Sustainable Business & Corporate Governance

Institute of Chartered Accountants of Nigeria – Stakeholders Dialogue 1

July 2018

Outline

01 Introduction

02 The "Apply and Explain" Principles Based- Approach

03 Key Objectives of the Code

04 Key Provisions in the Nigerian Code that Promotes Business Sustainability

05 Overall Benefits of the Code

06 Conclusion

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Introduction – Definition of Corporate Governance

"Corporate governance involves a <u>set of relationship</u> between a <u>company's management</u>, it's <u>board</u>, it's <u>shareholders</u> and it's other <u>stakeholders</u>. Corporate Governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined."

---- OECD Principle of Corporate Governance, 2004

"Corporate governance is a process that aims to allocate corporate resources in a manner that maximises value for all <u>stakeholders</u> – shareholders, investors, employees, customers, suppliers, environment and the community at large and holds those at the helms to <u>account</u> by <u>evaluating their decisions</u> on transparency, inclusivity, equity and responsibility.."

Sreeti Raut, IOD, India

"If management is about running business, <u>governance is about seeing that it runs properly</u>."

Professor Bob Tricker, 1984

In essence, corporate governance is the "system by which companies are directed and controlled."

Sir Adrian Cadbury, Cadbury Report, 1992

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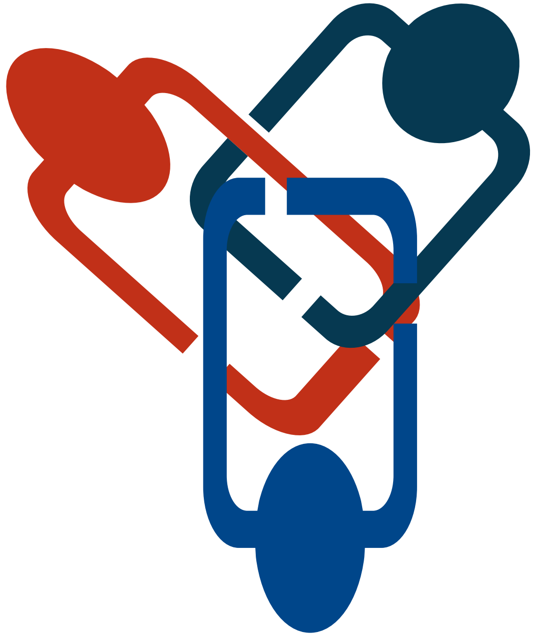
Introduction - Previous Governance Failures & Lessons Learned

Lessons Learned

- Overbearing CEO and/or Chairman
- Poor risk management practices
- Poor ethical culture
- Poor transparency and scrutiny of related party transactions
- Misalignment of shareholders' interest with that of management
- Ineffective Boards



Enforced Corporate Governance Models

Examples of Key Global Codes

- OECD Corporate Governance Principles
- Sarbanes Oxley (US)
- King II Report (SA)
- UK Code of Corporate Governance
- ASX Corporate Governance Guideline (Australia)

Nigeria

- SEC Code - 2003 & 2011
- CBN Code – 2006 & 2014
- NAICOM Code - 2009
- NCC Code – 2014 & 2016
- PENCOM Code – 2008

Objectives

- Prevent financial crisis
- Build investors confidence
- Curb corporate scandals
- Raise standards & drive reforms
- Measure corporate governance practices in organisations
- Provides guidelines for companies

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Introduction - Issues with the previous National code

Some of the key issues identified by various stakeholders relating to the previous National Code of Corporate Governance for Private Sector include:

1. Code philosophy- Mandatory versus Voluntary (Comply &/ or Explain; Apply & /or Explain)
2. Applicability of Code: Lack of clarity on definition of Public Interest Entity
3. Conflicts of certain provisions with existing legislation such as CAMA and FRC Act and Sector Codes
4. High cost of governance: Minimum board size of 8, Number of INEDS required on Boards and percentage of EDs to NEDs
5. Concept of Lead Independent Directors
6. Tenure and re-election of Directors; Maximum tenure of 15 years for EDs who become MDs
7. Long cool-off period for engaging the former staff of regulatory agencies on a board
8. Mandatory Joint External Audit; lack of definition of non-Nigerian Partners; long cool-off period for rotating audit firms
9. Prohibition on outsourcing of internal audit services
10. Short transition arrangement

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The Apply and Explain Principles Based- Approach

- **In response to emerging corporate governance challenges in their respective sectors, and due to the absence of a national code that applies to a wider range of companies irrespective of sectors, a number of sectoral regulators have developed sectoral codes specifying standards of corporate governance to apply to companies operating in their sectors.**

- **Most of these codes apart from that issued by SEC were mandatory. The philosophy adopted was a rules-based approach otherwise known as 'Comply or Else' sanctions would be applied.**

- **However, globally, most governance codes are typically voluntary, adopting a principles-based approach. This can either be:**

01

Comply or Explain: This philosophy requires companies to state that they have complied with the requirements of the code or explain why they could not do so

02

Apply or Explain: This philosophy requires companies to apply requirements of the code or to explain why they could not do so.

03

Apply and Explain: This philosophy assumes application of all principles, and requires entities to explain how the principles are applied.

Highlights of the Code Principles and Recommended Practices

7 Parts

Number of sections in the Code – Part a-Part G

28 Principles

Corporate governance ideals that companies should strive to embed

231 Recommended Practices

Governance best practices to be adopted on a scaled level by each company depending on their growth trajectory

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The Apply and Explain Principles Based- Approach

The argument against the 'Comply or Else' philosophy includes the fact that the philosophy is seen as a 'one-size fits all' approach which isn't suitable for all business types. Additionally, the cost of compliance is burdensome and there is a danger that the Board and management may become distracted by compliance at the expense of enterprise. Lastly, Mandatory codes tend to produce a box-ticking compliance approach by companies.

The Council also debated the 'Comply or Explain' philosophy and noted that the word 'comply' connotes strict adherence without room for flexibility. It also often leads to a mechanical response to a code and its recommendations. Consequently, the Council noted from its review that the 'Comply or Explain' principle has evolved into different approaches internationally. For example, the UN Code is an 'adopt or explain' basis while Mauritius and South Africa adopted an 'Apply and Explain' approach.

The Nigeria Code targets companies of varying sizes and complexities, who operate in diverse industries. Consequently, flexibility – the ability to apply the Nigerian Code in a wide range of circumstances – and scalability – the ability to apply to companies of differing sizes – were considered of utmost importance for its successful implementation.

The Nigeria Code has thus, adopted a principles-based approach - 'apply and explain. The decision to adopt the 'Apply and Explain' approach was made after careful consideration of our existing laws and the practices adopted by other countries with the key objective of making our market more attractive for investment flow.

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Key Objectives of the Code

The key objectives of the Nigerian Code of Corporate Governance are:

- Enhance the integrity of the Nigerian Market
- Rebuild public trust and confidence in the Nigerian economy
- Facilitate trade and investment
- Improve ease of doing business

Overview of the Nigerian Code Principles and Recommended Practices

7 Parts
Number of sections in the Code – Part A - Part G

28 Principles
Corporate governance ideals that companies should strive to embed

231 Recommended Practices
Governance best practices to be adopted on a scaled level by each company depending on their growth trajectory

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Key Provisions in the Nigeria Code of Corporate Governance that Promotes Business Sustainability

Board Operations

- Board structure and composition
- Board appointment process
- Roles and responsibilities of the board and its committees
- Roles and responsibilities of principal officers of the board
- Meeting proceedings
- Access to independent advice
- Director training
- Remuneration Governance

Monitoring & Evaluation

- Board evaluation
- Corporate governance evaluation

Assurance Mechanisms

- Risk Management
- Internal audit
- Internal control framework
- External audit

Integrity & Ethical Behaviour

- Whistle-blowing framework
- Code of ethics & business conduct
- Conflict of interest
- Related party transactions

Equitable treatment of shareholders & other stakeholders

- General meetings
- Shareholder engagement
- Protection of shareholder rights

Disclosure & transparency

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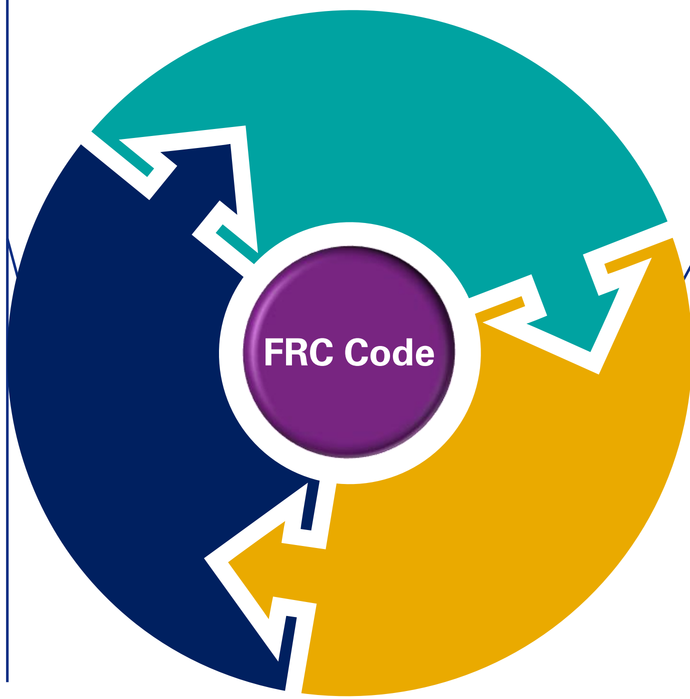
Overall Benefits of the Nigerian Code

The governance practices documented in the Nigerian Code is one of the most effective ways for building a sustainable business model and improving corporate performance. Good governance helps to provide reasonable assurance for achievement of business objectives through creation and preservation of value.

Application of the Nigerian Code will help management and the Board to:

- **Provide appropriate strategic direction**
- **Engender healthy debates and challenges propositions**
- **Build investors' confidence and improve access to funds**
- **Minimise the risk of regulatory sanctions and revenue losses**



Application of the Nigerian Code will help businesses to:

- **Convert risks into opportunities**
- **Improve decision-making process**
- **Proactively monitor and respond to regulatory uncertainties**
- **Promote ethical conduct and ensure value is delivered within acceptable business practices**

In conclusion…

"If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere.

Markets exist by the grace of investors. And it is today's more empowered investors that will determine which companies and markets will stand the test of time and endure the weight of greater competition."
—Arthur Levitt, former chairman of the U.S. Securities and Exchange Commission

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