

## SEC MEMORANDUM CIRCULAR NO. 2

Series of 2002

### CODE OF CORPORATE GOVERNANCE

In accordance with the State's policy to actively promote corporate governance reforms aimed to raise investor confidence, develop capital market and help achieve high sustained growth for the corporate sector and the economy, the Commission, in its Resolution No.135, Series of 2002 dated April 04 2002, approved the promulgation and implementation of this Code, which shall be applicable to corporations whose securities are registered or listed, corporations which are grantees of permits/licenses and secondary franchise from the Commission and public companies. This Code also applies to branches or subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed.

#### I. Definitions

- A. *Board of Directors* – refers to the collegial body that exercises the corporate powers of all corporations formed under the Corporation Code. It conducts all business and controls or holds all property of such corporations.
- B. *Corporate Governance* – refers to a system whereby shareholders, creditors and other stakeholders of a corporation ensure that management enhances the value of the corporation as it competes in an increasingly global market place.
- C. *Independent Director* – refers to a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having any relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. This means that apart from the directors' fees and shareholdings, he should be independent of management and free from any business or other relationship which could materially interfere with the exercise of his independent judgment.
- D. *Public Company* – refers to any corporation with a class of equity securities listed in an Exchange or with assets in excess of Fifty Million Pesos (P50,000,000.00) and having two hundred (200) or more stockholders each holding at least one hundred (100) shares of a class of its securities.

### **III. Supply Information**

In order to fulfill their responsibilities, Board members, should be provided with complete, adequate and timely information prior to Board meetings on an on-going basis.

Management should have an obligation to supply the Board with complete, adequate information in a timely manner. Reliance purely on what is volunteered by Management is unlikely to be enough in all circumstances and further inquiries may be required if the particular director is to fulfill his or her duties properly. Hence, the Board may have separate and independent access to the company's senior management.

The information may include the background or explanatory information relating to matters to be brought before the Board, copies of disclosure documents, budgets, forecasts and monthly internal financial statements. With respect to the budget, any variance between the projections and actual results should also be disclosed and explained.

Directors should also have a separate and independent access to the Corporate Secretary. The role of the Corporate Secretary should be clearly defined and should include responsibility for ensuring that Board procedures are being followed and that applicable rules and regulations are complied with. The Corporate Secretary should attend all Board meetings.

The Board should have a procedure for directors, either individually or as a group, in the furtherance of their duties, to take independent professional advice, if necessary, at the corporation's expense.

### **IV. Accountability and Audit**

1. The Board is primarily accountable to the shareholders and Management is primarily accountable to the Board. The Board should provide the shareholders with a balanced and understandable assessment of the corporation's performance, position and prospects on a quarterly basis. The Management should provide all members of the Board with a balanced and understandable account of the corporation's performance, position and prospects on a monthly basis. This responsibility should extend to interim and other price sensitive public reports and reports to regulators (if required). It should be primarily responsible in making financial reporting and internal control in accordance with the following guidelines:
  - a. Present a balanced and understandable assessment of the company's position and prospects. The Board's responsibility to present a balanced and understandable assessment should extend to interim and other price-sensitive public reports and reports to regulators as

well as to information required to be presented by statutory requirements;

- b. Explain their responsibility for preparing the accounts, for which there should be a statement by the auditors about their reporting responsibilities;
  - c. Report that the business is a going concern, with supporting assumptions or qualifications, if necessary;
  - d. **Maintain a sound system of internal control to safeguard stakeholders' investment and the company's assets;**
  - e. Based on the approved audit plans, scope and frequency of audits, ensure that internal audit examinations cover, at least, the evaluation of adequacy and effectiveness of controls encompassing the organization's governance, operations, information systems, to include reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, and compliance with laws, rules, regulations, and contracts.
  - f. Require the chief audit executive to render to the Audit Committee and senior management an annual report on the internal audit department's activity, purpose, authority, responsibility and performance relative to the audit plans and strategies approved by the Audit Committee of the Board. Such annual report should include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the Board and senior management. The chief audit executive's annual report shall likewise be made available to the stockholders of the company. Internal auditors shall report that their activities are "conducted in accordance with the Standards for the Professional Practice of Internal Auditing". Otherwise, the chief audit executive shall disclose to the Board and senior management that it has not yet achieved full compliance with the standards for the professional practice of internal auditing.
2. Selection/Appointment, Resignation, Dismissal or Cessation of Service of an External Auditor

The Board, through the Audit Committee, shall recommend to the stockholders a duly accredited external auditor who shall undertake an independent audit and shall provide an objective assurance on the way in which financial statements shall have been prepared and presented. Such external auditor cannot at the same time provide the services of an internal auditor to the same client. Other non-audit work should not be in conflict with the functions of the external auditor.

The external auditor should be rotated every five (5) years or earlier or the handling partner shall be changed.

The reason/s for the resignation, dismissal or cessation from service and the date thereof of an external auditor shall be reported in the company's annual and current reports. Said report shall include a discussion of any disagreement with said former external auditor on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which if not resolved to the satisfaction of the former auditor, would have caused making reference to the subject matter of the disagreement in connection with its report.

If an external auditor believes that the statements made in an annual report, information statement or proxy statement filed during his engagement are incorrect or incomplete, he shall also present his views in said reports.

## **V. Stockholders' Rights and Protection of Minority Stockholders' Interests**

The Board shall be committed to respect the following rights of the stockholders:

### **1. Voting Right**

Shareholders have the right to elect, remove and replace directors and vote on certain corporate acts in accordance with the Corporation Code.

The Code mandates the use of cumulative voting in the election of directors. Although directors may be removed with or without cause, the Code prohibits removal without cause if it will deny minority shareholders representation in the Board. Removal of directors requires an affirmative vote of two-thirds of the outstanding capital.

### **2. Pre-emptive Right**

All stockholders have pre-emptive rights, unless there is a specific denial of this right in the articles of incorporation or an amendment thereto. They shall have the right to subscribe to the capital stock of the corporation. The Articles of Incorporation may lay down the specific rights and powers of shareholders with respect to the particular shares they hold, all of which are protected by law so long as they are not in conflict with the Corporation Code.

### **3. Power of Inspection**

The Corporation Code mandates corporations to allow shareholders to inspect corporate books and records including minutes of Board

meetings and stock registries in accordance with the Corporation Code and to provide them an annual report, including financial statements, without cost or restrictions.

#### 4. Right to Information

The Shareholders shall be provided, upon request, with periodic reports which disclose personal and professional information about the directors and officers and certain other matters such as their holdings of the company's shares, dealings with the company, relationships among directors and key officers, and the aggregate compensation of directors and officers. The Information Statement/Proxy Statement where these are found must be distributed to the shareholders before annual general meetings and in the Registration Statement and Prospectus in case of registration of shares for public offering with the Commission.

The minority shareholders should be granted the right to propose the holding of a meeting, and the right to propose items in the agenda of the meeting, provided the items are for legitimate business purposes.

The minority shareholders should have access to any and all information relating to matters for which the management is accountable for and to those relating to matters for which the management should include such information and, if not included, then the minority shareholders can propose to include such matters in the agenda of stockholders' meeting, being within the definition of "legitimate purposes".

#### 5. Right to Dividends

Shareholders have the right to receive dividends subject to the discretion of the Board. However, the Commission may direct the corporation to declare dividends when its retained earnings is in excess of 100% of its paid-in capital stock, except: a) when justified by definite corporate expansion projects or programs approved by the Board or b) when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its consent, and such consent has not been secured; or c) when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is a need for special reserve for probable contingencies.

#### 6. Appraisal Right

The Corporation Code allows the exercise of the shareholders' appraisal rights under the following circumstances:

- a. In case any amendment to the articles of incorporation has the effect of changing or restricting the rights of any stockholders or class of shares,

or of authorizing preferences in any respect superior to those of outstanding shares of any class, or of extending or shortening the term of corporate existence;

- b. In case of sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets as provided in the Corporation Code; and
- c. In case of merger or consolidation.

It is the duty of the directors to promote shareholder rights, remove impediments to the exercise of shareholders rights and allow possibilities to seek redress for violation of their rights. They shall encourage the exercise of shareholders' voting rights and the solution of collective action problems through appropriate mechanisms. They shall be instrumental in removing excessive costs and other administrative or practical impediments to shareholders participating in meetings and/or voting in person. The directors shall pave the way for the electronic filing and distribution of shareholder information necessary to make informed decisions subject to legal constraints.

## **VI. Evaluation Systems**

The management may establish a performance evaluation system to measure the performance of the Board and top-level management of the corporation.

The establishment of such evaluation system, including the features thereof, may be disclosed in the company's annual report (SEC Form 17-A).

## **VII. Disclosure and Transparency**

A dominant theme in all issues related to corporate governance is the vital importance of disclosure. The more transparent the internal workings of the company and cash flows, the more difficult it will be for management and controlling shareholders to misappropriate company assets or mismanage the company.

The most basic and all encompassing disclosure requirement is that all material information, i.e., any thing that could potentially affect share price, should be publicly disclosed. Such information would include earnings results, acquisition or disposal of assets, board changes, related party transactions, shareholdings of directors and changes to ownership. Other information that should always be disclosed includes remuneration (including stock options) of all directors and senior management corporate strategy, and off balance sheet transactions. All disclosed information should be released via the approved stock exchange procedure for company announcements as well as through the annual report.