

**CODE OF BEST PRACTICE IN CORPORATE GOVERNANCE
FOR PUBLIC ENTERPRISES IN SRI LANKA**

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CODE OF BEST PRACTICE IN CORPORATE GOVERNANCE FOR PUBLIC ENTERPRISES IN SRI LANKA

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Section 1

Preface

The Code of Best Practice in Corporate Governance for Public Enterprises in Sri Lanka is intended for commercial Public Enterprises and Statutory Boards. Where certain principles and provisions are not applicable to statutory boards, they are duly noted.

The Code is aimed at improving the performance of Public Enterprises through greater accountability and transparency, improved boardroom practices and internal controls. These are the generic components of Corporate Governance. The Code also addresses additional issues peculiar to the Corporate Governance of Public Enterprises: specifically, the need for the Government to improve the ways in which it exercises ownership and governance functions over Public Enterprises, and the need for a professional Board and Management to enjoy greater operational autonomy without interference from the Government.

It is obvious that these two issues are indivisible and are two sides of the same coin. If Public Enterprises are to enjoy greater operational autonomy, then they must have highly qualified and effective professional Boards in which the Government -- and the public -- can have confidence. As such, the most critical first step that needs to be taken in complying with the Code, i.e. in improving Corporate Governance, is the appointment of a professional Board. This then needs to be complemented by building up the Government's institutional capacity, as the investor, in exercising its active "voice" in governance through properly constituted channels such as the Annual General Meeting of the enterprise. The development of Corporate Governance structures, procedures and practices within the Public Enterprise, in line with the Code's provisions, is an initiative and responsibility largely of the Board in consultation with the Government and, where necessary, with the professional advice of outside experts.

The **Implementation Guidelines** accompanying the Code elaborate on the purpose, meaning and practical aspects of the Code's principles and should be read together with the Code. Both the Code and the accompanying Implementation Guidelines have been kept as concise as possible. Various professional Associations, such as the Institute of Chartered Accountants of Sri Lanka (ICASL), the Institute of Chartered Secretaries and Administrators (ICSA), the Sri Lanka Institute of Directors (SLID) Ceylon Chamber of Commerce (CCC) and the Central Bank of Sri Lanka (CBSL) have published Codes of Best Practice in Corporate Governance and related manuals on Audit, Remuneration and Nomination Committees, boardroom practices, risk management, Annual Corporate Reports, Financial Statements and other disclosures, etc. Although all these are intended for listed and widely held companies, most of their contents are applicable to Public Enterprises. They are of a high quality and comparable with International Best Practice. It is strongly recommended that the Government and Public Enterprises use the corpus of this material as a reference in their adoption and compliance with the Code for Public Enterprises.

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Section 2

Introduction

The Purpose and Determinants of Corporate Governance. Corporate Governance is aimed at ensuring that firms are operated efficiently and in the best interests of shareholders and other stakeholders such as employees, creditors, major suppliers and consumers and society at large. Corporate Governance yields considerable benefits to firms, shareholders, other stakeholders and society. These benefits include:

- (i) Improved corporate performance and hence higher returns to investors as well as higher levels of remuneration to staff and employees;
- (ii) Significantly reducing the risk of corporate failures, abuses and malpractices;
- (iii) Raising the confidence of investors and lenders, thus enhancing the firm's ability to access low-cost finance and to compete for funds in an increasingly globalised international capital market;
- (iv) Promoting the development of sound, efficient and stable financial markets; and
- (v) Facilitating the development of an internationally competitive corporate sector that could serve as the engine of robust and sustainable growth of the national economy.

In contrast, the consequences of a poorly governed firm are often poor corporate performance, losses and collapse¹. The poor performance or collapse of a firm not only leads to losses, but it also has adverse impacts on society by undermining the stability of the financial system, efficient resource utilisation and the competitiveness of the national economy. **As such, Corporate Governance is a major issue of public policy of national importance and not limited to the narrow interests of shareholders with a direct financial stake in the firm.**

Extensive academic and policy research as well as international experience have led to a global consensus on the generic principles underlying Best Practice in Corporate Governance. These principles and criteria for best practice highlight the following core components of Corporate Governance:

¹ These often result either from incompetent Boards or from malpractices, abuses and fraud perpetuated by controlling shareholders at the expense of minority shareholders, or by Board members and senior management who have hijacked the firm in pursuance of their own interests.

- (i) **Shareholders' rights**, especially those of minority and outside shareholders, and stakeholders' interests, are adequately and clearly defined, respected and safeguarded, with shareholders able to exercise their rights in having a voice in the governance of the firm;
- (ii) **Accountability** by the Board of Directors and management to shareholders and other stakeholders on how well they fulfil their rights and responsibilities in attaining corporate objectives and protecting the assets or value of the firm;
- (iii) **Oversight** is actively and effectively performed by the Board of Directors over management and the operations of the firm to safeguard the best interests of the firm its shareholders and other stakeholders;
- (iv) **Transparency** is achieved through timely and accurate disclosures of information to allow shareholders, other stakeholders and the market to be informed about the finances, operations and prospects of the firm; and
- (v) **Incentives** are adopted to recruit, motivate and retain the best-qualified Members of the Board of Directors, senior management and employees, and to get in return, the best efforts from them.

The basic systemic arrangements for Corporate Governance in a firm is typically structured around and through the three main and legally constituted decision-making and control organs of the firm: the Annual General Meeting (AGM) of shareholders; the Board of Directors (BOD); and senior management led by a Chief Executive Officer (CEO). The respective powers, rights and responsibilities of each of these organs in the firm are typically prescribed in a general fashion in a country's company law. How effective the system of Corporate Governance in a firm is will depend on how the rudimentary structure is spelt out in greater detail in the firm's Company Charter².

Corporate Governance, however, requires more than re-designing and institutionalising the systemic arrangements and operational procedures of decision making and controls within a firm conducive to accountability, effective Board functioning and transparency. It requires a number of other prerequisites, including the following.

- (i) **A culture of Corporate Governance.** Values, attitudes and behaviour consistent with good Corporate Governance among shareholders and

² Of particular importance are provisions to ensure: safeguards on shareholders' rights; procedures at the AGM to enable shareholders to exercise their rights fully; accountability of Board and management; the configuration of an effective Board that is balanced and comprises independent non-executives to lead and perform oversight; internal systems of control and checks-and-balances; and systems and procedures for timely and regular disclosures of reliable, relevant financial and other information to enable shareholders and market participants to monitor and evaluate company performance.

stakeholders, Board directors, management and employees should be promoted and inculcated. The ingredients for Corporate Governance are essentially responsibility, ethical corporate culture and behaviour.

- (ii) **Shareholder (and stakeholder) activism.** Insistence by shareholders and other stakeholders that the firm adopts Best Practice in Corporate Governance, and their willingness to participate actively in governance instead of being passive investors. Corporate Governance is ultimately self-enforcing: it is as good as the shareholders and stakeholders expect it to be.
- (iii) **External mechanisms of Corporate Governance enforcement.** The effectiveness of Corporate Governance arrangements and practices within a firm is strongly conditioned by the policy and institutional environment within which the firm operates. Sound legal framework, enforceability of the law, high accounting and auditing standards, and competitive product and financial markets that exert disciplinary pressures on firm and management to be efficient are all vital factors determining Corporate Governance structures and practices.

The Imperative need and Challenges of Corporate Governance in Sri Lankan Public Enterprises. Corporate Governance in Public Enterprises is more urgent and more challenging than in privately owned firms. It is more urgent because Public Enterprises in Sri Lanka are often engaged in the provision of goods and services in strategic sectors of the national economy, which affect directly and indirectly the interests of a very large number of firms and households. Moreover, their performance has a direct impact on public finances and macroeconomic stability.

It is more challenging because Public Enterprises have ambiguous property rights. Public Enterprises are owned by all the people of Sri Lanka and by no one in particular. The Government owns and operates Public Enterprises on behalf of the public. The Government, and its departments and officials, entrusted with the ownership, control and other governance rights over Public Enterprises are in reality exercising these rights on behalf of the ultimate owners: the public of Sri Lanka. This creates ambiguity in property rights and difficulties in creating the necessary set of incentives and disincentives for effective Corporate Governance³.

Many Public Enterprises in Sri Lanka are inefficient and persistent loss-makers. Even in instances where losses are planned and budgeted to achieve social and policy objectives, actual losses are usually higher than targeted. Public Enterprises that are profitable have very low rates

³ Corporate Governance is contingent upon a clear property rights structure with identifiable owners who have an incentive to actively govern the firm effectively in order to ensure maximize returns to their investments on one hand, and to prevent losses so as to minimize risks on the other hand. Without these incentives (positive returns to investment) and disincentives or penalties (bearing of risks/losses) associated with the rights and responsibilities of ownership, there is no reason why an owner would care to govern, or to ensure that the firm is efficiently operated in his/her best interests. In this regard, public enterprises pose peculiar challenges in corporate governance because of their "diffused" ownership by the general public.

of returns, considerably below the potential and definitely lower than those of comparable domestic private and international operators.

Financial statements, audits and other reports are filed very late, often months and sometimes years behind schedule. Remedial action is rarely taken to address concerns expressed by the Auditor General over a particular enterprise's accounts or operations. Boards of Directors are generally passive and often do not comprise qualified professionals. Cronyism and patronage are reported to occur in the appointment of Board members and senior management, and there is a practice of replacing the Board and the CEO with a change of the responsible Minister or Government.

Many of the current shortcomings in the performance of Public Enterprises in Sri Lanka can be attributed to shortcomings in weak Corporate Governance: both in

- (ii) the ways Public Enterprises are "owned" and controlled by the Government ministries, departments and officials entrusted with exercising ownership and governance functions over Public Enterprises; and in
- (iii) ineffective boardroom and management skills and practices. The latter, however, is often a consequence of the former. These shortcomings include:
 - (a) Public Enterprises being treated essentially as subordinate Government units and controlled and operated primarily through administrative means, instead of being independent economic entities with the Government acting as investor seeking to maximise economic and/or social returns;
 - (b) Ownership and governance functions being delegated, shared and exercised by a multiplicity of Government departments with no single Minister or department assuming ultimate responsibility for the performance of the Public Enterprise;
 - (c) Lack of clear demarcation between the respective rights and responsibilities of the Government (as owner/investor) and the Board of Directors and senior management. This results in arbitrary Government interference in the management and operations of the Public Enterprise leading to ineffective operational and managerial autonomy and a lack of independent financial accountability; and
 - (d) The absence of a Corporate Charter for Public Enterprises, with the enabling legislation used as an inadequate substitute or surrogate.

In privately owned firms, Corporate Governance development is focused on the rights of shareholders, boardroom practices and transparency. Corporate Governance development in Sri Lanka's Public Enterprises, however, additionally requires that special attention be paid to clarifying and improving the relationship between the Government as owner on one hand and

the Public Enterprise (the Board and senior management) on the other hand. This inevitably entails improvement in the way the Government exercises its ownership and governance functions.

The Code of Best Practice in Corporate Governance for Public Enterprises in Sri Lanka.

The Code has been designed to address the specific characteristics and requirements of Corporate Governance in a publicly owned entity. The overall rationale underlying the purpose and design of the Code is that Public Enterprises should, as much as possible, be governed and operated like a firm in the private sector. There are two justifications for this rationale.

First, the property rights and decision-making and control structures essential to Corporate Governance are more clearly defined and developed in Sri Lankan private firms. This derives in part from the more rigorous requirements mandated by the Companies Act compared with those contained in the enabling legislations under which Public Enterprises are established and operated⁴. Second, as purely profit-driven and commercially oriented entities, private firms have governance and control structures more explicitly tailored to enhancing efficient performance.

Corporate Governance in private firms in Sri Lanka have its own shortcomings and also need considerable improvements but its basic Corporate Governance system is more developed and can more readily accommodate improvements than those in public sector enterprises. Indeed, as will be discussed later, many of the recommendations for improving the Corporate Governance of private firms -- as contained in Sri Lankan, other national and International Best Practice Codes for private firms -- have been incorporated in the Code for Sri Lankan Public Enterprises.

Adopting the systemic arrangements and operational procedures of Corporate Governance in Public Enterprises more akin to those in a private firm implies, *inter alia*, that:

- (i) **The role of the Government as owner/shareholder should be that of an investor.** The scope of its rights and responsibilities as shareholder, and the mechanisms and procedures for exercising these rights, should be essentially similar to -- no more and no less than -- those of investors in a private firm as specified in Sri Lanka's Companies Act and as prescribed by International Best Practice in Corporate Governance.
- (ii) **As investor on behalf of the public, the Government has a duty to ensure that a Public Enterprise delivers value for money and maximum financial returns, subject to the social considerations prescribed in policy objectives.** The financial implications of the trade-off between commercial and social policy objectives should be clearly identified and be regularly reviewed and updated whenever necessary.

⁴ In contrast, the rights and responsibilities among the constituent decision-making and control organs of a public enterprise are typically not clearly or adequately delineated. As noted earlier, public enterprises have tended to be operated through administrative means and methods rather than through economic or commercial ones.

- (iii) **The configuration, respective rights and responsibilities and operational procedures of the constituent decision-making organs (i.e. the AGM, the Board of Directors, the CEO/senior management) and control structures in a Public Enterprise should comply as fully as possible with those prescribed for a private firm in Sri Lanka's Companies Act and International Best Practice in Corporate Governance.**
- (iv) **Similar to firms in the private sector, the Public Enterprise should have a Corporate Charter,** comprising as fully as possible the structures and provisions prescribed by Sri Lanka's Companies Act and in compliance with International Best Practice in Corporate Governance.
- (v) **The Public Enterprise should be subjected to normal competitive market forces and all laws and regulations applicable to non-state firms and should operate on a level playing field with non-state firms.** Deviations from these principles should be clearly and publicly stated and justified, and should require approval by Parliament following opinions from the relevant regulatory agencies and the Attorney General's Department.

The Principles of Best Practice in Corporate Governance for Sri Lankan Public Enterprises contains six sets of principles and best practices. These include the generic core principles contained in most national and international codes or guidelines for Best Practice in Corporate Governance.

It has therefore been necessary to add principles, and in some cases to tailor other principles, to meet the needs of Public Enterprises. The additional ones are mainly aimed at improving the Government's exercise of its ownership and governance functions in order to safeguard the operational autonomy of Public Enterprises and to ensure an arms-length relationship between Government and enterprise, and at improving incentives for members of the enterprise.

Section 3

PRINCIPLES

Section 3.A Synopsis of Principles

1. The Public Interest and Accountability to Stakeholders

Highest levels of efficiency, accountability and transparency by Government and enterprise officials to stakeholders and the public are imperative. Mission Statements and Citizen's Charter will be the instruments for a Public Enterprise's accountability and transparency to ensure safeguards against conflict of interests. The Enterprise's Charter (Memorandum/Articles of Association) will supplement the enabling legislation.

2. Ownership Functions of the Government and Its Relationship with the Public Enterprise

Delineation of respective rights and responsibilities of Government as owner and a statutory arms-length relationship between Government and Enterprise will be a necessity. Operational autonomy of enterprise with reference to governance will thereby be ensured. Government's accountability for its ownership and governance of enterprises will be by submission of Annual Performance Statements by the responsible Minister.

3. The Annual General Meeting on Enterprise Performance, Strategy and Corporate Objectives

The AGM as the highest decision-making organ in the Public Enterprise and as the sole, legally constituted mechanism through which Government (and other shareholders) will determine strategic issues, corporate objectives, targets and other matters reserved for owners. Open sessions of the AGM will enhance accountability and transparency.

4. Boards for Effective Leadership and Oversight

The leadership and oversight roles of the Board including fiduciary duties of Board members; functional rights and responsibilities of the Board; safeguards against conflicts of interest, self-dealing and related party transactions should be clearly identified. Independence of the Board; separation of the posts of Board Chairman and CEO; balance between Executive and independent Non-Executive Board members; transparent and competitive procedures for Board appointments; Nomination, Audit and Remuneration Committees of the Board will serve the purpose of effective leadership and oversight.

5. Disclosures and Transparency

Disclosure of timely and accurate information to Government, other shareholders and stakeholders; the Annual Corporate Report and its contents; appointment of external auditor; external auditor precluded from providing consultancy and other services to the enterprises; standards of accounting, audits and financial reporting will be mandatory.

6. Performance-Related Incentives

(The following are not applicable to Statutory Boards whose remuneration policy and scales are determined by the Government).

- Market-based performance-related incentives for Board members, management and employees;
- Formal and transparent process of determination of remuneration of Board members, CEO and senior management;
- Remuneration Committee of the Board;
- Approval by AGM of remuneration of Board members, the CEO and senior management;
- Disclosure of individual Board member's remuneration in Annual Corporate Report.

Section 3.B Principles in Detail.

1. THE PUBLIC INTEREST AND ACCOUNTABILITY TO STAKEHOLDERS
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- 1.1** Public Enterprises should aim to attain the highest levels of efficiency, transparency and accountability to stakeholders and the public.
- 1.2** The Government, and all officials and persons entrusted with rights of ownership, supervision, governance and management of a Public Enterprise, have a duty to ensure that the enterprise is governed and operated in the best interest of the enterprise, including its stakeholders and the public, and in full compliance with all applicable legislation.
- 1.3** A Public Enterprise should have and be operated in compliance with a Corporate Charter (Memorandum and Articles of Association) to supplement its enabling legislation.
- 1.4** A system of Corporate Governance aimed at safeguarding the interests of stakeholders and the public and at improving enterprise performance should be implemented and continually improved.
 - 1.4.1** Public Enterprises should have a Mission Statement summarizing the enterprise's objectives, nature and scope of activities, performance targets and commitments.
 - 1.4.2** Public Enterprises engaged in providing public goods and services directly to the public should also have a Citizens Charter stating the standard of service that the public can expect.
- 1.5** The Public Enterprise should, within practicable limits, have regular dialogue with major stakeholders and representatives of the public on important matters relating to enterprise objectives and performance.
- 1.6** Insider trading and abusive self-dealing by Government Ministers and officials entrusted with the rights and responsibilities of ownership and governance of a Public Enterprise, and members of the enterprise's Board of Directors, senior management and employees are prohibited. Any other practice harmful or potentially harmful to the enterprise, stakeholders and the public interest need to be avoided. Government Ministers and public officials should adhere to the Code of Conduct issued by the Government.
- 1.7** Related party transactions and any other transactions or matters in which Government Ministers and officials, Members of the Public Enterprise's Board of Directors and senior management who have or may have directly or indirectly a material interests should be disclosed in a written declaration to the Minister of Finance and the enterprise's Board of Directors.

2. OWNERSHIP FUNCTIONS OF THE GOVERNMENT AND ITS RELATIONSHIP WITH THE PUBLIC ENTERPRISE

- 2.1** Effective Corporate Governance in Public Enterprises requires a clear delineation of the respective rights and responsibilities of the main constituent decision-making organs of the enterprise.
- 2.2** Government Ministers and officials entrusted with the rights and responsibilities of ownership and supervision over a Public Enterprise have a fiduciary duty to exercise these rights and responsibilities in an accountable and transparent manner, in good faith and in the best interests of the enterprise and the public.
- 2.2.1** The objectives and role of the Minister of Finance, responsible Minister and officials are to govern the enterprise by ensuring that the Board of Directors and Management of the enterprise achieve maximum returns and benefits for stakeholders and the public in line with Government policy and the enterprise's Corporate Plans as agreed with the enterprise's Board of Directors and adopted at the AGM.
- 2.2.2** Once the enterprise's Corporate Plans are approved at the AGM, the enterprise's Board of Directors and Management should automatically enjoy full operational independence in implementing the enterprise's Corporate Plans. No variations to the approved Corporate Plans may be made except through a Resolution at the Annual or Extraordinary General Meeting (EGM) of the enterprise.
- 2.3** A statutory arms-length relationship between the Government on one hand, and the enterprise's Board of Directors and Management on the other hand, should be instituted and safeguarded with a balance between the enterprise's autonomy and its accountability to Government and Parliament.
- 2.4** The Minister of Finance, the responsible Minister and officials and the Public Enterprise should institute a transparent and competitive procedure for the recruitment, and appointment by the AGM, of a balanced and professional Board of Directors comprising qualified and independent Non-Executive Members, based on the recommendations of the Nomination Committee of the Public Enterprise's Board of Directors.
- 2.5.1** The Board of Directors and senior management of the enterprise should enjoy operational independence in the exercise of their mandated rights and responsibilities, as specified in the enterprise's Corporate Charter and enabling legislation, in their implementation of the approved Corporate Plans and management of the enterprise.
- 2.6** The Minister of Finance, responsible Minister and officials should institute an effective system for reviewing and approving the strategic objectives, the 3-year rolling Corporate Plan, the Annual Plan and Budget of the enterprise to be recommended and implemented by the enterprise's Board of Directors. The preparation, approval and effective implementation of the 3-year rolling Corporate Plan, Annual Plan and Budget of a Public Enterprise are cornerstones of the Government's control and accountability framework for Public Enterprises.

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- 2.7 The Minister of Finance, responsible Minister and officials should institute a system of regular monitoring and reviewing the performance of the Board of Directors and the enterprise. They should ensure that Annual Corporate and other Periodic Reports (e.g. half-yearly and quarterly reports), Financial Statements, Audit Reports of the external auditor and the Audit Review of the Auditor General are submitted on time by the Board of Directors. The reports should be carefully reviewed and discussed before they are approved by the AGM.
- 2.8 The responsible Minister should submit, within 5 months of the end of the enterprise's financial year, to the Minister of Finance and to Parliament a brief and concise Annual Performance Statement (APS) for each Public Enterprise under his/her control. The APS submitted by the responsible Minister should be made available to the public.

3. THE ANNUAL GENERAL MEETING

- 3.1 An Annual General Meeting (AGM) should be held by the Public Enterprise with the officials of the Ministry of Finance, the responsible ministry, other shareholders where applicable, and others eligible to attend and vote at the AGM. The AGM should review, debate and approve the reports and recommendations of the Board including other matters reserved for the AGM as specified in the enterprise's Corporate Charter.
- 3.2 The AGM should be properly convened and conducted in line with best practice and the provisions contained in the Public Enterprise's Corporate Charter.
- 3.3 Officials of the Ministry of Finance, the responsible ministry, other shareholders where applicable and others eligible to attend the AGM should be provided in a timely manner with the Agenda and all relevant information (including Financial Statements, the Report and Audit of the external auditor, the Audit Review of the Auditor General and the Annual Corporate Report) on issues to be discussed and decided at the AGM.
- 3.4 Key issues on the capital structure, organisation, strategy, control and performance of the enterprise and other matters reserved for the AGM should be decided by the AGM. These issues should include:
- 3.4.1 Appointment (or election) of Members of the Board of Directors and the Chairman of the Board upon the recommendation of the Board of Directors and its Nomination Committee with the concurrence of the Government;
- 3.4.2 Approval of the appointment of the Chief Executive Officer (CEO) upon the recommendation of the Board of Directors;
- 3.4.3 Remuneration policy and remuneration for individual Board members, the CEO and senior management upon the recommendation of the Board of Directors and its Remuneration Committee (N.B. Statutory boards will have their remuneration policy and scales set by the Government and will not have a Remuneration Committee or the AGM approve the remuneration of Board members, the CEO and senior management.);

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- 3.4.4 Approval of the appointment of the external auditor upon the recommendation of the Board of Directors and its Audit Committee;
 - 3.4.5 Approval of the strategic objectives, 3-year rolling Corporate Plan, the Annual Plan and Budget, the Annual Corporate and other Reports submitted by the Board of Directors and Board Committees, the Reports and Audits submitted by the external auditor and the Audit Review of the Auditor General;
 - 3.4.6 The recommendations of the Board of Directors on declarations of dividend, the Enterprise's Resource Plan and employment and procurement policies;
 - 3.4.7 Capitalization, major borrowings, mergers and acquisition or sale of substantial part of enterprise assets and other extraordinary material transactions affecting the valuation and financial performance of the enterprise and the interests of the Government, other shareholders and the public;
 - 3.4.8 Review of the enterprise's legislated mandate and public policy objectives and the Board's recommendations to the Government on updating these to ensure its continued relevance and;
 - 3.4.9 Adoption of the Enterprise's Corporate Charter, Statutes and other governance instruments and their amendments.
- 3.5 There should be an open session of the AGM to allow the attendance of Members of Parliament and non-shareholding stakeholders as observers without decision-making or voting powers.

4. BOARDS FOR EFFECTIVE LEADERSHIP AND OVERSIGHT

- 4.1 The Board of Directors should explicitly assume fully the responsibilities of the stewardship of the enterprise on behalf of the Government, other shareholders and the public. It has two principal functions in its stewardship of the enterprise; to lead the enterprise and to oversee the management and operations of the enterprise.
- 4.2 The Board must meet regularly, at least once every two months, and have a formal schedule of matters specifically reserved for it as specified in the enterprise's Corporate Charter.
- 4.3 Members of the Board of Directors have a statutory duty of loyalty to the Public Enterprise devoid of conflict of interest. They are legally accountable for breach of their duties. Their rights and responsibilities must be specified in the Enterprise's Corporate Charter. Their responsibilities include:
 - 4.3.1 A fiduciary duty to perform their duties in good faith and in a manner that they believe to be in the best interests of the enterprise, shareholders, other

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- stakeholders and the public, and to exercise the degree of skill and care that may be reasonably expected of a person of his/her knowledge or experience;
- 4.3.2 A fiduciary duty of loyalty to the Public Enterprise avoiding any conflict of interest, and acting in a manner which is not reckless or grossly negligent; and;
- 4.3.3 A fiduciary duty to ensure that the enterprise and its officers and staff comply with the law and all relevant Statutes and Regulations (including the Accounting and Audits Standards Act).
- 4.4 The duties, rights and responsibilities of Board Members should be specified in a letter of appointment signed by the responsible Minister (or any other appointing authority) and accepted by the Board Members.
- 4.5 Newly appointed or elected Board Members should receive the necessary induction into his/her specific responsibilities, the enterprise's strategic aims and corporate objectives, and the enterprise's Corporate Governance, managerial and control systems and procedures.
- 4.6 The Board should have access to the advice and services of the professional qualified Corporate Secretary who is responsible to the Board for advising the Board on compliance with Board and AGM procedures, the law and relevant rules and regulations, and for ensuring that reliable and relevant information is provided to the Board and the AGM in a timely manner.
- 4.7 The Board of Directors should actively seek information it requires from management and other sources, and to verify its reliability, adequacy and accuracy and be provided by management with all relevant and timely information the Board needs to enable it to perform its functions effectively.
- 4.8 To perform their oversight functions effectively, Board members must bring an independent judgement to bear on issues of corporate strategy, performance, use of resources, appointments and standards of conduct.
- 4.9 The Board of Directors' duties and responsibilities in running the Board on one hand, and in running the enterprise's business on the other hand, should best be met by keeping the roles of the Board's Chairman and the CEO separate, and by achieving a balance of power and authority within the Board so that no one individual has unlimited powers of decision or influence.
- 4.10 The Board of Directors should have a balance of Executive and independent Non-Executive Directors so that no individual or small group of individuals can dominate the Board's decision making.
- 4.10.1 Independent Non-Executive Board members should comprise at least one-half, and preferably a majority, of the Board.
- 4.10.2 Government officials should not comprise more than one-third of the Board and must safeguard the interests of the Government and make independent judgements in the exercise of their duties.
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4.11 Members of the Board of Directors should be appointed or elected by the AGM upon the recommendation of the Nomination Committee of the Board of Directors. There should be a formal, competitive and transparent process for appointments.

4.11.1 A Nomination Committee should be established under the Board to make recommendations to the Board and the AGM on Board appointments.

4.11.1.1 The Nomination Committee should be headed by an independent Non-Executive Member of the Board.

4.11.1.2 The Nomination Committee should determine the specific criteria and profile, including professional qualifications, relevant work experience and other characteristics of eligible candidates for Board membership.

4.11.1.3 The Nomination Committee should, where appropriate, consult and co-opt relevant Government officials and outside experts as non-voting members to assist the Committee in its selection process.

4.11.1.4 The Nomination Committee's recommendations for Board appointments should be based on an open and competitive process of recruitment, including notices in the public media.

4. 4.11.2 Members of the Board of Directors should not be elected or appointed for a term of office of more than three years. Reappointment should not be automatic, and members should stand for re-election every three years. Candidates for election or re-election should provide sufficient personal data and professional background information to enable a transparent decision to be taken on their election or appointment.

4. 4.11.3 Board appointments should be staggered over time so that not all Members of the Board are retired or, elected or appointed at the same time to ensure a degree of continuity.

4.12 The Board should have an Audit Committee empowered to oversee due diligence and control over the financial aspects of the Public Enterprise's operations and performance.

4.12.1 The Audit Committee should be able to take independent (outside) professional advice when necessary, at the Public Enterprise's expense, and have an agreed procedure for doing so.

4.12.2 The Board of Directors, the internal and external auditors, and the management should provide the Audit Committee with all relevant and timely information that the Committee needs to enable to perform its functions effectively.

4.12.3 No member of the Audit Committee can be an executive or employee of the enterprise. The Chairman of the Audit Committee should be an independent

Non-Executive Board member, and at least one member of the Committee must be qualified in accounting and auditing work.

5. DISCLOSURES AND TRANSPARENCY

- 5.1** Timely and accurate information on the Enterprise's finances, operations, and performance should be regularly disclosed to the Minister of Finance, the responsible Minister and officials, other shareholders and stakeholders.
- 5.2** The most effective and cost-efficient methods and modalities, including the Internet, for the dissemination of information should be utilised.
- 5.3** The annual audit of the enterprise should be conducted by an external auditor, from the list of Chartered Accountants approved by the Auditor General, and appointed by the AGM upon the recommendation of the Audit Committee of the Board of Directors. The Annual Audit must be completed by the external auditor within 2.5 months of the end of the Public Enterprise's financial year and submitted by the Board of Directors to the Minister of Finance, the responsible Minister, the Auditor General and where applicable, other shareholders at least 15 working days before the AGM. The annual audit and Report must be reviewed by the Board of Directors and submitted to the AGM for approval.
- 5.3.1 The external auditor is precluded from providing consultancy or any other services to the enterprise that might compromise its impartiality and independent judgement in its audit of the enterprise.
- 5.3.2 The external auditor should be changed at least every five years.
- 5.3.3 The external auditor should be appointed through a letter stating that audits are to be completed within 2.5 months of the end of the Public Enterprise's financial year and other terms of reference set by the Board's Audit Committee. The external auditor should be legally obliged to report to the Minister of Finance, the responsible Minister and the AGM, any impediments he faces from the Public Enterprise, or from any other party resulting in his inability to complete the audit in time and in executing any of his duties specified in the Letter of Appointment.
- 5.3.4 The audit review by the Auditor General of the Public Enterprise should be completed within 3 months of the end of the enterprise's financial year and submitted to Parliament. Copies of the Audit Review should be sent to the Minister of Finance, the responsible Minister and the enterprise's Board of Directors.
- 5.4** Internal and external audits, financial statements and other information should be prepared using the highest international standards of accounting, auditing, financial and non-financial reporting and in line with the Accounting and Auditing Standards Act and other relevant legislation.

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- 5.5** Full disclosure and transparency should be enforced within the enterprise to provide the Board of Directors, the CEO and senior management with timely and reliable information required by them to fulfil their responsibilities effectively.
- 5.6** The Public Enterprise should issue an Annual Corporate Report within 3 months of the end of its financial year. Disclosures in the Annual Corporate Report should include:
- 5.6.1 Financial and operating results of the enterprise, and the Audit and Report of the external auditor and the Audit Review of the Auditor General;
 - 5.6.2 The enterprise's Mission Statement and Citizens Charter where applicable, its objectives and strategy, how these are to be met and the extent to which they have been met and foreseeable material risk factors;
 - 5.6.3 Capital structure of the enterprise, and where applicable, major share ownership and voting rights;
 - 5.6.4 Members of the Board of Directors and senior management, their background, qualifications (including directorships or positions in other companies) and their individual remuneration;
 - 5.6.5 Corporate Governance structure and policy; and
 - 5.6.6 Material issues concerning employees and other major stakeholders.
- 5.7** Financial Statements, the Annual Corporate Report and other matters to be discussed at the AGM should be provided to the Minister of Finance, the responsible Minister and officials, and where applicable other shareholders, in a timely manner to enable them to be informed about matters to be discussed at the AGM. The Annual Corporate Report should be provided to eligible attendees of the AGM at least 15 working days before the AGM.
- 5.8** The responsible Minister and officials, and other shareholders, should upon a written request have a right to inspect in person or by attorney or by other agent, minutes of meetings of the Board of Directors and its Committees.
- 5.9** The Minister of Finance, responsible Minister and officials, and where applicable other shareholders, members of the Board of Directors, the CEO and other senior management personnel and Parliament should have the right to examine the Public Enterprise's stock ledger and its other books and records and keep such information so obtained confidential.

6. PERFORMANCE-RELATED INCENTIVES
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(This section is not applicable to Statutory Boards whose remuneration policy and scales are determined by the Government.)

- 6.1** A Public Enterprise should enjoy autonomy in implementing market-based, performance-related incentive systems and in return get best efforts from Members of the Board of Directors, the CEO, senior management and employees of the enterprise.
- 6.2** The level of remuneration for Members of the Board of Directors, the CEO and senior management should be sufficient to attract, motivate and retain them, and be approved by the AGM.
- 6.3** The Public Enterprise should establish a formal and transparent procedure for the determination of the remuneration of Members of the Board of Directors, the CEO and senior management.
- 6.3.1 No Executive Member of the Board of Directors should be involved in deciding on his/her own remuneration.
- 6.4** The Board of Directors should establish a Remuneration Committee under the Board empowered to determine and recommend to the Board of Directors and the AGM the remuneration for Executive Members of the Board of Directors, the CEO and senior management. The Remuneration Committee should:
- 6.4.1 Comprise exclusively of Non-Executive Board members independent of management and free from any business or other relationships which could materially interfere with the exercise of their independent judgement;
- 6.4.2 Make recommendations to the Board of Directors and the AGM, within agreed terms of reference, on the Public Enterprise's policy, framework and structure of executive remuneration and its cost, and to determine on behalf of the Board specific remuneration packages (including pension rights and any compensation payments) for Executive Board Members, the CEO and senior management;
- 6.4.3 Consult the Chairman of the Board of Directors about the Remuneration Committee's proposals for remuneration of Executive Board Members (other than the Chairman's), and have access to professional advice, inside and outside the enterprise, and;
- 6.4.4 Submit a Report to be included in the Annual Corporate Report and Accounts, stating the list of members of the Remuneration Committee, the enterprise's remuneration policy and full details of remuneration for each Member of the Board of Directors and the CEO.
- 6.5** The remuneration of independent Non-Executive Board Members should be determined by the AGM upon recommendation of the Board as a whole.

One of the most contentious Corporate Governance issues has been Board members awarding themselves high remuneration packages despite poor Public Enterprise performance and shareholder value. A core principle of Best Practice in Corporate Governance adopted world wide is that while remuneration for executive Board members and CEO's need to be sufficient to attract, motivate and retain highly skilled professionals, no Board Member and CEO should decide on his /her own remuneration.

International Best Practice in Corporate Governance require the establishment of a Remuneration Committee under the Board of Directors to determine policy and levels of remuneration for Executive Board Members, and to make recommendations on remuneration for Executive Board Members and the CEO which should be presented and approved by the AGM. Details of remuneration for Board Members should be disclosed in the Public Enterprises Annual Corporate Report.

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Section 3.C Schedule of decision making, reporting and disclosure instruments

Instruments, Documentation & Reports	Responsible Party	Approval/Timeframe
A. Instruments for Structure, Operation & Accountability of Pes		
<i>Enterprise's Corporate Charter</i>	Minister of Finance	Adoption by AGM
<i>Mission Statement</i>	Board of Directors	Endorsement by AGM
<i>Citizens Charter (where applicable)</i>	Board of Directors	Endorsement by AGM
<i>Terms of References for Audit, Remuneration and Nomination Committees</i>	Board of Directors	Approval by the Board of Directors
B1. Monitoring & Disclosure Instruments		
<i>Audit of Enterprise's Account</i>	External Auditors	Two and a half (2.5) months following the end of the Financial Year. (Vide 5.3 pg.18)
<i>Review of Audit of Accounts</i>	Auditor General	Three (3) months following the end of the Financial Year.
<i>Annual Corporate Report</i>	Board of Directors	Three (3) months following the end of the Financial Year end submitted at least 15 days before AGM. (Vide 5.6 pg.19)
B2. Corporate Objectives		
<i>3 Year-Rolling Corporate Plan</i>	Board of Directors	Approval by AGM.
<i>Annual Plan and Budget</i>	Board of Directors	- do -
B3. Boards Committees and Other Reports		
C. Other Disclosure / Report Documents		
<i>Periodic Reporting: Half Yearly and Quarterly Reports</i>	Board of Directors	When required.
<i>Continuous Disclosure</i>	Board of Directors	When required.
D. Government Accountability to Parliament & the Public		
<i>Annual Performance Statement (APS)</i>	Responsible Minister	Five (5) months after the end of the financial year. (Vide 2.8 pg.14)

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Section 4

IMPLEMENTATION GUIDELINES

1. THE PUBLIC INTEREST AND ACCOUNTABILITY TO STAKEHOLDERS

- 1.1 Public Enterprises should aim to attain the highest levels of efficiency, transparency and accountability to stakeholders and the public.**
- 1.2 The Government, and all officials and persons entrusted with the rights of ownership, supervision, governance and management of a Public Enterprise have a duty to ensure that the enterprise is governed and operated in the best interest of the enterprise including its stakeholders and the public and in full compliance with all applicable legislation.**

A Public Enterprise is established, owned and operated by the Government on behalf of the public and in the public interest. The public of Sri Lanka as ultimate "owners" are the stakeholders to whom the enterprise and its Board of Directors and management are accountable. However, the enterprise's Board and management are immediately accountable to the Government because public ownership is legally vested in and exercised by the Government.

For the purpose of this Code and as a matter of convenience, the Government is regarded as the shareholder of a Public Enterprise although a Public Enterprise may not have a corporate structure with clearly defined shareholders. In Public Enterprises that operate as companies under the Companies Act and have a diversified ownership, the Board and management are accountable to all shareholders as well as to stakeholders.

It must be emphasised that in the Code & Implementing Guidelines, a responsible Minister refers to the Minister of the Ministry or the Head of a Department and other officials of the Government mandated with the powers and duties of supervision and direction over a Public Enterprise. It also includes the Public Enterprises Department and the National Budget Office in the Ministry of Finance responsible for the supervision and control of the financial and budgetary aspects of Commercial Public Enterprises and Statutory Boards.

Stakeholders (persons and/or institutions) comprise:

- (i) shareholders who hold equity in the enterprise; and
- (ii) non-shareholders who do not have equity holdings but whose interest may be directly or indirectly affected by the activities of the enterprise. This is the meaning of the terms "shareholders" and "stakeholders" used in this Code.

Non-shareholding stakeholders are a very broad concept. As noted earlier, the general public of Sri Lanka as ultimate owners constitutes the stakeholders. However stakeholders can be more narrowly defined as those whose interests or welfare are affected by the enterprise. For example, firms, households and individuals that are end-users of and dependent on the supplies or services of an electricity, transport or telecommunications enterprise are all stakeholders of the enterprise. Similarly, all those affected by the environmental pollution caused by an enterprise are also stakeholders. In both examples the stakeholder's interest are either positively or

adversely affected by the performance and behaviour of the enterprise. Best Practice in Corporate Governance require a firm to be socially responsible and to state in its Annual Corporate Report its policy on social responsibility.

Stakeholders can be even more narrowly identified as immediate or major shareholders whose interests and welfare are directly and significantly linked, usually financially, to the enterprise. These include major creditors, suppliers or consumers whose finances, commercial viability and interests can be seriously impacted by a Public Enterprise's performance. For example, the failure of a Public Enterprise to service its debts to banks or suppliers would seriously undermine the latter's profitability or even viability, while late or non-delivery of contracted goods and services by a Public Enterprise would damage a client firm's operations and finances. While a Public Enterprise should be accountable to all stakeholders, it should be particularly mindful of the interests of these major stakeholders. A Public Enterprise should identify these major stakeholders and develop dialogue with them.

1.3 A Public Enterprise should have and be operated in compliance with a Corporate Charter (Memorandum and Articles of Association) to supplement its enabling legislation.

The Minister of Finance, in consultation with the responsible Minister and officials, should prepare the Corporate Charter. It should be based on the enabling legislation under which the enterprise was established, and be consistent with other applicable legal and regulatory frameworks. The structure and provisions of the Corporate Charter should as far as possible, conform to those stipulated in the Companies Act.

The enterprise's Charter should include specific provisions on Corporate Governance matters such as the legal constituent decision-making and control mechanisms of the enterprise, its respective rights and responsibilities, financial and other internal controls, disclosures and transparency and operational procedures for its functioning.

The Corporate Charter should be debated and formally adopted by the AGM of the Public Enterprise.

1.4 A system of Corporate Governance aimed at safeguarding the interests of stakeholders and the public and at improving enterprise performance should be implemented and continually improved.

The enterprise's policy and system of Corporate Governance should be stated in the Annual Corporate Report.

Safeguarding the public interest and good Corporate Governance include observance of the law, regulations and business ethics. The enterprise should not engage in activities and practices, which may be detrimental to the development and effective functioning of competitive markets and private sector firms. This is an important issue given the monopolistic position of some major Commercial Public Enterprises in public utilities. It is strongly recommended that the major Public Enterprises with monopolistic or market-dominant positions disclose in its Annual Corporate Reports the extent to which it complies with the respective laws and regulations.

In Public Enterprises with diversified ownership, good Corporate Governance demands that all shareholders are treated equally, based on the ideal principle of "one share, one vote". Where a

company issues different classes of shares, then all holders of a particular class of shares should be treated equitably. The rights attached to each class of ownership should be clearly stated so that a potential investor knows beforehand what his rights are with a given class of shares.

Certain types of capital and corporate ownership structures, such as pyramidal holdings and cross-holdings, are very detrimental to good Corporate Governance because it:

- (i) gives certain shareholders financial claims and control rights, which are disproportionate relative to actual equity ownership;
- (ii) undermines transparency and disclosures of capital and control structures, reliable financial information and related party transactions; and
- (iii) hinders the role of the market for corporate control in promoting financial discipline and corporate performance.

These unfairly privilege certain shareholders and deprive others. For these reasons these types of capital structures and corporate arrangements should be strongly discouraged.

1.4.1 Public enterprises should have a Mission Statement summarizing the enterprise's objectives, nature and scope of activities, performance targets and commitments.

1.4.2 Public enterprises engaged in providing public goods and services directly to the public should also have a Citizens Charter stating the standard of service that the public can expect.

Both the Mission Statement and the Citizens Charter (where applicable) should be included in the enterprise's Annual Corporate Report. They should be drafted by the enterprise's Board of Directors and endorsed by the AGM.

The purpose of the Citizens Charter is to provide a clear commitment by the enterprise to the public on the scope and quality standards of activities it is committed to provide and which the public can reasonably expect. It should give the name, contact number and address of an enterprise officer responsible for information dissemination and for liaison with the public. Procedures for filing complaints and seeking recourse should be stated.

1.5 The Public Enterprise should within practicable limits have regular dialogue with major stakeholders and representatives of the public on important matters relating to enterprise objectives and performance.

The enterprise should nominate a Member of the Board of Directors to assume responsibility for relations and dialogue with major stakeholders and the public (and where applicable, with shareholders).

1.6 Insider trading and abusive self-dealing by Government Ministers and officials entrusted with the rights and responsibilities of ownership and governance of a Public Enterprise, and members of the enterprise's Board of Directors, senior management and employees are prohibited. Any other practice, harmful or potentially harmful to the enterprise, stakeholders and the public interest needs to be avoided. Government Ministers and public officials should adhere to the Code of Conduct issued by the Government.

1.7 Related party transactions and any other transactions or matters in which Government Ministers and officials, members of the Public Enterprise’s Board of Directors and senior management who have directly or indirectly a material interests should be disclosed in a written declaration to the Minister of Finance and the enterprise's Board of Directors.

In certain Public Enterprises established under Special Acts of Parliament, Board members are prohibited from voting on a matter in which he/she has a material interest. Where an enterprise is not subject to this prohibition, the responsible Minister, official, and Board Member should abstain from voting on a matter in which he/she has a material interest unless explicitly permitted by the Minister of Finance and the Board of Directors.

The Government Ministers, officials and Board Members must declare any material interest in other firms and organisations which are likely to have commercial transactions or other contractual relationships with or which are or are likely to be engaged directly in competitive activities against, the Public Enterprise under their supervision. This disclosure should also be made in the enterprise's Annual Corporate Report.

Government Ministers, officials and Board members must declare whether they have any close relative (either by blood or affinity/marriage) presently employed, being considered for employment, presently serving as Board Member or being nominated as a Board Member, in the Public Enterprise under their supervision.

The Government Ministers and officials and the enterprise's Board of Directors should consult the Attorney General on how issues of related party transactions and conflicts of interest can best be resolved.

2. OWNERSHIP FUNCTIONS OF THE GOVERNMENT AND ITS RELATIONSHIP WITH THE PUBLIC ENTERPRISE

2.1 Effective Corporate Governance in Public Enterprises require a clear delineation of the respective rights and responsibilities of the main constituent decision-making organs of the enterprise.

As noted in Principle 1.6 above, a Public Enterprise should have a Corporate Charter, which defines clearly its legally constituted decision-making and control organs and their respective rights and responsibilities.

2.2 Government Ministers and officials entrusted with the rights and responsibilities of ownership and supervision over a Public Enterprise have a fiduciary duty to exercise these rights and responsibilities in an accountable and transparent manner, in good faith and in the best interests of the enterprise and the public.

2.2.1 The objectives and role of the Minister of Finance, responsible Minister and officials are to govern the enterprise by ensuring that the Board of Directors and Management of the enterprise achieve maximum returns and benefits for stakeholders and the public in line with Government policy and the

enterprise's Corporate Plans as agreed with the enterprise's Board of Directors and adopted at the AGM.

2.2.2 Once the enterprise's Corporate Plans are approved at the AGM, the enterprise's Board of Directors and Management should automatically enjoy full operational independence in implementing the enterprise's Corporate Plans. No variations to the approved Corporate Plans may be made except through a Resolution at the Annual or Extraordinary General Meeting (EGM) of the enterprise.

The role and functions of the Government as owner (provider of the Public Enterprise's capital) should be that of a shareholder or investor. The scope of its rights and responsibilities should be similar to those defined and assigned to shareholders in companies operating under the Companies Act.

As owner or shareholder, the Government enjoys both property and non-property rights as specified by law and in the Corporate Charter. In practice, an owner or shareholder has two basic sets of rights: first, rights entitling them to share in the profits in the Public Enterprise; and second, rights entitling them to participate in the governance or control of the Public Enterprise. The effectiveness of the Government's exercise of its ownership rights depends on how clearly the rights are defined in the Public Enterprise's Corporate Charter and the Constitution and enabling legislation, and where applicable the Companies Act. The clarity with which the Government's ownership rights are defined also helps Board members and senior management fulfil their obligations in safeguarding and promoting the interests of shareholders.

The Government (and other shareholders) should exercise their rights and responsibilities through properly constituted channels (such as the AGM and EGM) and procedures as stipulated in the Corporate Charter. The Government should therefore not seek to intervene in the Board of Director's and the management's execution of their duties, rights and responsibilities, or in the operations of the enterprise.

As the owner of the Public Enterprise, the Government's main functions are to review and approve the enterprise's corporate objectives, strategy, plans and targets formulated in the Corporate Plans by the Board, and to appoint a professional Board that is best qualified to set objectives and strategy as well as to attain those objectives. In carrying out these core functions, the Government should regularly monitor the performance of the Board and enterprise, and take timely remedial action when there are concerns. These concerns should be communicated in regular dialogues with the Board. If these concerns are not adequately addressed through dialogue, the Government should convene an EGM of the enterprise to discuss these concerns and approve remedial measures.

For Commercial Public Enterprises, the Government should make financial returns a key performance target of the enterprise. This and other targets should be reviewed and approved at the AGM. This target should also be considered in the determination of formulae for performance-related remuneration of Board members and senior management (and employees where applicable).

Although financial returns may not be a key or relevant target for Statutory Bodies, these should nevertheless, where possible or appropriate, be measured to provide costs and benefits and value-for-money indicators.

Where the Government's policy objectives are incorporated in a Public Enterprise's corporate objectives, plans and targets (and adopted by the AGM), the implications for and impact of these policy objectives on the enterprise's finances, balance sheet and operations should be clearly reflected in the Financial Statements and audits and disclosed in the Annual Corporate Report. The Government and Board should periodically review the appropriateness and relevance of these policy objectives.

2.3 A statutory arms-length relationship between the Government on one hand, and the enterprise's Board of Directors and Management on the other hand, should be instituted and safeguarded with a balance between the enterprise's autonomy and its accountability to Government and Parliament.

The Government Ministers, officials and any other Government bodies, should be prohibited from interfering in the Board's and management's exercise of their mandated rights and responsibilities, or in any way influencing the staffing and operations of the enterprise except on matters which are explicitly reserved for the Minister of Finance, the responsible Minister and officials as stipulated in the enterprise's Corporate Charter.

Members of the Board of Directors, management and staff of the enterprise should be entitled to report to the Minister of Finance and the Parliamentary Ombudsman any instances of such interference by the responsible Minister and officials or by any other party.

As a rule, the Government should not issue directives or instructions to the Board outside the AGM or EGM. Instructions should be tabled and approved at Annual or Extraordinary General Meetings. In extraordinary circumstances where urgent remedial action is required before an EGM can be convened, the Government's issuance of instructions to the Board of the enterprise should be in a written form, signed by both the responsible Minister and the Minister of Finance. All such instructions should be recorded and be made available for inspection by Parliament (and other shareholders) and disclosed in the Annual Corporate Report. If the Board disputes the appropriateness or legality of an instruction, then an opinion from the Attorney General should be sought.

The Government should not issue any instructions directly or indirectly to the management of the Public Enterprise.

2.4 The Minister of Finance, the responsible Minister and officials and the Public Enterprise should institute a transparent and competitive procedure for the recruitment, and appointment by the AGM, of a balanced and professional Board of Directors comprising qualified and independent Non-Executive Members, based on the recommendations of the Nomination Committee of the Public Enterprise's Board of Directors.

The appointment of Board members and senior management should not be a "political" decision or the personal prerogative of the responsible Minister. The responsible Minister and Minister of Finance (and the Government more generally) are accountable for the performance of the Board Members he/she appoints. A transparent and competitive system and procedures for Board (and other senior executive) appointments, involving an open and formal process of recruitment by the Nomination Committee of the Board, is discussed in Principle 4 (item 4.11) of the Code. The

need for competitive market-based and performance-related remuneration is discussed in Principle 6 of the Code.

While the recommendations contained in those Sections strengthen the role and procedures of the Board in identifying and nominating candidates for Board membership, it remains with the Government (and other shareholders) at the AGM to make the appointments. Before the Board can assume its nomination functions effectively, there needs to be a competent and professional Board in place first. It is therefore crucial that the Government first improves its system and procedures for Board appointments.

2.5 The Board of Directors and senior management of the enterprise should enjoy operational independence in the exercise of their mandated rights and responsibilities, as specified in the enterprise's Corporate Charter and enabling legislation, in their implementation of the approved Corporate Plans and management of the enterprise.

2.6 The Minister of Finance, responsible Minister and officials should institute an effective system for reviewing and approving the strategic objectives, the 3-year rolling Corporate Plan, the Annual Plan and Budget of the enterprise to be recommended and implemented by the enterprise's Board of Directors. The preparation, approval and effective implementation of the 3-year rolling Corporate Plan, Annual Plan and Budget of a Public Enterprise are cornerstones of the Government's control and accountability framework for Public Enterprises.

The Minister of Finance, responsible Minister and officials should require an enterprise's Board of Directors to submit a 3-year rolling Corporate Plan, an Annual Plan and Budget. These Plans should be carefully reviewed, debated and formally adopted by the AGM. The Annual Plan and Budget should include detailed performance and financial targets, the enterprise's strategy for achieving the objectives and targets, and the Annual Budget. The Annual Plan and Budget should be summarized in the enterprise's Annual Corporate Report.

The Minister of Finance, responsible Minister and officials should whenever appropriate seek outside, independent and specialist advice to evaluate the enterprise's strategic objectives, commercial mandate, Annual Plan and Budget and performance and financial targets submitted by the Board of Directors.

2.7 The Minister of Finance, responsible Minister and officials should institute a system of regular monitoring and reviewing the performance of the Board of Directors and the enterprise. They should ensure that Annual Corporate and other Periodic Reports (e.g. half-yearly and quarterly reports), Financial Statements, Audit and Reports of the external auditor and the Audit Review of the Auditor General are submitted on time by the Board of Directors. The reports should be carefully reviewed and discussed before these are approved by the AGM.

2.8 The responsible Minister should submit, within 5 months of the end of the enterprise's financial year, to the Minister of Finance and to Parliament a brief and concise Annual Performance Statement (APS) for each Public Enterprise under his/her control. The APS submitted by the responsible Minister should be made available to the public.

The APS should be an Executive Summary (of a few pages) of the Public Enterprise's performance in the last financial year and signed by the responsible Minister. The APS should include:

- (i) a synopsis of the enterprise's Annual Corporate Report, Financial Statement and externally Audited Accounts submitted by the Chairman of the Board of Directors;
- (ii) an independent assessment by the responsible Minister of how and why the enterprise's Board of Directors and management have or have not achieved Corporate Plans objectives and financial targets; and
- (iii) an explanation of what strategic and annual corporate objectives and targets for the forthcoming financial year, and other major Resolutions, have been agreed upon with the enterprise's Board of Directors at the AGM.

The APS should serve as an important means for ensuring that the responsible Minister (and his department) has performed proper monitoring, exercised due diligence and governance of a Public Enterprise. It therefore means that the responsible Minister does not simply rubber-stamp Reports submitted by enterprise Boards. It therefore requires that an independent evaluation of the reports and performance of the Board be made by the responsible Minister. This would also serve to enhance the accountability of the responsible Minister to the Government and of the Government to Parliament and the public, in his/her exercise of ownership and governance functions over a Public Enterprise.

It is vital that the APS be submitted within 6 months of the end of the enterprise's financial year. This deadline should be strictly enforced. Since the finalisation of the APS is dependent on the submission of the enterprise's Financial Statements, Annual Corporate Report, and the convening of the AGM, the timely submission of the APS is imperative.

The failure of a responsible Minister to submit the APS by the deadline should be reported to the Minister of Finance and Parliament, and be publicly disclosed.

3. THE ANNUAL GENERAL MEETING

3.1 An Annual General Meeting (AGM) should be held by the Public Enterprise with the officials of the Ministry of Finance, the responsible ministry, other shareholders where applicable, and others eligible to attend and vote at the AGM. The AGM should review, debate and approve the reports and recommendations of the Board including other matters reserved for the AGM as specified in the enterprise's Corporate Charter.

The AGM is the highest decision-making body of a company. It is the most important forum for shareholders to govern the company through strategic decisions on capitalisation, corporate strategy and objectives, appointment and remuneration of the Board of Directors (and the CEO) and on other fundamental matters that are reserved for shareholders and the AGM as stipulated in the company Charter. By reviewing, debating and adopting (or rejecting, as the case may be) the reports and recommendations of the Board of Directors, the AGM is also a critical instrument for ensuring that the Board and management are fully accountable for their performance to shareholders.

AGMs are not held in the vast majority of Public Enterprises. Its introduction would provide both Government and the enterprise with improved systems and procedures for Corporate Governance, accountability and transparency. The Resolutions adopted by the AGM constitute the mandate given by the Government (and other shareholders) to the Board of Directors in their stewardship of the enterprise. The mandate is effectively a "contract" between Government and the Board, and once approved at the AGM the Board should then be empowered to fulfil the terms of the "contract". Neither party (the Government and the Board) should unilaterally deviate from or seek to alter the terms of the "contract" agreed at the AGM. Any proposed deviations or alterations should be discussed and agreed between the Government and the Board at the AGM or an EGM.

The AGM should be held within 4 months of the end of the Public Enterprise's financial year. It is critical that this deadline be met because an AGM held on schedule becomes an instrument for imposing discipline and ensuring the timely completion of Financial Statements, Audits, Annual Corporate Reports, etc., without which the AGM cannot be held. Late submissions of these disclosures prevent timely review of enterprise performance and delay the adoption of measures to seize business opportunities or to rectify problems. As such, the AGM is a landmark event that compels the timely fulfilment of other milestones.

The failure to hold the AGM on schedule therefore represents a major failure in the governance and control of the enterprise. The failure on the part of the Board to hold the AGM, without good cause, represents a failure in complying with its fiduciary duties.

The AGM should not be an event to merely endorse Reports on the Public Enterprise's financial and operational performance or the appointments and remuneration of Board Members and the CEO. Instead, the AGM should be a forum for responsible and constructive shareholder activism where key issues and resolutions -- and their implications -- are properly discussed and debated before being voted upon. Such constructive shareholder activism is a powerful means for ensuring that Board members and senior management perform their best on behalf of the Government, other shareholders and stakeholders.

3.2 The AGM should be properly convened and conducted in line with best practice and the provisions contained in the Public Enterprise's Corporate Charter.

The AGM should be attended on behalf of the Government by responsible officials of the Ministry of Finance, responsible ministry, or their proxies, and where applicable, other shareholders or their proxies and representatives of the Auditor General or their proxies.

The Government should compile a list of names of the responsible officials eligible to attend and vote at the AGM on behalf of the Government. The list should be submitted to the Public Enterprise and registered by the enterprise's qualified secretary at least two months before the AGM. The names so registered should be entitled, when necessary, to call for and attend an Extraordinary General Meeting until the next AGM. No other party should be entitled to attend the AGM without the joint and prior consent of the Government and the enterprise's Board of Directors.

Procedures for the convening and conduct of the AGM should be clearly specified in the Public Enterprise's Corporate Charter and should comply with Best Practices.

The external auditor should be invited to attend the AGM and to answer any questions the Government (and other shareholders) may have on its audit and Reports.

In Public Enterprises with diversified shareholdings:

- All shareholders should have an automatic right to attend, participate and vote at the AGM. The principle of "one share, one vote" should be adhered to.
- There should be simple and effective rules allowing shareholders to vote by proxy or to appoint nominees to attend on their behalf.
- The interests of minority shareholders should be safeguarded by adopting cumulative voting on key decisions such as appointment of Board Members.

3.3 Officials of the Ministry of Finance, the responsible ministry, other shareholders where applicable and others eligible to attend the AGM should be provided in a timely manner with the Agenda and all relevant information (including Financial Statements, the Report and Audit of the external auditor, the Audit Review of the Auditor General and the Annual Corporate Report) on issues to be discussed and decided at the AGM.

3.4 Key issues on the capital structure, organisation, strategy, control and performance of the enterprise and other matters reserved for the AGM should be decided by the AGM. These issues should include:

3.4.1 Appointment (or election) of members of the Board of Directors and the Chairman of the Board upon the recommendation of the Board of Directors and its Nomination Committee with the concurrence of the Government;

3.4.2 Approval of the appointment of the Chief Executive Officer (CEO) upon the recommendation of the Board of Directors;

3.4.3 Remuneration policy and remuneration for individual Board members, the CEO and senior management upon the recommendation of the Board of Directors and its Remuneration Committee (N.B. Statutory boards will have their remuneration policy and scales set by the Government and will not have a Remuneration Committee or the AGM approve the remuneration of Board members, the CEO and senior management.);

3.4.4 Approval of the appointment of the external auditor upon the recommendation of the Board of Directors and its Audit Committee;

3.4.5 Approval of the strategic objectives, 3-year rolling Corporate Plan, the Annual Plan and Budget, the Annual Corporate and other Reports submitted by the Board of Directors and Board Committees, the Reports and Audits submitted by the external auditor and the Audit Review of the Auditor General;

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- 3.4.6 The recommendations of the Board of Directors on declarations of dividend, the enterprise's Resource Plan and on employment and procurement policies;**
 - 3.4.7 Capitalization, major borrowings, mergers and acquisition or sale of substantial part of enterprise assets and other extraordinary material transactions affecting the valuation and financial performance of the enterprise and the interests of the Government, other shareholders and the public;**
 - 3.4.8 Review of the enterprise's legislated mandate and public policy objectives and the Board's recommendations to the Government on updating these to ensure its continued relevance; and**
 - 3.4.9 Adoption of the enterprise's Corporate Charter, Statutes and other governance instruments and their amendments.**

As noted above, matters reserved for the AGM should be clearly specified in the enterprise's Corporate Charter. These should conform as closely as possible to the provisions contained in the Companies Act and manuals on Best Practices issued by various professional Associations in Sri Lanka.

There should be prior consultation with the Minister of Finance on major decisions relating to financial and budgetary matters.

The Minutes of the AGM should be sent to the responsible Minister, the Minister of Finance and made available to Parliament.

3.5 There should be an open session of the AGM to allow the attendance of members of Parliament and non-shareholding stakeholders as observers without decision-making or voting powers.

Accountability and transparency should be enhanced by instituting an open session of the AGM with attendance open to (but without any decision-making or voting rights for) stakeholders or their representatives, the media and the general public. The open session of the AGM should be aimed at explaining the objectives and performance of the enterprises to stakeholders and to developing relationships and dialogue with stakeholders.

Notice of the open session of the AGM should be made in the Public Enterprise's website (if available) and the public media at least three weeks before the event. The notice of the open session of the AGM should also be sent directly to key stakeholders, such as major creditors, suppliers and consumers.

There are two options for limiting the attendance of observers in line with the space capacity at the AGM. One is to request stakeholders to register with the enterprise's qualified secretary their interest in attending the AGM open session as observers, with those eligible to attend based on a "first come, first served" basis until the limit of numbers for observers is reached. The other option is to limit entry on the day of the AGM on a simple "first come, first served" until the limit is reached.

Observers should be able to purchase, at cost, copies of the enterprise's Annual Corporate Report before or during the AGM. There should be a brief agenda for the open session of the AGM distributed at the AGM.

4. BOARDS FOR EFFECTIVE LEADERSHIP AND OVERSIGHT

- 4.1 The Board of Directors should explicitly assume fully the responsibilities of the stewardship of the enterprise on behalf of the Government, other shareholders and the public. It has two principal functions in its stewardship of the enterprise: to lead the enterprise and to oversee the management and operations of the enterprise.**
- 4.2 The Board must meet regularly, at least once every two months, and have a formal schedule of matters specifically reserved for it as specified in the enterprise's Corporate Charter.**

The duties of the Board include:

- Guidance in the formulation of the enterprise's 3-year rolling Corporate Plan and Annual Plan and Budget, which should include notably the enterprise' Resource Plan and Procurement Plan, for approval by the AGM, and to ensure that these are met;
- Periodically reviewing the enterprise's legislated mandate and public policy objectives, and making recommendations to Government on how these may be updated to ensure its continued relevance;
- Identifying the trade-offs between competing public policy and commercial objectives and recommending the balance to be achieved;
- Identifying the principal risks of the enterprise and implementing effective systems for managing risks;
- Ensuring that appropriate systems and technologies for information management and transmission are developed to provide the Board and management with regular, reliable and timely information and to achieve the highest standards of disclosure and transparency to the Government and the public;
- Ensuring that systems and procedures for financial, operational, compliance and other internal controls are in place and functioning effectively so as to safeguard the enterprise's assets and to ensure compliance with laws, regulations and high standards of Corporate Governance and business ethics;
- Establish, and develop precise terms of reference on the scope, composition and duties for, Board Committees on audit and financial controls, nomination and remuneration of Board members, and other functions as deemed necessary, to ensure that key Board duties are clearly defined and executed responsibly and professionally;

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- Appointing, incentivising and retaining the best qualified CEO and senior management for the day-to-day management of the enterprise;
 - Regular and active monitoring and evaluation of the management's and enterprise's performance in attaining corporate strategic aims and operational objectives as set forth in the enterprise's 3-year rolling Corporate Plan and Annual Plan and Budget;
 - Ensuring that a system is instituted for regular corporate communications and relationships with the Government, stakeholders and the public;
 - Preparing the enterprise's Annual Corporate Report, Financial Statements, the Directors' Report and other Reports and disclosures to the Government and the public, and for ensuring the accuracy, reliability, relevance and timeliness of these Reports and disclosures and its compliance with relevant legislation, including the Accounting and Auditing Standards Act; and
 - Instituting, periodically reviewing and improving, in consultation with the Government, stakeholders and the public, the enterprise's system and practice of Corporate Governance and code of ethics.

International Best Practice in Corporate Governance requires a clear separation between the leadership (policy) and oversight role of the Board on one hand, and the day-to-day executive and managerial functions of senior management on the other hand. For example, the enterprise's 3-year rolling Corporate Plan, Annual Plan and Budget should be prepared by senior management, but the Board should provide leadership and guidance over the process by ensuring that key issues are identified and addressed and by monitoring and evaluating the preparation of these documents. Similarly, the Annual Corporate Report, Financial Statements and other Reports prepared by the Board for submission to the AGM should be supported by inputs from senior management.

The rights, responsibilities, functional duties and operational procedures of the Board should be clearly stated in the Public Enterprise's Corporate Charter. They should conform as fully as possible with those specified in the Companies Act and be complemented by various Corporate Governance Codes/guidelines and manuals on best boardroom practices, duties of directors, etc., issued by professional Associations in Sri Lanka.

4.3 Members of the Board of Directors have a statutory duty of loyalty to the Public Enterprise devoid of conflict of interest. They are legally accountable for breach of their duties. Their rights and responsibilities must be specified in the enterprise's Corporate Charter. Their responsibilities include:

- 4.3.1 A fiduciary duty to perform their duties in good faith and in a manner that they believe to be in the best interests of the enterprise, shareholders, other stakeholders and the public, and to exercise the degree of skill and care that may be reasonably expected of a person of his/her knowledge or experience;**
- 4.3.2 A fiduciary duty of loyalty to the Public Enterprise, avoiding conflict of interest, and acting in a manner which is not reckless or grossly negligent; and**

4.3.3 A fiduciary duty to ensure that the enterprise and its officers and staff comply with the law and all relevant Statutes and Regulations (including the Accounting and Audits Standards Act).

4.4 The duties, rights and responsibilities of Board members should be specified in a letter of appointment signed by the responsible Minister (or any other appointing authority) and accepted by the Board members.

Members of the Board of Directors in an enterprise enjoy considerable powers. Any form of abusive self-dealing and insider trading by members of the Board of Directors should therefore be explicitly prohibited in the enterprise's Corporate Charter. Similarly, procedures to declare and avoid conflicts of interests should be stipulated in the Corporate Charter.

Members should not take to their own advantage a business opportunity that the Public Enterprise might use, and should not use information obtained in their position as Board members for their own personal gain or for the benefits of any other organisation or individual.

Members have an obligation to disclose to the Board of Directors any potential conflict of interest.

4.5 Newly appointed or elected Board members should receive the necessary induction into his/her specific responsibilities, the enterprise's strategic aims and Corporate objectives, and the enterprise's Corporate Governance, managerial and control systems and procedures.

Members of the Board should receive appropriate professional training when necessary and at the expense of the enterprise.

4.6 The Board should have access to the advice and services of the professional qualified Corporate Secretary who is responsible to the Board for advising the Board on compliance with Board and AGM procedures, the law and relevant Rules and Regulations, and for ensuring that reliable and relevant information is provided to the Board and the AGM in a timely manner.

4.7 The Board of Directors should seek timely information it requires from management and other sources, and to verify its reliability, adequacy and accuracy and be provided by management with all relevant and timely information the Board needs to enable it to perform its functions effectively.

4.8 To perform their oversight functions effectively, Board Members must bring an independent judgement to bear on issues of corporate strategy, performance, use of resources, appointments and standards of conduct.

They should be able to obtain independent (outside) professional advice when necessary, at the Public Enterprise's expense and lay down proper procedures for such action.

4.9 The Board of Directors' duties and responsibilities in running the Board on one hand, and in running the enterprise's business on the other hand, should best be met by keeping the roles of the Board Chairman and the CEO separate, and by

achieving a balance of power and authority within the Board such that no one individual has unlimited powers of decision or influence.

A principle of Best Practice in Corporate Governance adopted in an increasing number of countries is that the Chairman of the Board, whose role is to lead and manage the Board, should not also be concurrently the CEO who is entrusted with managing the business of the Public Enterprise. Combining the Board chairmanship with the post of CEO not only confuses stewardship or oversight role with that of directly running the public enterprise, but it also leads to an unhealthy concentration of power. In instances where the roles of the Chairman and the Chief Executive Officer are combined, the Board needs to explain and justify this arrangement.

4.10 The Board of Directors should have a balance of Executive and independent Non-Executive Directors so that no individual or small group of individuals can dominate the Board's decision making.

The purpose of the presence of independent Non-Executive Members on the Board of Directors is to enhance the Board's capacity for impartial, objective judgements, especially when the Board also comprises executives of the enterprise.

An independent Non-Executive Board Member should be independent of management and free from any business or other relationship, which could materially interfere with the exercising of their independent judgement.

4.10.1 Independent Non-Executive Board Members should comprise at least one-half, and preferably a majority of the Board.

4.10.2 Government officials should not comprise more than one-third of the Board and must safeguard the interests of the Government and make independent judgements in exercising their duties.

A key principle of Corporate Governance increasingly adopted globally is that Non-Executive Directors should form a majority, or at least a significant proportion, of the Board of Directors to enhance the Board's oversight function.

A Government official serving as a Board member has a primary duty to safeguard the interests of the enterprise and the public. The interests of his/her Government Dept should not attain priority.

4.11 Members of the Board of Directors should be appointed or elected by the AGM upon the recommendation of the Nomination Committee of the Board of Directors. There should be a formal, competitive and transparent process for appointments.

4.11.1 A Nomination Committee should be established under the Board to make recommendations to the Board and the AGM on Board appointments.

4.11.1.1 The Nomination Committee should be headed by an independent Non-Executive Member of the Board.

4.11.1.2 The Nomination Committee should determine the specific criteria and profile, including professional qualifications,

relevant work experience and other characteristics of eligible candidates for Board membership.

4.11.1.3 The Nomination Committee should, where appropriate, consult and co-opt relevant Government officials and outside experts as non-voting members to assist the Committee in its selection process.

4.11.1.4 The Nomination Committee's recommendations for Board appointments should be based on an open and competitive process of recruitment, including notices in the public media.

The majority of the Nomination Committee should comprise Non-Executive Members of the Board of Directors, and either the Chairman or a Non-Executive Member of the Board of Directors should chair the Nomination Committee.

The Board should develop precise terms of reference for the Nomination Committee. The various manuals on Corporate Governance issued by the Professional Associations provide useful guidelines and templates, and should be consulted in the formulation of the terms of reference.

4.11.2 Members of the Board of Directors should not be elected or appointed for a term of office of more than three years. Reappointment should not be automatic, and members should stand for re-election every three years. Candidates for election or re-election should provide sufficient personal data and professional background information to enable a transparent decision to be taken on their election or appointment.

4.11.3 Board appointments should be staggered over time so that not all members of the Board are retired or, elected or appointed at the same time to ensure a degree of continuity.

The continuity of the Board is important. The replacement of the responsible Minister and/or change in Government should not lead to the replacement of Board members without good cause. Board members should be able to fulfil the tenure of their appointment and should only be replaced or dismissed on grounds and causes clearly specified in the enterprise's charter and the letter of appointment.

4.12 The Board should have an Audit Committee empowered to oversee and exercise due diligence and control over the financial aspects of the Public Enterprise's operations and performance.

4.12.1 The Audit Committee should be able to take independent (outside) professional advice when necessary, at the Public Enterprise's expense, and have an agreed procedure for doing so.

4.12.2 The Board of Directors, the internal and external auditors, and the management should provide the Audit Committee with all relevant and timely information that the Committee needs to enable it to perform its functions effectively.

4.12.3 No member of the Audit Committee can be an executive or employee of the enterprise. The Chairman of the Audit Committee should be an independent Non-Executive Board member, and at least one member of the Committee must be qualified in accounting and auditing work.

Amongst other duties, the role of Audit Committee is to:

- Recommend to the Board of Directors and the AGM the appointment of the Public Enterprise's external auditor, the external auditor's fee and matters relating to the resignation or dismissal of the external auditors;
- Discuss with the external auditor the terms of reference of the audit;
- Review the quarterly, half-yearly and annual Financial Statements and discuss with the external auditor any matters of concern, without the involvement of the management, whenever necessary, before submission to the Board of Directors;
- Periodically review and where necessary make recommendations to the Board of Directors on the adequacy of the Public Enterprise's accounting and audit systems, financial reporting systems, internal control systems and risk management systems; and
- Review of conflicts of interest and related party transactions involving members of the Board and senior management.

The Board should develop precise terms of reference for the Audit Committee based on the various manuals on Corporate Governance issued by the Professional Associations, which provide useful guidelines and templates on International Best Practices, together with the Treasury Circulars on the establishment of Audit and Management Committees.

5. DISCLOSURES AND TRANSPARENCY

5.1 Timely and accurate information on the enterprise's finances, operations, and performance should be regularly disclosed to the Minister of Finance, the responsible Minister and officials, other shareholders and stakeholders.

The responsibility for making the appropriate disclosures of information, and the transparency of that information as decided by the AGM rests with the Board of Directors. The Board must properly account to shareholders and other stakeholders for its governance of the Public Enterprise and it does so through high standards of disclosure.

Appropriate information is:

- Accurate: contains no material errors;
- Reliable: clear with no ambiguity

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- Complete: has no significant omissions;
 - Timely: information is current and relevant; and
 - Not misleading: observes the spirit of true and fair disclosure.

The principal means of disclosure include:

- Interim reports (quarterly and half yearly) which should include condensed or summarized Financial Statements, but may be un-audited, and are normally required to provide only summary information on the other material events of the period; and
- Continuous disclosures ("real time disclosures"), which are also required when a material event occurs or is about to occur. Where a Public Enterprise is listed, such events must be immediately disclosed to the Securities & Exchange Commission, the Colombo Stock Exchange and the public.

5.2 The most effective and cost-efficient methods and modalities, including the Internet, for the dissemination of information should be utilised.

5.3 The annual audit of the enterprise should be conducted by an external auditor, from the list of Chartered Accountants approved by the Auditor General, and appointed by the AGM upon the recommendation of the Audit Committee of the Board of Directors. The annual audit must be completed by the external auditor within 2.5 months of the end of the Public Enterprise's financial year and submitted by the Board of Directors to the Minister of Finance, the responsible Minister, the Auditor General and where applicable, other shareholders at least 15 working days before the AGM. The annual audit and report must be reviewed by the Board of Directors and submitted to the AGM for approval.

5.3.1 The external auditor is precluded from providing consultancy or any other services to the enterprise that might compromise its impartiality and independent judgement in its audit of the enterprise.

5.3.2 The external auditor should be changed at least every five years.

5.3.3 The external auditor should be appointed through a letter stating that audits are to be completed within 2.5 months of the end of the Public Enterprise's financial year and other terms of reference set by the Board's Audit Committee. The external auditor should be legally obliged to report to the Minister of Finance, the responsible Minister and the AGM any impediments he faces from the Public Enterprise, or from any other party, resulting in his inability to complete the audit in time and in executing any of his duties specified in the letter of appointment.

5.3.4 The Audit Review by the Auditor General of the Public Enterprise should be completed within 3 months of the end of the enterprise's financial year and submitted to Parliament. Copies of the Audit review should be sent to the Minister of Finance, the responsible Minister and the enterprise's Board of Directors.

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- 5.4 Internal and external audits, financial statements and other information should be prepared using the highest international standards of accounting, auditing, financial and non-financial reporting and in line with the Accounting and Auditing Standards Act and other relevant legislation.**
- 5.5 Full disclosure and transparency should be enforced within the enterprise to provide the Board of Directors, the CEO and senior management with timely and reliable information required by them to fulfil their responsibilities effectively.**
- 5.6 The Public Enterprise should issue an Annual Corporate Report within 3 months of the end of its financial year. Disclosures in the Annual Corporate Report should include:**
- 5.6.1 Financial and operating results of the enterprise, and the audit and report of the external auditor and the Audit Review of the Auditor General;**
 - 5.6.2 The enterprise's Mission Statement and Citizens Charter where applicable, its objectives and strategy, how these are to be met and the extent to which they have been met and foreseeable material risk factors;**
 - 5.6.3 Capital structure of the enterprise, and where applicable, major share ownership and voting rights;**
 - 5.6.4 Members of the Board of Directors and senior management, their background, qualifications (including directorships or positions in other companies) and their individual remuneration;**
 - 5.6.5 Corporate Governance structure and policy; and**
 - 5.6.6 Material issues concerning employees and other major stakeholders.**

The Annual Corporate Report is the main means of communication between the Public Enterprise and the Government, other shareholders and stakeholders. It is also the document on which most users rely in making economic decisions about the Public Enterprise. For this reason, the requirements in Annual Reports are most stringent and must meet the highest standards of disclosure and transparency.

In preparing and presenting the Financial Statements, International Accounting Standards (IAS) are the benchmarks, supported by International Standards of Auditing (ISA).

In addition, the Annual Report should provide descriptive information that gives a broader and comprehensive view of the Public Enterprise, its operations and its plans for the future. This should include information about:

- (i) the Public Enterprise itself, and its goals and objectives (Public Enterprise Profile);
- (ii) the Public Enterprise's financial and operating performance, and future plans (Directors Report and Management Review); and

(iii) the public enterprise's shareholding, where applicable, Corporate Governance systems and practices, including information on the qualifications and interests of directors.

- 5.7 Financial Statements, the Annual Corporate Report and other matters to be discussed at the AGM should be provided to the Minister of Finance, the responsible Minister and officials, and where applicable other shareholders, in a timely manner to enable them to be informed about matters to be discussed at the AGM. The Annual Corporate Report should be provided to eligible attendees of the AGM at least 15 working days before the AGM.**
- 5.8 The responsible Minister and officials, and other shareholders, should upon a written request have a right to inspect in person or by attorney or by other agent, Minutes of meetings of the Board of Directors and its Committees.**
- 5.9 The Minister of Finance, responsible Minister and officials, and where applicable other shareholders, Members of the Board of Directors, the CEO and other senior management personnel and Parliament should have the right to examine the Public Enterprise's stock ledger and its other books and records and keep such information so obtained confidential.**

Principle 4 (Boards for Effective Leadership and Oversight), aimed at strengthening boardroom responsibilities and practices and **Principle 5 (Disclosures and Transparency)** are similar to and represent a synthesis of, those contained in leading national and international codes such as the Cadbury Code (1992, UK), the Combined Code (1999, UK) the OECD Principles (1999), the Commonwealth Association of Corporate Governance (CACG) Guidelines (1999) and the Corporate Governance Principles and Recommendations (2000) of the European Association of Securities Dealers (EASD). Although these codes are primarily intended for listed firms, their principles and provisions relating to boardroom practices and disclosures are relevant and largely applicable to Public Enterprises in Sri Lanka.

6. PERFORMANCE-RELATED INCENTIVES

(This section is not applicable to Statutory Boards whose remuneration policy and scales are determined by the Government.)

- 6.1 A Public Enterprise should enjoy autonomy in implementing market-based, performance-related incentive systems and in return get best efforts from Members of the Board of Directors, the CEO, senior management and employees of the enterprise.**

To enhance efficiency, and to eventually become competitive both domestically and internationally, Public Enterprises should strive to become modern corporations manned by highly qualified professionals. This means the recruitment of highly competent and professional Members of Board of Directors and the senior management. The costs of recruiting such professionals should be seen as a key investment by the enterprise and the Government.

6.2 The level of remuneration for Members of the Board of Directors, the CEO and senior management should be sufficient to attract, motivate and retain them, and be approved by the AGM.

Non-Executive Members of the Board of Directors should receive director's fees in addition to out-of-pocket expenses. These fees should be sufficient, and competitive with those in the private sector, to ensure that they devote the time and effort necessary to execute their Board duties actively and responsibly.

Government officials should be allowed, without any restraints, to receive director's fees in the execution of their Board functions.

A proportion of the remuneration of Executive Members of the Board of Directors and the CEO should be performance-related so as to link rewards with performance.

6.3 The Public Enterprise should establish a formal and transparent procedure for the determination of the remuneration of Members of the Board of Directors, the CEO and senior management.

6.3.1 No Executive Member of the Board of Directors should be involved in deciding on his or her own remuneration.

6.4 The Board of Directors should establish a Remuneration Committee empowered to determine and recommend to the Board of Directors and the AGM the remuneration for Executive Members of the Board of Directors, the CEO and senior management. The Remuneration Committee should:

6.4.1 Comprise exclusively of Non-Executive Board Members independent of management and free from any business or other relationships which could materially interfere with the exercise of their independent judgement;

6.4.2 Make recommendations to the Board of Directors and the AGM, within agreed terms of reference, on the Public Enterprise's policy, framework and structure of executive remuneration and its cost, and to determine on behalf of the Board specific remuneration packages (including pension rights and any compensation payments) for Executive Board Members, the CEO and senior management;

6.4.3 Consult the Chairman of the Board of Directors about the Remuneration Committee's proposals for remuneration of Executive Board Members (other than the Chairman's), and have access to professional advice inside and outside the enterprise; and

6.4.4 Submit a Report, to be included in the Annual Corporate Report and Accounts, stating the list of members of the Remuneration Committee, the enterprise's remuneration policy and full details of remuneration for each Member of the Board of Directors and the CEO.

6.5 The remuneration of independent Non-Executive Board Members should be determined by the AGM upon recommendation of the Board as a whole.

One of the most contentious corporate governance issues has been Board members awarding themselves high remuneration packages despite poor Public Enterprise performance (and shareholder value). A core principle of Best Practice in Corporate Governance adopted worldwide is that while remuneration for Executive Board Members and CEOs need to be sufficient to attract, motivate and retain highly skilled professionals, no Board Member and CEO should decide on his or her own remuneration.

International Best Practices in Corporate Governance either require or strongly recommend the establishment of a Remuneration Committee under the Board of Directors to determine policy and levels of remuneration for Executive Board Members. The Remuneration Committee should comprise only Non-Executive Board Members, and its recommendations on remuneration for Executive Board Members and the CEO should be presented and approved by the AGM. Details of remuneration for Board Members should be disclosed in the Public enterprise's Annual Corporate Report.

Section 5

CONCLUSION

These codes are also the basis upon which the various Sri Lankan codes and guidelines on best practice in corporate governance -- similarly intended for private firms -- issued by the Institute of Chartered Accountants of Sri Lanka (ICASL), the Institute of Chartered Secretaries and Administrators of Sri Lanka (ICSASL), the Sri Lankan Institute of Directors (SLID) and the Ceylon Chamber of Commerce (CCC) have been derived. Indeed, the Sri Lankan codes are essentially restatements of the Cadbury and the Combined Codes and the CACG Guidelines. The Sri Lankan codes are:

- (i) **The Code of Best Practice: Report of the Committee to Make Recommendations on Matters Relating to Financial Aspects of Corporate Governance** (1998) issued by the ICASL;

(This code has since been supplemented a Code of Best Practice in Audit Committees issued in May 2002 and an exposure draft on **Boardroom Governance** issued in 2001)

- (ii) **The Handbook on Corporate Governance: Principles and Guidelines to Best Practice in Sri Lanka** (undated, but ca. 2001) published by the ICSASL; and
- (iii) **Corporate Governance** (undated, but ca. 2001) published by the CCC and SLID.
- (iv) Code of Corporate Governance for Banks and other Financial Institutions issued by the CBSL in 2002.

These Sri Lankan codes should be read in conjunction with the Code of Best Practice in Corporate Governance for Public Enterprises in Sri Lanka. Whereas the Code for public enterprises has to be more concise and generic to ensure their applicability to a wide range of diverse types of Public Enterprises. The four Sri Lankan codes referred to above contain more detailed provisions, explanations and recommendations for best practice on matters such as boardroom practices, board committees on audit, remuneration, nomination and risk management, annual company reports, financial statements, etc.

In addition, the ICASL, ICSASL and CCC have published handbooks on professional and business ethics, good boardroom practices, best practice at annual general meetings, duties of directors and company secretaries, transparent disclosures and auditing and accounting standards, tax compliance, etc. **These Corporate Governance codes and handbooks published by the Sri Lankan professional bodies represent an invaluable corpus of material on Corporate Governance, which should be closely consulted by the responsible Government ministers and officials and by the Public Enterprises.** The material contained therein is of a high standard and are comparable with the best available internationally. They provide essential practical guidelines for compliance with the various principles and provisions of the Code for Public Enterprises.

In drafting the Code for Public Enterprises in Sri Lanka, codes and studies of Corporate Governance in public sector firms in countries such as India, China, Vietnam, the UK, Australia and Canada were also reviewed. Where relevant and appropriate, selected ideas and recommendations in these materials have been incorporated.

Finally, it should be emphasized that the adoption of the Code is only a first step towards attaining best practice in Corporate Governance among public enterprises. **Corporate Governance development is an evolutionary process.** Systemic arrangements and operational procedures implemented in a public enterprise to comply with the Code's principles and recommended best practices will need to be fine-tuned and adapted to the enterprise's particular conditions and requirements. **A corporate governance culture needs to be developed.**

More importantly, **there needs to be complementary initiatives to improve the policy and institutional environment within which Public Enterprises operate.** These initiatives should include the following.

- (i) The property rights structure of Public Enterprises need to be clarified, ideally through corporation and conversion of public enterprises into corporate entities (e.g. limited liability companies, joint stock companies) operating under Companies Act.
- (ii) Public Enterprises will be subjected to financial and competitive market discipline like any other firm. This is vital if their efficiency -- value for the public's money -- is to improve. Subsidies, explicit or implicit, and preferential treatment for commercial Public Enterprises will have to cease.
- (iii) For those Public Enterprises, which are to remain under some degree of state ownership, private sector equity participation through partial divestiture would create a diversified ownership and capital structure far more conducive to Corporate Governance than possible under sole state ownership.
- (iv) The system and *modus operandi* through which the Government exercises ownership and corporate Governance functions over public enterprises need to be rationalised, with management of state assets delegated to professional commercially-oriented bodies (e.g. state-owned holding companies and private sector asset managers) rather than bureaucrats.

These initiatives are outside the scope of a Code of Best Practice in corporate governance. But they need to be noted here because compliance with the Code would significantly facilitate these options

CODE OF BEST PRACTICE FOR PUBLIC ENTERPRISES IN SRI LANKA

Schedule of decision-making reporting and disclosure instruments

Instruments, Documentation & Reports	Responsible Party	Timeframe
A. Instruments for Structure, Operation & Accountability of PEs		
<i>Enterprise's Corporate Charter</i>	Minister of Finance	Adoption by AGM
<i>Mission Statement</i>	Board of Directors	Endorsement by AGM
<i>Citizens Charter (where applicable)</i>	Board of Directors	Endorsement by AGM
<i>Terms of References for Audit, Remuneration and Nomination Committees</i>	Board of Directors	Approval by the Board of Directors
B1. AGM - Monitoring & Disclosure Instruments		
<i>Audit of Enterprise's Account</i>	External Auditors	Two and a half (2.5) months following the end of the Financial Year.
<i>Review of Audit of Accounts</i>	Auditor General	Three (3) months following the end of the Financial Year.
<i>Annual Corporate Report</i>	Board of Directors	AGM' Convening Notice (fifteen (15) working days before the AGM, which must be held four (4) months following the end of the Financial Year).
B2. AGM - Corporative objectives		
<i>3 Year-Rolling Corporate Plan</i>	Board of Directors	AGM' Convening Notice.
<i>Annual Plan and Budget</i>	Board of Directors	AGM' Convening Notice.
B3. AGM - Boards Committees and Other Reports		
C. Other Disclosure / Report Documents		
<i>Periodic Reporting: Half Yearly and Quarterly Reports</i>	Board of Directors	When required.
<i>Continuous Disclosure</i>	Board of Directors	When required.
D. Government Accountability to Parliament & the Public		
<i>Annual Performance Statement (APS)</i>	Responsible Minister	Six (6) months after the end of the financial year.

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