of risks to which the FI is exposed, as well as the provisions to mitigate and control those risks. This should include proof that risk management systems are being properly and robustly applied. Reporting to the board should include a report of the estimates of allowances for doubtful accounts.
- E. CEOs/MDs should sign an attestation that they are fully satisfied to the best of their ability that the FIs material risks¹⁹ are being effectively identified, monitored, and managed through operating systems of risk management. The attestations should appear in the Directors' Report. Regulators should hold CEOs/MDs responsible if the attestations are found to be misleading or false.

VII. Corporate Governance Compliance

Principle:

FIs should have an officer assigned to monitor and report on corporate governance compliance. The Compliance officer should make regular reports to the board on the adequacy of corporate governance arrangements.

¹⁸ Business risk includes market risk, foreign exchange risk, interest rate risk, duration risk, credit risk, default risk, political risk, reputation risk, operational risk, event risk, etc.

¹⁹ Generally, any exposure greater than 1% of net worth or 10% of profits should be considered material.

STATE-OWNED ENTERPRISES

State-owned enterprises (SOEs)²⁰ have an important role in the economy of Bangladesh. For the overall economy to improve and become more competitive, SOEs must rationalise and compete on an even playing field with the private sector. Corporate governance is necessary for the government to exercise its ownership of SOEs in a transparent and accountable manner. Transparency, disclosure, and accountability are of primary importance in the public sector as the government, which serves as trustee, represents and is accountable to millions of taxpayers and citizens for the appropriate and efficient use of public assets. In a sense, SOEs have the widest possible shareholder base of any corporation in Bangladesh. The government, as the representative of these shareholders, has the responsibility to maximise the value and use of resources, while ensuring the highest levels of corporate social and environmental responsibility.

The proper assignment of roles and responsibilities, for shareholders, government, boards, and management, is the first step in establishing a good corporate governance system in SOEs in Bangladesh. In some cases the commercial interests of an SOE may be different and separate from the interest of the government. It is for this reason that the Code recommends a limitation on the ability of the shareholder (government) to participate in day-to-day management decisions and an agreed Statement of Corporate Intent that will be used to measure the performance of SOEs. Making SOEs accountable to achieve performance targets by implementing good corporate governance practices, will start the process of improving profits and growth in the state-owned sector.

To enable a level playing field between the state-owned sector and the private sector, laws and regulations must apply to both equally. The same is true of corporate governance requirements. SOEs should follow all the recommendations and requirements laid down in other sections of the Code of Corporate Governance. However, this section highlights some specific, additional provisions for SOEs, given the current state of corporate governance.

I. Application of the Code of Corporate Governance

Principle:

All the provisions included in previous sections of the Code of Corporate Governance must be equally applied to SOEs. The provisions for Financial Institutions should also be applied to Nationalised Commercial Banks.

II. Legal mandate and Monitoring

Principle:

The relevant laws and supervision applying to all commercial enterprises owned or undertaken by the government and their directors should be clearly stated. Preferably, all government entities engaged in commercial activities should be governed by the

²⁰ For purposes of the Code, an SOE refers to any entity owned wholly or partly by the government engaged in commercial activities (i.e. the trade of services or products for payment) whether under a sector corporation, regulatory agency, or other branch of government.

Companies Act. It should be clearly stated which agency or ministry is the shareholder of the SOE and, if different, which is responsible for monitoring, supervision, and evaluation of the SOE. It is emphasised that the true owners of SOEs are the citizens of Bangladesh, whose shares are held and managed by the government on their behalf.

III. Statement of Corporate Intent

Principles:

- A. A Statement of Corporate Intent (SCI) should be negotiated annually and agreed upon by the directors, relevant government entity, and all shareholders. The Statement should establish specific operational goals and performance targets. Any social, policy, or non-economic arrangements should be detailed in the Statement. A Mission Statement should be part of the SCI.
- B. The board must take responsibility and be evaluated on the progress made towards achieving the mission of the organisation.

Guidelines:

- C. The Mission Statement or SCI should cover long-term goals and provide the framework for subordinate performance contracts between the Board of Directors and the Board and the CEO/MD. The statement should be set for a particular period, at least three years but not to exceed five years, and must be evaluated annually.
- D. Specific operational goals of an SOE should encompass a mission to operate:
 - 1. as a profitably and efficiently as a comparable business that the Government does not own;
 - 2. to the highest standards as a good employer of its own staff; as a good customer for external products and services; and as a good supplier to its customers;
 - 3. as an organisation which demonstrates the highest standards of Corporate Social And Environmental Responsibility.
- E. The Statement of Corporate Intent could be similar to or adapted from the System for Autonomous Bodies, Reporting and Evaluation (SABRE) system in effect in public enterprises at present.

IV. Board of Directors

Principles:

- A. The primary role of the board is the governance of the company/enterprise. The board exercises stewardship on behalf of the shareholder to ensure the ongoing health and financial viability of the company.
- B. The SOE must state where the director's prime duty lies; in most cases that will be to the shareholders of the enterprises. Members of the board must keep confidential all confidential matters of the SOE
- C. Due to the complex nature of the relationship between SOEs and the government, shareholders' ability to participate in decisions and issue directions to the board and management should be confined to policy matters clearly defined in the Corporate Performance Contract and should be excluded from operational matters and day-to-day management. However, the board should regularly and fully

- report to the shareholders on results, strategic plans, and material information as per an agreed upon schedule.
- D. All provisions of the Code of Corporate Governance on Board Issues equally apply to the boards of SOEs. In particular, the board should evaluate its own performance, both collectively and individually including the performance of the chairman, to ensure its operating effectively.
 - E. The authority that appoints directors of SOEs, whether it be the government or the current board, must appoint directors with sufficient experience, integrity and independence to carry out their duties. The appointment process should be transparent and appointments should be made on merit, not due to political considerations.

Guidelines:

- F. All SOE directors should have significant professional or management experience area in banking, finance, law, marketing, operations, human resources management, or general management. Such experience should have been gained from an organisation with a commercial focus. Directors may also be chosen based on their expertise and experience in other related fields including: science, technology, health, agriculture, social policy or community organisations.
- G. In addition to the duties enumerated for all directors in other parts of this Code, SOE directors also have the duty to negotiate the SCI with the shareholders, developing the business plan so that it will receive shareholder support and hold management responsible for meeting the performance measures/milestones in the SCI and business plan.

V. Board and Management

Principles:

- A. The board should set the role, duties, and responsibility of the Managing Director/CEO and the MD/CEO should be accountable to the Board of Directors only, not to politicians or other government officials. The appointment of the CEO should also be done by the board
- B. All operational decisions²¹ should be the mandate of the management and Board of Directors.

VI. Reporting

Principle:

- A. SOEs should comply with all the internal control, auditing, financial and non-financial reporting and disclosure recommendations in the Code. The board should submit audited financial statements and auditor's report and commentary on performance against SCI targets.

Guidelines:

²¹ Operating decisions include product manufacture, product pricing, suppliers, and other contractors.

- B. Annual reports, including Audit Report and Directors' Report, should be made publicly available on a timely basis.
- C. The board should submit the following information to the shareholders for discussion before placing the same in parliament. This should be done before the beginning of the financial year:
 - 1. The Statement of Corporate Intent (public document)
 - 2. A Business Plan (not public document)
 - 3. Semester presentation by the shareholding entity to parliament on the progress against SCI
 - 4. The above issues should also be addressed during the AGM of the SOE

VII. Remuneration

Principles:

- A. Remuneration for directors should be in accordance with the constitution of the SOE and subject to approval by the shareholders.
- B. The pay structure of SOEs should be independent of the government pay structures, so as to better compete for skilled workers with the private sector.

EXHORTATIONS TO OTHER ENTITIES

I. Responsibilities of Shareholders

Shareholders play an important role in the governing of any corporation. Shareholders should take seriously their responsibilities. Shareholders should learn and exercise their shareholding and voting rights in an appropriate and relevant manner. This includes the behaviour of shareholders and shareholder representatives at Annual General Meetings. Shareholders should also be mindful of the legal rights and duties of directors and managing directors.

II. Responsibilities of Institutional Shareholders

Institutional shareholders are parties that control shares for the benefit of others, including mutual funds, pension funds, other companies, and various government entities. Institutional shareholders have a unique and important role to play in ensuring good corporate governance and have an important responsibility to fiduciaries, the company, and other shareholders.

Institutional shareholders can be a powerful force for reform in company practices. In many developed and emerging markets they play an important role in improving corporate governance. Institutional investors have the key ingredients to motivate companies to change practices: they should have staff qualified to evaluate financial statements, business strategy, and company performance; they control large amounts of capital that must be invested; they serve as a leading indicator to other investors; and they control blocks of shares which force companies to take notice of their concerns.

However, for institutional investors to become a powerful motivating force for change, they must take seriously their responsibility to achieve results for their beneficiaries and must exercise their shareholder rights in a responsible manner. For this reason, the Code emphasises the role of institutional shareholders.

Institutional shareholders should vote their proxies in keeping with their fiduciary duty, making voting decisions based on the best interests of their beneficiaries. Reports should be provided to shareholders, investors, and members as to the votes exercised on their behalf. Records of votes and the analysis completed to determine the voting position should be maintained.

Institutional shareholders should:

1. Demand high standards of corporate governance from companies in which they invest.
2. Take an active role in evaluating and improving director decisions, company performance, risk management, business strategy, and corporate governance procedures. For example, they may require companies in which they invest to introduce independent board and director appraisal systems.

3. Ensure that companies in which they invest are committed to Corporate Social Responsibility; sensitive to labour rights; do not violate the principles of ethical business; and produce, supply and extend quality products and services.
4. Recognise the importance of a long term commitment to the companies in which they invest, and the consequences of withdrawing investments.

To begin to set their own standard for investment policy and corporate governance, institutional shareholders should publish the corporate governance principles and practices, which they expect from the companies in which they invest, and also their own investment principles and practices which they intend to follow.²²

III. Responsibilities of External Auditors

External auditors should exercise their duties with independence and due attention to their professional and statutory requirements. The Institute of Chartered Accountants of Bangladesh should strive to fully discharge its duty to educate auditors and uphold statutory and professional standards.

²² For more guidelines on the responsibilities of institutional shareholders, please refer to the Myners Report to the UK Treasury which specifically addresses types of institutional shareholders and establishes investment principles. It can be accessed at www.hm-treasury.gov.uk (Financial Services, then Securities and Investments).

BASIC CHECKLIST FOR IMPLEMENTATION OF THE CODE OF CORPORATE GOVERNANCE

Below is a simplified summary of specific recommendations for implementation of the Code of Corporate Governance. The basic checklist below is drawn from the Code but is not an exhaustive list of steps that could be taken to improve corporate governance.

I. Board of Directors

1. Develop a Director Job Description including roles, rights, responsibilities, and required qualifications.
2. Develop and agree to a Board Code of Conduct.
3. Create Committees of the Board of Directors as appropriate.
4. Initiate a board performance review process. If a review has not previously evaluated the size of the board, director re-election policy and term limits, such items should be included in the review.
5. Create and affirm a Statement of Going Concern and Compliance Certificate.
6. Develop a Board Charter, which establishes the roles, responsibilities, and specific annual objectives of the board. From the Board Charter, a board work plan can be developed.
7. Develop a programme of training of individual directors and the board as a whole. Particular focus should be given to new directors.
8. Based on the above, make appropriate changes to the Memorandum and Articles of Association.

II. Employees

1. Develop an Employee Code of Conduct.
2. The Code of Conduct should be incorporated into employment contracts and be a requirement of employment.
3. An enforcement programme should identify and punish violations of the Code of Conduct.

III. Shareholders

1. Create and distribute a Shareholders' Handbook.
2. Examine procedures for AGM notice, setting the AGM agenda, voting practices, and recording the results of the AGM.
3. Review procedures for nomination of directors and nomination of the external auditors to ensure adequate and appropriate opportunities for shareholder participation.

IV. Disclosures and Reporting

1. Make appropriate changes in auditor appointment guidelines to institute a rotation of audit firms or partners.
2. Expand the annual report to include disclosures as provided in the Sample Contents of an Annual Report (Appendix).

V. Financial Institutions

1. Develop and publish a Code of Best Practice for Customers.
2. Develop and publish a Code of Corporate Social and Environmental Responsibility.
3. Expand disclosures in the Annual Report and other public documents to comply with the Code of Corporate Governance.
4. Initiate a risk management review, if such a review is not already practiced.
5. Review credit assessment process to incorporate corporate governance into credit decisions.
6. Develop and affirm an attestation from the CEO/MD that material risks are being effectively identified, monitored, and managed.
7. Develop and assign personnel to a Corporate Governance Compliance programme.

VI. State Owned Enterprises

1. Define shareholder(s) and monitoring agency.
2. Develop a Statement of Corporate Intent and negotiate and agree such statement with the responsible monitoring agency. Develop a process for reporting and performance appraisal based on the Statement of Corporate Intent.
3. Develop statement of director's duties and responsibilities.
4. Review internal control systems, auditing, and reporting and disclosure practices for compliance with the Code of Corporate Governance.

VII. Institutional Investors

1. Develop and publish investment principles and practices.
2. Develop voting guidelines and procedures. Establish a record-keeping system for proxy voting performance monitoring.
3. Develop guidelines for taking an active role in corporate governance of companies in which investments are made.
4. Publish corporate governance principles and practices which are expected from companies in which investments are made.

NGO GOVERNANCE PRINCIPLES

Preamble

Why NGO Governance Principles?

Since 1860 the state has attempted to regulate NGOs with the most significant step resulting in the creation of the NGO Affairs Bureau and the appointment of the Advisor for NGO Affairs with Ministerial status. The State and its various agencies have from time to time introduced rules and regulations that have largely been ignored by NGOs due to their complexity and lack of capacity to enforce. However, in the wake of corporate scandals nationally and internationally experts have been quick to point out that responsible governance is unavoidable in the health of any organisation. By being involved in a system of checks and balances with management, boards can protect stakeholders' investments and interests by ensuring that sound decisions are made that advance the primary objectives of the organisation in an accountable and legally responsible manner.

Clearly, in both the public and the private sectors, good governance is considered a norm for a responsible and accountable organisation. Unfortunately emphasis has not been made on the governance of NGOs to ensure a vibrant and accountable sector. Although the Boards of NGOs are by law vested with the same responsibility of overseeing the organisation's performance as the boards of any corporate organisation, most NGO boards fall short of this duty in several ways. Moreover, there is a lack of sufficient acknowledgement that the principles of good governance apply to NGOs and that the sector should perhaps be subjected to higher standards of governance if their claim to being the bedrock of transparent and accountable civil society is to be upheld.

The NGO sector in Bangladesh mainly evolved as societies or groups of philanthropic individuals who were ready to work on projects to meet specific public needs, within a specific time frame, to bridge the gap on public services and in due course handover to the government. However, due to lack of capacity within the public sector to adopt and replicate these programmes, the NGOs have ended up running the same for several years, leading to a continuation of most services and eventually to the institutionalisation of this sector. Consequently, this raises the need for strengthening the Governance of these institutions.

There is no doubt that prevention and proactive approaches to organisational probity is more favourable than dealing with collapse of NGOs due to the absence of good governance systems. Providing Governance principles for this sector is therefore essential as a means of reducing the potential risk of poor governance within the NGO sector that includes inefficient, inappropriate or improper use of funds. The development of NGO Governance principles will not only help raise the performance standards of the NGO sector but also increase accountability and act as tool for detecting and preventing loopholes and flaws in the current regulations. This in turn will promote the evolution of institutions capable of sustaining performance whilst maintaining greater accountability and transparency based on stronger ethical foundations.

Introduction

Good governance is essential for all successful organisations. The principles of good governance - stewardship, transparency, accountability and internal controls - are not just optional extras. They are the fundamental foundations on which effective organisations are built. In the public sector, governance is as important, or even more important, than in the private sector. NGOs as civil society organisations should therefore represent the views of the civil society in their services and provide public disclosures of their organizational mission, management, financing, programs and impact. Governance processes and arrangements are therefore essential to ensure that NGOs live up to their name.²³ The term Governance from the NGO perspective assumes that NGOs participate in the definition, protection and promotion of public interest.

The Core objective of these Governance Principles is to provide a structure through which the mission and objectives of the organisation are set and performance monitoring is carried out. These Governance Principles also aim to provide incentives for the Board and Management of an NGO to pursue the mission of the organisation in the interests of the organisation and its stakeholders while facilitating effective monitoring and efficient use of resources, thereby promoting institutions that are well-governed and capable of sustained performance.

The Principles contained in this document build upon experiences from national initiatives, regulations and international best practices embodied in the OECD Principles and Commonwealth Guidelines. The preparation of this work was considered under the direction and consultation with professional working group members, the Taskforce on Corporate Governance, INGOs, NGOs, donors, and other regulatory authorities and practitioners within the sector. These governance principles also benefited from broad exposure and input from the various sectors represented in the Taskforce.

It is the expectation that these Governance Principles will guide NGO practitioners, the donors and other stakeholders in the sector towards improved governance structure and serve as a model of proper corporate governance structure. The Taskforce, therefore, has endeavoured focus on the practical use of the principles. While international governing principles and standards served as guidelines, the unique managerial circumstances faced by Bangladeshi NGOs has been taken into account. The Governance Principles respect the demands of the present laws and ordinances while simultaneously providing a direction for exemplary corporate governance systems to promote organisational accountability and effectiveness from a future-oriented perspective. The focus of the Governance Principles is on the NGO sector as a whole, but a section of the Governance Principles has been dedicated to specifically address the additional issues that should be considered by NGO-MFIs to achieve good governance.

The extent to which an NGO integrates the principles of good governance is increasingly becoming an important factor for stakeholders and funders' decisions. Bangladesh has

²³ Reworded from: Governance in the Public Sector—An ECSAFA Perspective, ECSAFA, June 2002

the largest number of international NGOs (INGOs) and donor agencies worldwide and hence the international flow of funding and human resources in the sector. The demand for corporate governance worldwide both in the private and in the public sector is therefore becoming an essential factor to enable countries to fully benefit in the global economic system. Institutions that adherence to these set of principles will reinforce the confidence of investors and donors in the sector and maximise stakeholder/beneficiary value.

Objective

The main purpose of the NGO Governance Principles is to maximize corporate value by enhancing the transparency and efficiency to promote sustainable institutions for the future. The Governance Principles also aim at promoting and gaining stakeholder trust in the sector by promoting transparency in the overall operations and management of NGOs. Based on such transparency and reliable management, the Principles highlight the establishment of managerial systems that promotes creative and progressive enterprises in the NGO sector.

These Governance Principles recognize the diverse stakeholders within the NGO sector and how the NGOs can mediate their interest through a rational and fair means to achieve stakeholder and social representation to strengthen their viability.

The Principles aim to promote institutions that exhibit a sense of social responsibility with a strict sense of morality. Sustainable civil society organizations can evolve from “founder- driven” organizations by defining the role of the board, professional managers and staff and ensuring financial sustainability and autonomy.

In effect, the NGO Governance Principles seek to promote the following:

1. Development of viable internal governance for organizational effectiveness, beyond financial and managerial accountability;
2. Structures and processes to define organizational mission/goals;
3. Structure and effectiveness of organizational management and programs;
4. Ensuring financial sustainability and appropriate use of funds;
5. Compliance with legal and administrative regulations;
6. Public disclosure of organizational mission management, financing, programs, and impact.

The content of these Governance Principles are evolutionary in nature and should be reviewed in light with significant changes in circumstances. To remain competitive in a changing world, NGOs must innovate and adapt their governance practice so that they can meet new demands and grasp new opportunities. Similarly, the Governance Principles will take into consideration any review in the government regulations in the sector while providing sufficient flexibility to allow institutions to function effectively

Contents and Structure of the Governance Principles

The following document is divided into three sections. The Principles presented in the Section One of the document cover seven areas: (1) Mission and Vision (2) The Board

(3) The Role of Stakeholders, (4) Human Resources (5) Conflict of Interest (6) Financial and Non-Financial Disclosures (7) Fundraising Policy. Each of the sections is headed by a single Principle and is followed by a number of supporting guidelines. Section Two of this document contains the specific additional MFI-NGO guidelines and covers the following areas: (A) Board, (B) Communication, (C) Financial Disclosure, and (D) Auditors. Section Three of this document contains, sample Terms of References, conflict of interest policy and commentary and annotations on the Principles and is intended to help readers understand the rationale to apply the Principles.

NGO Governance Principles

Underlying the Governance principle is a set of values, which have been identified as being of core importance to any NGO serving the community. These include professionalism, accountability, integrity and responsibility.

SECTION ONE

I. Mission and Vision

Principle:

- A. NGOs are established for a social mission, which is to be achieved through specific programmes and services. The mission statement therefore acts as a guideline for achieving this social mission. The NGO shall clearly articulate their mission, programmes and services in a manner that enables them to operate efficiently and effectively towards achieving that social mission.

Guidelines:

- B. The Board shall define and approve the mission of the NGO and have it clearly documented and communicated.
- C. The mission statement shall be reviewed periodically to ensure relevance to changing environment and needs.
- D. The Board shall prepare a Statement of Values to guide the operations and culture of the NGO.
- E. The Board shall approve a strategic plan for the NGO (such as annual work plan, 3 or 5 year plan etc) to ensure that its operations and programmes are directed towards achieving the stated mission.
- F. The Board shall ensure that resources of the NGO are utilised for the operations and programmes according to the stated mission, and that such resources are effectively and efficiently managed; the Board will further seek to ensure that the NGO has sufficient resources to fulfil its mission to a satisfactory degree.
- G. The Board shall ensure the NGO has an evaluation system that can measure the effectiveness and efficiency of programmes and their outcomes in line with the NGO's mission and objectives, and ensure that the NGO's mission and objectives are appropriate for the current priority needs of society and the NGO's intended beneficiaries.

II. Board²⁴ Composition and Structure

Principles:

- A. An effective board of directors, properly constituted, with a mix of proficient directors providing a full range of appropriate knowledge and skills is the linchpin of good governance. Boards are responsible for supervising managerial performance in meeting the stated Mission and Vision of the NGOs, compliance

²⁴ The term "board" as used in this document does not espouse any particular board structure and is meant to embrace the different models of board structures found in the NGO sector.

- with applicable laws and regulations, and protection of stakeholder rights in particular the needs of society and the beneficiaries.
- B. Board shall have term limits for service to allow for periodic board rejuvenation and succession. Term limit is an effective mechanism to ensure regular renewal with new Board members joining.
 - C. Board members will serve for as long as they are of sound mind and able to contribute to the mission of the NGO.
 - D. Overlarge boards can be unwieldy and ineffectual, boards that are too small run the risk of exclusivity and stagnation. The board should therefore aim for the kind of member diversity that feeds lively debate and responsible decision-making, yet a size that allows members to participate fully in discussions and reach a true consensus.

Guidelines:

E. Board Structure

1. The board should be composed of a mix of qualified individuals of integrity who will together provide a diversity of experience knowledge and skills for the advantage of the NGO. At a minimum, qualified means a good working knowledge in the areas of development activities of the NGO, or specialised professional subjects such as finance, or all of these.
2. The Board of Directors of each NGO will prepare a Board Charter covering the structure, term and age limits of directors, board size, operations, appointments, committees, roles and issues of the board.
3. Each board member should be able to devote sufficient time to his/her duties and responsibilities
4. Boards should be composed of a substantial number of independent directors. Independent here meaning, members who are not closely related nor directly employed by the NGO or to the members of the executive management, or former staff of the NGO, or present or former staff of organisations which are closely functionally linked to the NGO as suppliers, financiers or beneficiaries.
5. The Board of an NGO is liable to disclose to stakeholders, how many family members are sitting on the Board, key positions held and any other such potential conflicting interests in the organisation.
6. The Chair and CEO (or by any other name the head of management is known) posts should be separated to ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board and within the organisation.

F. Term limits

1. The Board members should retire in rotation (i.e. one-third of the Board retire at every AGM). Members should have a term limit of not more than 2 (two) consecutive terms.
2. The Chair of the Board can be appointed for two consecutive terms to enable strategic continuity.

3. Retired members are subject to re-election after a 'breathing period' of not less than 3 (three) years before standing for re-election to the Board.
- G. The Board should consist of not less than 7 members and not more than 11 members.²⁵

III. Board Operations

Principles:

- A. The Board should ensure a thorough and effective process in board appointment that provides a mix of proficient directors, each of whom is able to add value and to bring independent judgement to bear on the decision-making process.
- B. The need to act on a "fully informed" basis demands a base level of experience and competence on the Board members' part in order to carry out the duty of skill and care. The Board members need to be knowledgeable in the relevant areas of the NGOs' services to enable informed and deliberative decision-making and an ability to understand and execute the specific responsibilities imposed on the board. To be fully informed, the Board must be aware of what it needs to know and must either have, or be able to acquire, this knowledge through appropriate orientation and training of the Board members.
- C. The Board should ensure the organisation's effective operation and use of resources by monitoring and evaluating the performances of the CEO/MD and the organisation as whole against set targets. Besides monitoring the Management and organisational performances, the board should provide guidelines for measuring its own effectiveness against its organisation's mission and strategy.
- D. All Board officials shall have clear written job descriptions and contracts of appointments which should be reviewed every year to ensure they still articulate the need of the NGO and its beneficiaries and the roles members are playing as Board members. (Sample job description annexed in Section three)

Guidelines:

- E. Selection and Appointment
 1. The General Body of the NGO will appoint members by election or as per the constitution/bylaws. The composition of the board should be planned by the whole Board with strategic consideration and objectives of the NGO in mind.
 2. Board selection and appointment should be done through a transparent process preferably through a board nomination sub-committee, and appointments by election at a properly constituted AGM or EGM.
 3. The board shall draw up a retirement rotation in order to avoid, as far as possible, a situation in which many reappointments occur simultaneously. The retirement rotation shall be made generally available and shall, in any event, be put on the NGO's website and public documents.

²⁵ Societies Registration Act No. XXI of 1860 requires a minimum of 7 persons

F. Orientation and Training

1. All members on taking office shall receive orientation on the operation of the organisation and training on their fiduciary roles, responsibilities and liabilities as board members.
2. The Board should possess the core competencies necessary for effective governance. Board members should work to achieve these competencies through relevant Board training and development.
3. Board development sessions should be conducted at least once a year with a certificate awarded to show participation.

G. Meetings

1. The Board shall meet at least once in every 3 months. The NGO's constitution or rules shall state the quorum required for a meeting, which shall be at least 50% of the Board, and should include proportional representation of the total number of members (if applicable).
2. The Chair is responsible for convening meetings at a time and place, which facilitates the participation of all board members, with arrangements by the Secretary.
3. Board papers shall be circulated so that all board members receive them at least one week before the meeting. Board meetings' proceedings and decisions shall be minuted and circulated to the whole Board as soon as practicable, and not more than one month after the meeting. It is the responsibility of the Chair to set the agenda and arrange the preparations and distribution of the board papers with the Board secretary.
4. Board members shall make every effort to attend all board meetings with a minimum attendance rate of not less than 75% during their tenure and shall not absent themselves without good reasons. The attendance rates of all individual board members shall be published in the annual report.

H. Annual Evaluation

1. To maximise efficiency and effectiveness of the board's works, each individual director's performance should be monitored and appraised on an annual basis and training opportunities and appropriate development undertaken.
2. The board should evaluate the performance of the CEO/MD, on an annual basis. In practice this can be done by the board as a whole or by a committee formed to specifically conduct CEO/MD evaluation with the Board Chair taking a lead role in the process.

I. The Board shall have the following committees for more detailed consideration and from which it will receive recommendations to discharge its duties. The Board however cannot delegate its responsibility to sub-committees:

1. A Finance and Audit Committee must be mandatory. A sample Terms of reference is included in Section Three.
2. A Programme Committee is recommended.
3. A Nomination and Human Resources Committee is recommended.

IV. Roles of the Board

Principle:

- A. The Board's role is to provide entrepreneurial leadership to the NGO within a framework of prudent and effective controls that enables risk to be assessed and managed. The board should set the NGO's strategic aims, ensure that the necessary financial and human resources are in place for the NGO to meet its objectives and review management performance. The board should set the NGO's values and standards and ensure that its obligations to all stakeholders and beneficiaries are understood and met. The Board shall discuss, in any event at least once a year, the corporate strategy the risks and the impact of the NGOs programme, and the result of the assessment by the board of the structure and operation of the internal risk management and control systems, as well as any significant changes affecting the same. These discussions shall be referred in the Annual Board Reports.

Guidelines:

- B. It is the responsibility of the Board to determine and guard the purpose of the organization by:
1. Setting guidelines for management and review the strategy of the organization, prepared by management
 2. Maintaining awareness of government, donor policies and other external factors affecting the work of the NGO.
 3. Identifying legal obligations relevant to the NGO and ensuring compliance
 4. Developing protocols in line with the mission and vision of the NGO
 5. Ensuring the NGO is dealing with the current priority needs of society and the intended beneficiaries
 6. Establishing codes of conduct for the board and staff
 7. Establishing principles and policies for running the organisation effectively
 8. Dealing with conflict and ensure an effective conflict of interest policy
 9. Protecting against bad publicity by acting as good ambassadors for the cause of the NGO.
- C. It is the responsibility of the Board to ensure the ability of the organisation to operate.
1. Recruit board and CEO/MD and review appointment, removal and remuneration of Senior Management
 2. Build relationships/commitment with donors and other stakeholders
 3. Induct new board members
 4. Ensure the integrity of financial information, financial control and that the systems of risk management are robust and defensible
 5. Provide Leadership for the organisation
 6. Facilitate activities in line with the Mission.
 7. Ensure availability and proper management of resources

- D. It is the responsibility of the Board to monitor the activity of the organization
1. Set targets and monitor progress against targets
 2. Identify long term goals in terms of development outcomes and evaluate effectiveness of NGO in achieving these goals
 3. Appraise budgets
 4. Review and evaluate CEO/MD activity
 5. Review management
 6. Appraise skills
 7. Review and evaluate itself
 8. Ensure management and Board succession planning

V. Other Board Issues

Principles:

- A. The three universal requirements for a good NGO board member are commitment, understanding and time. Any two without the third is insufficient.
- B. Board members of the NGOs are volunteers and therefore not entitled to any form of compensation besides reimbursements to cover reasonable transport cost and other out-of-pocket costs actually incurred in their service as board members on behalf of the NGO.

Guidelines:

- C. Board members should not sit on the boards of more than 3 NGOs at the same time.
- D. Board members who are totally committed to serving on the Board of NGOs (full time professional Board members) and are not involved in any other form of employment may sit on the Board of not more than 5 other NGOs.

VI. General Body

Principle:

- A. The function of the General Body (GB) is to supervise the board and the general affairs of the NGO and its business. In discharging its function, the GB shall be guided by the Mission and interests of the NGO and its business, and shall take into account the relevant interests of the NGO's stakeholders. The GB is responsible for the quality of the overall organisational performance.

Guidelines:

- B. The division of duties within the General Body and the procedure of the General Body and its chair shall be laid down in the organisation's constitution. The General Body shall include in the constitution a passage dealing with its relations with the board, and the general meeting of members. The NGO's constitution shall, in any event, be put on the NGO's website (if any) along with other public documents.
- C. The following information about each General Body and Board member shall, in any event, be published on the NGO's website and Annual Report:
 1. gender
 2. age

3. profession
 4. principal position
 5. nationality
 6. other important positions, in so far as this information is relevant to the performance of the duties of the General Body/ Board member
 7. date of initial appointment
 8. the current term of office.
- D. The General Body shall arrange for the receipt, recording and handling of complaints received by the NGO in respect of the financial reporting, the internal risk management and control systems, and the audit. Internal 'whistleblowers' shall have the opportunity, without jeopardising their legal position, to report on irregularities in the above-mentioned matters and to report complaints about members of the board to the chairman of the General Body.
- E. The General Body shall meet in accordance with a fixed schedule and members who are frequently absent shall be asked to explain their nonattendance.
- F. The general duties of the General Body may be deemed to include supervision of the following:
1. achievement of the NGO's objectives
 2. corporate strategy and the risks inherent to the business activities of the NGO
 3. the structure and operation of the internal risk management and control systems
 4. the financial reporting process
 5. observance of the legislation and regulations.
- G. The General Body shall discuss, at least once a year, both its own functioning and that of the individual members, and the desired profile, composition and competence of the Board.
- H. The General Body shall also discuss, at least once a year, both the functioning of the board as an organ of the NGO and the performance of the individual members, and the conclusions of these evaluations. These discussions and evaluations shall be referred in the annual report.
- I. The General Body shall be at liberty to delegate with authority to the Board any of the above functions except those specific to its supervisory role and monitor the same at least once a year. All such duties so delegated should be referred to in the GB's report.

VII. Stakeholder Representation

Principle:

- A. NGOs are formed with the mission to provide important services to their clients and to the community. They shall be able to communicate on matters relating to its mission, programmes or activities to the public and stakeholders and respond readily to requests for such information. NGOs shall ensure a means of stakeholder representation to ensure that the organisation's policies address the need of these stakeholders and of the community they are formed to serve. Beneficiary representation should be adopted in a manner that would not reduce

the process to tokenism or lead to the risk of running the organisation by beneficiary referendum.

Guidelines:

B. Beneficiary representation

1. The organisation shall have frequent communications with clients annually through mechanisms such as client group workshops to ensure client views are represented in the strategy.
2. Communications from any such client group shall be printed and incorporated into the programme to ensure the programmes offered are need-based.
3. The NGO shall disclose the following in its Annual report to ensure that the organisation is well informed about its achievements, the relevance of its programmes and outreach to the community:
 - a. The number of clients the organisation is reaching including the indirect clients such as members and numbers of families covered.
 - b. The numbers of employees within the organisation.
 - c. How beneficiary views are represented in the programme and the methods used by the NGO to ensure representation.

C. Donor representation

1. As one of the key stakeholders, the NGOs shall integrate donor policies into their programmes in order to meet the required standards agreed upon for funding.
2. NGOs will endeavour to keep the donors informed of the progress and changes in the programme by inviting them to attend key meetings such as the AGM and workshops.

D. The NGO, as a representative of society's views and needs, should ensure that:

1. They are accessible to the general public and carry out their services in a transparent manner.
2. They should circulate their Annual Reports in Bangla and English to relevant facilities, such as public libraries, etc.
3. They frequently review their mission statement and their services to ensure that they are still consistent with the needs of the communities they represent.

VIII. Human Resources

Principle:

- A. Human resources are one of the most important resources of NGOs. NGOs have a pool of both paid staff and volunteers to run its operations and programmes. NGOs shall have human resource policies to address both these groups.

Guidelines:

- B. There shall be clear written human resource policies approved by the Board for both paid staff and volunteers. Such policies shall cover areas including recruitment, remuneration, benefits, training, development, performance

appraisal, disciplinary actions etc. in accordance with the Employment law and applicable laws of Bangladesh.

- C. The human resource policies shall aim to attract the right staff and volunteers with the appropriate type and level of qualification and experience.
- D. The Board shall ensure a fair and transparent performance review and appraisal system for staff and volunteers where appropriate.
- E. The Board shall ensure a system and process to identify training needs of staff and volunteers to equip them with the necessary skills to perform their jobs effectively.
- F. The Board shall ensure a system to address grievances and resolve conflicts for staff and volunteers.
- G. The Board shall ensure an appropriate and effective channel of communication for staff and volunteers for feedback and exchange of information.
- H. For NGOs that engage volunteers and staff for work involving children and other vulnerable groups (e.g. the intellectually disabled, abuse victims, frail elderly and destitute), there shall be policies and procedures for the screening of volunteers and staff and there shall be proper supervision and training for them.

IX. Conflict of Interest

Principle:

- A. The NGO Board, staff and volunteers serving the NGO shall act in the best interest of the NGO and its Beneficiaries with full due regard to the overriding interests of the society as a whole. There should be no vested or personal interest or interest of third parties. Clear policies and procedures shall be set and measures taken to prevent actual, potential or perceived conflict of interest that could affect the integrity, fairness and accountability of the NGO. (Sample conflict of interest policy in Section Three.)

Guidelines:

- B. The Board shall establish clear written policies on measures to avoid conflict of interest in areas where such conflict may arise.
- C. To uphold the Board's independence, integrity and objectivity, the Board should not be comprised of immediate family members of the executive team, founders, donors or main beneficiaries.
- D. In any event, no Board members holding key positions within the Board and the organisation shall be family members related by blood/ marriage or adoption.
- E. Examples of areas where conflict must be disclosed are, but are not limited to:
 - 1. Current, past or potential contracts with vendors
 - 2. Vested interest in other organisations that have dealings or relationship with the NGO
 - 3. Joint Ventures
 - 4. Recruitment of staff or board member with close relationship

X. Financial and Non Financial Disclosures

Principle:

- A. NGOs being voluntary organisations, providing services for the good of the public and having donated funds as their major source of income for their operations, shall have sound financial management and compliance with applicable laws to ensure accountable, transparent and legitimate use of their resources. The NGOs shall demonstrate their openness to the public by providing their key stakeholders and the public with information about their mission, programme, activities and finances.

Guidelines:

The Board will ensure high standards of financial and non-financial disclosures covering the following:

- B. Audit of Financial Accounts and operations conditions of the NGO
 - 1. NGOs with a budget exceeding Tk 1,000,000 shall appoint an Internal Auditor.
 - 2. The Board shall ensure an annual audit of financial accounts by an approved External Auditor.
 - 3. The Board shall ensure internal control systems with documented procedures.
- C. Overall percentage of Administrative cost against actual organisation's funds/budget
 - 1. The overall administrative cost compared to the organisations total fund should not exceed 15% of total funds/budget identifying both general organisational overhead and administration and programme management costs.
 - 2. In the event that an organisation's administrative cost exceeds this limit, the Board will be required to include a statement explaining the reasons for this deviation in the Annual Report.
- D. Investment plan and capital investments (if any)
 - 1. The NGO shall maintain a Fixed Assets Register to account for all the fixed assets and their updated actual value against book value.
 - 2. The Board shall put in place a policy to ensure that the facilities and fixed assets of the NGO are efficiently utilised for maximum value of the organisation.
- E. Procurement procedures and control
 - 1. The NGO, with the authority of the Board shall call for quotations or tender where the purchase of goods or services exceeds the value of Tk. 500,000 or any other amount as per the organisation's constitution.
 - 2. Cheques and other mode for payments or withdrawals from the NGO's bank account shall be signed by at least 2 (two) authorised signatories.
- F. Accounting Standards
 - 1. Financial statements with comparative budget figures shall be presented at the Board meeting, with analysis and explanations for major variances, if any, for Board discussion and adoption.

2. The Board of NGOs with an organisational budget exceeding Tk. 1000,000 shall ensure periodical internal audit on controls, processes.
3. Annual accounts shall be in accordance with International Accounting Standards as adopted by Bangladesh.

G. Appointment and Terms of Auditors

1. Auditors shall be appointed and approved at the AGM by the General Body of members.
2. Auditors will be appointed for a term of 3 (three) years and a maximum term of 5 (five) years. This is to ensure transparency and authenticity of the Auditors' report and also ensure strategic continuity.

XI. Fundraising Policies

Principle:

- A. Charitable donations are an important source of financial support for NGOs. NGOs shall adopt proper procedures to ensure honest and ethical fundraising policies destined solely for the causes of the NGOs.

Guidelines:

The Board should therefore ensure as follows:

- B. The NGO shall take care to ensure that all solicitation materials consists of accurate information and reflect the NGO's mission and intended use of the solicited funds.
- C. The fundraising solicitation material shall respect the dignity of the clients and confidentiality of their personal information.
- D. The NGO shall avoid raising excessive funds that are kept in reserves instead of being utilised in the programmes and shall in any case exercise all due prudence in managing these reserves.
- E. The NGOs shall ensure that the donations and funds are properly managed and accounted for. There shall be timely receipting and prompt banking of funds, prompt issuance of tax-deductible receipt (if applicable) and prompt production of audited statements of Income and Expenditures at the end of each financial year.
- F. The NGO shall have an explicit policy in its constitution covering the distribution of any unused funds to donors or to equivalent NGOs with a similar vision in the event of discontinuation of operations of the NGO.
- G. NGOs with more than one bank account must disclose all accounts and account details to their Internal and External Auditors.
- H. The NGOs shall ensure that the fund and donations are used in accordance with donors' NGO terms of agreement. The NGO whenever applicable and practicable, will have to obtain the express consent of the donor before altering the conditions of the fund or donations.
- I. NGOs shall not pay, seek or accept any donations related to any political party at any time.
- J. NGOs shall not raise funds on commission basis.

SECTION TWO

MFI GUIDELINES

Including the principles and guidelines mentioned above, the following additional guidelines apply to NGO-MFIs.

I. Board Qualifications

- A. The Board of MFIs shall have a minimum of 2 (two) Board members with financial background and at least 1 (one) member with MFI background.
- B. In the event that the NGO is involved in other development activity besides Micro Finance (MF), they shall have a special MF programme committee that will deal with the MF issues and ensures that the programme meets all the requirements applicable to the sector.

II. Communications

- A. For the Board of an MFI to operate effectively they shall receive the following communications from management on a monthly basis:
 - 1. Details of Loan Portfolio
 - 2. Comprehensive financial report
 - 3. Loan repayment due and not received
 - 4. Profitability of individual loan products
 - 5. Caseload of Credit officers
 - 6. Variance in budget forecast, loan portfolio, liquidity, income and expense and actual results
 - 7. Rates of Interest
 - 8. Loan loss provision
- B. The Board shall be well versed with the interpretations of the above information and their relevance to the organisation's strategy.
- C. The organisation shall have frequent communications with clients through annual workshops such as Chief Kendra (Client group) workshops to ensure client views are represented in the strategy.
- D. Communications from Kendra (Client group) workshops shall be printed and incorporated into the programme to ensure the programmes offered are need-based.
- E. The organisation shall print its Annual Report in both English and Bangla and ensure that it is widely distributed and accessible to all stakeholders.

III. Financial disclosures

- A. Including the above financial disclosures MFIs shall also disclose the following financial information in their Annual Report:

1. Portfolio size
2. Loan size
3. Savings size
4. Reinvested percentages
5. Repayment rates
6. Default rates with range and average size of default
7. Analysis of default clients and circumstances
8. Types of investments and percentage of capital actually invested.
9. Minimum of three years financial trend

IV. Auditors

- A. All MFIs should have external independent and reputed auditors to conduct the annual audit of accounts of the organisation
- B. It is highly recommended that MFIs with a loan portfolio of TK. 1,000,000 amount shall have Internal Auditors.
- C. Annual accounts shall be in accordance with International Accounting Standards as adopted by Bangladesh.
- D. All statements of audited reports shall be printed in the Annual Report of the organisation.
- E. The Auditors' report should not only give financial status of the organisation but also clarify Internal Control systems adopted by the organisation to protect its resources.
- F. Donors should review the auditors' reports to ensure that they offer a true and fair report on the organisation's operations and finances.

SECTION THREE

ANNEX 1: COMMENTARY AND ANNOTATIONS²⁶

I. Role And Responsibilities of Boards of Directors

Most of the literature on governance focuses its analysis within the framework of a given corporate structure: a for-profit corporation, a non-profit entity, or a public agency. Such approaches implicitly assume that the board of directors' behaviour is defined by the corporate structure it governs. While acknowledging that corporate structure affects the achievement of effective governance, it does not define it. The following is a broad definition of effective governance that can be applied regardless of the corporate structure of an institution.

A board of directors is entrusted with the fiduciary affairs of the corporation. The term "fiduciary" refers to a person or persons to whom property or power is entrusted for the benefit of another. Treating directors and managers as fiduciaries provides a mechanism for imposing sanctions if they fail to exercise their responsibilities to the corporation, without necessarily requiring that all of those responsibilities be detailed in advance. As explained by legal scholars "the fiduciary principle is an alternative to elaborate promises and extra monitoring. It replaces prior supervision with deterrence, much as criminal law uses penalties for bank robbery rather than pat-down searches of everyone entering banks." ²⁷

II. Duties of a Board Director

The standards of conduct applicable to individual board directors fall into three categories: Duty of Care, Duty of Loyalty, and Duty of Obedience. These concepts provide a "code of behavior" that serves to frame the way board members carry out their respective roles and responsibilities.

A. Duty of Care

The Duty of Care calls on a director to participate in the decisions of the board and to be informed on the data relevant to such decisions. A common statement of the Duty of Care asks a director (1) to be reasonably informed, (2) to participate in decisions, and (3) to do so in good faith and with the care of an ordinarily prudent person in similar circumstances. To discharge the Duty of Care efficiently and effectively, directors must attend meetings, exercise independent judgment, and ensure that they have an appropriate level of understanding of the issues critical to the institution.

B. Duty of Loyalty

The Duty of Loyalty requires directors to exercise their powers in the interest of the corporation and not in their own interest or in the interest of another entity or person. By assuming a board position, directors acknowledge that for any corporate activity, the best

²⁶ MFI Governance Review, Josephine Oguta and S.M. Rahman, sponsored by DFID-Bangladesh/Bangladesh MFI Local Consultative Group.

²⁷ Frank H. Esterbrook and Daniel R. Fischel.

interests of the corporation must prevail over their individual interests or the particular interests of the constituency that selected them.

The Duty of Loyalty primarily relates to conflicts of interest, corporate opportunity, and confidentiality. Directors may have interests in conflict with those of the corporation. The Duty of Loyalty requires that a director be conscious of the potential for such conflicts and act with candor and care in dealing with such situations.

Conflicts of interest are neither inherently illegal nor are they to be regarded as a reflection on the integrity of the board or of the director. Once a director discloses a potential conflict of interest issue, it is the board's interpretation of the issue that will determine if it is a proper or improper transaction. Corporate opportunity is another area related to Duty of Loyalty. It requires that a director, before engaging in a transaction that he or she knows may be of interest to the corporation, inform the board of directors in sufficient detail and adequate time to allow it to act or decline to act to a director's possible involvement in that transaction.

C. Duty of Obedience

The Duty of Obedience requires board members to be faithful to the institution's mission. Although board members have the authority to determine how the institution is to best meet its mission, they are prohibited from behaving in a manner inconsistent with the basic institutional objectives. The Duty of Obedience grows, in part, out of nonprofit organizations' heavy reliance on the public's trust when soliciting donations and grants. In turn, the public has the right to be assured that such funds will be used for the purpose for which they are given. In for-profit organizations, the responsibility is toward the investors (both equity and debt), especially if the funds are from public sources. In this context, being faithful to the institutional mission translates into maximizing stakeholder value (and in some cases, like microfinance, balancing profitability with social impact), in a manner consistent with ethical practices.

III. Legal Obligations of the Board

As a fiduciary, the board of directors has several legal obligations. First, the board must ensure that the institution complies with its articles of incorporation, bylaws, and internal policies and procedures. Further, the board must ensure that the institution maintains its legal status. The board must also ensure that the institution complies with government rules and regulations, which will vary with the institution's corporate structure. For example, as a microfinance institution becomes regulated, it will be subject to a new set of regulatory requirements that the board must understand. A final element of the board's legal obligations is the level of personal liability of individual directors for the institution's activities. Such liability varies by country, yet board members must be keenly aware of the degree of responsibility and immunity provided for them by local law. Under many banking laws, the liabilities may be criminal.

In representing the interests of a third party and fulfilling their legal obligations, boards delegate responsibility to management and hold management internally accountable to a set of objectives and performance standards that the board has defined. However,

achieving these standards and objectives can be impaired and effective governance diminished when board members are unclear about their role. For example, a director may assume that activities related to operations are part of his or her responsibilities and may hinder management's ability to perform effectively or management's accountability. Similarly, a CEO/MD may depend too much on a board and request its input on decisions outside of the board's domain.

IV. Relationship Between Board and Executive

Although the relationship between a board and the executive director or CEO/MD is dynamic, it must be grounded in a clear understanding of the roles each serves. Effective governance strikes the appropriate balance in the relationship between a board of directors and management in their combined efforts to move the institution forward. Each brings unique skills to this joint effort and views the institution from a different lens. Together they add value precisely because they are complementary. It is suggested that this complementary nature exists because board and executives use different frames of reference to understand the institution and to deploy their responsibilities. Unlike the executive /management role which may be vested in one person, the role of the board is vested in a team.

Effective boards carry out their responsibilities by (1) maintaining operational distance from the institution to enable an aerial perspective, (2) drawing on the institutional memory of the directors, and (3) making binding decisions as a group. Board decisions are based on the voice of the majority. Arriving at a consensus may be time-consuming and decrease the board's operating expediency, but the process is essential to a well-functioning board. These three factors empower the board and add significant value to the management of the institution.

Management, in contrast, is intimately involved in daily operations, has an up-to-date and in-depth understanding of the immediate challenges and opportunities facing the institution, and the flexibility to react quickly. An institution's executive will consult with senior management on key issues but is individually accountable. What then is the optimal balance between these two sets of circumstances and perspectives and how do they meld to create effective governance?

Effective governance requires boards to focus on three major areas of responsibility: (1) management accountability, (2) strategic planning and policy-making, and (3) self-regulation. These three areas allow the board to fulfill its fiduciary obligations, and each requires board members to perform specific tasks, as outlined below.

V. Major Area of Responsibility and Board Tasks

A. Management Accountability

To ensure that management is held accountable for the activities of the organization, a board must first focus on the process and mechanisms it uses to identify a competent executive. Second, it must set clear and measurable goals. Third, a board must monitor the performance of the executive. Finally, it must be able to identify managerial

weaknesses and confront them when these adversely affect the institution. If necessary, the board must be prepared to remove the CEO/MD.

B. Install Management Capacity

Hiring a strong, competent CEO/MD is one of the primary functions of a board of directors. This individual, as the operational leader for the institution and the representative of the entire staff to the board, plays a key role in the long-term success of the institution and in the realization of effective governance. A board can only be as effective as the CEO/MD it appoints, and therefore it must consider this a core responsibility.

C. Set Goals

Once an executive is in place, the board's role is to monitor the performance and progress of the institution through its oversight of the CEO/MD. Well-functioning boards spend the required time working with management to define goals and set targets for the institution. They then monitor the institution's attainment of these goals and targets by assessing the executive's performance. Boards identify the key areas in which an executive should perform effectively.

Vision refers to management's capacity to define a long-term view of the institution's future, which is critical for its sustainability over time. Management's vision should be clearly defined and the steps to its achievement well conceived. The vision is articulated in a strategic plan, which also outlines the main program areas of the institution and the results that are expected. For example, key benchmarks for a nonprofit microfinance institution against which management performance is measured will likely include targets for scale of operation, market penetration, level of self-sufficiency of the institution, legal structure required to reach targets, level of efficiency of the operations, and quality of the assets.

D. Assess Management

A board assesses a CEO/MD's ability to manage the institution's human resources. This area addresses issues of productivity, performance, and development of staff. Additionally, a board reviews the organizational structure of the institution to ensure its adequacy for the effective deployment of its operations.

The CEO/MD is responsible for maintaining an institution's financial solvency. In the for-profit context, this includes generating a return to investors. In the nonprofit context, a balanced budget or surplus is expected. Although losses or deficits may be acceptable in the short term for well-defined circumstances, a board should not allow repeated poor financial performance. Asset quality and the ability to mobilize financial resources are also key in obtaining good financial results.

The CEO/MD is responsible for ensuring an effective board-staff relationship. This relationship is a product of the official, formal board meetings and the numerous informal interchanges that occur between individual board directors, the CEO/MD, and individual staff members. Among the factors that contribute to this relationship are the extent to

which the board is well informed and prepared for meetings, the strength of the working relationships between board directors and staff, and the degree to which individual directors are knowledgeable of the institutional mission. It is generally understood that board members have access to an institution's staff but will use judgment in their interactions so as not to distract the business operation of the institution or undermine the CEO/MD. Additionally, boards often invite senior staff members other than the CEO/MD to attend board meetings. This provides the board with additional insight into areas under discussion and allows board members to have exposure to staff with future potential for senior management positions.

How can the board of a NGO most effectively ensure that management attains the established goals and objectives? The effective monitoring of executive performance requires the following elements:

1. Availability of information

The board must have timely access to the appropriate information.

2. Clarity of objectives

Strategic goals and objectives against which the performance of a particular period is measured must be clearly articulated. This is a prerequisite to receiving the right information.

3. Candor

The executive must report to the board with candor and the level of detail and analysis necessary for effective board deliberations. For example, an executive cannot withhold information from the board about a situation or crisis that may seriously affect the institution, even if that member thinks it will be resolved soon.

4. Analytical rigor

Board members must have the analytical skills to pose the right questions and to be incisive in their discussion of institutional performance.

5. Incentives

One approach to motivate management's performance in attaining the mutually agreed upon goals is to create incentive mechanisms. The latter should align the well-being and interest of the individual manager with what is good for the institution and by extension, in the case of for-profit corporations, the shareholders. The need for such incentive plans arises because in most organizational structures in the private sector, ultimate ownership of the assets may reside in the shareholders but day-to-day control of those assets rests in the hands of management. In the nonprofit setting, the tension could also exist between individual and institutional priorities. Examples include individual job security and comfortable stability versus rapid institutional change, and personal friendships versus job performance. In designing an incentive scheme for the executive of an institution, it is important to consider focus, control, logic, and targets.

6. Focus

Key indicators in the incentive scheme must be limited to those few factors that truly matter. In microfinance, although portfolio size and quality are obvious indicators related to effective management, financial performance and the number and characteristics of clients are examples of additional indicators that could be utilized.

7. Control

Incentives should reward people for issues that are within their control and for a behavior that they can directly affect. Incentive schemes should be simple. No more than five, and preferably fewer, variables should be selected. Staff should readily understand the mechanics of the plan.

8. Logic

The rationale for the selected indicators should be clear for them to have legitimacy.

9. Targets

The targets set must be measurable and achievable. It is no use to select a variable that everyone agrees is very important, like customer service, but no one knows how to measure reliably, or to set targets that are unattainable.

10. Confront Weaknesses

In assessing the performance of the executive, the board must also be willing to confront institutional and management weaknesses and act to address them. Countless examples have shown that effective management competency and conduct cannot be taken for granted. It is incumbent upon the board to identify those areas in which the institution displays poor performance because of weak management practices. Examples might include poor financial controls, low staff morale, or weak information systems. A board's responsibility is to demand and support management in strengthening these areas and to monitor the process of improvement. The strength of trust between the board and management and the level of the board's exposure to other members of senior management facilitates this process. Institutional and management weaknesses fall on a spectrum of severity. On one end are procedural matters that may result from management inexperience and require a practical solution. On the other end are actions that may include fraud. In either case—incompetent performance or fraudulent actions—boards must be willing to confront and, in the worst case, fire the CEO/MD.

Confronting management, however, can be a difficult and uncomfortable task for a board. The pitfalls of “group think” often are played out, with no single individual willing to step out in front of the others and challenge a CEO/MD. This may be due to a sense of personal loyalty to the CEO/MD or to the chair of the board. Individual directors may also hesitate to act because they are unsure that they have seen the full picture; in so doing, they may give the benefit of doubt to an incompetent or ill-intentioned CEO/MD. A board's ability and willingness to make the hard decisions and confront weakness in the executive, and therefore the institution, is a function of the following:

- Degree of board member independence from management;
- Leadership skills of individual directors;

- Climate that allows for dissension;
- Mechanisms or opportunities for the board as a group or individually to voice their concerns; and
- Effective ownership stake in the institution or strong identification with the objectives of the organization.

Many times, with the best of intentions, boards are tempted to assist an under-performing CEO/MD by assuming the management of certain tasks or projects. This approach is extremely damaging because it both obscures the accountability of the CEO/MD and delays addressing that individual's underlying incompetence. Additionally, it displaces decision making from those that are close to operations (management) to others who are remote (board). Accordingly, board assumption of management duties should be assumed only after the board has decided on a permanent solution to the deficiency and only as a temporary solution in the absence of any other alternative.

E. Strategic Planning and Policy Setting

The second major area of board responsibility is strategic planning and policy making. However, although effective governance assumes that the strategic planning process involves the board in a significant way, the board should include and expect strategic thinking to be part of the leadership qualities that the top executive brings to the institution. The distance and diversity of experiences of board directors enables them to bring a perspective to the institution unique from that of management. If the board does not add significant value to the institution's strategic plan, it is not performing its duty. The board should provide guidance and input in three distinct areas: charting the institution's strategic course, setting broad operational policies for the institution, and resolving strategic issues as they arise.

1. Providing Direction

It is not uncommon for daily operational priorities to overtake the more thoughtful process of strategic planning. Effective governance requires that the board raise strategic issues that may not otherwise be addressed and, thus, significantly contribute to identifying and setting long-term goals for the institution. Exceptions, the board's role in setting policy should differ from that of management not by topic but by levels within topics. For example, it is typical for management to bring to the board general policies on compensation. In this matter, the board might decide that the institution should compensate its staff with packages that are competitive with other institutions of the same size and scope. The actual wage and salary administration plan is then left up to management. Or a board might be involved in setting a policy on the characteristics of the neighborhoods in which it wants to establish additional branch offices, and management is left to determine the specific locations. A policy-centered approach allows a board to effect the most change and to place all operational and administrative activities of the institution within the framework of defined policies. This approach also encourages the recruitment of individual directors with general strategic management skills who are more likely to keep the board focused on its governing mandate.

In actuality, everyone in the organization unknowingly sets policy or impacts strategic direction in their daily activities. A board can be most valuable in establishing a clear, accessible set of overarching policies that synchronizes these various levels.

2. Developing and Mobilizing Solutions

Boards that go beyond the above-mentioned elements—providing key input in charting a strategic direction and in defining general policies—assist the institution in identifying tactics and solutions for reaching its goals. In this sense, the board provides governance *plus guidance*. Additionally, a board that includes individuals with specific technical skills might assist the institution in addressing legal issues, public relations, and fundraising concerns or topics related to technology or pricing.

F. Board Self-Assessment

A final area of effective governance involves the board's assessment of itself as a body of individuals and as a permanent entity. Three areas constitute the core of any assessment that the board conducts on itself: continuity, renewal, and evaluation.

1. Continuity

Of great value to management is that the board and its individual directors possess an institutional perspective. In cases of management turnover, this perspective of the board is unique. Even when there has been continuity at the executive level, the board perspective adds greatly given its collective experience. The board must therefore be responsible for maintaining this continuity by ensuring that even with natural attrition, the board's "institutional memory" is preserved. The design of board terms and succession policies, as well as a corporate binder, are the mechanisms used to ensure continuity.

2. Renewal

Having stated the need for continuity, so too is there a need for an infusion of new directors who bring fresh perspectives, talents, and expertise. Working with management, board members can fundamentally shape effective governance by identifying new directors who could enhance the board operation. Ideally, board composition is a balance of the old and new.

3. Evaluation

As discussed earlier, given the contradictory frames of reference of boards and management, by definition board performance is vulnerable to being undermined by a set of complex dynamics. An effective board recognizes its own weaknesses and has in place mechanisms for self-evaluation. Board performance can be assessed under three categories: the role, the working style, and the directors themselves. Though still an infrequent part of board processes, self-evaluation is being embraced by increasing numbers of entities.

ANNEX 2: SAMPLE BOARD MEMBER JOB DESCRIPTION

The statutory duties of a Board Member are:

- To ensure that the organisation complies with its governing document, law, and any other relevant legislation or regulations
- To ensure that the organisation pursues its objectives as defined in its governing document
- To ensure the organisation uses its resources exclusively in pursuance of its objectives: the organisation must not spend money on activities which are not included in its own objectives, no matter how worthwhile or charitable those activities are
- To contribute actively to the board's role in giving firm strategic direction to the organisation, setting overall policy, defining goals and setting targets and evaluating performance against agreed targets
- To safeguard the good name and values of the organisation.
- To ensure the effective and efficient administration of the organisation
- To ensure the financial stability of the organisation
- To protect and manage the property of the NGO and to ensure the proper investment of the funds
- To appoint the chief executive officer and monitor his/her performance

In addition to the above statutory duties, each Board Member should use any specific skills, knowledge or experience they have to help the Board Members reach sound decisions. This may involve:

- Scrutinising board papers
- Leading discussions
- Focusing on key issues
- Providing guidance on new initiatives
- Other issues in which the Board Member has special expertise

A Board Member should have the following qualities:

- Commitment to the organisation
- Willingness to devote the necessary time and effort
- Strategic vision
- Good, independent judgement
- Ability to think creatively
- Willingness to speak their mind
- Understanding and acceptance of the legal duties, responsibilities and liabilities of the Board
- Ability to work effectively as a member of a team
- Commitment to the seven principles of public life: selflessness, integrity, objectivity, accountability, openness, honesty and leadership

ANNEX 3: SAMPLE CONFLICT OF INTEREST POLICY

Potential conflicts of interest need to be carefully considered and correctly managed. Members should think about potential or perceived conflicts as well as actual conflicts - they can be just as damaging. It is good practice to have an agreed policy and practice that Board members follow when considering conflicts of interest. The starting point should always be the organisation's governing documents e.g Constitution, By-laws, Memorandum and Articles, etc.

A policy on conflicts of interest can include:

1. A Code of Conduct for board members.
2. Register of personal interests.
3. A procedure for identifying conflicts.
4. A procedure for withdrawing from discussion and decision.
5. A procedure for minuting of this process.
6. Sample policy on conflicts of interest.
7. Any Board member who has a financial interest in a matter under discussion, should declare the nature of their interest and withdraw from the room, unless they have a dispensation to speak.
8. If a Board member has any interest in the matter under discussion, which creates a real danger of bias, that is, the interest affects their, or a member of their household, more than the generality affected by the decision: they should declare the nature of the interest and withdraw from the room, unless they have a dispensation to speak.
9. If a Board member has any other interest which does not create a real danger of bias, but which might reasonably cause others to think it could influence their decision, they should declare the nature of the interest, but may remain in the room, participate in the discussion, and vote if they wish.
10. If in any doubt about the application of these rules they should consult with the chair.
11. It is recommended that Board member's interests are listed in a register.

Examples of good practice

1. When Board members become aware of a new, actual or potential conflict of interest, they should give notice of it to the Secretary to enable him/her to update the Conflicts Register.
2. The Secretary should include in their report for each Board meeting details of any contracts/agreements to be entered into prior to the next meeting of the Board members and any potential conflicts identified from a check of the Register.
3. Competitive tendering for contracts or work for which a Board member might be suited (and taking up references from other clients or customers).

ANNEX 4: SAMPLE TERMS OF REFERENCE FOR A FINANCE AND AUDIT COMMITTEE

[The square brackets contain recommendations which are in line with best practice but which may need to be changed to suit the circumstances of the particular organisation.]

The Board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the auditors

The main role and responsibilities of the Audit Committee should be set out in written terms of reference which express a clear need for a Financial and Audit Committee (“the Committee”).

The Financial and Audit committee arrangements need to be proportionate to the task, and will vary according to the size, complexity and risk profile of the organisation.

As with most aspects of corporate governance, the above principles make it clear that, not only should organisations go through a formal process of considering their internal audit and control procedures and evaluating their relationship with their external auditor, but they must be seen to be doing so in a fair and thorough manner. It is, therefore, essential that the Committee is properly constituted with a clear remit and identified authority.

As regards the make up of the Committee, the Board should satisfy itself that at least one member of the Committee has recent and relevant financial experience. Others members of the organisation may be required to assist the Committee from time to time, according to the particular items being considered and discussed.

The Financial and Audit Committee should appoint a Chair and a Secretary who must attend all meetings and ensure that the meetings are properly constituted and proceedings properly minuted.

The frequency with which the Committee needs to meet will vary from organisation to organisation and may change from time to time. As a general rule, most Finance and Audit Committees would be expected to meet at least quarterly.

The lists of duties proposed below are those, which we believe all Finance and Audit Committees should consider. Some organisations may wish to add to this list and some smaller organisations may need to modify it in other ways.

A description of the main activities of the year to:

- a) Monitor the integrity of the financial statements;
- b) Review the integrity of the internal financial control and risk management systems;
- c) Review the independence of the external auditors, and the provision of non-audit services;
- d) Describe the oversight of the external audit process, and how its effectiveness was assessed;
- e) Explain the recommendation to the Board on the appointment of auditors.

.

The Chairman of the Committee should attend the AGM prepared to respond to any questions that may be raised on matters within the Committee's area of responsibility.

Membership

The Board shall appoint members of the Committee. The Committee shall be made up of at least [3] members. All members of the Committee shall have recent and relevant financial experience. The Chairman of the Board shall not be a member of the Committee.

Only members of the Committee have the right to attend Committee meetings. However, other individuals such as the Chairman of the Board, Chief Executive, Finance Director, other Board members, internal audit and representatives from the finance function may be invited to attend all or part of any meeting as and when appropriate. The external auditors will be invited to attend meetings of the Committee on a regular basis.

Appointments to the Committee shall be for a period of up to one Board term, which may be extended according to the organisation requirements but for a maximum of a further term. The Board shall appoint the Committee Chairman who shall not be a member of staff. In the absence of the Committee Chairman and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.

Quorum

The quorum necessary for the transaction of business shall be [3] members. A duly convened meeting of the Committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers and discretions vested in or exercisable by the Committee.

Frequency of Meetings

The Committee shall meet [*at least three times a year at appropriate times in the reporting and audit cycle*] and otherwise as required.²⁸

Notice of Meetings

Meetings of the Committee shall be summoned by the Secretary of the Committee at the request of any of its members or at the request of external or internal auditors if they consider it necessary.

Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the Committee, any other person required to attend no later than [5] working days before the date of the meeting. Supporting papers shall be sent to Committee members and to other attendees as appropriate, at the same time.

²⁸ The frequency and timing of meetings will differ according to the needs of the organisation. Meetings should be organised so that attendance is maximised (for example by timetabling them to coincide with Board meetings).

Minutes of Meetings

The Committee Secretary shall minute the proceedings and resolutions of all meetings of the Committee, including recording the names of those present and in attendance. The Secretary shall ascertain, at the beginning of each meeting, the existence of any conflicts of interest and minute them accordingly. Minutes of Committee meetings shall be circulated promptly to all members of the Committee and, once agreed, to all members of the Board.

Annual General Meeting

The Chairman of the Committee shall attend the Annual General Meeting prepared to respond to any questions on the Committee's activities.

The Committee should carry out the following duties as explained below:

- Financial Reporting
- Internal Controls and Risk Management Systems
- Internal Audit
- External Audit

Financial Reporting

The Committee shall monitor the integrity of the financial statements of the organisation, including its annual and interim reports, and any other formal announcement relating to its financial performance, reviewing significant financial reporting issues and judgements which they contain.

The Committee shall also review summary financial statements; significant financial returns to regulators and any financial information contained in certain other documents.

The Committee shall review and challenge where necessary:

1. The consistency of, and any changes to, accounting policies both on a year on year basis and across the organisation/group;
2. The methods used to account for significant or unusual transactions where different approaches are possible;
3. Whether the organisation has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
4. The clarity of disclosure in the organisation's financial reports and the context in which statements are made; and all material information presented with the financial statements, such as the operating and financial review
5. The Committee shall review the annual financial statements where not reviewed by the Board as a whole.

Internal Controls and Risk Management Systems

The Committee shall:

1. Keep under review the effectiveness of the organisation's internal controls and risk management systems; and

2. Review and approve the statements to be included in the Annual Report concerning internal controls and risk management ²⁹.

Internal Audit

The Committee shall:

1. Monitor and review the effectiveness of the organisation's internal audit function in the context of the organisation's overall risk management system ³⁰;
2. Approve the appointment and removal of the head of the internal audit function;
3. Consider and approve the remit of the internal audit function and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee shall also ensure the function has adequate standing and is free from management or other restrictions;
4. Review and assess the annual internal audit plan;
5. Review promptly all reports on the organisation from the internal auditors;
6. Review and monitor management's responsiveness to the findings and recommendations of the internal auditor; and meet the head of internal audit at least once a year, without management being present, to discuss their remit and any issues arising from the internal audits carried out. In addition, the head of internal audit shall be given the right of direct access to the Chair of the Board and to the Committee.

External Audit

The Committee shall:

1. Consider and make recommendations to the Board, to be put to the General Body for approval at the AGM, in relation to the appointment, re-appointment and removal of the organisation's external auditor. The Committee shall oversee the selection process for new auditors;
2. Oversee the relationship with the external auditor including (but not limited to):
 - a. Approval of their remuneration, whether fees for audit or non audit services and that the level of fees is appropriate to enable an adequate audit to be conducted;
 - b. Approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
 - c. Satisfying itself that there are no relationships (such as family, employment, investment, financial or business) between the auditor and the organisation (other than in the ordinary course of business);
 - d. Agreeing with the Board a policy on the employment of former employees of the organisation's auditor, then monitoring the implementation of this policy;

²⁹ Unless this is done by the Board as a whole.

³⁰ If the organisation does not have an internal audit function, the Committee should consider annually whether there should be one and make recommendation to the Board accordingly. The absence of such a function should be explained in the Annual Report.

- e. Monitoring the auditor's compliance with relevant ethical and professional guidance on the rotation of audit partners, the level of fees paid by the organisation compared to the overall fee income of the firm, office and partner and other related requirements;
- f. Assessing annually their qualifications, expertise and resources and the effectiveness of the audit process which shall include a report from the external auditor on their own internal quality procedures;
- g. Meet regularly with the external auditor, including once at the planning stage before the audit and once after the audit at the reporting stage. The Committee shall meet the external auditor at least once a year, without management being present, to discuss their remit and any issues arising from the audit;
- h. Review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement;
- i. Review the findings of the audit with the external auditor. This shall include but not be limited to, the following;
 - i. a discussion of any major issues which arose during the audit,
 - ii. any accounting and audit judgements, and
 - iii. levels of errors identified during the audit.
- 3. The Committee shall also review the effectiveness of the audit.
- 4. Review any representation letter(s) requested by the external auditor before they are signed by management;
- 5. Review the management letter and management's response to the auditor's findings and recommendations; and
- 6. Develop and implement a policy on the supply of non-audit services by the external auditor, taking into account any relevant ethical guidance on the matter.

Reporting Responsibilities

The Committee Chairman shall report formally to the Board on its proceedings after each meeting on all matters within its duties and responsibilities.

The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed.

The Committee shall compile a report to shareholders on its activities to be included in the organisation's Annual Report.

Other Matters

The Committee shall:

- 1. Have access to sufficient resources in order to carry out its duties, including access to the organisation secretariat for assistance as required;
- 2. Be provided with appropriate and timely training, both in the form of an induction programme for new members and on an ongoing basis for all members;
- 3. Be responsible for co-ordination of the internal and external auditors;

4. Oversee any investigation of activities which are within its terms of reference and act as a court of the last resort; and
5. At least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval.

Authority

The Committee is authorised:

1. To seek any information it requires from any employee of the organisation in order to perform its duties;
2. To obtain, at the organisation's expense, outside legal or other professional advice on any matter within its terms of reference; and
3. To call any employee to be questioned at a meeting of the Committee as and when required.

RESOURCES

OECD Principles of Corporate Governance

Commonwealth Principles

Principles and Practices of Microfinance Governance, by R Rock, M Otero, S Saltzman, ACCION International, August 1998

Microfinance Newsletter, Corporate Governance of Microfinance in Bangladesh, by Credit Development Forum

CCH Corporate Governance, A Director's Handbook, 1999

The 7 Habits of Highly Effective people, By Stephen Covey, - The Business library, 1989

Business Ethic Research Conference Paper –Corporate Governance and Audit independence: A Trilogy. By Irene Tempone and Antoinette Richardson School of Business, Swinburne University of Technology,

Current Governance Practices of MFIs, By Anita Campion, 1998

Harvard Business School Report, 2002

Raising Expectations of Corporate Governance, by PricewaterhouseCoopers, Aug' 2002

Power relations between boards and senior managers in the governance of public and non-profit organisations, by Chris Cornfoth, April 2001
CGAP – Website (www.cgap.org)

Increasing the Effectiveness of Charity Trustees and Management Committees, London, Charity Commission, 1992

Company Secretarial Practice, Corporate Governance, ICSA Text

Societies Registration Act No. XXI of 1860, Bangladesh.

NGO Governance, An overview on Financial System, by K. Shivarkumar (India)

Guidelines for Selection of Partner Organization (PO) of PKSf

APPENDICES

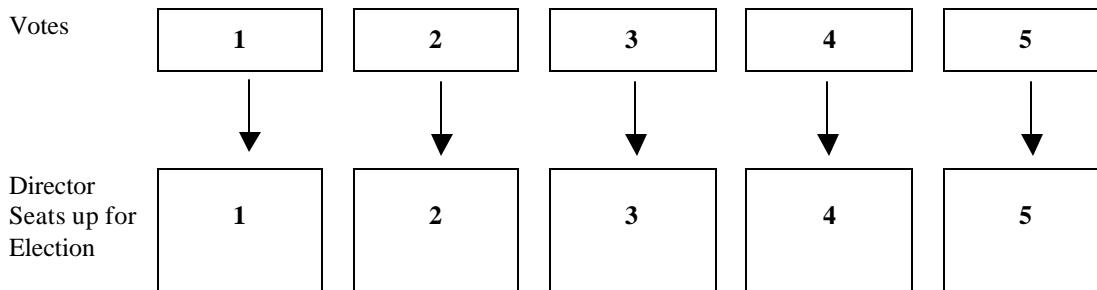
CUMULATIVE VOTING: A BRIEF DESCRIPTION

Cumulative voting is a voting procedure that allows shareholders to accumulate their votes for one or more candidates, thereby allowing minority shareholders to organise their votes to support a director candidate. An example is the best way to illustrate cumulative voting.

Example: A company has 5 seats on the Board of Directors due for election.

Standard Voting: One Share = One Vote per Director Seat

In the standard voting situation, a shareholder holding one share could cast five votes, one for each Board seat up for election; the shareholder can vote yes or no for each candidate.

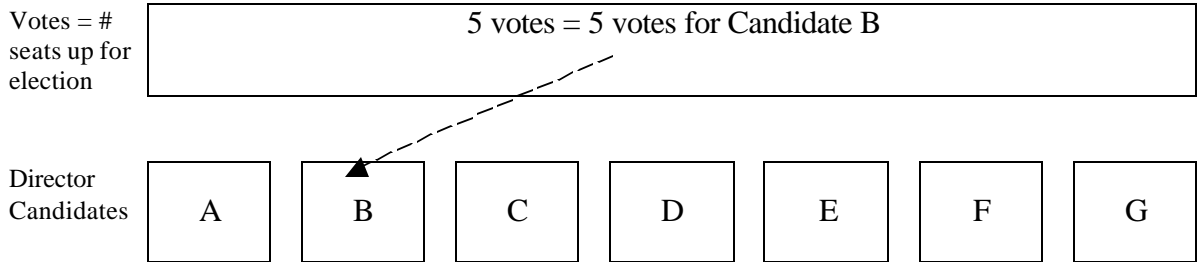


Cumulative Voting: Number of Votes = Number of Director Seats up for Election

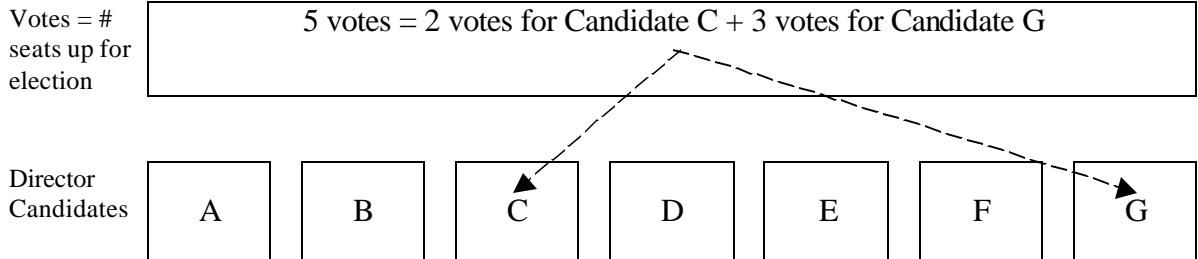
In a cumulative voting situation, a shareholder holding one share could cast five votes total. The votes could be cast all for one director candidate, one for each director seat, or their five votes could be distributed to any combination of the director candidates. (The two diagrams below show two possible alternative voting positions.) The five director candidates with the most votes will be elected to the open board seats. Effective cumulative voting requires that the number of candidates exceeds the number of seats up for election; the company must put forward multiple candidates for each seat or shareholders should nominate director candidates.

Cumulative voting allows minority shareholders to join collectively to elect a director of their choice. The number of votes required to elect a director depends on the number of seats up for election; in this example, with five seats up for election, 20% plus one vote will guarantee election, but a director could be elected with less if there are many candidates and votes are distributed widely.

Cumulative Voting Alternative 1: All five votes are cast for one director candidate.



Cumulative Voting Alternative 2: Five votes split between two candidates.



The ADB-SEC Corporate Governance recommendations supported mandatory cumulative voting for public listed companies. The OECD Asian Roundtable White Paper on Corporate Governance also recommended mandatory cumulative voting to protect the interests of minority shareholders.

SAMPLE SHAREHOLDERS' HANDBOOK

This provides a general outline of a Shareholders' Handbook. As per the requirements of the Code of Corporate Governance on the Role of Shareholders, each company should provide a Shareholders' Handbook to their shareholders to better enable shareholders to play their role in effective corporate governance. Each company will have unique and specific procedures and requirements as per their Articles of Association. The Shareholders' Handbook should include specific references to the company's Articles of Association that provide for the rights explained.

I. Classes of Shares: The Handbook should explain the various types and classes of shares, including the rights associated with each.

II. General meetings

- A. What is a general meeting? AGM? EGM?
- B. When should an AGM be held?
- C. What should be discussed?
- D. What is my role at an AGM?
- E. What information can I expect from a company prior to the AGM?
- F. What is the difference between an AGM and EGM?
- G. Who can call a general meeting?

III. Minority Shareholders Rights

- A. What is a "minority shareholder"?
- B. What rights do I have as a minority shareholder?
- C. How can I exercise my minority shareholder rights?

IV. Right to Dividends

- A. What is a dividend?
 - 1. Dividends are a payment to shareholders from the excess profits of the company. Dividends may only be paid out of the net profits of the company or previously undistributed profits. If there are no such profits, dividends may not be paid.
- B. Do shareholders receive dividends every year?
 - 1. Shareholders may not receive a dividend every year. There can be many reasons for not paying dividends. For instance, when the company makes a loss, it cannot pay dividends.
 - 2. Management and directors may also recommend not paying a dividend when the company has investment projects that will earn a high rate of return for the shareholders.
- C. How is a dividend decided?
 - 1. Dividends are recommended by the board and approved by the shareholders. Shareholders may not approve a dividend in excess of that recommended by the board.
- D. When the shareholders approve a dividend, all shareholders have the right to be paid a pro-rata portion of that dividend.

- E. Once the dividend is declared, shareholders should receive their dividend payments within two months.
- F. What is a Bonus Share?
 - 1. Bonus Share is another term for a stock dividend. Instead of cash paid for dividends, a new share or partial share is issued to each shareholder as a dividend payment.
 - 2. When a stock dividend is proposed, companies should explain to shareholders the potential dilution of their shareholding and the implications of such dilution. Cashflow implications of a bonus share issue should also be explained; bonus shares will not produce cash inflow but will increase cash outflow if the dividend rate is unchanged.
- G. How can my shares be transferred to a new owner?

V. Directors. The Shareholders' Handbook should include:

- A. The shareholders' right to nominate and elect directors, along with the procedures by which a director (or MD) can be removed.
- B. A statement to the effect that all directors represent all shareholders.
- C. Roles, restrictions, responsibilities, and liabilities of executive and non-executive directors should be disclosed to shareholders. The distinction and relationship between management and the board of a company should be explained.
- D. Directors' remuneration, including executive directors.
- E. The ratio of executive to non-executive directors.
- F. Shareholders should know the procedures for directors to excuse themselves from voting on items and contracts in which they have an interest.
- G. Shareholders should be informed of a register of directors' interests in contracts or arrangements of the company and their right to inspect such a register.

VI. Voting Rights

- A. Right to request a poll or ballot at a general meeting
- B. Right to proxy
 - 1. Any shareholder may elect a proxy to attend the AGM and vote their shares. The shareholder must inform the company in writing of their chosen proxy at least 48 hours prior to the AGM. The person elected as a proxy need not be a shareholder of the company.

VII. Reporting and Disclosures

- A. Shareholders have the right to receive information about company resolutions, decisions, and operations such that it can be understood by a layperson.
- B. Distribution of Annual Report. Annual reports and minutes of the AGM should be made easily available to shareholders.
 - 1. If shareholders are not provided with a copy of the Annual Report and minutes of the AGM, they should be informed where and how they can obtain a copy.
 - 2. Shareholders can also utilise the libraries of the SEC, DSE, and CSE to obtain information about public listed companies.

C. Annual reports should include:

1. Audited financial statements, which include Balance Sheet and Profit and Loss Accounts. The Handbook should explain what should be in the financial statements and a basic explanation of how to interpret the financial statements.
 2. Auditors' Report.
 3. Directors' Report
 4. Explanation of the company's performance and prospects for the future, include the business strategy and an analysis of the strengths, weakness, opportunities and threats.
 5. Clear identification of the company's risk factors and consequences.
 6. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
 7. Total shares authorised and allotted, as well as number of shareholders in various tiers of shareholding (e.g. number of shareholders with 100,000 or more shares).
- D. Companies should provide unaudited quarterly results to shareholders, as well timely information about events or results that will materially affect the company.
- E. Shareholders have the right to review public documents, including Articles of Association of a company, at the company's registered offices.
- F. Companies should disclose whether and how they are upholding: social corporate responsibilities (CSR); environmental responsibilities; workers' rights; gender rights; other standards/codes appropriate to the industry (e.g. consumer rights, passing quality control/safety standards)

VIII. Required Shareholder Approval

- A. Shareholders must approve all ordinary resolutions of the company put before the AGM, which include resolutions:
1. to increase, decrease, consolidate or divide all or any of its shares;
 2. to convert paid-up shares into stock and reconvert stock into paid-up shares, as well as subdivide shares; and
 3. to cancel shares which have not been taken or agreed to be taken by any person.
- B. Shareholder approval (three-fourths) is required for major company decisions, including:
1. To change the Memorandum or Articles of Association of the company
 2. To reduce share capital
 3. To reserve capital
 4. To remove a director from office
 5. To remove an auditor before the expiry of his term
 6. On winding up through the Court
 7. For a voluntary winding up because of excess liability
 8. To sanction all arrangements between a company and a creditor

IX. Rights Issues

- A. Rights Issue refers to an increase in share capital by a company. The procedure for a Rights Issue is defined in Section 155 of the Companies Act, 1994, Further Issue of Capital.
- B. Shareholders should be made aware of the criteria for the issue of Rights Shares, and the limitations of the issue of Rights Shares
- C. When a Rights Issue is put forward to the shareholders, a three-fourths majority should be required for approval.
 - 1. Directors should explain the reason for the Rights Issue and the suggested use(s) of the funds that will be raised.
 - 2. Shareholders should receive a clear explanation of the potential positive and negative outcomes of the Rights Issue, specifically the dilution effect should be clearly explained.
- D. After a Rights Issue, directors should report back to shareholders about the uses of the funds and the returns from said projects. Directors should provide an audited quarterly account of the Premium Share Account, which contains the proceeds from the Rights Issue.

X. Regulatory Bodies

- A. Shareholders should be made aware as to the role of the regulatory bodies.
- B. Shareholders should know and understand the procedures for upholding their rights, registering complaints/actions against a public company, its board, or any other entity, if those rights are abused.
- C. Regulatory bodies should disseminate the 'Rights and Responsibilities of Shareholders' in the public sphere, or ensure that companies include a Shareholders' Handbook in the prospectus for an IPO, so that potential shareholders may take an informed decision to subscribe.

SAMPLE CONTENTS OF AN ANNUAL REPORT

This appendix provides a sample of the contents of an Annual Report, drawing on the disclosures and requirements as explained in the Code of Corporate Governance. This sample contents can serve as a checklist of disclosures. In preparing an Annual Report, the principles of transparency and accountability should be kept in mind; the importance of explaining results and plans in a manner that is understandable to the average shareholder should be a primary concern.

I. Audited Financial Statements including:

- A. Balance Sheet
- B. Profit and Loss Accounts (Income Statement)
- C. Cashflow Statement

II. Auditors' Report, including fees paid to the audit firm for audit and non-audit work.

III. Annual Directors' Report should include the following items presented in a narrative format:

A. Directors' information

1. Directors' remuneration, including executive directors.
2. The ratio of executive to non-executive directors.
3. The procedures for directors to excuse themselves from voting on items and contracts in which they have an interest.
4. Shareholders should be informed of a register of directors' interests in contracts or arrangements of the company and their right to inspect such a register.
5. Directors' shareholding and any changes therein
6. Report on the relatives of directors as employees or members of the board and their shareholdings
7. Details of directors' remuneration
8. Persons who have attended Board meetings in the last year, included attendance of directors and any substitute directors.
9. Details of loans to directors
10. Information on related party transactions, such as the purchase or sale of shares in associated companies where the company itself has a shareholding, or where the other company has a shareholding in the company, or where members of the board jointly or severally have a significant shareholding equivalent to 5% or more of the total share, and also on operational links and trading transactions with related parties.

B. Ownership Information

1. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

2. Total shares authorised and allotted, as well as number of shareholders in various tiers of shareholding (e.g. number of shareholders with 100,000 or more shares) or patterns of equity holding by (i) shareholding category and (ii) percentage of shareholding in the company.

C. Company Information

1. Clear identification of the company's risk factors and consequences.
2. Explanation of the company's performance and prospects for the future, include the business strategy and an analysis of the strengths, weakness, opportunities and threats.
3. Statement of the company's policy and practice on Corporate Social Responsibility, Corporate Environmental Responsibility, and compliance with Bangladesh environmental standards.
4. Quantitative disclosure of sales and market share, local and foreign (if applicable)
5. Material risk factors and uncertainties
6. Explanation of results, including key results for divisions or business segments.

D. Compliance

1. Compliance Certificate, provided by the Company Secretary or other compliance officer, attesting that:
 - a. the company has duly filled all statutory returns during the year
 - b. the company has maintained all statutory books and registers, and in such order, as required by the Companies Act
 - c. the company has duly paid all applicable duties, levies and taxes to the exchequer during the year
 - d. the company has not paid or offered any gratification to any quarter
 - e. the company has practiced all corporate norms, rules and regulations as required by other regulatory authorities during the year under report
2. The Chairman of the Board, CEO and CFO should supply two additional statements:
 - a. That they are satisfied the company is a going concern and will be for at least a year from the date of the Balance Sheet.
 - b. On the effectiveness of the Company's internal control system and internal audit department. This should include any irregularities involving management or employees who have significant roles in the system of internal control. This statement should also be signed by the Chairman of the Audit Committee.

E. Financial and Accounting

1. The Balance Sheet and Profit and Loss Statement should be reviewed and signed off by the Chairman of the Board, MD/CEO and Head of Accounting or Finance (or CFO) to certify that, to the best of their knowledge, accounts:

- a. conform with BAS or if they do not disclosure has been made of material differences,
 - b. reflect a true and fair picture of the company, and
 - c. there are no post balance sheet events or off balance sheet items, non-disclosure of which can affect the ability of the users of the financial statements to evaluate the company or make decisions.
 - d. Assets are safeguarded against unauthorised use by the employees and/or management and/or third parties.
 - e. expenses incurred are for the purposes of the Company's business.
 - f. no material information has been omitted.³¹
2. Report on the end use of funds raised from the public by issuing shares or debentures
 3. Contractual agreements, if any, that would have a material effect on the accounts in the event of non-compliance
 4. Contingent liabilities and ongoing, pending, or likely legal actions against or by the company which may result in significant gain or loss to the company
 5. Creditors and details of material loans
 6. Details of investments, including market valuation, in equities, government bonds, and other securities
 7. Critical accounting policies, namely those accounting policies to which the financial results are particularly sensitive (e.g. depreciation and tax policy)
 8. Basis of estimates used in financial reporting (e.g. allowances for doubtful accounts, inventory obsolescence, intangible asset valuation and useful life, employees' benefit plans, etc.)
 9. Depreciation and tax policy
- F. Corporate Governance
1. Corporate Governance Statement which explains compliance and/or non-compliance with the Code of Corporate Governance.
 2. Disclosure as to how a shareholder may receive a Shareholders' Handbook or other source of information explaining the rights of shareholders and how to exercise those rights.

³¹ Section 189 of The Companies Act, 1994 clearly states that the financial statements have to be authenticated by not less than two directors one of whom shall be the managing director where there is one.