



*cutting through complexity*

# The KPMG Indonesia Board Governance Toolkit

November 2015



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# Foreword

As the corporate governance landscape continues to evolve, globally and in Indonesia, to improve transparency, consistency and oversight of governance practices there is a need to raise awareness of requirements and share insights not only about what companies need to comply with but how they can do so more efficiently and effectively. These are critical factors in building investor and stakeholder confidence in the Indonesian capital markets.

Our business environment presents a fast moving spectrum of risks and opportunities. The role of Commissioners and Directors continues to be shaped by a multitude of forces including economic uncertainty, larger and more complex organizations, a more intense pace of technological development and a more rigorous regulatory environment.

At the same time there is more focus on Commissioners and Directors' duties, roles and responsibilities in light of increased regulatory changes. Commissioners and Directors play a critical role in shaping the corporate governance culture and framework within companies. Greater understanding of the requirements and how to apply them in practice is essential to improve governance standards.

To support Commissioners, Directors and those charged with implementing corporate governance in their challenging roles, KPMG Indonesia has developed the KPMG Indonesia Board Governance Toolkit. This Toolkit, in a user-friendly electronic format, cuts through the complexity of the regulatory environment whose rules are captured in various key instruments such as the Limited Liability Company Law, Indonesian Stock Exchange Listing Rules and Indonesia's Code of Good Corporate Governance. The Toolkit pulls together the key requirements and is a dynamic tool for Commissioners and Directors to better understand their scope of work, roles and responsibilities and hence improve board performance and decision making.

The Toolkit is intended to be updated and revised from time to time. We trust that you will find this Toolkit an important resource. If you have any questions or require assistance in this area, please contact us at [www.kpmg.co.id](http://www.kpmg.co.id). As always, we welcome any suggestions for improvements as we seek to continuously improve guidance in this critical area.

## **Kusumaningsih Angkawidjaja**

Partner in-charge  
Audit Services  
KPMG Indonesia

## **Irving Low**

Partner in-charge  
Risk Consulting Services  
KPMG Singapore and Indonesia

# About KPMG

KPMG Indonesia is a member firm of the KPMG global network of professional services firms providing Audit, Tax and Advisory services. KPMG member firms operate in 156 countries and collectively employ over 155,000 people across a range of disciplines. We contribute to the effective functioning of international capital markets and we support reforms that strengthen the markets' credibility and social responsibility. Drawing on industry insight and technical knowledge, our professionals assist clients in their pursuit of business growth, enhanced performance, governance and compliance objectives.

KPMG Indonesia has established the KPMG Board Governance Forum to provide regular thought leadership to Boards and senior executives on current and emerging topics. If you would like to become a member or would like more information, please visit [www.kpmg.co.id](http://www.kpmg.co.id).



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## Company types and scope

Law 40/2007 Limited Liability Company Law governs the establishment of a limited liability company (Perseroan Terbatas - PT), which is the most prevalent form of commercial entity in Indonesia. The Limited Liability Company Law defines a limited liability company as a legal entity that “constitutes a capital alliance, established based on an agreement, to conduct business activities with the company’s authorized capital divided into shares.”<sup>1</sup>

The size, capital structure and sector in which the company is operating will determine the Corporate Governance (CG) requirements which the company must follow. For example, issuers, state-owned enterprises and financial services organizations have a higher standard of CG to adhere to given the increased responsibility of managing public funds, stakeholder expectations and potential systemic risks that could eventuate if not governed effectively.

“Issuer” means a public company or company which exercises a public offering of shares in accordance with the prevailing Capital Market regulations.<sup>2</sup>

A public company must have at least 300 shareholders and a paid-up capital of at least IDR 3 billion.<sup>3</sup>

The focus of the KPMG Indonesia Board Governance Toolkit is on issuers and public companies. The purpose of the Toolkit is to provide a general overview of the key roles and responsibilities applicable across all sectors, rather than specific sector requirements, such as those regulations pertinent for the financial services sector.

## Governance structure

There are predominantly two CG structures adopted by countries globally:

- One-tier (unitary) Board system – consists of a single Board of Directors that supervises and governs the company and includes a mix of executive, non-executive and independent non-executive directors. This structure is adopted in the United Kingdom, United States, Australia, Singapore, Hong Kong, Malaysia, etc. Refer to Diagram 1.
- Two-tiered (dual) Board system – consists of separate Supervisory and Management Boards. The Supervisory Board consists of non-executive and/or independent members. It supervises and provides advice to the Management Board. The Management Board primarily consists of executive directors (although may have an independent director(s)) and is responsible for managing the company (or business operations). Indonesia follows a two-tiered (dual) Board governance structure. This structure is also followed in The Netherlands, Germany, China, etc. Refer to Diagram 2.

<sup>1</sup> Law 40/2007, Article 1 (1)

<sup>2</sup> Law 40/2007, Article 1 (7); Law 8/1995, Article 1 (6)

<sup>3</sup> Law 8/1995, Article 1 (22)

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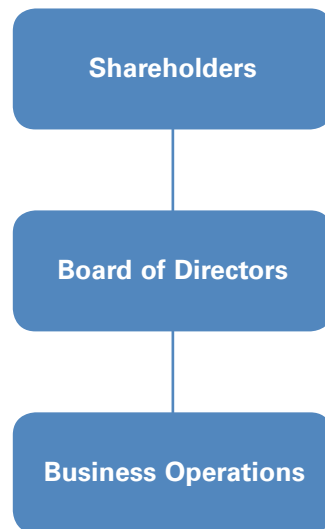
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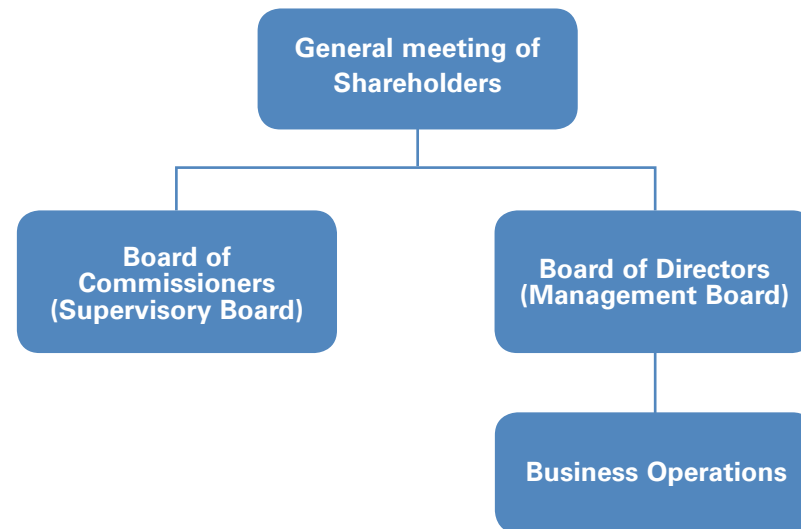
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**One tier (unitary) system (Diagram 1)**



**Two tier (dual) system (Diagram 2)**



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## Indonesian company governance

The Indonesian CG requirements refer to the General Meeting of Shareholders (GMS), the Board of Commissioners (BoC), and the Board of Directors (BoD) as the critical components of the CG system.

### General Meeting of Shareholders

As effective owners of the company, the GMS is provided with certain rights and powers by the shareholders of the company that are not conferred to the BoC or the BoD. Among others, it has authorities over matters related to governing bodies, such as the appointment, dismissal and replacement of members of the BoC and the BoD. The Limited Liability Company Law specifies that shareholders are not personally liable for any agreement made by the company or for the company's losses in excess of their prospective shareholding.<sup>4</sup>

### Board of Commissioners

The BoC has supervisory and advisory functions over management and the implementation of management policy.<sup>5</sup> Issuers and public companies are required to have at least 30% of the BoC members who are independent.<sup>6</sup> The BoC is prevented from participating in making any operational decisions.<sup>7</sup> However, the BoC may perform management duties for a limited period under certain conditions, such as when a vacancy occurs in the BoD.<sup>8</sup>

### Board of Directors

The BoD has a duty and responsibility to manage the company in the pursuit of the company's purposes and objectives. The BoD should consist of at least one independent Director.<sup>9</sup>

## Stakeholder considerations

The law provides that the duties of the BoC and the BoD are owed to 'the company'.<sup>10</sup> However, the CG Code also states that Commissioners and Directors owe their duties to the:<sup>11</sup>

- Shareholders – should protect shareholders rights in accordance with laws, regulations and the Articles of Association (AoA)
- Employees – should consider the interests of the employees when exercising their powers
- Creditors – should take into consideration the interests of the creditors to ensure that the assets of the company are not improperly dissolved or its affairs improperly managed
- Resource providers (suppliers, distributors, debtors, etc.) – should establish rules and regulations to ensure that any resource provider can exercise its rights and obligations including the rights to obtain relevant information to make informed business decisions
- Community and user of products and services – should maintain a harmonious relationship with the communities and are responsible for the quality of products and services produced and the negative impact on the safety of the users, the communities and the environment.

<sup>4</sup> Law 40/2007, Article 3 (1)

<sup>5</sup> Law 40/2007, Article 108 (1)

<sup>6</sup> IDX Listing Rules, Article III.1.4.2; No.33/POJK.04/2014, Article 20 (2-3)

<sup>7</sup> CG Code, Part IV, C

<sup>8</sup> Law 40/2007, Article 118 (1)

<sup>9</sup> IDX Listing Rules, Article III.1.5

<sup>10</sup> Law 40/2007, Article 92 (1) and 114 (2)

<sup>11</sup> CG Code, Part V, 2 and Part VI, 1, 2, and 3

# Section A

Company Governance –  
key roles and  
responsibilities





## 2. Board of Commissioners

BoC has significant legal responsibilities and it is critical to understand these duties, maintain compliance and continuously keep abreast of any relevant changes to regulations and guidance.

### QUESTIONS THAT COMMISSIONERS SHOULD ASK

1. Do I have adequate working knowledge of the laws and regulations relevant to the company and the consequences of breaching them?
2. Does the BoC receive reports about material changes to laws, regulations and the CG Code?
3. Are members of the BoC immediately advised of queries received from key regulators?
4. Am I fully aware of my duties and responsibilities regarding conflicts of interest?
5. Is there an effective procedure for identifying and disclosing related party transactions?
6. Are Commissioners' interests properly disclosed in the financial statements and/or accountability reports?
7. Do I understand the scope and limitations of the Commissioners' liability insurance policy?
8. Am I confident that there are mechanisms in place to detect insider trading?
9. Does the Corporate Secretary monitor compliance with the company's AoA?

### RED FLAGS

1. The company's AoA is never, or rarely, referred to in BoC discussions or documentation
2. Certain Commissioners are perceived to have conflicts of interest but no action is taken
3. A family member of a Commissioner is a senior executive of a major supplier or customer
4. The Commissioners fail to act in the best interests of the company as a whole (e.g. by having undue regard to the interests of a special interest group or major shareholder)
5. A Commissioner lets price sensitive information slip
6. Insider trading by an employee is discovered, but no action is taken
7. Certain Commissioners trading in company securities immediately before public announcements

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## Overview

Establishing a BoC is a mandatory requirement for all limited liability companies in Indonesia.<sup>12</sup>

BoC has a duty to provide strategic oversight and consultation to the BoD in pursuit of the company's interests and objectives.<sup>13</sup> It protects shareholders rights and maintains long-term sustainability of the company while ensuring its compliance with prevailing laws and regulations and the company's AoA.

Commissioner responsibilities are regulated and guided by the following examples of key regulations and better practice guidelines (including but not limited to):

- Law 40/2007 – Limited Liability Company Law
- Law 8/1995 – Capital Market Law
- Financial Services Authority (Otoritas Jasa Keuangan – OJK) Regulations and/or Bank Indonesia Regulations
- Kep-00001/BEI/01-2014 – Indonesian Stock Exchange Listing Rules (IDX LR)
- Indonesia's Code of Good Corporate Governance 2006 (CG Code)
- Individual company's AoA

and a variety of regulatory and legal regimes related to bribery and anti-corruption, financial reporting and accounting standards, competition, human resource, risk management and internal controls, procurement and taxation. Commissioners should be well-versed with the laws, regulations and industry guidelines applicable to the entities that they oversee.

This chapter provides an overview of some of the key duties for Commissioners; however it is not intended as a comprehensive summation of all Commissioner duties. Commissioners should always seek legal advice if they are unsure about their legal position to avoid situations where they are held responsible for breaching certain regulations, even when they did not specifically commit or authorize such a breach.

## Composition

### Size and composition

Limited liability companies are required to have a minimum of one member for the BoC.<sup>14</sup> However, issuers and public companies are required to have a minimum of two Commissioners.<sup>15</sup> The CG Code prescribes the composition of the BoC to be of "sufficient size" taking into account the company's size and effective decision making.<sup>16</sup>

### Independence

At least 30% of the BoC members are required to be independent<sup>17</sup>. The Limited Liability Company Law makes a distinction between independent and representative Commissioners.<sup>18</sup>

Independence is defined as having "no affiliation with the main shareholders, BoD and/or other members of the BoC."<sup>19</sup> An independent Commissioner must satisfy the following criteria:<sup>20</sup>

1. Has not worked or has the authority and responsibility for planning, directing, controlling or supervising the activities of the issuer or public company within the last six months

<sup>12</sup> Law 40/2007, Article 1 (2)

<sup>13</sup> Law 40/2007, Article 108 (1-2)

<sup>14</sup> Law 40/2007, Article 108 (3)

<sup>15</sup> Law 40/2007, Article 108 (5); No 33/POJK.04/2014, Article 20 (1)

<sup>16</sup> CG Code, Part IV, C.1.1

<sup>17</sup> IDX Listing Rules, Article III.1.4.2; No.33/POJK.04/2014, Article 20 (2-3)

<sup>18</sup> Law 40/2007, Article 120 (1)

<sup>19</sup> Law 40/2007, Article 120 (2)

<sup>20</sup> Bapepam Regulation IX.1.5, Article 2.c

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2. Has no shares either directly or indirectly in the issuer or public company
3. Has no affiliation with the issuer or public company, other members of the BoC and the BoD or the majority shareholders
4. Does not have any business relationships, either directly or indirectly, that are related to the business activities of the issuer or public company.

An Independent Commissioner who has served for two terms (typically one term is five years) can be reappointed for another term as long as he/she provides a declaration of independence to the GMS. The independence declaration must be disclosed in the Annual Report. An independent Commissioner can only serve a maximum of two terms on the Audit Committee (AC).<sup>21</sup>

Affiliation is defined in the Capital Market Law as:<sup>22</sup>

1. A family relationship by marriage and descent to the second degree, either horizontally or vertically
2. A relationship between a person and employees, Directors or Commissioners
3. A relationship between two companies with one or more Directors or Commissioners in common
4. A relationship between a company and a person, who controls or is controlled by the company, either directly or indirectly
5. A relationship between two companies that is controlled by the same person
6. A relationship between a company and substantial shareholders.

<sup>21</sup> No. 33/POJK.04/2014, Article 25

<sup>22</sup> Law 8/1995, Article 1 (1)

Non-independent (representative) Commissioners include those members who are appointed based on the resolution of the BoC meeting.<sup>23</sup>

In the event that a Commissioner ceases to be independent, he/she must immediately notify the BoC with an explanation as to why the criteria of independence no longer applies. It is also recommended for the BoC to notify shareholders that a Commissioner is no longer independent and disclose this information in the Annual Report.

#### Membership requirements

Individuals who can be appointed as members of the BoC should meet the following requirements:<sup>24</sup>

- Good morals and integrity
- Capable of performing legal actions
- Within five years prior to his/her appointment and during his/her appointment:
  - ▶ Has never been declared bankrupt
  - ▶ Has never been a member of BoC/BoD convicted for causing a company to go bankrupt
  - ▶ Has never been sentenced for a criminal offense which caused financial loss to the state and/or the financial sector
  - ▶ Has never been a member of a BoC/BoD that did not conduct an annual GMS, whose statement of accountability was rejected by the GMS, did not provide a statement of accountability or did not fulfill Annual Report and/or financial statement disclosures to the OJK
- Committed to follow prevailing rules and regulations
- Have knowledge and/or skills required by the company.

<sup>23</sup> Law 40/2007, Article 120 (3)

<sup>24</sup> No.33/POJK.04/2014, Article 4 (1)

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For the BoC to be able to effectively exercise its duties, the following principles from the CG Code shall be observed:<sup>25</sup>

1. The composition of the BoC shall enable it to make effective, right and timely decisions and to act independently
2. Members of the BoC must be professionals who possess the integrity and capability to enable them to carry out their roles properly, including to ensure that the BoD observes the interests of all stakeholders
3. The oversight and advisory function of the BoC includes the acts of prevention, improvement and suspension.

#### Concurrent positions

To ensure Commissioners have sufficient time to discharge their duties and to minimize conflicts of interest, a member of the BoC can only hold concurrent positions as:<sup>26</sup>

- A member of the BoD at two other issuers and public companies
- A member of the BoC at two other issuers and public companies
- In the case that he/she is not a member of the BoD, then he/she can hold concurrent positions as a member of the BoC at four other issuers and public companies
- A committee member of a maximum of five committees where he/she is a member of the BoC/BoD.

#### President Commissioner

The President Commissioner is responsible to coordinate the activities of the BoC. Each member of the BoC, including the President Commissioner has an equal position.<sup>27</sup> Better practices suggest the following roles for the President Commissioner:

- Provides leadership to ensure an effective and efficient functioning of the BoC
- Establishes, implements and reviews mechanisms and procedures to govern the BoC's work
- Schedules the BoC meeting calendar and organizes the BoC meeting agendas
- Acts as a liaison between members of the BoC, the BoD and management
- Facilitates effective contributions of independent Commissioners and manages constructive relationships and communications between Commissioners
- Ensures effective communications with shareholders
- Arranges regular performance evaluations of the BoC and its committees
- Facilitates the process for consensus decision-making by encouraging free and open discussion of issues in a friendly and constructive atmosphere.

A Commissioner may only be represented by another member of the BoC by virtue of a power of attorney. A member of the BoC may only represent one member of the BoC.

<sup>25</sup> CG Code, Part IV, C

<sup>26</sup> No.33/POJK.04/2014, Article 24 (1)

<sup>27</sup> CG Code, Part IV, C

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### Legal duties of Commissioners

The BoC's primary responsibility is to oversee and provide advice to the BoD. Each BoC member is required to act in the interest of the company and shall be personally and fully liable for any loss suffered by the company if it resulted from negligence and lack of care in performing his/her duties.<sup>28</sup> Refer to Appendix A for a summary of the key penalties related to breach of duties.

In discharging his/her duties, a Commissioner should act in good faith, prudently and with full responsibility.<sup>29</sup> Commissioners need to understand and comply with the company's AoA, relevant laws and regulations and the CG Code to ensure that the company does not act unlawfully.<sup>30</sup> They also need to regularly attend, actively participate and set the agenda for BoC meetings. The BoC has the right to have access to and obtain information regarding the company in a timely and thorough manner so that its members are properly informed on corporate issues.<sup>31</sup> In order to exercise reasonable supervision over the BoD, the BoC's supervisory and advisory function may include the acts of prevention, improvement and suspension.<sup>32</sup> The BoC also needs to ensure an effective and efficient implementation of risk management and internal controls.<sup>33</sup>

### Duty of care

#### To act in good faith

Commissioners must act in good faith for the interests of the company and in accordance with the purpose and objective of the company,<sup>34</sup> instead of for personal gain, and must ensure transactions are commercially justifiable and not for improper purposes. A Commissioner is not entitled to make a personal

profit or obtain personal advantage by using company property and money or with company information acquired as a Commissioner. Commissioners must not act beyond powers given in the AoA, illegally or contrary to laws, regulations and public policy.

#### To act prudently

A Commissioner is under a mandatory duty at all times to act prudently<sup>35</sup> and use reasonable skill, care and diligence in discharging his/her duties. A diligent Commissioner would be expected to seek the advice of other fellow Commissioners or a professional advisor on matters that he/she is not familiar with and make proper enquiries about the company's business where needed.

Some examples where the duty of care may not be satisfied:

- Signing circulating resolutions because others have signed them
- Attending BoC meetings without adequate preparation, including reading papers
- Failing to make further enquiries/seek more information when in doubt about certain matters
  - ▶ Supporting an investment decision when only cursory information about the new business is provided
  - ▶ Knowing that some Commissioners and Directors have excessive entertainment expenses but failing to act
  - ▶ Being aware of new laws being introduced and not checking to see how they could impact the company.

<sup>28</sup> Law 40/2007, Article 114 (2-3)

<sup>29</sup> Law 40/2007, Article 114 (2)

<sup>30</sup> CG Code, Part IV, C.2.3-2.4

<sup>31</sup> CG Code, Part IV, C.3.4

<sup>32</sup> CG Code, Part IV, C.3

<sup>33</sup> CG Code, Part IV, B.1.1

<sup>34</sup> Law 40/2007, Article 114 (2)

<sup>35</sup> Law 40/2007, Article 114 (2)

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### To act with full responsibility

Members of the BoC should act with full responsibility in discharging their duties and in compliance with disclosure and other requirements.<sup>36</sup>

Specific duties for the BoC as stated in the Limited Liability Company Law include:<sup>37</sup>

- Prepare minutes of BoC meetings and keep a copy thereof
- Report to the company his/her and/or his/her relatives' share of ownership in the company and other companies
- Submit a report to the GMS regarding the supervisory duties performed within the previous financial year.

Commissioners must establish processes for keeping abreast of all key regulatory requirements relevant to the industry and company circumstances including (but not limited to):

- Tax – the Income Tax Law (UU 36/2008) which outlines tax obligations for individuals and companies
- Employment – the Manpower Law (UU 13/2003) which outlines the rights and obligations of employees and employers
- Environment – the Government Regulation on Social and Environmental Responsibilities for Limited Liability Companies (PP 47/2012) requires companies which operate in the field of and/or related to natural resources to perform social and environmental responsibilities.

<sup>36</sup> Law 40/2007, Article 114 (2)

<sup>37</sup> Law 40/2007, Article 116

### Duty of loyalty

#### Conflicts of interest

Commissioners should avoid being in a position where other interests or duties conflict with their duties to the company. Conflicts of interest arise when there is a conflict between the economic interest of the company and the personal economic interest of its shareholders, members of the BoC and the employees of the company. Conflicts of interest can also arise in situations where:

- Commissioners have a direct or indirect material interest in transactions that the company enters into
- Commissioners hold positions or possess property that may result in conflicting duties
- Commissioners stand to benefit from corporate information received by them or opportunities made available to them in their capacity as Commissioners.

In dealing with conflicts of interest, Commissioners should pay close attention to the provisions of the CG Code:<sup>38</sup>

- Members of the BoC must prioritize the economic interests of the company above their personal and families' economic interests as well as those of any other party
- Members of the BoC are prohibited from abusing their respective power and positions in the company in the interest and for the benefit of themselves, their families and another party
- Members of the BoC with a possible conflict of interest are prohibited from participating in discussions and the decision-making process

<sup>38</sup> CG Code, Part III, 3.2

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- A shareholder having a conflict of interest must cast his/her vote in the GMS to concur with the decision made by shareholders having no conflict of interest
- Each member of the BoC having decision-making authority must make an annual statement certifying that he/she had no conflicts of interest in any decisions made by him/her and that he/she had complied with the code of conduct issued by the company.

Commissioners should exercise caution when considering fellow Commissioners' actual, potential or perceived conflicts of interest. Conflicts of interest may not be avoidable at times given the more complex business environment a company now operates in. An actual or potential conflict does not necessarily disqualify a person from serving on a company's BoC, but Commissioners should provide a full disclosure of their relevant interests to the company. The disclosure should be reported to the GMS, filed at the company's headquarters and be made available to shareholders at all times.

#### Affiliated (related party) transactions

Affiliated transactions include any transaction undertaken by a Commissioner, Director or controlling shareholder with an affiliation of a Commissioner, Director or controlling shareholder in which there is a conflict of interest.<sup>39</sup> Affiliated transactions must be approved by the majority of independent shareholders through the GMS.<sup>40</sup> BoC members should familiarize themselves with the affiliated transactions disclosure and approval requirements outlined in Bapepam Regulation IX.E.1 and IFRS IAS 24 *Related Party Disclosures*.

<sup>39</sup> Bapepam Regulation IX.E.1, Article 2

<sup>40</sup> Bapepam Regulation IX.E.1, Article 2; Law 8/1995, Article 82 (2)

<sup>41</sup> CG Code, Part III, 3.2.C

#### Confidentiality of information

Commissioners, by virtue of their positions, have access to confidential information that could potentially harm the interests of the company and its shareholders if divulged. Commissioners are therefore prohibited from abusing their respective powers and positions (including their access to confidential information) for their personal interests or the interests of third parties.<sup>41</sup> Better practices suggest that companies develop standards to safeguard the use of confidential information, which should require Commissioners to notify the BoC prior to engaging in transactions that involve securities of the company or its subsidiaries and disclose information about previous transactions with securities of the company. Commissioners should be required to sign a non-disclosure agreement regarding confidential information prior to accepting their appointment.

#### BoC – authorities and responsibilities

##### Authorities

As a rule, the BoC has the authority to decide all issues that do not fall under the authority of the GMS and other corporate bodies.

The authority of the BoC is stated in the AoA and the CG Code as follows:<sup>42</sup>

- The BoC should exercise its authority within the boundary of supervisory and advisory functions. It should not assume a management role over the company, except under limited conditions for a certain period of time, such as when a vacancy occurs in the BoD<sup>43</sup>

<sup>42</sup> CG Code, Part IV, C.3

<sup>43</sup> Law 40/2007, Article 118 (1)

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- In circumstances where it is deemed necessary in the interest of the company, the BoC may impose sanctions on members of the BoD in the form of a suspension, subject to further determination by the GMS
- Members of the BoC, collectively and individually, are entitled to have access to, and to obtain information regarding the company on a timely and complete basis. Such access may include the right to enter any premise used by the company during the company's office hours, the right to examine accounts, cash flows, letters, minutes and other documents and the right to request information and explanation from members of the BoD
- The BoC has authority to develop a Board Charter that comprises rules and guidelines to facilitate an effective and efficient discharge of its responsibilities. Refer to Appendix B for an example of BoC Charter
- The BoC has authority to form committees to enable it to delegate certain responsibilities to allow for more in-depth and timely consideration of matters. AC and NRC are mandatory for issuers and public companies,<sup>44</sup> whereas other committees may be formed as required.

#### Responsibilities

The following outlines the general responsibilities of the BoC:

- Supervise and provide advice over the BoD's management of the company<sup>45</sup> as regulated by the company's AoA, prevailing laws and regulations and the resolutions of the GMS

- Supervise, review and approve the implementation of the company's work plan and annual budget that is prepared and submitted by the BoD<sup>46</sup>
- Examine, review and sign the Annual Report prepared by the BoD<sup>47</sup>
- Follow the development of the company's activities and report to the GMS on significant events and relevant mitigating actions
- Propose the appointment of an external auditor to the GMS
- Evaluate the BoD's periodic reports and, at any time, provide assessments on the performance of the company and report the implementation of its duties to the shareholders<sup>48</sup>
- Submit an accountability report on the conduct of management by the BoD to obtain the release and discharge from GMS.<sup>49</sup>

### Other legal duties and obligations

#### Insider trading

Insider trading involves the misuse of price or value-sensitive company information that is not generally available to the public. By virtue of Commissioners' roles, they will be privy to inside information and should take steps to ensure that insider trading laws are carefully observed.

An insider is defined as:<sup>50</sup>

- A Commissioner, Director or employee of an issuer or public company

<sup>44</sup> Bapepam Regulation IX.1.5, Article 1.b

<sup>45</sup> Law 40/2007, Article 108 (1)

<sup>46</sup> Law 40/2007, Article 64 (1)

<sup>47</sup> Law 40/2007, Article 66 (1) and 67 (1)

<sup>48</sup> Law 40/2007, Article 75 (2)

<sup>49</sup> CG Code, Part IV, C.3.6

<sup>50</sup> Law 8/1995, Clarification of Article 95



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- A key majority shareholder of an issuer or public company
- An individual, who because of his/her position or profession, or because of a business relationship with an issuer or public company, has access to inside information
- An individual who within the last six months was a person defined above.

Insider trading liability is based not on whether a person trading on price-sensitive information is connected with the relevant company, but whether the person is in possession of price-sensitive information. If in possession of such information, an insider is prohibited from buying or selling the securities of the issuer or public company or any other company that is engaged in transactions with the issuer or public company. He/she is also prohibited from influencing others to buy or sell the securities in question and provide inside information to others who might use such information to buy or sell the securities in question.<sup>51</sup> An officer of the company shall not make improper use of any information acquired by virtue of his/her position to gain, directly or indirectly, an advantage for himself/herself or for any other person or to cause any detriment to the company.

The Capital Market Law also prohibits anyone from making a statement and giving material information that is false or misleading and that affects the price of securities on the exchange, if at the time of making such statement or giving such information:<sup>52</sup>

1. The person knows or should have known that such material information was false or misleading; or

2. The person failed to exercise due care in determining the truth of such statement or information.

The following situations represent breaches of insider trading requirements by a Commissioner:

- Buying or selling securities of the company while in possession of any insider information concerning the company
- Influencing another person to buy or sell securities of the company while in possession of insider information
- Communicating information, or causing information to be communicated, to another person who is likely to trade in those financial products.

Insider trading is a serious offense attracting substantial fines and potential imprisonment. Refer to Appendix A for an overview of the penalties.

Subject to the general prohibition against insider trading, the Capital Market Law also prohibits anyone with intent to influence others to buy, sell or hold securities from making two or more transactions that directly or indirectly cause the price of securities to rise, fall or remain steady.<sup>53</sup>



<sup>51</sup> Law 8/1995, Article 95 and 96

<sup>52</sup> Law 8/1995, Article 93

<sup>53</sup> Law 8/1995, Article 92

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### Continuous disclosure

The Capital Market Law requires issuers and public companies to publish periodic reports on their business information and financial status, submit such reports to the OJK and make them available to the public. These companies are also required to keep their shareholders and the OJK informed of any material information<sup>54</sup> regarding events that may affect the price of securities within two working days following such events, such as:<sup>55</sup>

- A merger, acquisition, consolidation or establishment of a joint venture
- A stock split or distribution of stock dividends
- An unusual dividend
- An acquisition or loss of an important contract
- A significant new product or innovation
- A change in control or significant change in management
- A call for the purchase or redemption of debt securities
- A sale of a material amount of securities to the public or in a limited manner
- A purchase, or loss from the sale, of a material asset
- A relatively important labor dispute
- Any important litigation against the company and/or the company's Commissioners or Directors
- An offer to purchase securities of another company
- The replacement of the auditor who audits the company
- The replacement of the company's Trust Agent
- A change in the company's fiscal year.

<sup>54</sup> *Material information includes any important and relevant facts concerning events, incidents, or data that may affect the price of a security on an exchange or that may influence the decisions of investors, prospective investors, others that have an interest in such information (Law 8/1995, Article 1 (7)).*

Issuers and public companies are required by law to submit Annual Reports to the OJK, which must be made available to the shareholders and the public at the company's website.<sup>56</sup> The Annual Report must contain the following information:<sup>57</sup>

- Summary of financial highlights
- Reports of the BoC
- Reports of the BoD
- Company profile
- Management analysis and discussion
- CG implementation
- Corporate social responsibility
- Audited yearly financial statements
- Statement of responsibility from the BoC and the BoD.

Refer to Chapter 13 for further information on "Reporting and Disclosures".

### Relief from Commissioner liabilities

BoC members may not be held liable for a company's loss if they can prove that:<sup>58</sup>

- They performed their supervisory duties in good faith and with prudent principles for the interest of the company and in accordance with its purpose and objective
- They had no, either directly or indirectly, personal interests in the BoD's management over the company's which caused losses to the company
- They provided advice to the BoD in order to prevent the occurrence or continuity of such loss.

<sup>55</sup> *Law 8/1995, Article 86 (1); Bapepam Regulation X.K.1, Article 2*

<sup>56</sup> *Bapepam Regulation X.K.6, Article 1.a, 1.d, 1.f*

<sup>57</sup> *Bapepam Regulation X.K.6, Article 2.a*

<sup>58</sup> *Law 40/2007, Article 114 (5)*

# 3. Board of Directors

BoD has significant legal responsibilities and it is critical to understand these duties, maintain compliance and continuously keep abreast of any relevant changes to regulations and guidance.

## QUESTIONS THAT DIRECTORS SHOULD ASK:

1. Do I have adequate working knowledge of the laws and regulations relevant to the company and the consequences of breaching them?
2. Does the BoD receive reports about material changes to laws, regulations and the CG Code?
3. Am I fully aware of my duties and responsibilities regarding conflicts of interest?
4. Is there an effective procedure for identifying and disclosing related party transactions?
5. Are members of the BoD immediately advised of queries received from key regulators?
6. Are Directors' interests properly disclosed in the financial statements and/or accountability reports?
7. Do I understand the scope and limitations of the Directors' liability insurance policy?
8. Am I confident that there are mechanisms in place to detect insider trading?
9. Does the corporate secretary monitor compliance with the company's AoA?

## RED FLAGS

1. The company's AoA is never, or rarely, referred to in BoD discussions or documentation
2. Certain Directors are perceived to have conflicts of interest, but no action is taken
3. A family member of a Director is a senior executive of a major supplier or customer
4. The Directors fail to act in the best interests of the company as a whole (e.g. by having undue regard to the interests of a special interest group or major shareholder)
5. A Director lets price sensitive information slip
6. Insider trading by an employee is discovered, but no action is taken
7. Certain Directors trading in company securities immediately before public announcements

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## Overview

Establishing a BoD is a mandatory requirement for all limited liability companies in Indonesia.<sup>59</sup>

BoD has the authority and full responsibility to manage the company in pursuit of the company's interest, purpose and objective, as well as to represent the company in or outside the court of law.<sup>60</sup> Members of the BoD are selected from the management team and are usually very senior executives of the organization who have at least one operation/function in the company to manage on a day-to-day basis.

Directors' responsibilities are regulated and guided by the following:

- Law 40/2007 – Limited Liability Company Law
- Law 8/1995 – Capital Market Law
- Financial Services Authority (Otoritas Jasa Keuangan – OJK) Regulations and/or Bank Indonesia Regulations
- Kep-00001/BEI/01-2014 – Indonesian Stock Exchange Listing Rules (IDX LR)
- Indonesia's Code of Good Corporate Governance 2006 (CG Code)
- Individual company's AoA

and a variety of regulatory and legal regimes related

to bribery and anti-corruption, financial reporting and accounting standards, competition, human resource, risk management and internal controls, procurement and taxation. Directors should be well-versed with the laws, regulations and rules applicable to the entities that they oversee.

This chapter provides an overview of some of the key duties for Directors; however it is not intended as a comprehensive summation of all Director duties. Directors should always seek legal advice if they are unsure about their legal position to avoid situations where they are held responsible for breaching certain regulations, even when they did not specifically commit or authorize such a breach.

## Composition

### Size and composition

Limited liability companies are required to have a minimum of one member for the BoD.<sup>61</sup> However, issuers and public companies are required to have a minimum of two Directors.<sup>62</sup> At least one independent Director is required.<sup>63</sup>

The CG Code prescribes the composition of the BoD to be of "sufficient size to suit the complexity of the business of the company."<sup>64</sup>

<sup>59</sup> Law 40/2007, Article 1 (2)

<sup>60</sup> Law 40/2007, Article 1 (5)

<sup>61</sup> Law 40/2007, Article 92 (3)

<sup>62</sup> Law 40/2007, Article 92 (4); No 33/POJK. 04/2014, Article 2 (1)

<sup>63</sup> IDX Listing Rules, Article III.1.5

<sup>64</sup> CG Code, Part IV, D.1.1

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### Independence

An independent Director is defined as:<sup>65</sup>

1. Not having any affiliation with the controlling shareholder of the listed company at least six months prior to his/her appointment
2. Not having any affiliation with any Commissioners or Directors of the listed company
3. Does not have position as a member of the BoD in any other company
4. Has not been an insider in the capital markets supporting institution or a profession whose service is utilized by the listed company for six months prior to the appointment as Director.

### Membership requirements

Individuals who can be appointed members of the BoD should meet the following requirements:<sup>66</sup>

- Good morals and integrity
- Capable of performing legal actions
- Within five years prior to his/her appointment and during his/her appointment:
  - ▶ Has never been declared bankrupt
  - ▶ Has never been a member of BoC/BoD which was convicted of causing a company to go bankrupt
  - ▶ Has never been sentenced for a criminal offense which caused financial loss to the state and/or the financial sector
  - ▶ Has never been a member of a BoC/BoD that did not conduct the annual GMS, whose statement of accountability was rejected by the GMS, did

not provide a statement of accountability or did not fulfill Annual Report and/or financial statement disclosures to the OJK

- Committed to follow prevailing rules and regulations
- Have knowledge and/or skills required by the company.

For the BoD to be able to effectively exercise its duties, the following principles from the CG Code shall be observed. Members of the BoD:<sup>67</sup>

- Shall have the capability and integrity required to ensure a proper execution of management functions
- Are prohibited from utilizing the company for their personal, family, business group and/or other parties' interests
- Shall understand and comply with the AoA as well as the laws and regulations related to their duties
- Shall understand and implement the CG Code.

### Concurrent positions

To ensure Directors have sufficient time to discharge their duties and to minimize conflicts of interest, a member of the BoD can only hold concurrent positions as:<sup>68</sup>

- A member of the BoD at one other issuer and public company;
- A member of the BoC at three other issuers and public companies; and/or
- A member at a maximum of five committees where he/she is a member of the BoC/BoD.

<sup>65</sup> IDX Listing Rules, Article III.1.5.2

<sup>66</sup> No.33/POJK.O4/2014, Article 4 (1)

<sup>67</sup> CG Code, Part IV, D.2

<sup>68</sup> No.33/POJK.O4/2014, Article 24 (1)

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### President Director

Each member of the BoD, including the President Director has equal positions. The main duty of the President Director is to coordinate the activities of the BoD.<sup>69</sup> The President Director shall be independent of the controlling shareholder. The President Director is responsible for the executive management of the company and is accountable to the BoD for the day-to-day operations. He/she is also responsible to coordinate the implementation of operational duties in the areas of internal audit, corporate secretariat and compliance, and to monitor the implementation of CG within the company. The President Director is authorized to delegate such powers conferred on him/her as he/she deems appropriate.

### Legal duties of Directors

The BoD is responsible for the management of the company “for the interest of the company in the pursuit of its purposes and objectives.”<sup>70</sup> Directors play an important role in steering and controlling the company. They have the same duties and liabilities as members of the BoC (unless the AoA or other internal documents call for higher standards), as detailed below:

### Duty of care

#### To act in good faith

Directors must act in good faith for the interests of the company and in accordance with the purpose and objective of the company,<sup>71</sup> instead of for personal gain, and must ensure transactions are commercially justifiable and not for improper purposes. A Director is not entitled to make a personal profit or obtain personal

advantage by using company property and money or with company information acquired as a Director. Directors must not act beyond powers given in the AoA, illegally or contrary to laws, regulations and public policy.

#### To act with full responsibility

Members of the BoD should act with full responsibility in discharging their duties and in compliance with disclosure and other requirements.<sup>72</sup>

Specific duties for the BoD as stated in the Limited Liability Company Law include:<sup>73</sup>

- Represent the company, in or outside the court of justice
- Establish and maintain a register of shareholders, a special register, minutes of GMS and minutes of BoD meetings
- Prepare an Annual Report and financial documents of the company
- Maintain all lists, minutes and financial documents of the company
- Submit a report regarding the shares of the company or other companies owned by members of the BoD and/or their families, to be registered in the special register.

Directors must establish processes for keeping abreast of all key regulatory requirements relevant to the industry and company circumstances including (but not limited to):

- Tax – the Income Tax Law (UU 36/2008) which outlines tax obligations for individuals and companies

<sup>69</sup> CG Code, Part IV, D

<sup>70</sup> Law 40/2007, Article 92 (1)

<sup>71</sup> Law 40/2007, Article 92 (1) and 97 (2)

<sup>72</sup> Law 40/2007, Article 97 (2)

<sup>73</sup> Law 40/2007, Article 98 and 100

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- Employment – the Manpower Law (UU 13/2003) which outlines the rights and obligations of employees and employers
- Environment – the Government Regulation on Social and Environmental Responsibilities for Limited Liability Companies (PP 47/2012) requires companies which operate in the field of and/or related to natural resources to perform social and environmental responsibilities.

### Duty of loyalty

#### Conflicts of interest

Directors should avoid being in a position where other interests or duties conflict with their duties to the company. Conflicts of interest arise when there is a conflict between the economic interest of the company and the personal economic interest of its shareholders, members of the BoD and the employees of the company. Conflicts of interest can also arise in situations where:

- Directors have a direct or indirect material interest in transactions that the company enters into
- Directors hold positions or possess property that may result in conflicting duties
- Directors stand to benefit from corporate information received by them or opportunities made available to them in their capacity as Directors.

In dealing with conflicts of interest, Directors should pay close attention to the provisions of the CG Code:<sup>74</sup>

- Members of the BoD must prioritize the economic interests of the company above their personal and

families' economic interests as well as those of any other party

- Members of the BoD are prohibited from abusing their respective power and positions in the company in the interest and for the benefit of themselves, their families and another party
- Members of the BoD with a possible conflict of interest are prohibited from participating in discussions and the decision-making process
- A shareholder having a conflict of interest must cast his/her vote in the GMS to concur with the decision made by shareholders having no conflict of interest
- Each member of the BoD having decision-making authority must make an annual statement certifying that he/she had no conflicts of interest in any decisions made by him/her and that he/she had complied with the code of conduct issued by the company.

Directors should exercise caution when considering fellow Directors' actual, potential or perceived conflicts of interest. Conflicts of interest may not be avoidable at times given the more complex business environment a company now operates in. An actual or potential conflict does not necessarily disqualify a person from serving on a company's BoD, but full disclosure should be made to guard the best interests of the company and its shareholders. The disclosure should be reported to the GMS, filed at the company's headquarters and be made available to shareholders at all times.

<sup>74</sup> CG Code, Part III, 3.2

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### Affiliated (related party) transactions

Affiliated transactions include any transaction undertaken by a Commissioner, Director or controlling shareholder with an affiliation of a Commissioner, Director or controlling shareholder in which there is a conflict of interest.<sup>75</sup> Affiliated transactions must be approved by the majority of independent shareholders through the GMS.<sup>76</sup> BoD members should familiarize themselves with the affiliated transactions disclosure and approval requirements outlined in Bapepam Regulation IX.E.1 and IFRS IAS 24 *Related Party Disclosures*.

### Confidentiality of information

Directors, by virtue of their positions, have access to confidential information that could potentially harm the interests of the company and its shareholders if divulged. Directors are therefore prohibited from abusing their respective powers and positions (including their access to confidential information) for their personal interests or the interests of third parties.<sup>77</sup> Better practices suggest that companies develop standards to safeguard the use of confidential information, which should require Directors to notify the BoD prior to engaging in transactions that involve securities of the company or its subsidiaries and disclose information about previous transactions with securities of the company. Directors should be required to sign a non-disclosure agreement regarding confidential information prior to accepting their appointment.

## BoD – authorities and responsibilities

### Authorities

The BoD has authority to represent the company in or outside the court of law on all matters and in any event, to bind the company to another party and vice versa, and to perform any action with regard to management or ownership with certain restrictions as set forth in the company's AoA.

### Responsibilities

The CG Code stipulates that the responsibilities of the BoD should cover the following tasks:<sup>78</sup>

- **Management:** the BoD formulates the vision, mission, values and short and long-term programs of the company to be discussed and approved by the BoC or the GMS in accordance with the company's AoA
- **Risk Management:** the BoD establishes and implements sound risk management that covers all aspects of the company's activities. The CG Code recommends establishing a unit or appointing a person to be in charge of this function
- **Internal Control:** the BoD establishes and maintains a sound internal control system to safeguard company assets and performance, as well as its compliance with laws and regulations. Issuers and public companies are required to have an internal control function or unit
- **Public Relations:** the BoD ensures the existence of sound communications between the company and its stakeholders by empowering the function of a Corporate Secretary

<sup>75</sup> Bapepam Regulation IX.E.1, Article 2

<sup>76</sup> Bapepam Regulation IX.E.1, Article 2; Law 8/1995, Article 82 (2)

<sup>77</sup> CG Code, Part III, 3.2.C

<sup>78</sup> CG Code, Part IV, D.3



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- **Social Responsibility:** to maintain sustainability the BoD should have a clear and focused written plan to meet the company's social responsibility.

As part of its management duty, the BoD should prepare an annual work plan, which includes the company's annual budget, to be delivered to and approved by the BoC or the GMS as stipulated in the AoA.<sup>79</sup> Better practices recommend that companies develop an internal regulation that outlines a detailed procedure for the BoD to seek the BoC's approval for transactions that fall outside the scope of the financial and business plan (non-standard operations) and establish an appropriate veto mechanism for the BoC.

### Other legal duties

#### Insider trading

Insider trading involves the misuse of price or value-sensitive company information that is not generally available to the public. By virtue of Directors' roles, they will be privy to inside information and should take steps to ensure that prohibition against insider trading in the Capital Market Law is carefully observed.

Insider is defined as:<sup>80</sup>

- A Commissioner, Director or employee of an issuer or public company
- A substantial shareholder of an issuer or public company
- An individual, who because of his/her position or profession, or because of a business relationship with an issuer or public company, has access to inside information

- An individual who within the last six months was a person defined above.

Insider trading liability is based not on whether a person trading on price-sensitive information is connected with the relevant company, but whether the person is in possession of price-sensitive information. If in possession of such information, an insider is prohibited from buying or selling the securities of the issuer or public company or any other company that is engaged in transactions with the issuer or public company. He/she is also prohibited from influencing others to buy or sell the securities in question and provide inside information to others who might use such information to buy or sell the securities in question.<sup>81</sup> An officer of the company shall not make improper use of any information acquired by virtue of his position to gain, directly or indirectly, an advantage for himself or for any other person or to cause any detriment to the company.

The Capital Market Law also prohibits anyone from making a statement and giving material information that is false or misleading and that affects the price of securities on the exchange, if at the time of making such statement or giving such information:<sup>82</sup>

1. The person knows or should have known that such material information was false or misleading; or
2. The person failed to exercise due care in determining the truth of such statement or information.

The following situations represent breaches of insider trading requirements by a Director:

- Buying or selling securities of the company while in possession of any insider information concerning the company

<sup>79</sup> Law 40/2007, Article 63 and 64

<sup>80</sup> Law 8/1995, Clarification to Article 95

<sup>81</sup> Law 8/1995, Article 95 and 96

<sup>82</sup> Law 8/1995, Article 93

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- Influencing another person to buy or sell securities of the company while in possession of insider information
- Communicating information, or causing information to be communicated, to another person who is likely to trade in those financial products.

Insider trading is a serious offense attracting substantial fines and potential imprisonment. Refer to Appendix A for an overview of the penalties.

Subject to the general prohibition against insider trading, the Capital Market Law also prohibits anyone with intent to influence others to buy, sell, or hold securities from making two or more transactions that directly or indirectly cause the price of securities to rise, fall or remain steady.<sup>83</sup>

#### Continuous disclosure

The Capital Market Law requires issuers and public companies to publish periodic reports on their business information and financial status, submit such reports to the OJK and make them available to the public. These companies are also required to keep their shareholders and the OJK informed of any material information<sup>84</sup> regarding events that may affect the price of securities within two working days following such events, such as:<sup>85</sup>

- A merger, acquisition, consolidation or establishment of a joint venture
- A stock split or distribution of stock dividends
- An unusual dividend
- An acquisition or loss of an important contract

- A significant new product or innovation
- A change in control or significant change in management
- A call for the purchase or redemption of debt securities
- A sale of a material amount of securities to the public or in a limited manner
- A purchase, or loss from the sale, of a material asset
- A relatively important labor dispute
- Any important litigation against the company and/or the company's Commissioners or Directors
- An offer to purchase securities of another company
- The replacement of the company's Trust Agent
- The replacement of the auditor who audits the company
- A change in the company's fiscal year.

Issuers and public companies are required by law to submit Annual Reports to the OJK, which must be made available to the shareholders and the public at the company's website.<sup>86</sup> The Annual Report must contain the following information:<sup>87</sup>

- Summary of financial highlights
- Reports of the BoC
- Reports of the BoD
- Company profile
- Management analysis and discussion
- CG Implementation

<sup>83</sup> Law 8/1995, Article 92

<sup>84</sup> Material information includes any important and relevant facts concerning events, incidents, or data that may affect the price of a security on an exchange or that may influence the decisions of investors, prospective investors, others that have an interest in such information (Law 8/1995, Article 1 (7)).

<sup>85</sup> Law 8/1995, Article 86 (1); Bapepam Regulation X.K.1, Article 2

<sup>86</sup> Bapepam Regulation X.K.6, Article 1.a, 1.d, 1.f

<sup>87</sup> Bapepam Regulation X.K.6, Article 2.a

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- Corporate social responsibility
- Audited yearly financial statements
- Statement of responsibility from the BoC and the BoD.

Refer to Chapter 13 for further information on “Reporting and Disclosures”.

### Relief from Director liabilities

BoD members may not be held liable for a company’s loss if they can prove that:<sup>88</sup>

- Such loss did not result from their fault or negligence
- They performed management of the company in good faith and with prudent principles for the interest of the company and in accordance with its purpose and objective
- They had no conflicts of interest, either directly or indirectly, in the management which caused losses to the company
- They had taken precautionary measures to avoid such loss.



<sup>88</sup> Law 40/2007, Article 97 (5)

# 4. BoC Committees

As managing and controlling companies becomes more complex, the BoC can enhance its oversight function and remain accountable to shareholders by establishing committees to assist Commissioners to better perform their duties and discharge their responsibilities.

## QUESTIONS THAT COMMISSIONERS SHOULD ASK

- |  |  |
|--|--|
| <ol style="list-style-type: none"> <li>1. Does the BoC have an appropriate committee structure in place?</li> <li>2. Are there charters for BoC committees and are the charters approved by the BoC and reviewed annually?</li> <li>3. Are there guidelines specifying the BoC committee composition (particularly the proportion of independent Commissioners required)?</li> <li>4. Do all BoC committees have the expertise and experience to properly advise the BoC?</li> </ol> | <ol style="list-style-type: none"> <li>5. Does the BoC constructively challenge information provided by a BoC committee, even when endorsed by 'experts'?</li> <li>6. Does the BoC receive from each BoC committee reports that are complete, concise, timely and accurate?</li> <li>7. Is the BoC informed of any issues in which BoC committee members are not in full agreement?</li> <li>8. Is there a robust process to evaluate the Chairman and members of each BoC committee?</li> </ol> |
|--|--|

## RED FLAGS

- |   |  |
|---|--|
| <ol style="list-style-type: none"> <li>1. BoC committees lack terms of reference or charters</li> <li>2. Certain BoC committees are not resourced with appropriately skilled people</li> <li>3. The committees are not meeting regularly enough to address issues on hand</li> <li>4. BoC committee meetings are not recorded or the minutes are not distributed in a timely manner to members</li> </ol> | <ol style="list-style-type: none"> <li>5. Similar sized companies or competitors have established additional committees that the company is yet to establish</li> <li>6. The AC meets only when required by internal or external auditors</li> <li>7. The AC has little to do with assessing internal control systems and coordinating with the internal audit function</li> </ol> |
|---|--|

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The BoC may form committees to assist in the implementation of its duties, however, any proposal from the committees should be submitted to the BoC for approval.<sup>89</sup>

The advantages of setting up BoC committees include:

- Improving efficiency and effectiveness of Commissioners to fulfill duties and responsibilities with the amount of time available
- Achieving greater focus on matters needing to be addressed
- Sending a positive signal to the shareholders that pertinent issues are being dealt with impartially by Commissioners with the relevant experience and skill sets
- Allowing independent Commissioners to attain in-depth understanding of the business.

The most common BoC committees in Indonesia are:

- AC (mandatory for issuers and public companies)<sup>90</sup>
- Nomination and Remuneration Committee (NRC) - (mandatory for issuers and public companies)<sup>91</sup>
- Risk Policy Committee (RPC)
- Corporate Governance Committee (CGC).



<sup>89</sup> CG Code, Part IV C.3.7

<sup>90</sup> Bapepam Regulation IX.1.5, Article 1b

<sup>91</sup> No. 34/POJK.04/2014, Article 2

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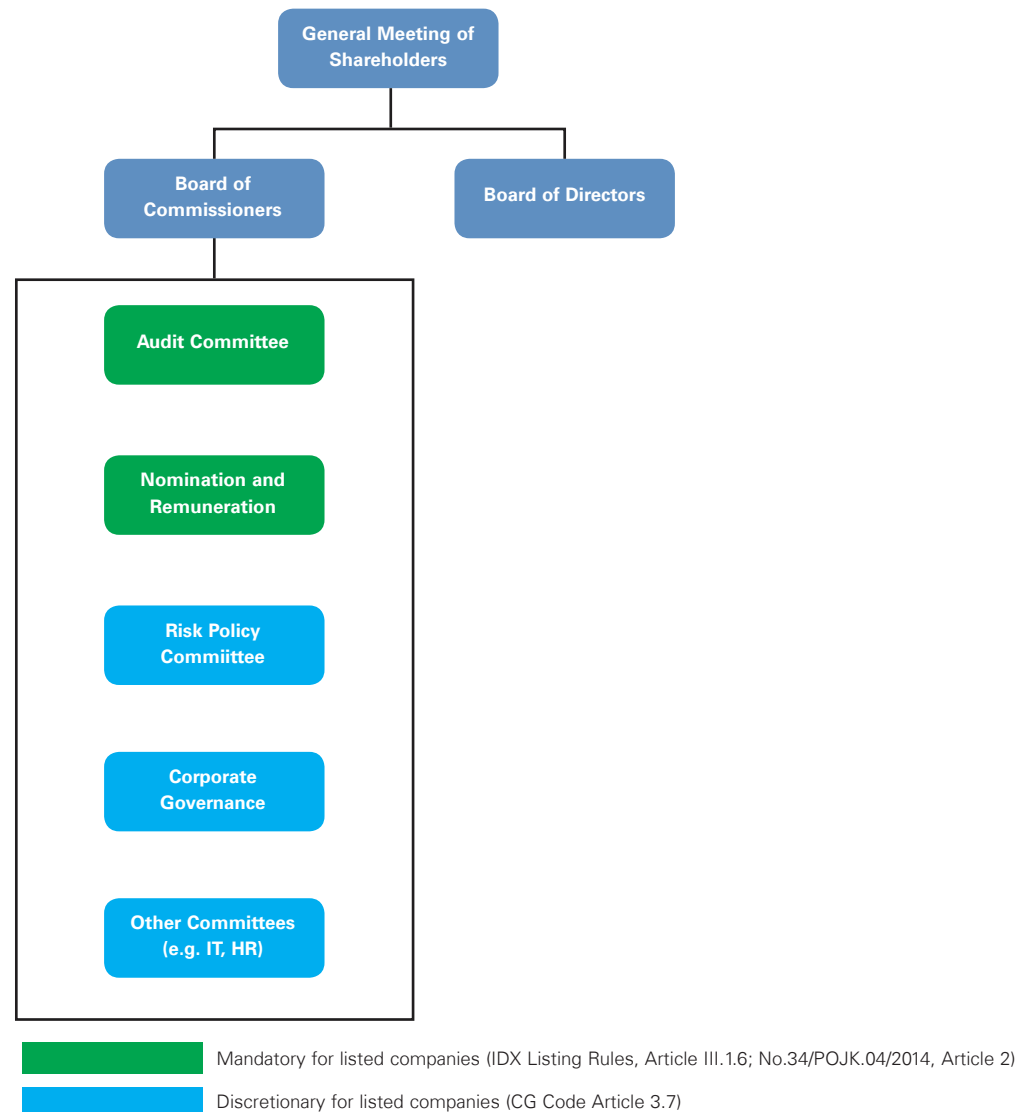
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Other types of committees may also be set up if necessary, taking into account the size and nature of the company's business and/or regulatory requirements. These committees may include a Finance and Investment Committee, a Human Resource Committee and/or a Special Purpose Committee.

In establishing a committee, it is essential to ensure that the committee comprises the appropriate expertise and resources to provide the BoC with sound advice. The committees should adopt the same systematic planning and processes as the full Board, including:

- Setting up a committee charter with detailed description of roles and responsibilities
- Establishing an annual agenda
- Documenting matters being discussed and resolved.

Refer to Appendix C for an overview of BOC Committee Charters.

Committees should report regularly to the BoC through both a verbal report by the committee Chairman and a detailed report and/or committee minutes in the BoC papers. They should also review their charter and membership at least annually and recommend any required changes to the BoC.

Since all members of the BoC have equal positions and therefore are subject to joint responsibility and liabilities, the ultimate authority for decision-making rests with the entire BoC. Nevertheless, this should not preclude committee members from resolving issues

and making decisions that have been delegated to them. The resolutions of a committee should only be considered legitimate if the majority of members who are present and vote at the committee's meeting are also members of the BoC.

## Audit Committee

### Size and composition

It is mandatory for issuers and public companies to have an AC.<sup>92</sup> The AC should consist of at least three members chosen from among the independent Commissioners and/or those appointed from external sources and be chaired by an independent Commissioner.<sup>93</sup> The Bapepam regulation defines independent as follows:<sup>94</sup>

1. Having not worked or been responsible to plan, lead, control or monitor activities of the issuer or public company within the past six months
2. Having no share ownership, either directly or indirectly, in the issuer or public company
3. Having no affiliation with the issuer or public company, other members of the BoC and the BoD or the majority shareholders
4. Having no business relationships, either directly or indirectly with the issuer or public company.

At least one member should have an accounting or finance background.<sup>95</sup>

<sup>92</sup> IDX Listing Rules, Article III.1.6

<sup>93</sup> Bapepam Regulation IX.1.5, Article 2.a and 2.b

<sup>94</sup> Bapepam Regulation IX.1.5, Article 2.c

<sup>95</sup> Bapepam Regulation IX.1.5, Article 3.e; CG Code, Part IV C.4.1.c

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#### In 2013, KPMG surveyed 1,800 AC members in a number of countries.

The main opportunities for enhancing AC performance raised in this survey by many countries included:

- Obtaining a deeper understanding of the key assumptions underlying management's material accounting judgments
- Seeking greater value and insight from the internal and external auditors
- A robust and effective self-evaluation process.

#### In 2014, KPMG surveyed 1,500 AC members in a number of countries.

Key findings are as follows:

- Regulation, uncertainty, volatility and operational risks are the top challenges
- The quality of information about cyber risk, technology and innovation and global systemic risk is falling short
- Leading indicators and non-financial drivers of long term performance are often elusive
- The AC's job continues to grow more difficult
- Most companies do not have a CFO succession plan in place
- Internal audit should also be looking at risk management, IT, and operational risk – but may lack the necessary skills and resources.

### Appointment and dismissal

AC members are appointed and dismissed by the BoC and the company is required to report to the OJK regarding the appointment or dismissal of AC members at least two working days following such event.<sup>96</sup>

Issuers and public companies must have an AC charter that is published on the company's website and at least contains the following:<sup>97</sup>

- Duties, responsibilities and authorities of its members
- Composition, structure and criteria for membership
- Work procedure
- Policy on AC meetings

<sup>96</sup> Bapepam Regulation IX.1.5, Article 8.c

<sup>97</sup> Bapepam Regulation IX.1.5, Article 1.f

<sup>98</sup> Bapepam Regulation IX.1.5, Article 5

- Activities monitoring system
- Policy on handling complaints/reports regarding financial reporting irregularities
- Tenure for AC members.

### Duties and responsibilities

The following outlines the duties and responsibilities of AC members as specified in the regulation.<sup>98</sup>

- Reviewing the accuracy of financial reports published by the company
- Monitoring the company's compliance with relevant regulations
- Providing independent opinions in case there are differences of opinions between management and the auditing firm
- Providing recommendations to the BoC regarding the appointment of an auditing firm based on independency, scope of authority and fees
- Reviewing the results of internal audits and monitoring the BoD's follow up actions in response to the internal audit findings
- Evaluating the implementation of a risk management system by the BoD
- Evaluating complaints received regarding the company's accounting and financial reporting process
- Evaluating and providing recommendations to the BoC regarding potential conflicts of interest
- Guarding the confidentiality of the company's documents, data and information.



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The Guidelines for Establishing an Effective AC (2002) specifies additional functions for the AC as follows:<sup>99</sup>

- Provide independent assessment of the financial reporting process and ensuring that financial reports are presented in accordance with generally accepted accounting principles
- Provide independent monitoring over risk management and internal control processes
- Provide independent evaluations regarding the implementation of CG principles
- Ensure that the internal control structure is adequate and effective
- Confirm that internal and external audits are conducted according to applicable audit standards
- Ensure that audit findings are followed up by the management.

Furthermore, the AC should also perform the following:

- Routinely inform the BoC regarding violations of procedures and regulations by the company's Directors and officers
- Regularly update the BoC regarding individuals responsible for irregularities, circumstances in which they took place and how similar violations could be prevented in the future
- Evaluate risks associated with company's transactions and operations
- Provide the BoC with information on the financial and operating results of the company, which requires members of the AC to have unlimited access to the company's books and records. The Corporate

Secretary plays a critical role in facilitating a free flow of information in response to the AC's requests.

### Meetings

Bapepam requires that the AC meets at least once every quarter according to an agreed schedule. The meeting must be attended by more than half of the AC members and decisions must be made based on consensus. The meeting must be minuted and the minutes must be signed by every attendee and reported to the BoC.<sup>100</sup> The AC should provide a report of its work and performance at least annually to the BoC.<sup>101</sup> The AC should carefully consider the length of term of each member. Rotation of AC members introduces new perspectives to the AC, however, given the complex nature of the role, this has to be balanced with the need to have members who possess the necessary knowledge to discharge their responsibilities effectively.

### Nomination and Remuneration Committee

#### Size and composition

It is mandatory for issuers and public companies to have a nomination and remuneration committee.<sup>102</sup> The BoC may establish an NRC (together or separately) in order to discharge its nomination and remuneration functions as required by the law.<sup>103</sup> The NRC should comprise at least three members and be chaired by an independent Commissioner.<sup>104</sup> Issuers and public companies are required to report to the GMS and disclose the NRC functions (including its role and authority, composition and membership structure and meeting procedures) in the Annual Report and on the company's website.<sup>105</sup>

<sup>99</sup> CG Manual on Audit Committee, Part III, 3.1

<sup>100</sup> Bapepam Regulation IX.1.5, Article 7

<sup>101</sup> CG Manual on Audit Committee, Part V, 5.e

<sup>102</sup> No. 34/POJK.04/2014, Article 2

<sup>103</sup> No. 34/POJK.04/2014, Article 2

<sup>104</sup> No. 34/POJK.04/2014, Article 3 (1)

<sup>105</sup> No. 34/POJK.04/2014, Article 22

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### Duties and responsibilities

Examples of NRC responsibilities according to better practices include (but are not limited to):

#### *Nomination*

- Provide recommendations to the BoC regarding structure, size and composition (including the skills, knowledge, experience and diversity) of the BoC and the BoD, policy and criteria for the nomination process and policy on performance evaluation for members of the BoC and the BoD
- Before recommending a new Board appointment, evaluate the balance of skills, knowledge and experience on the BoC/BoD. A description of the role and capabilities required for a particular Board appointment should be prepared. Upon appointment, Commissioners and Directors should receive a formal letter of appointment setting out clearly what is expected of them in terms of their time commitment, committee service and involvement outside Board meetings
- Support the BoC in evaluating the performance of BoC and BoD members based on an agreed benchmark
- Prescribe training and professional development programs for members of the BoC and the BoD
- Consider progressive renewal of the BoC and the BoD, as well as each Commissioner/Director's competencies, commitment, contribution and performance (e.g. attendance, preparedness, participation and candor). All Commissioners and Directors should be required to submit themselves for re-nomination and re-appointment at regular intervals and at least once every three years

- Review measurable objectives for the implementation of the Board's diversity policy and monitor progress towards the achievement of these objectives
- Assess the independence of Commissioners and Directors
- Advise the GMS on candidacy proposals for members of the BoC and the BoD.

#### *Remuneration*

- Provide recommendations to the BoC regarding the remuneration structure and policy for members of the BoC and the BoD
- Support the BoC in evaluating the suitability of existing remuneration based on the current and projected financial situation of the company as well as a balanced evaluation of each member's past performance and the performance of the BOC and BOD as a whole.

In order to put together and operate an effective NRC, the following attributes are recommended to be in place:

#### **i. Leadership, size and composition**

The NRC must have at least three members and be chaired by an independent Commissioner. The rest of its members can consist of a Commissioner, external party from outside of the company or HR managers (although the NRC should not be dominated by HR managers). The law also prohibits members of the BoD from serving in the NRC.<sup>106</sup> It is not encouraged for the President Commissioner to chair the NRC due to concerns of over dominance.

<sup>106</sup> No. 34/POJK.04/2014, Article 3 (4)

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#### ii. Clearly defined charter

The BoC should clearly define and approve the NRC's terms of reference, in accordance with the AoA. Refer to Appendix C.

#### iii. Regular and planned meetings

The NRC is required to meet regularly at least once every four months. The meeting must be attended by the Chairman and the majority of its members.<sup>107</sup> Decisions must be made by consensus. Simple majority voting can be used as an alternative mechanism if a consensus cannot be reached. The results of the meeting need to be minuted and reported to the BoC.<sup>108</sup>

#### iv. Clear discussion and documentation on key decisions

Key issues have to be discussed in depth with demonstrable due care and diligence. Key decisions include matters such as reviewing Commissioners and Directors' independence, nomination and selection process, and disclosure of multiple Commissionerships/Directorships held by each Commissioner/Director in its Annual Report.

When Commissioners/Directors have multiple Board representations, each must ensure that sufficient time and attention are given to the affairs of each company. The NRC should decide if a Commissioner/Director is able to and has been adequately carrying out his/her duties, taking into consideration the Commissioner/Director's number of listed company Board representations and other principal commitments.

#### v. Adequate access to resources and information

The NRC must have access to the Corporate Secretary since the latter is familiar with regulations and other governing instruments of the company. The NRC may also meet with the Head of Human Resource on matters relating to succession planning of key senior executives and the competency framework. External consultants may also be engaged.

#### vi. Balance continuity with renewal

It is important that the NRC recognizes the need to strike a balance between appointing a new Commissioner/Director and re-electing an existing Commissioner/Director, and the specific basis for retaining a long-standing Commissioner/Director. The NRC should also give full consideration to succession planning for Commissioners, Directors and other key executives.

#### vii. Assessment of the NRC

The NRC should be assessed in discharging its responsibilities by the BoC. Processes and tools adopted can be similar to those used to assess the performance of the BoC, the BoD, other committees and individual Commissioners and Directors.

#### viii. Reporting by the NRC

Issuers and public companies are required to report to the GMS and disclose the NRC functions (including its role and authority, composition and membership structure and meeting procedures) in the Annual Report and on the company's website.<sup>109</sup>

<sup>107</sup> No. 34/POJK.04/2014, Article 12

<sup>108</sup> No. 34/POJK.04/2014, Article 13 and 14

<sup>109</sup> No. 34/POJK.04/2014, Article 22

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## Risk Policy Committee

Although not mandatory, many large organizations have established RPCs in recent years; many are often combined with the AC. If an RPC is established, clearly defined roles, responsibilities and communication channels need to be specified in its charter, particularly when multiple committees need to interact with each other.

### Duties and responsibilities

The RPC generally has the following responsibilities:

#### A. Determine Structure and Resources

- Confirming the risk governance structure across the organization (BoC, BoD, supporting committees, group and business unit structures/ personnel)
- Confirm the adequacy of resources directly involved in establishing and maintaining the risk management framework across the company (including whether there is a CRO and/or dedicated risk management function)
- Review the company's existing capability to identify and manage risk types
- Establish a process for setting objectives and reviewing performance of the CRO (or equivalent)
- Review risk management capabilities across the company including risk management training, risk communication channels, crisis readiness and recovery capabilities
- Monitor the independence of risk management functions throughout the organization.

## B. Establish Risk Management Framework

- Establish an appropriate 'tone at the top' that fosters a risk aware culture focused on managing risks in a transparent and constructive manner
- Review and recommend to the BoC the company's risk appetite, levels of risk parameters and risk policies
- Oversee the BoD in the design, implementation, and monitoring of the risk management and internal control systems
- Review and monitor the company's risk profile/ risk dashboard on a regular basis to understand the significant risks facing the company and how they are being mitigated
- Review and monitor BoD's responsiveness to the findings
- Oversee and advise the BoD on the current risk exposures and future risk strategy of the company
- Before a decision to proceed is taken by the BoC, advise the BoC on proposed strategic transactions, focusing in particular on risk aspects and implications for the risk tolerance of the company, and taking independent external advice where appropriate and available
- Review reports on any material breaches of risk limits and the adequacy of proposed actions
- Provide advice to the NRC on risk weightings to be applied to performance objectives incorporated in executive remuneration.

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## C. Review Risk Management Framework

- At least annually, review the soundness (adequacy and effectiveness) of the risk management and internal control systems (including understanding the linkage between risks, controls and sources/evidence of assurance) with respect to key risks and controls
- Review the sources of assurance across the organization to validate the adequacy and effectiveness of the risk management and internal control systems (e.g. review IA reports to highlight significant findings and recommendations, inclusive of BoD's responses)
- Establish regular formal and informal communication channels between other committees, in particular the AC, to seek inputs where they have responsibility for various risk types, risk management and/or internal controls
- Review the assurance provided by the CEO/CFO regarding the adequacy and effectiveness of risk management and internal controls.

The RPC can consist of members of the BoC and, if necessary, members outsourced from outside the company.<sup>110</sup> However, the ultimate responsibility for risk oversight rests with the BoC, regardless of whether or not a separate committee is established. Ideally, members of the committee should have experience in the industry in which the company is active and other areas of expertise, such as finance, risk management and/or operations.

<sup>110</sup> CG Code, Part IV C.4.3.b

<sup>111</sup> CG Code, Part IV C.4.4.a

## Corporate Governance Committee

The CGC is not a mandatory committee but is recommended to assist the BoC in reviewing the CG policies prepared by the BoD and monitoring the effectiveness of the CG practices, including those related to business ethics and corporate social responsibility.<sup>111</sup> CGC members should consist of members of the BoC, but if and when necessary, professionals from outside of the company may be nominated.<sup>112</sup> If necessary, the CGC may be combined with the NRC.<sup>113</sup> Members of the CGC should have integrity, be trusted by all the shareholders and be knowledgeable about legal and ethical standards.

### Other committees

A number of other committees often exist and are frequently chaired by the President Commissioner to provide additional oversight on key risk areas, for example:

- Information Technology steering committee – generally in place where there is a significant reliance on information technology, such as call centers, emergency response services and technology service providers
- Research & Development committee – often found where revenue generation is dependent on ongoing research activities, such as in the pharmaceutical and mining industries
- Workplace Health & Safety committee – often used in high risk industries such as mining, petroleum and healthcare, where staff are placed in complex production or service environments.

<sup>112</sup> CG Code, Part IV C.4.4.b

<sup>113</sup> CG Code, Part IV C.4.4.c

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Special purpose committees are usually established to consider a specific matter; they usually have limited terms. Nevertheless, the committee's charter or terms of reference should be approved by the BoC and the committee should follow the same operating principles as other BoC committees.

Special purpose committees are often formed to deal with one-off events including:

- Takeovers, mergers, acquisitions or divestments
- Capital projects or system upgrades
- Reputational matters
- First-time adoption of significant laws, regulations, industry codes and organizational standards.

### Committee size and composition

The BoC needs to determine the appropriate size and composition of each committee with a minimum requirement that at least one member of the committee should be a member of the BoC and at least one member should be an independent Commissioner.

While the size of a committee varies according to the organization, a sufficient number of members with the necessary knowledge and expertise should be present in any committee.

In determining the appropriate size for each committee, the following should be taken into account:

- Complexity and geographic diversity of the organization
- Nature and extent of the committee's responsibilities
- Number of members needed to encourage robust and insightful debates

- Knowledge and experience required of committee members
- Minimum number of members to provide a quorum.

Although the composition of other committees is not regulated by the law, better practices recommend that BoC committees be chaired by an independent Commissioner and include a majority of independent members. The BoC and its committees should consist of Commissioners who, as a group, provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company. As a whole, committee members should have core competencies, such as accounting or finance, business or management experience, industry knowledge, strategic planning experience and customer-based experience or knowledge.

A committee Chairman should be responsible in ensuring that the committee performs its tasks, provides timely submission of all data requested by the BoC and informs the BoC regarding the committee's performance on a regular basis.

### BoC committee working protocols

#### Committee charter

The starting point for any BoC committee is a formal charter or terms of reference. The charter helps committee members to understand their duties and responsibilities, and how these can be reconciled with the expectations of the full BoC and the organization's stakeholders.

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A typical committee charter covers the:

- Committee objective and purpose
- Committee structure and terms of appointment for the Chairman and members
- Members' skills and experience requirements
- Meeting requirements and procedures (e.g. frequency of meetings, quorums, voting and minutes)
- Duties and responsibilities as well as authority and accountability of the committee (including delegations by the BoC)
- Board reporting requirements
- Access to company personnel and independent external advisers
- Committee assessment process.

Ideally, committee charters should also be posted on the organization's website with their key features included in the governance statement in the Annual Report. In addition, the charter should be reviewed at least annually and any changes should be tabled to the BoC for approval. Refer to Appendix C for example of committee charters.

#### Committee annual agenda

The annual agenda provides the framework to manage the committee's time, resources, meeting frequency and matters considered by the committee.

An effective annual agenda:

- Reflects the committee's complete roles and responsibilities

- Shows alignment with the BoC annual agenda to ensure integration of the BoC and its committees
- Provides a summary of the committee's key activities and follow up measures to achieve results
- Prevents meetings being 'crowded-out' by peripheral issues
- Ensures the committee's insights and expertise are fully utilized.

The annual agenda brings the committee charter to 'life' as it drives the committee's activities, agendas and information requirements. For more information, refer to the sample AC annual agenda in Appendix D.

The discussion on the annual agenda should encourage involvement of committee members concerning the nature and timing of agenda topics. The committee annual agenda also helps to determine non-committee members who should be invited (including management and external advisers) to meetings and identifies potential conflicts of interest.

#### Committee meeting agendas and minutes

Each committee meeting agenda should be prepared with reference to the committee's charter and annual agenda. The meeting agenda should consider the topics for discussion, the time allocation to discuss each item and the invitees relevant for the discussion.

The committee Chairman and the Corporate Secretary should take responsibility for the content of the agenda. They may seek feedback from other committee members, the President Director and senior management. A good agenda is one that enhances the quality of the committee's discussion by focusing on those critical matters requiring careful deliberation.

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The Corporate Secretary is usually tasked with the responsibility of maintaining a complete set of committee papers, including minutes of meetings, meeting agendas and supporting documents.

Draft minutes should be circulated to committee members after meetings and to all Commissioners for information. Approval of minutes should be obtained at the next meeting of the committee.

### Committee/BoC interaction and reporting

The BoC committees should provide complete, comprehensive and accurate reporting to the full BoC on a periodic basis, as ultimately the BoC is responsible to make decisions based on the recommendations of its committees.

It is therefore vital that the BoC takes the following measures:

- Questions the committee Chairman and members when the committee report is being presented to obtain assurance that the information can be relied upon
- Challenges whether the organization's culture is appropriate, including the 'tone at the top', from a control perspective
- Be informed of any issues on which committee members were not in total agreement
- Reviews the committee memberships to ensure there are cross committee members to facilitate the flow and sharing of information (e.g. at least one common member between AC and RPC)
- Confirms that any external parties/advisors have been effective in providing the required assurance.

### Committee induction framework

Over the last few years, the responsibilities of BoC committees have increased significantly. Committees will not be able to safeguard the interests of shareholders unless their committee members have the capability to challenge management. Committee members are also expected to have sound knowledge of financial and regulations governing the areas impacting the company; where required, they should have access to seek independent advice from external consultants or advisors. Refer to Appendix E for an example of committee induction framework.

A formal induction framework for new committee members is essential. The induction framework should include provision of:

- Information package with key business documentation
  - An information package could include the committee charter, annual agenda, papers and minutes for the past 12 months, resources utilized to undertake its duties, details of regulatory or compliance framework matters in relation to the committee and details of how the committee has discharged its responsibilities.
- Training sessions
  - The company can organize a training session for new committee members, including guidance on committee protocols, effective meetings, roles and accountabilities and review and reporting requirements.
- Meetings with key business executives and external consultants/ advisors



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Meetings with key executives and management (President Director, Chief Financial Officer, general counsel, compliance officers, the head of internal audit) and external advisors (external auditor, legal counsel) could include discussions on main strategies and financial and operational dynamics.

### Committee evaluations

Better practices recommend a formal annual assessment of the effectiveness of BoC committees. In addition, the process of evaluating the performance of BoC committees should be disclosed in the company's Annual Report. If an external facilitator is engaged to make the committee's performance evaluation, the company should also disclose whether the external party has any connection with the company.

Individual assessments of committee chairmen should be undertaken regularly by the President Commissioner and by committee Chairmen for individual committee members.

The key areas that should be covered in a BoC committee's assessment:

- Roles and responsibilities – focuses on understanding of structures, roles and authorities

- Practices – covers matters relating to decision-making in meetings and access to information
- Performance – looks into whether the committee's objectives are achieved and performance monitoring
- Culture – refers to the robustness and openness of discussions among members
- Composition – refers to members' competencies and skill sets.

The assessment process typically is conducted using several methods, including:

- Completing a self-assessment survey or questionnaire
- Conducting interviews with committee members, as well as management and assurance providers. This could be conducted less frequently i.e. as and when the company seeks to obtain more insights into areas needing improvements
- A review of the quality, quantity and relevance of information coming to, and emanating from the committee.

The assessment's outcome should be a report providing an objective, balanced evaluation of the committee's effectiveness and highlighting specific areas for improvement.

# 5. General Meeting of Shareholders

Issuers and public companies are owned by individual and institutional shareholders who have different investment objectives which are based on varying degrees of financial and commercial understanding, literacy, competency and market intelligence.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

- |  |  |
|--|--|
| <ol style="list-style-type: none"> <li>1. Do the BoC and the BoD have a general understanding of the objectives of different investor groups and key individual investors?</li> <li>2. Do the BoC and the BoD receive regular briefings from the company's investor relations officer?</li> <li>3. Do the Commissioners and Directors play an active role in the investor relations program?</li> <li>4. Are mechanisms in place to capture market intelligence and investor feedback?</li> <li>5. Are the President Commissioner and the President Director always well prepared for questions</li> </ol> | <ol style="list-style-type: none"> <li>6. Do the BoC and the BoD have a process to ensure that all statutory reporting obligations are met in a timely manner?</li> <li>7. Is there a continuous disclosure policy approved by the BoC and the BoD and linked to the spokesperson policy?</li> <li>8. Do the BoC and the BoD regularly review the effectiveness of their business reporting and communications in assisting investor decision-making?</li> </ol> |
|--|--|

## RED FLAGS

- |  |  |
|--|--|
| <ol style="list-style-type: none"> <li>1. Major marketplace concern regarding executive remuneration incentives</li> <li>2. The AGMS is a major public relations challenge</li> <li>3. The investor relations manager has no contact with the BoC/BoD</li> <li>4. Institutional investors publicly voice concerns regarding some of the organization's governance practices</li> </ol> | <ol style="list-style-type: none"> <li>5. The Indonesian Stock Exchange (IDX) expresses concern regarding the timeliness of the organization's market disclosures</li> <li>6. The linkage between financial and non-financial reporting is not evident in external communications</li> <li>7. There is a significant protest vote against the company's remuneration report</li> </ol> |
|--|--|

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Shareholders possess certain rights in exchange for their contributions to the company's equity capital, which include the right to receive dividends, the right to approve BoC and BoD membership and the right to approve amendments to the AoA (among others). These rights are important to protect, maintain and grow their investment in the company.

The notion of accountability to shareholders is at the core of any CG framework. Certain shareholders are becoming more active in asserting their rights and many Boards are responding by trying to engage with their shareholders more effectively. Nevertheless the BoC and the BoD must balance the equitable treatment of shareholders and the protection of their rights against the need to create sustainable shareholder value.

### Protecting shareholders' rights

Companies should facilitate the exercise of shareholders' rights and responsibilities based on the principle of fairness and in accordance with laws and regulations, as well as the AoA.<sup>114</sup>

A basic principle of CG is that it should protect shareholder rights. These rights typically relate to, but are not limited to:<sup>115</sup>

- Attending, expressing an opinion and voting in the GMS based on the provision of one share, one vote
- Obtaining information regarding the company on a timely, proper and regular basis
- Receiving shares of profit in the form of dividends and other profit sharing arrangements

- Obtaining full explanation and accurate information regarding the procedures to be met in convening the GMS in order for the shareholders to participate in decisions, including those affecting the existence of the company and the rights of the shareholders
- In the event that there is more than one type and classification of shares in the company, then each shareholder is entitled to cast a vote and obtain fair treatment in accordance with the type, classification and number of shares owned
- Each shareholder has the right to file a suit against the company in the district court if he/she suffers losses due to an action of the company which is considered to be unfair and unreasonable as a result of a resolution of the GMS, the BoC and/or the BoD.<sup>116</sup>



<sup>114</sup> CG Code, Part V

<sup>115</sup> Law 40/2007, Article 52 (1); CG Code, Part V 1

<sup>116</sup> Law 40/2007, Article 61 (1)

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Ordinary shares provide the following rights:<sup>117</sup>

- The right to vote to adopt resolutions in the GMS regarding all matters related to the management of the company
- The right to receive dividends
- The right to receive the remainder of assets in liquidation.

Preference shares provide the following rights:<sup>118</sup>

- Shares with or without voting right
- Shares with special right to nominate members of the BoC and/or the BoD
- Shares which, after a certain period of time, can be withdrawn or exchanged with other shares classification
- Shares which provide rights to its owner to receive dividends first before shareholders of different share classifications
- Shares which provide rights to its owner to receive allocation of the remainder of the company's asset in liquidation before shareholders of different share classifications.

### The BoC and the BoD's role

Some key roles of the BoC and the BoD in protecting shareholder rights include:<sup>119</sup>

- Applying fiduciary duties and oversight processes to protect shareholder rights in accordance with laws and regulations, as well as the AoA

- Maintaining a register of shareholders in an orderly manner and in accordance with laws and regulations, as well as the AoA
- Providing information regarding the company on a timely, correct and regular basis, except with respect to confidential matters
- Providing equitable treatment to all shareholders and not favoring certain shareholders by providing them with information that is not disclosed to other shareholders. Information shall be provided to all shareholders, regardless of the type and classification of shares owned
- Providing full explanations and accurate information regarding the conduct of a GMS.

Other better practice examples of the roles of the BoC and BoD in protecting shareholder rights include:

- Maintaining a detailed understanding of shareholders' rights that are laid down in the Limited Liability Company Law and other relevant legislation, as well as the company's AoA
- Maintaining up-to-date knowledge of the company's beneficial shareholders
- Ensuring shareholder communications are open and transparent
- Ensuring debate on contentious issues is embraced and prepared for
- Making appropriate provisions in their AoA to allow for absentia voting at the GMS
- Implementation of shareholder proposals approved by a majority of votes/proxies cast at a general meeting.

<sup>117</sup> Law 40/2007, Explanation of Article 53 (3)

<sup>118</sup> Law 40/2007, Article 53 (4)

<sup>119</sup> CG Code, Part V.2

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The BoD is required to maintain a register of shareholders<sup>120</sup> that contains the following:

- Shareholders' names and addresses
- The number, serial number and date of acquisition of shares held by shareholders and their classification (in the event that there is more than one classification of shares)
- The amount paid up on every share
- The name and address of individuals or legal entities who have pledged shares or are the recipient of fiduciary security over shares and the date of acquisition of the pledge or registration of the fiduciary security
- Information on shares having been paid up in other forms.

The BoD is also required to maintain a special register that contains information regarding the shares of the company and other companies owned by members of the BoD and/or their families.<sup>121</sup> The register of shareholders and the special register must be kept in the company's domicile and must be made available to shareholders.<sup>122</sup>

### Shareholders' responsibilities

The key legal responsibility of shareholders is to make full payment for their subscribed shares. The Limited Liability Company Law requires a minimum amount for the authorized capital of the company, 25% of which must be issued and paid up in full.<sup>123</sup> Shareholders are not personally liable for agreements made on behalf of the company and for the company's losses in excess of their shareholding, unless under the following conditions:<sup>124</sup>

- The requirements for the company as a legal entity have not been or are not fulfilled
- The relevant shareholders, either directly or indirectly, exploit the company for their personal interests
- The relevant shareholders are involved in illegal actions committed by the company
- The relevant shareholders, either directly or indirectly, illegally utilize the assets of the company, which results in the company's assets being insufficient to settle the company's debts.

The CG Code outlines the responsibility of shareholders to include:

1. The controlling shareholders should (i) consider the interests of the minority shareholders and other stakeholders in accordance with laws and regulations, and (ii) disclose information regarding the company's ultimate shareholders to the law enforcement agencies, in the event that there is a suspected violation of the law, or when requested by the relevant authority
2. The minority shareholders should be responsible for exercising their rights properly in accordance with laws, regulations and the AoA
3. All shareholders should (i) segregate the company's assets from their personal assets, and (ii) segregate their function as shareholders from that as members of the BoC and/or the BoD if such position is held
4. In the event a shareholder becomes the controlling shareholder in several companies, it is necessary that the accountability and inter-company relations are carried out clearly.

<sup>120</sup> Law 40/2007, Article 100 (1.a)

<sup>121</sup> Law 40/2007, Article 101 (1)

<sup>122</sup> Law 40/2007, Article 100 (2 and 3)

<sup>123</sup> Law 40/2007, Article 32 (1) and 33 (1)

<sup>124</sup> Law 40/2007, Article 3

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### Institutional shareholders' principles

Certain shareholders, particularly some institutional shareholders, are becoming more assertive in protecting their own rights and are taking various measures to influence the companies in which they invest. These measures include:

- Communicating with the company openly and transparently
- Adopting a clear, comprehensive and pragmatic view of what constitutes good CG
- Understanding and monitoring company performance and providing feedback to the company
- Teaming with like-minded shareholders to exert collective influence
- Lobbying and targeted activism
- Adopting consistent positions, where appropriate, on particular issues and voting accordingly.

Several sets of best practice principles have been published addressing the responsibilities of institutional investors. One such example includes the International Corporate Governance Network's (ICGN), *Statement of Principles on Institutional Shareholder Responsibilities*,<sup>125</sup> which sets out its view of the responsibilities of institutional shareholders in relation to their external role as shareholders and also in relation to internal governance. With respect to voting responsibilities, the ICGN suggests that institutional shareholders should:



- Disclose an annual summary of their voting records, together with their full voting records in important cases
- Seek to reach a clear decision, in favor or against, for each resolution on which they are expected to vote
- Disclose details of any outsourcing of ownership responsibilities (including the names of agents to whom they have outsourced, together with a description of the nature and extent of outsourcing and how it is regularly monitored).

<sup>125</sup> *International Corporate Governance Network (ICGN), Statement of Principles on Institutional Shareholder Responsibilities, 2007 (Endorsed by the ICGN Board for member approval at the 2007 AGM).*

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### The BoC and BoD's role in investor relations

Shareholders have different investment objectives; some invest for short-term gain, some for long-term value and others invest for socially responsible reasons. Better practices suggest that companies should actively engage their shareholders and put in place an investor relations policy to promote regular, effective and fair communications with shareholders. Companies with an effective approach to investor relations understand the objectives of different investor groups and key individual investors. Communications and active engagement with shareholders generate feedback on investor concerns.

At a minimum, the BoC and the BoD should devise an effective investor relations policy to regularly convey pertinent information to shareholders and approve any policies that control investor relations engagement risks. The BoC and the BoD should also provide input into, and approve, the investor relations strategy as well as regularly monitoring investor relations activities. This strategy typically addresses an organization's approach, performance targets and accountability for:

- Market intelligence and feedback mechanisms
- Shareholder and key stakeholder analysis and engagement planning
- Shareholder services (including share registry and transactional support)
- Investor targeting initiatives
- Shareholder and key stakeholder communications
- Media and public relations initiatives (including brand and reputation management).

Shareholders should have online access to comprehensive price, volume and trading data, as well as details of broker trading activity and company announcements on the IDX website.

Regular dialogue with shareholders to gather feedback and address shareholders' concerns should also be established and maintained. Such engagements with the shareholders should be stated in the company's Annual Report.

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## Convening the GMS

The BoD is responsible for convening the company's GMS.<sup>126</sup> If the Directors fail to do so, one or more shareholders who jointly represent at least 1/10 of the total shares or the BoC can submit a request to the BoD to convene the GMS.<sup>127</sup>

The types of shareholders meetings include Annual General Meeting of Shareholders (AGMS) and other GMS, which is also called Extraordinary General Meeting of Shareholders (EGMS).<sup>128</sup> The Limited Liability Company Law requires companies to hold the AGMS no later than six months after the end of the accounting year.<sup>129</sup> The GMS should be convened at the

company's domicile or at a location of the company's business activities.<sup>130</sup> Other GMS may be convened any time as deemed necessary for the interest of the company.<sup>131</sup> They are usually held in response to specific needs of the company, such as providing approval for consolidation, merger, acquisition or separation, electing and dismissing members of the BoC and/or the BoD and approving capital increases or reduction.

Shareholders typically participate in the decision-making of the company by exercising their right to vote during the GMS. Overall, the GMS has authority over the following issues (which include but are not limited to):

<b>The company's governing bodies</b>	<ul style="list-style-type: none"> <li>• Appointment, replacement and dismissal of members of the BoC and the BoD<sup>132</sup></li> <li>• Provision regarding the amount of salary and remuneration of members of the BoC and the BoD<sup>133</sup></li> <li>• Investigation and handling of breaches by the BoC and/or the BoD, which cause losses to the company and shareholders</li> </ul>
<b>The company's operations</b>	<ul style="list-style-type: none"> <li>• Approve Annual Report including annual financial statements<sup>134</sup></li> <li>• Approve the BOC report</li> <li>• Approve the BoD report</li> </ul>
<b>The internal procedures for governing bodies</b>	<ul style="list-style-type: none"> <li>• Approve any amendments to the AoA<sup>135</sup></li> </ul>
<b>Capitalization</b>	<ul style="list-style-type: none"> <li>• GMS approval is required to increase or reduce the company's capital<sup>136</sup></li> </ul>
<b>Reorganization and liquidation</b>	<ul style="list-style-type: none"> <li>• Approve merger, consolidation, acquisition, separation and liquidation of the company<sup>137</sup></li> </ul>

<sup>126</sup> Law 40/2007, Article 79 (1)

<sup>127</sup> Law 40/2007, Article 79 (2)

<sup>128</sup> Law 40/2007, Article 78 (1)

<sup>129</sup> Law 40/2007, Article 78 (2)

<sup>130</sup> Law 40/2007, Article 76 (1)

<sup>131</sup> Law 40/2007, Article 78 (4)

<sup>132</sup> Law 40/2007, Article 94 (5) and 111 (5)

<sup>133</sup> Law 40/2007, Article 96 (1) and 113

<sup>134</sup> Law 40/2007, Article 69 (1)

<sup>135</sup> Law 40/2007, Article 19 (1)

<sup>136</sup> Law 40/2007, Article 41 (1)

<sup>137</sup> Law 40/2007, Article 89 (1)



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<b>Dividends</b>	<ul style="list-style-type: none"> <li>GMS has the right to determine the use of net earnings, including the amount allocated to the reserve fund. The remaining net earnings can be distributed to shareholders as dividends, but only if the company has a positive profit balance<sup>138</sup></li> </ul>
<b>Major transactions</b>	<ul style="list-style-type: none"> <li>The BoD is obliged to request GMS approval to transfer or secure company's assets, which constitute more than 50% of the total net assets of the company in one transaction or more, either separate or inter-related<sup>139</sup></li> </ul>

### Notice for GMS

Notice of the GMS must be issued through Registered Mail and/or with an advertisement in a newspaper.<sup>140</sup> The minimum period of notice is 14 days prior to the GMS.<sup>141</sup> The notice should specify the date, time, place and meeting agenda.<sup>142</sup>

One or more shareholders who represents at least 1/20 of the total shares has the right to propose GMS agenda items at the latest seven days prior to the GMS being convened.<sup>143</sup>

Other than the ordinary business of an AGMS, the meeting should only deal with matters of which notice has been given. A resolution passed for anything not disclosed in the notice of meeting may not be legally valid if a voting member happens to be absent and therefore has no knowledge of the matter.

Ordinary business of a GMS usually includes the following:

- Declaration of dividends
- Election of Directors
- Appointment and fixing auditors' remuneration (if any)

- Consideration of the accounts, balance sheets and reports of Commissioners, Directors and auditors
- Any other business will usually be classified as "special business"

### Shareholders' resolutions

The Limited Liability Company Law specifies that the resolution of GMS should be taken based on mutual consensus. In the event that a consensus cannot be reached, the resolution will require approval by more than half of the total votes, except if the AoA stipulates a higher requirement for affirmative votes.<sup>144</sup> Some resolutions, such as merger, consolidation, acquisition, separation, bankruptcy, extension of duration and the liquidation of the company require approval by more than three quarters of the total votes.<sup>145</sup>

### Proxy

A shareholder who cannot attend the GMS may grant a power of attorney to a proxy to attend and vote for him/her during the meeting.<sup>146</sup> However, members of the BoC and the BoD, as well as employees of the company, are not allowed to act as a shareholder's proxy during the voting period of the GMS.<sup>147</sup>

<sup>138</sup> Law 40/2007, Article 71

<sup>139</sup> Law 40/2007, Article 102 (1)

<sup>140</sup> Law 40/2007, Article 82 (2)

<sup>141</sup> Law 40/2007, Article 82 (1)

<sup>142</sup> Law 40/2007, Article 82 (3)

<sup>143</sup> 5No.32/POJK.O4/2014, Article 12

<sup>144</sup> Law 40/2007, Article 87

<sup>145</sup> Law 40/2007, Article 89 (1)

<sup>146</sup> Law 40/2007, Article 85 (1)

<sup>147</sup> Law 40/2007, Article 85 (4)

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## Effective GMS

For many public companies, the GMS is a major exercise in shareholder communications and investor relations. The GMS offers shareholders a unique opportunity to question the BoC and the BoD, express their views on company performance and suggest changes to company governance and operations.

As well as a forum for communications and discussion, the business of the GMS primarily considers the financial report and auditor's report, together with resolutions to approve the Commissioner/Director's statement and report, and may include consideration of the appointment and remuneration of the auditor and the election and compensation of Commissioners and Directors. If the business of the meeting relates to the election (or re-election) of Commissioners/Directors, shareholders will expect those Commissioners/Directors to address them at the meeting.

As such, all Commissioners and Directors should attend the GMS. In particular, the President of the BoC and the BoD, as well as the respective Chairman of the AC and NRC, should be present and available to address shareholders' queries at these meetings. The external auditors should also be present to address questions about the conduct of the audit and the preparation and content of the auditors' report.

The following are some key considerations for GMS:

- A hostile GMS is rarely the result of spontaneous combustion. Boards in touch with shareholder concerns will anticipate and embrace debate on contentious issues

- The BoC and the BoD should anticipate specific shareholder questions and develop appropriate responses. Speakers should be identified in advance to respond to specific issues
- Difficult or contentious questions can sometimes be short-circuited by raising and answering them in the Annual Report, or in the formal President Commissioner/President Director's address to the meeting
- Shareholders can be invited to submit questions prior to the GMS
- Shareholders should be able to access a webcast of the meeting
- The President Commissioner and the President Director should be thoroughly familiar with the GMS agenda and meeting procedures, and have developed an approach for dealing with difficult or hostile responses from the floor of the meeting
- The President Director must allow a reasonable opportunity for members to ask questions about the management of the company.

Public companies are required to prepare full and summary minutes of the GMS, which must be announced to the public through a national newspaper, the IDX website and the company's website.<sup>148</sup> The summary of minutes shall contain the following:<sup>149</sup>

- Date, place, time and agenda of the GMS
- Members of the BoC and the BoD in attendance
- The attendees' total number of shares represented by valid voting rights and its percentage of the total number of shares with valid voting rights

<sup>148</sup> No.32/POJK.04/2014, Article 32 and 34 (2)

<sup>149</sup> No.32/POJK.04/2014, Article 34 (1)

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- Whether shareholders had opportunities to raise questions and provide opinions in regards to the GMS agenda and the number of shareholders who raised questions and provided opinions
- Mechanism for decision-making during the GMS
- Voting results
- GMS resolutions
- Dividend payout.

Meeting minutes for each GMS must be signed by the chairperson of the meeting and at least one shareholder appointed by and from among those present. The signature requirement is not needed if the minutes are included in a notaries deed.<sup>150</sup>

There have been increased efforts by the BoC and the BoD to engage shareholders in less contentious, more cooperative interaction and communications. Shareholders are also encouraged to consider how they, in turn, might foster more constructive relationships with the BoC and the BoD through consideration of the appropriate limits of shareholder powers.

### Dividends

One key shareholder right is the right to receive dividends. The BoD should make a proposal on the pay out ratio for each share classification to be approved by the GMS. For listed companies, the final decision on the pay out rests exclusively with the GMS, although it should not be higher than the rate proposed by the BoD. Dividends can be made in cash or in the form of common shares. All net earnings after deduction for the reserve fund can be distributed to shareholders

<sup>150</sup> No.32/POJK.04/2014, Article 32 (2-3)

<sup>151</sup> Law 40/2007, Article 71 (2)

<sup>152</sup> Law 40/2007, Article 72 (1)

<sup>153</sup> Law 40/2007, Article 72 (5)



as dividends.<sup>151</sup> A company may distribute interim dividends as long as it is stipulated in the company's AoA.<sup>152</sup> In the event that the company has paid an interim dividend and experienced losses at the end of the accounting year, the Limited Liability Company Law requires the dividend to be returned to the company in order to fulfill the company's obligation to creditors.<sup>153</sup> Companies should adopt a rational dividend policy in line with shareholders' preferences.

### Major transactions

The BoD is obliged to request GMS approval to transfer or secure company's assets, which constitute more than 50% of the total net assets of the company in one transaction or more, either separate or inter-related.<sup>154</sup>

Bapepam Regulation IX.E.2 provides a detailed procedure for disclosure and approval of material transactions by issuers and public companies. Material transactions are defined as transactions that constitute either 10% of the company's revenues or 20% of the company's equity.<sup>155</sup> All material transactions must be approved by the GMS.<sup>156</sup>

<sup>154</sup> Law 40/2007, Article 102 (1)

<sup>155</sup> Bapepam Regulation IX.E.2, Article 1

<sup>156</sup> Bapepam Regulation IX.E.2, Article 2

# Section B

Establishing an  
efficient and  
effective BoC  
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# 6. Governing Instruments and Internal Regulations

There are many instruments, roles and responsibilities required for a Board to deliver its governance function effectively. Key factors such as independence, Board composition and skills are vital in delivering strong Board performance.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

- |   |  |
|---|--|
| <ol style="list-style-type: none"> <li>1. Is there an approved annual agenda that is linked to the BoC/BoD's key responsibilities?</li> <li>2. Does the BoC/BoD tailor its charter to the company's evolving operating environment and is the charter periodically reviewed?</li> </ol> | <ol style="list-style-type: none"> <li>3. Are matters that must be referred to the BoC for approval clearly communicated to the BoD?</li> <li>4. Are delegations to management, including the delegations policy, documented?</li> </ol> |
|---|--|

## RED FLAGS

- |   |   |
|---|---|
| <ol style="list-style-type: none"> <li>1. The BoC/BoD is heavily weighted towards a certain skill set, background or gender</li> <li>2. Some Commissioners or Directors have family ties or cross-directorships that have not been discussed or are overlooked</li> </ol> | <ol style="list-style-type: none"> <li>3. A statement of matters reserved for the BoC has not been prepared, nor is it publicly available</li> <li>4. Matters reserved for the BoC implies limits on the President Director, but is not explicit and clear, resulting in various assumptions and interpretations</li> </ol> |
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The way in which roles, responsibilities and authorities are allocated within a company is critical to ensure there is clarity, consistency and formality in decisions and actions taken by the company. There are various governing instruments that are required to be established by law and others that are recommended as better practices to help companies establish efficient and effective authorities. The key governing instruments include:

- AoA
- Internal Regulations of the Company
  - ▶ Company Codes of CG
  - ▶ Delegation of Authority
  - ▶ BoC and BoD Charters
  - ▶ Code of Ethics/Conduct (and/or other internal rules)

## Articles of Association

The deed of establishment includes the AoA and other information related to a company's establishment.<sup>157</sup> A deed of establishment establishes a company and determines its purpose, objective and capital structure. The AoA is critical in guaranteeing the protection of shareholders rights and equitable treatment of shareholders, regulating the distribution of authority within a company and ensuring timely disclosure of the company's activities to shareholders and stakeholders. The power to control the affairs of a company is typically vested in the BoC and the BoD by the company's AoA. The Limited Liability Company Law requires the AoA to include the following provisions, among others:<sup>158</sup>

- The name and domicile of the company
- The purposes, objectives and the business activities of the company
- The period of incorporation of the company
- The amount of authorized capital, issued capital and paid-up capital
- The number of shares and share classifications, including the number of shares for each classification, the rights attached to each share and the nominal value of each share
- Name, title, position and number of members of the BoC and the BoD
- Determination of the place and procedures for holding a GMS
- The appointment, replacement and dismissal procedures for members of the BoC and the BoD
- The procedure for profit utilization and dividend distribution.

The provisions of the AoA are a key component of a company's governance framework. Members of the BoC and the BoD should be familiar with the AoA and take the necessary steps to ensure that it is understood, complied with and provides the appropriate framework for the operation of the company. The BoC and the BoD should ensure that the original AoA document is kept in a secure location – typically at a registered office of the company. Shareholders have the right to request access to the AoA. In addition, the BoC and the BoD should be familiar with the process to amend the AoA by working closely with the Corporate Secretary and legal counsel to formally and accurately amend it.

<sup>157</sup> Law 40/2007, Article 8 (1)

<sup>158</sup> Law 40/2007, Article 15 (1)

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The company registry, which contains key company details such as the company's name and address, as well as shareholders information, must be open to the public.<sup>159</sup>

### Internal regulations of the company

A company may also create internal regulations, which specify the AoA provisions and other provisions to regulate the affairs of the company. These internal regulations can not conflict with the AoA and prevailing laws and regulations.

The BoD has the right to adopt and change the company's internal regulations. Better practices recommend that companies also outline a detailed procedure in their internal regulations to allow the President Director and the BoD to seek approval of the BoC for non-standard operations. The BoC should also be given a veto power to deny such request. The internal regulations should govern the rights, duties and responsibilities of the executive bodies. The delineation of responsibilities between the BoC and the BoD should be made clear on paper and in practice. The internal regulations should also specify in great detail the different authorities and responsibilities conferred to the President Commissioner and the President Director.

### Company codes of corporate governance

A company code of CG is a value-based statement on the company's CG practices. It is meant to provide disclosure on the company's governing structure and affirm its commitment to good CG principles.

Companies are encouraged to develop their own CG manual that aligns with the Indonesian CG Code and how it will be implemented in practice. The company CG manual should include the following:<sup>160</sup>

- Company's vision, mission and values
- Position and function of the GMS, the BoC and its supporting committees, the BoD and the internal control system
- Policy to ensure the effective functioning of each company activity
- Policy to ensure accountable and effective internal control and proper financial reporting
- Code of conduct based on the company's values and business ethics
- Instruments for disclosure of information for shareholders and other stakeholders
- Policy on improving various company regulations necessary for the implementation of CG principles.

### Delegation of authority

A company should prepare a document with guidelines setting forth matters reserved for the BoC's decision and clear directions to the BoD on matters that must be approved by the BoC.

Some of these responsibilities may include:

- Responsibility for the overall strategic oversight of the company
- Reviewing changes to the company's capital structure
- Approving financial policies and announcements
- Ensuring maintenance of a sound system of internal control and risk management
- Monitoring and approving major investments and contracts

<sup>159</sup> Law 40/2007, Article 29 (5)

<sup>160</sup> CG Code, Part VIII, 1

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- Reviewing matters pertaining to shareholder communications
- Reviewing BoC/BoD membership and senior executive appointments
- Assessing remuneration of members of the BoC and the BoD
- Ensuring an adequate and effective delegation of authority framework is in place
- Reviewing independence of Commissioners and Directors.

The relative importance of some matters included above may vary according to the size and nature of the company's business.

Given the complexity and size of a typical large organization, it is not possible at all times for the BoC or the BoD to exercise all of their roles and powers. A Commissioner or Director may delegate some duties to other Commissioners, Directors or key executives of the company.

The AoA of a company typically outlines the mechanisms for Commissioners or Directors to delegate powers to committees. The CG Code has a provision allowing the BoC to form committees to carry out its duties although any proposal from the committee requires the BoC's approval.<sup>161</sup> The CG Code also permits the BoD to delegate its authority to its respective committees established in support of the execution of its duties or to an employee of the company. However, the ultimate responsibility remains with the BoD.<sup>162</sup>



The delegations policy, which is approved by either the BoC or the BoD, should specify the limits of authority for all individuals. This will assist the BoC and the BoD to fulfill their duty of care and provide a useful reference to all company personnel as to who has responsibility for decision-making for various types of business transactions and matters.

The KPMG Delegation of Authority framework below is designed to deliver simple, efficient standards and clear accountabilities for decision-making across the organization. To achieve an effective delegation of authority, it requires the BoC and BoD to endorse these instruments, oversee their implementation and regularly consider their compliance.

<sup>161</sup> CG Code, Part IV, C.3.7

<sup>162</sup> CG Code, Part IV, D.3.1.d



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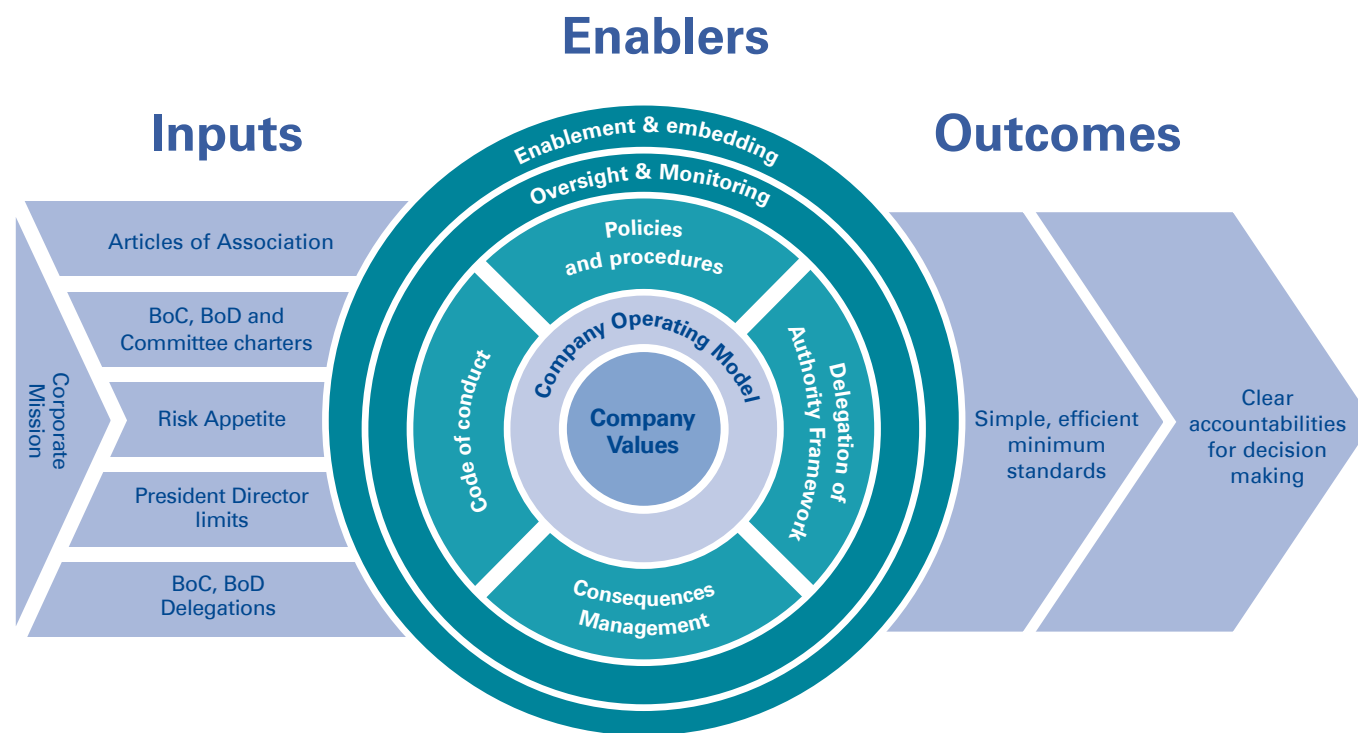
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KPMG Delegation of Authority framework



Source: KPMG Delegation of Authority framework

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#### BoC and BoD charters

The purpose of a BoC/BoD charter is to document the BoC/BoD terms of reference and to articulate its approach to important governance practices. The charter should contain a statement clarifying the division of responsibilities between the BoC and the BoD. The charter should set out rules and guidelines to ensure that the BoC/BoD can execute duties in an objective and effective manner.<sup>163</sup>

The BoC/BoD charter should be periodically reviewed to ensure that the charter remains relevant to the circumstances of the company. The charter should also be available to Commissioners and Directors, management and staff, auditors and shareholders.

Refer to Appendix B for further guidance.

#### Code of ethics and code of conduct

The BoC and the BoD of issuers and public companies are required to set up a code of ethics that is binding for all members of the BoC and the BoD, BoC committees and all employees of the company. The code of ethics must contain the following, among other things:<sup>164</sup>

- Principles of the implementation of duties that include good faith, prudence and full responsibility
- Provision for members of the BoC and the BoD, BoC committees and all employees governing issues related to conflicts of interest.

The code of ethics needs to be communicated and socialized to all employees and must be posted on the company's website in its entirety.<sup>165</sup>

Good CG is ultimately about personal and organizational integrity. Though this cannot be regulated, investor

confidence can be enhanced if a company clearly articulates acceptable practices for Commissioners, Directors and employees. The CG Code prescribes the following principles regarding business ethics and code of conduct:<sup>166</sup>

1. Each company must have company values that constitute its moral basis in achieving the company's vision and mission
2. Each company must formulate business ethics that manifests the company's values and has been agreed upon by all the company's employees
3. The company's values and business ethics should be elaborated in a code of conduct to ensure proper understanding and implementation.



<sup>163</sup> CG Code, Part IV, C.3.5 and D.3.1.e

<sup>164</sup> No. 33/POJK.04/2014, Article 36 (2)

<sup>165</sup> No. 33/POJK.04/2014, Article 36 (3 and 4)

<sup>166</sup> CG Code, Part III, 1, 2 and 3

# 7. BoC and BoD Composition and Performance

Structure, composition and internal dynamics can affect the performance of individual Commissioners, Directors, and the Board as a whole.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. Is the composition of the BoC/BoD appropriately diverse for it to perform effectively?
2. Is there a regular assessment of each Commissioner and Director's independence, and is the process effective?
3. Are there any significant conflicts of interest issues that could make it difficult to accept a BoC/BoD appointment?
4. Do you believe you can work cooperatively and constructively with the existing Commissioners/Directors?
5. Does the BoC/BoD have a robust process for handling succession planning?
6. Do all new Commissioners/Directors receive a letter of appointment setting out key terms and conditions?
7. Is there an appropriate induction program (including committee induction) for new Commissioners/Directors and continuous training for all Commissioners/Directors?
8. Does the BoC/BoD regularly review its own performance and the effectiveness of its governance process?

## RED FLAGS

1. BoC/BoD appointments are decided by the President Commissioner/President Director with little input from other Commissioners/Directors
2. Unreasonable demands are placed on the Commissioners/Directors' time
3. The BoC/BoD is too large or too small compared to similar organizations
4. Overuse of external advisors occurs due to skill gaps on the BoC/BoD
5. Gaps identified in BoC/BoD assessments are not acted upon in a timely manner
6. There is a lack of ongoing BoC/BoD succession planning
7. No formal (or insufficient) BoC/BoD induction is provided to new members
8. No regular training or developmental program that is conducted for all Commissioners/Directors

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A well designed governance structure will help the BoC and the BoD to function effectively by:

- Clarifying BoC and BoD appointments with defined terms of reference for each Commissioner and Director
- Improving the balance of skills and expertise of the BoC and BoD to ensure that the company's current and long-term strategies are fulfilled
- Enhancing communications among members of the BoC, BoD and shareholders
- Instilling confidence in shareholders and the public that the company is well governed.

### Appointment, dismissal and resignation protocols

#### Appointment

Appointing new Commissioners/Directors who are able to make positive contributions is one of the key elements of Board effectiveness. The NRC should evaluate the existing and future BoC/BoD composition requirements to identify where there is a gap in terms of having the appropriate age group, gender, qualifications, experience, personal attributes, public office, community standing and skills. Potential new members can be recommended by existing fellow BoC/BoD members, business associates or by engaging a professional search firm to identify potential candidates as well. The outcome of this process will be a brief containing detailed selection criteria approved by the BoC/BoD.

There should be a robust and transparent process of BoC/BoD appointments and succession planning development. A description of the process for the selection, appointment and re-appointment of Commissioners/Directors to the BoC/BoD should be disclosed in the company's Annual Report. This should include disclosures on the search and nomination process. The NRC must assess the nominee's experience, commitment, ability to contribute to the BoC/BoD process and if the potential candidate will be able to fulfill the existing need for a new member. Upon completion of its assessment, the NRC should recommend the nomination of successful candidates to the BoC/BoD.

The following are provisions for appointing and dismissing members of the BoC and the BoD:<sup>167</sup>

1. Members of the BoC and the BoD are appointed by the GMS
2. The initial appointment of members of the BoC and the BoD is made by the founder as stipulated in the deed of establishment
3. Members of the BoC and the BoD are appointed for a limited period and may be reappointed
4. The AoA shall regulate the procedures to appoint, replace and dismiss members of the BoC and the BoD and may also regulate the procedures to nominate members of the BoC and the BoD.

<sup>167</sup> Law 40/2007, Article 111 (1-4) and 94 (1-4)

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Shareholders are entitled to receive adequate information to determine the suitability of the BoC nominees and, if applicable, to determine their independence. Information about BoC nominees should be made available to shareholders prior to the GMS and be made available on the company's website and at the company's headquarters. Examples of information that should be furnished to the GMS for the purpose of BoC nomination include the identity of the nominee, as well as the shareholder putting forward the nomination, age, educational background and professional experience, evaluation report of the nominee's current work for reappointment and other BoC memberships or official positions held by the nominee.

### Dismissal

The law specifies that the provision regarding the dismissal of a member of the BoD also applies for the dismissal of a member of the BoC.<sup>168</sup> The following are provisions regarding the dismissal of a member of the BoD:<sup>169</sup>

1. A member of the BoD may be dismissed at any time based on a GMS resolution specifying the reasons
2. The resolution to dismiss a member of the BoD shall be adopted after the relevant member has been given an opportunity to defend him/herself in the GMS
3. In the event the resolution to dismiss a member of the BoD is adopted without convening the GMS, that member of the BoD shall be first notified regarding the plan of dismissal and be given opportunity to defend him/herself prior to the resolution regarding such dismissal becoming effective

<sup>168</sup> Law 40/2007, Article 119

<sup>169</sup> Law 40/2007, Article 105

<sup>170</sup> No. 33/POJK.04/2014, Article 27

<sup>171</sup> No. 33/POJK.04/2014, Article 7

4. The opportunity to defend oneself shall not be deemed necessary in the event that the relevant member of the BoD shows no objection against such dismissal
5. The dismissal of the member of the BoD shall be effective as of:
  - a. the closing of GMS as referred to in number 1
  - b. the resolution date as referred to in number 3
  - c. the date determined in the GMS resolution referred to in number 1
  - d. the date determined in the resolution referred in number 3.

### Resignation

The provision regarding resignation procedures for members of the BoD also apply for members of the BoC.<sup>170</sup> For issuers and public companies, suggestions for nomination, dismissal and/or replacement of members of the BoD must consider recommendations from the BoC or the NRC.<sup>171</sup> Any member of the BoD can resign from his/her position before the end of his/her tenure by providing a resignation submission. The company is obliged to convene the GMS within 90 days to decide on the request.<sup>172</sup> The company is also required to provide disclosure to the public and OJK within two days following the receipt of a resignation submission and the resolution of the GMS regarding the request.<sup>173</sup>

In the event of appointment, replacement and dismissal of members of the BoC and the BoD, the BoD must notify the change to the MOLHR to be registered in the company registry within 30 days following the resolution date of the GMS.<sup>174</sup>

<sup>172</sup> No. 33/POJK.04/2014, Article 8

<sup>173</sup> No. 33/POJK.04/2014, Article 9

<sup>174</sup> Law 40/2007, Article 111 (7) and 94 (7)

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### Tenure

The tenure limitation for members of the BoC/BoD for issuers and public companies must not exceed five years for one period or until the end of the annual GMS of the tenure period.<sup>175</sup> Typically, members of the BoC/BoD in Indonesia are appointed for five years and can be re-elected for a maximum of two times.

### Board skills and expertise

The BoC/BoD should be made of a group of professionals with the right mix of skill sets and expertise that complement each other. The various disciplines and backgrounds will enable the BoC/BoD to function more effectively as a whole and make good decisions when it has core competencies in business, operational planning and management, accounting and finance, risk management, strategy, legal, other industry-related expertise and independence. The competencies required for any particular BoC/BoD will vary considerably, depending on the company's industry, strategy and business environment.

In addition to a competency assessment, an analysis of Commissioner/Director behavioral types may help the BoC/BoD function as an effective decision-making body. When selecting future Commissioners and Directors, and planning for their education, a tailored competency and behavioral-based analysis may assist the BoC/BoD to identify gaps and focus on recruiting individuals with the required competencies.

<sup>175</sup> No. 33/POJK.04/2014, Article 3 (3)

### Boardroom diversity

In structuring an effective Board, the company should consider diversity of its Board members based on mix of skills, backgrounds, experience, expertise, age, gender and perspectives of its Directors that would be necessary to meet the unique requirements of the company.

The NRC, usually led by the Chairman, should be responsible for BoC/BoD recruitment with the objective of securing a boardroom which achieves the right balance between challenge and teamwork, fresh input, and thinking, while maintaining a cohesive BoC/BoD. It is also important to consider a diversity of personal attributes among BoC/BoD candidates, including intellect, critical assessment and judgment, courage, openness, honesty and tact, the ability to listen, forge relationships and develop trust, diversity of psychological types, background and gender to ensure that a BoC/BoD is not composed solely of like-minded individuals. There will be a blind gap if BoC/BoD members consist of people who read the same books, move in the same circles and exchange similar views.

Diversity is an important factor in order to have effective and high-performing BoC/BoD. The BoC/BoD should have appropriate composition, size, diversity of skills, experience, gender and knowledge of the company. In addition, they should also possess core competencies, such as accounting and finance, business or management experience, industry knowledge, strategic planning and customer-based experience.

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The Organization of Economic Board Co-operation and Development (OECD) recommends the following for Boards to improve their composition and effectiveness by:

- Considering a wide set of skills and experience for Directors, in particular, financial industry experience, risk management and remuneration expertise
- Emphasizing the Chairman's leadership skills and industry experience
- Enhancing Director search and nomination processes
- Placing importance on a robust process in determining independence of Directors
- Improving the process of assessing gaps within the Board, BoC committees, Chairman and individual Directors
- Improving the Board evaluation process by using a qualified external party as a facilitator
- Improving time commitment of Directors.

#### Commissioner and Director's due diligence

The role of BoC/BoD has become significantly more complex over the years with more demanding responsibilities and liabilities. A prospective member should carry out sufficient due diligence prior to accepting the appointment. The individual needs to:

- Understand the company's business, finances and other activities relevant to its success
- Review documentation provided by the company including its policies and strategies, as well as access to resources that the company lacks internally

- Review financial data, announcements made by the company in the last 12 months and press releases
- Assess personal commitment to contributing and devoting time to the long-term interest of the company and willingness to sit on or chair sub-committees of the BoC/BoD as may be required from time to time
- Identify any potential diverging interests that could create conflict of interest situations
- Assess information regarding the company's leadership and management; make arrangements to speak with other key Commissioners, Directors and senior management. Consider if the company has a culture of candor, transparency and voluntary disclosure
- Ascertain if there is any current litigation and potential liability of the company by meeting with its external and internal legal counsel and auditors
- Ascertain if there have been any queries from regulatory authorities
- Understand the adequacy of the company's remuneration package.



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## Commissioner and Director letter of appointment

The new Commissioner and Director should be issued with a letter of appointment, setting out the terms and conditions of appointment, including:

- Period of office
- Compensation and benefits
- Duties and responsibilities
- Resignation and termination.

## Board induction and education program

Commissioners and Directors bring a wealth of experience, knowledge and skills generated over their careers. The BoC/BoD should nevertheless design and implement an effective orientation program for new Commissioners and Directors, and should encourage and finance continuing education.

Induction programs are designed to make the most of a Commissioner/Director's existing knowledge base by filling any knowledge gaps, typically concerning the company's industry, the competition landscape and technical issues, as well as familiarizing the Commissioner/Director with all relevant aspects of the company. Induction programs make it more likely that new Commissioners and Directors can make an immediate contribution.

There is no prescriptive formula for what should be included in an induction program. The elements of the program should be tailored to take account of the appointee's knowledge and experience, and will

vary depending on company structure, processes and the major issues it faces. Typically, a combination of written materials, coupled with presentations and activities, such as meetings and site visits, will provide the appointee with a realistic picture of the company's position and the challenges it faces. It will also serve to foster a constructive relationship between the new Commissioner/Director and their fellow Commissioners/Directors and senior management.

According to OJK regulation, one of the Corporate Secretary's duties is to implement orientation programs for members of the BoC and the BoD.<sup>176</sup> Initially, a new Commissioner/Director should receive an induction pack, which may include the following:

- Corporate information – strategic and business plans, financial accounts, regulatory frameworks, major shareholders, corporate communications, overview of the company's competitors and industry information, risk profile and appetite, company history and product information
- Governance framework – BoC/BoD charter/governance statement, annual agenda, selected Board packs, full details of Directors, committee structures, BoC/BoD processes, assurance providers, resources available, key stakeholders, procedures for sign-off of financial statements and items requiring approval outside of BoC/BoD meetings
- Management information – names and background of senior management, organizational and management structure outline, etc.

<sup>176</sup> No 35/POJK.04/2014, Article 5 (c.5)



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In addition to the provision of induction materials, it is also important to schedule in-depth meetings for a new Commissioner/Director to discuss the BoC/BoD charter, how the company operates, the main issues for the company's business, its financial position, business value drivers and other matters of significance.

An induction to BoC committees, with particular emphasis on those committees which the new Commissioner will join, should not be overlooked. An induction pack containing relevant documents, such as committee charters, annual agendas, copies of minutes, plus a full briefing by the relevant committee Chairmen will help the new Commissioner gain an appreciation of the major issues.

Refer to Appendix E.

### Performance evaluation

The procedures to evaluate the performance of the BoD by the BoC should be stipulated in the company's AoA or internal regulations. Ideally, such evaluation should be conducted at least annually.

The NRC should review the performance of the BoC/BoD members, assessing the individual

Commissioner/Director's competencies and whether each Commissioner/Director continues to contribute effectively and demonstrates commitment to the role. The NRC should also discuss professional development needs and programs for Commissioners and Directors particularly on relevant new laws, regulations and changing commercial risks, from time to time.

Board evaluations enable the effectiveness of a BoC/BoD to be assessed in relation to:

- Fostering communications among Directors, management and other stakeholders
- Coordinating efforts of the BoC/BoD as a whole and utilizing company's resources to achieve the company's long term goals.

It is a tool for BoC/BoD's continuous improvement and learning. The process also identifies the "best fit" in BoC/BoD composition with the objective of improving shareholders' value over time.

There should be a formal annual BoC/BoD evaluation process as a whole (to be disclosed in the company's Annual Report), as well as for BoC committees and the individual Commissioners and Directors.



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Relevant performance criteria to be considered should comprise the following:

- Company-related factors - a benchmark index of its industry peers return on assets, return on equity, return on investment and economic value added over a longer-term period
- Individual-related factors-contribution and commitment to the role, attendance at meetings, involvement and actual participation at meetings, additional responsibilities assigned to the relevant Commissioners/Directors, including involvement in sub-committees of the BoC/BoD.

Board effectiveness assessment should cover key areas:

- BoC/BoD culture and dynamics
- BoC/BoD composition and role of BoC/BoD leaders
- BoC/BoD organization, processes and procedures
- Quality of information (written and verbal) and accessibility provided during BoC/BoD meetings
- BoC's relationship with the BoD
- Potential BoC/BoD developmental needs
- Shareholders' engagement and communications.

The NRC is responsible for design of the evaluation process (but many engage an external party to assist). Companies adopt various techniques in conducting BoC/BoD assessments i.e. some companies evaluate the performance of its BoC/BoD through analyzing results completed by individual Commissioner/Directors in a form of a questionnaire while others may engage an external party to conduct interviews.

BoC/BoD assessment will provide the highest value when the following factors exist:

- The objective of the evaluation is clear
- BoC/BoD must agree to commit to the purpose and process. Questions on roadblocks on effectiveness have to be addressed at the onset. To be effective, the evaluation process must be relevant to the company's BoC/BoD governance structure and culture norms.
- A BoC/BoD leader drives the process

The BoC/BoD performance evaluation is to be carried out by the NRC while the assessment criteria should be approved by the entire BoC. The performance criteria should be comparable with other industry peers and should address how long term shareholder value can be enhanced. The evaluation technique should be reviewed periodically to ensure that gaps are identified in order to make the process more productive.

- The process incorporates perspectives beyond the Commissioner/Directors themselves, including those from senior management and best practices from outside the company

Constructive feedback can come from senior management, e.g. CFO, CEO, legal counsel and HR, who interact with the BoC regularly. The BoC/BoD assessment can also be more valuable when it is being benchmarked against other high performing BoC/BoD in the same industry or against leading practices for a specific area. A third-party facilitator with significant experience in the boardroom and knowledge of governance guidelines and regulations can provide perspectives on how the BoC/BoD

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compares to its peers or how it “measures up” to the evolving standards of CG by providing an up-to-date perspective on leading practices.

- The assessment process goes beyond compliance issues to examine BoC/BoD effectiveness across a broad range of measures

The NRC together with the BoC should consider if the evaluation should be done internally by another committee, by the NRC, by self-evaluation or by an external consultant. The NRC should also determine whether the process is intended to be conducted through a written questionnaire or via interview or a combination of both.

In most effective BoC/BoD assessments, Commissioners/Directors are interviewed individually on a confidential basis and asked for both their qualitative and quantitative assessment of the key areas that determine the effectiveness of the BoC/BoD. Studies suggest that the most effective way of conducting the evaluation is via individual confidential interviews and reviewing of governance documents, committee charters, BoC/BoD meeting minutes, BoC/BoD meeting agendas and observation of a live BoC/BoD meeting in determining the quality of discussions and interactions between members. BoC/BoD may also consider discussing areas such as succession planning and strategy planning for early involvement. Such interviews and assessments should be facilitated by an experienced boardroom person or consultant who understands boardroom issues. This person has to be in a solid position to discuss a wide-range of topics - BoC/BoD composition, processes, roles and responsibilities to communication, boardroom dynamics, the BoC/BoD/management relationship and the quality of boardroom

discussions. [The Executive Guide, Improving Board Effectiveness: Five Principles for Getting the Most Out of a Board Assessment, 2012].

Commissioners/Directors must commit to reviewing the results of the assessment together and address issues that emerge on a timely basis. The BoC/BoD should not treat the assessment as part of a compliance exercise i.e. where the process is initiated, with no concerted effort and commitment made in reviewing the results of the evaluations on a timely basis. BoC/BoD needs to be open and receptive of the results and deal with the findings appropriately and timely. Clear action plans and timelines to address the gaps identified need to be established by the BoC/BoD. A committee may be set up to monitor the progress and/or oversight future follow up assessments. In addition, the BoC, along with the NRC Chairman, should take appropriate steps to counsel or, at worst, replace non-performing Commissioners/Directors. BoC/BoD evaluation should be kept confidential throughout the process.

Effective BoC/BoD, BoC committees and individual Commissioner/Director evaluation improves:

- Effectiveness by identifying gaps, if any, and correcting them
- Focus on how they operate and identifies areas that can be enhanced
- Focus on long-term strategies
- Credibility in having a written record to show that the BoC/BoD is focused on continuous improvement and diligent in monitoring its own actions.

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However, Commissioners/Directors need to take note that written records of the BoC/BoD evaluation process may be relied upon in litigation. Any areas identified as gaps which have not been acted upon could possibly be used adversely during litigation.

### Board succession planning

The BoC/BoD succession planning process challenges its members to anticipate and plan for their future needs. Such an important and on-going exercise is led by the NRC. It should be a continuous process that is regularly reviewed by the BoC so that changes in the Board composition can be anticipated and planned for in advance. A strategic map of succession planning should be in place, initiating the plan for 12-24 months.

BoC/BoD succession planning is built on:

- An assessment of the challenges and opportunities facing the company, both currently and in the future
- An analysis of the core skills, competencies and behaviors that are required, both immediately and in the future
- An evaluation of the skills, competencies and behaviors of existing Commissioners/Directors, including their strengths and weaknesses, skills and experience gaps, current age, gender composition and length of tenure
- Assessments of existing Commissioners/Directors' performance.

In developing a succession plan, the President Commissioner/President Director's role needs to be considered. In situations where the current President's

retirement period is known, plans can be drawn up to identify a new President, either internally or externally. Companies should also have a contingency plan for the President's role, in the case of some unexpected event.

The optimal BoC/BoD composition should be reviewed by the President Commissioner with the assistance of the NRC to review the skills required, identify the gaps, develop transparent appointment criteria and address succession planning.

### Remuneration

The BoC is required to review the Annual Report prepared by the BoD prior to its submission to the GMS, which contains salary and compensation for members of the BoC and the BoD.<sup>177</sup> Better practices suggest disclosing details of the remuneration policy for Commissioners, including the annual salary and bonus for each Commissioner in the company's annual financial statements. This issue should also be an explicit item in the GMS agenda to provide shareholders the opportunity to contest it.

Commissioner and Director remuneration for issuers and public companies can be distributed in several forms:<sup>178</sup>

1. Annual salary
2. Honorarium
3. Incentive
4. Fixed/variable benefits.

<sup>177</sup> Law 40/2007, Article 66 (1-2)

<sup>178</sup> No.34/POJK.04/2014, Article 10 (2)

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Furthermore, the remuneration structure and policy for issuers and public companies should be determined by the BoC or the NRC following careful consideration of the following factors:<sup>179</sup>

1. Prevailing remuneration at comparable industries and company size
2. Duties, responsibilities and authorities of members of the BoC that are linked with the company's objective and performance
3. Work performance or performance target of the individual member
4. Balance between fixed and variable benefits
5. The remuneration structure and policy should be re-evaluated at least on an annual basis.

The remuneration payable to Commissioners should be equal for all Commissioners, which is critical to maintain the special status of independent Commissioners. Independent or otherwise, a Commissioner's compensation should not be the main source of livelihood for any members of the BoC, since this factor alone could potentially impair his/her judgment and independence.



<sup>179</sup> No.34/POJK.04/2014, Article 10 (3)

# 8. The Corporate Secretary

The way the BoC and BoD meetings are run says much about how a company is being managed. These meetings should be carefully scheduled as forums for informed discussions to facilitate decision-making and improve key business strategies.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

- |   |  |
|---|--|
| <ol style="list-style-type: none"> <li>1. Is the number and length of BoC and BoD meetings sufficient to allow the BoC and the BoD to effectively discharge its duties and responsibilities?</li> <li>2. Are BoC and BoD members able to access the previous meeting's minutes with ease and review these prior to the next meeting?</li> <li>3. Are all BoC and BoD members provided sufficient time to review the BoC and BoD papers prior to entering the meeting?</li> <li>4. Is the President Commissioner/President Director clearly accountable for the BoC/BoD agenda's content, with all Commissioners, Directors and</li> </ol> | <ol style="list-style-type: none"> <li>committee Chairmen having the opportunity to contribute?</li> <li>5. Are communication channels used by the BoC and the BoD to conduct its business secure and confidential?</li> <li>6. Is regular feedback and evaluation of the effectiveness of meetings provided to BoC and BoD members?</li> <li>7. Do the BoC and the BoD manage actions arising from Board minutes, with outstanding actions being reviewed at each meeting?</li> </ol> |
|---|--|

## RED FLAGS

- |  |  |
|--|--|
| <ol style="list-style-type: none"> <li>1. BoC, BoD and/or BoC committee meetings are not scheduled on a regular basis</li> <li>2. Meeting agendas and materials are not circulated in advance, hence not allowing for adequate time for review</li> <li>3. The Corporate Secretary provides incomplete or late distribution of BoC and BoD meeting minutes</li> <li>4. Many issues discussed are carried over to the next meeting</li> </ol> | <ol style="list-style-type: none"> <li>5. Attendee and absentee lists are kept irregularly and sometimes not noted in the minutes</li> <li>6. Meetings are usually closed without an agreed set of actions</li> <li>7. The mode to exchange and store information and documents are not secured</li> </ol> |
|--|--|

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In order to effectively discharge their duties, Commissioners and Directors should be fully prepared for BoC/BoD meetings. Board papers should be read in advance as Commissioners and Directors are expected to contribute meaningfully to these meetings.

## Corporate Secretary

Issuers and public companies are required to have the function of Corporate Secretary that can be held either by an individual or work unit.<sup>180</sup> The Corporate Secretary is appointed and dismissed by the BoD.<sup>181</sup> The position of Corporate Secretary can also be held in conjunction by any member of the BoD, although a Corporate Secretary is not allowed to have any appointment in other issuers and public companies.<sup>182</sup>

According to the CG Code, the main function of the Corporate Secretary is to ensure a sound communication between the company and its stakeholders, and to guarantee the availability and accessibility of information to stakeholders.<sup>183</sup> A Corporate Secretary has the following key roles and responsibilities:<sup>184</sup>

- a. Monitoring the development in the capital market, particularly in regards to capital market regulations
- b. Providing advice to the BoC and the BoD regarding compliance with the capital market regulations
- c. Supporting the BoC and the BoD in implementing good CG principles, which include disclosure of information to the public, regular and timely reporting to the OJK, execution and documentation of meetings and orientation programs for members of the BoC and the BoD

- d. Acting as liaison between the company, its shareholders, OJK and other stakeholders.

The BoD is responsible for determining a detailed job description for the Corporate Secretary, including rights and responsibilities that are not specified in the laws and regulations. The term of office of the Corporate Secretary also needs to be stipulated in the company's regulation.

The Corporate Secretary is also instrumental in ensuring that meetings are conducted smoothly by being proactive and anticipatory of Commissioners and Directors' needs and should ensure:

- Agendas and briefing materials are completed and circulated on a timely manner
- Invitations are sent to the appropriate personnel required to attend meetings
- Presentations are concise and highlight significant issues
- President Commissioner and President Director are appropriately briefed and supported
- Meeting venue and location is appropriate and secure
- Audio-visual and other equipment is operational
- Expert or professional advice is available when required
- Meeting begins and ends promptly at the scheduled times
- Awareness of particular customs, rules and etiquette for the meeting.

<sup>180</sup> No. 35/POJK.04/2014, Article 2 (1-2)

<sup>181</sup> No. 35/POJK.04/2014, Article 3 (1)

<sup>182</sup> No. 35/POJK.04/2014, Article 3 (2-3)

<sup>183</sup> CG Code, Part IV, D.3.4

<sup>184</sup> No. 35/POJK.04/2014, Article 5

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## Productive meeting protocols

### Roles and responsibilities to host productive meetings

The President Commissioner and the President Director have the most influence in any BoC/BoD meeting and play pivotal roles in the effective functioning of meetings, maintaining responsibility for leadership of the BoC and the BoD and its efficient organization and functioning. Their key roles include leading discussions, encouraging participation of and interaction among members, preventing anyone from dominating the discussion, conducting meetings in an effective manner i.e. summarize what has been decided to avoid misunderstandings, being firm in allocating responsibilities and making sure that they are carried out and that all decisions have been put into practice, promoting high standards of CG and ensuring that there is sufficient time devoted to discuss pertinent matters. The President Commissioner and the President Director should receive regular feedback on what could be improved.

BoC committees provide an effective way of distributing work between Commissioners and Directors and allow for more detailed consideration of important issues. There is also greater opportunity to focus on relevant matters without having to compromise the limited time available during full BoC and BoD meetings.

Although the President Commissioner normally convenes BoC meetings, the AoA may stipulate that BoC meetings be held by one or more members of the BoC,

upon a written request by the BoD or upon a written request from one or more shareholders who jointly hold 1/10 of the total number shares of the company.<sup>185</sup>

### Agenda

A meeting should only be held if it is necessary. If the same information could be covered in an email or report, for example where all agenda items are information sharing, a meeting should be avoided. As meetings are costly, the outcome must be valuable enough to justify holding the meeting.

It is useful to set and cascade the agenda in advance to all Commissioners and Directors as this enables them to be fully informed of items to be proposed and discussed at their respective meetings. Each agenda should be referenced to the annual agenda. The President Commissioner, the President Director and the Corporate Secretary should take responsibility for the content of the agenda, seeking input from other attendees, such as other committee members, after which, the President Commissioner/President Director decides on the final content of their respective agendas. The agenda should provide an overview of the content, the ordering of items, the allocation of time for each item and deciding on invitees. Time should be allocated to items according to their importance and it is also essential to categorize items which are for decision, discussion, noting or information purposes. A timed agenda will assist Commissioners and Directors in recognizing the relative significance of each issue and ensure the meeting ends on time.

<sup>185</sup> Law 40/2007, Article 79 (2)



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The agenda below shows a typical structure:

1. Approval of the minutes of the last meeting  
BoC and BoD members can highlight errors or add points which have been left out.
2. Matters arising  
Members are invited to raise issues which are not due to be covered in the published agenda.
3. Strategic issues  
For example, discussion of the acquisition of another company or the creation of a new company department.
4. President Commissioner/ President Director's report  
This may cover major new initiatives, business outlook, foreseeable threats and opportunities, review of ongoing projects and operational issues.
5. Presentation of financial reports  
This is a review of the company's financial performance.
6. Procedural and compliance issues  
For example, this may include the appointment of a new Director.
7. Any other business
8. Date of next meeting.

#### Meeting preparation

It is crucial that BoC and BoD members have sufficient notice of forthcoming meetings. Circulation of a list of prearranged dates is sufficient notice and typically a convenient practice.

Careful preparation of the agenda enhances the BoC and the BoD's productivity and supports its strategic and oversight role. The meeting should be an opportunity for Commissioners and Directors to add value to the discussion and decisions instead of being informed of the issues for the first time. There should not be any surprises. In fact, one of the President Commissioner and the President Director's duties is to apprise members of any sensitive issues in advance.

When the agenda and purpose of the meeting is communicated to members in advance, this allows them to become familiar with the proposed agenda and raise questions or undertake research prior to the meeting. The purpose of the meeting should be linked to a specific plan or outcome.

#### Meeting attendance

BoC/BoD meetings require attendance of the majority of BoC and BoD members.<sup>186</sup> Attendance at meetings is part of discharging the duties of a Commissioner and a Director. Commissioners and Directors should be present for BoC, BoD and appropriate committee meetings. Absenteeism will never excuse a Commissioner or a Director from their duties to the company. To facilitate participation, Commissioners and Directors may attend in person, via teleconference or video-conference.

Commissioners and Directors who are unable to attend a meeting should notify the BoC or the BoD in advance and the absence with apology should be documented in the meeting minutes. The number of meetings of the BoC, the BoD, and BoC committees held in the year, as well as the attendance of every member at these meetings, should be disclosed in the company's Annual Report.<sup>187</sup>

<sup>186</sup> No. 33/POJK.04/2014, Article 16 (2) and 31 (2)

<sup>187</sup> No. 33/POJK.04/2014, Article 16 (4) and 31 (4)

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If there are repeated absences on the part of a Commissioner/Director, the President Commissioner/President Director should meet with the individual to assess their future availability and commitment. The President Commissioner/President Director may have to decide whether it may be in the company's best interest for the Commissioner/Director to resign or continue serving on the BoC/BoD.

### Meeting frequency and duration

Both the frequency and duration of meetings are factors which influence the quality of Board discussions. The BoD members of issuers and public companies are required to convene one meeting a month; while the BoC members are required to have at least one meeting every two months.<sup>188</sup> The regulation also stipulates a requirement for the BoC and the BoD to have at least one joint meeting every four months.<sup>189</sup> Commissioners and Directors must schedule Board meetings for the next year before the end of the company's fiscal year.<sup>190</sup> To have an effective BoC and BoD, an annual agenda should be provided for the attendees at least five days before the meeting.<sup>191</sup> There could be ad hoc meetings organized as and when there are important matters to be deliberated.

When planning the agenda for a long meeting, it may be useful to consider splitting the meeting into shorter meetings or to hold the meeting offsite, for example a BoC/BoD retreat day. Scheduling breaks in the meeting is important to keep participants focused, attentive and productive. The length of the meeting should also allow sufficient time and attention given to all issues.

### Access to information

Commissioners should have access to complete, adequate and timely information of the company at all times to enable them to discharge their duties. Commissioners are entitled to request from the BoD additional information as needed to make informed decisions and the BoD should provide full and accurate responses in a timely manner. The company's internal document should include the right of Commissioners to request information from the BoD.

Information that the BoD should furnish to the Commissioners includes timely Board papers and related materials, disclosure documents, budgets and periodic financial statements with budget fluctuations from actual results being adequately and satisfactorily explained. Such information should be furnished to the BoC monthly and when required by the Commissioners to make balanced and informed decisions.

The BoC could consider adopting an information policy which provides that the company Secretary hold a complete set of BoC, BoD and committee papers. Under this policy, Commissioners should be entitled, on request, to access Board papers for the period during which they were a Commissioner, even if they have ceased to be a Commissioner. Increasingly, such papers are being held electronically, with approval granted to Commissioners, enabling easy access and avoiding the need for the retention of hard copies by individual Commissioners.

<sup>188</sup> No. 33/POJK.04/2014, Article 16 (1) and 31 (1)

<sup>189</sup> No. 33/POJK.04/2014, Article 16 (3) and 31 (3)

<sup>190</sup> No. 33/POJK.04/2014, Article 17 (1)

<sup>191</sup> No. 33/POJK.04/2014, Article 17 (2)

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Board papers should be concise documents that fully present the information the BoC and the BoD will require to comprehend all issues and make appropriately informed decisions. They should be prepared to strict standards in terms of presentation and content, have a consistent format and include the date, version reference and the author's name and title.

Technology is rapidly moving into boardrooms, with the digital distribution of Board papers becoming increasingly widespread. While electronic communication methods may facilitate the exchange of timely and accurate information between BoC and BoD members, companies must also consider the adequacy of the security of confidential data sharing and storage technology such as email, iPad and dropbox-type applications. The use of online portals for hosting Board papers and other company materials is growing substantially as a secure, efficient and economical way of facilitating Board meeting process.

A Commissioner/Director's meeting can be called or held using any technology, provided the Board has all Commissioners/Directors' consent. Emergency meetings called at short notice may not allow all Commissioners/Directors to physically meet and the use of technology, such as teleconferences or video conferences, enables issues needing prompt attention to be discussed. Face-to-face meetings are often preferred, especially when contentious matters are to be discussed. It is fundamental that where technology is used, that it is secure, reliable and fully functional, especially given the commercially sensitive and nature of discussions.

<sup>192</sup> No. 33/POJK.04/2014, Article 18 (1) and 33 (1)

<sup>193</sup> No. 33/POJK.04/2014, Article 18 (2) and 33 (2)

## Confidentiality

Consistent with their fiduciary duties, Commissioners and Directors are expected to maintain the confidentiality of the matters discussed. Confidential company papers must remain secure. It is leading practice for Commissioners and Directors to return meeting papers to the Corporate Secretary after a meeting, who will then arrange for the secure destruction of those documents.

Several fundamental security recommendations include:

- Encrypting documents
- Installing password-protection mechanisms for all electronic equipment
- Activating automatic locking after periods of inactivity on electronic devices
- Careful use of PINs for conference calls.

## Decision-making process

The emphasis in the Boardroom is on consensus decision-making, which focuses on securing the agreement of the full BoC/BoD.<sup>192</sup> If unable to reach a consensus, the BoC/BoD should make a decision based on simple majority voting.<sup>193</sup>

The BoC and the BoD should agree on having a number of predetermined elements included in all material proposals for Board decision. The following elements, at a minimum, should be considered in material proposals for informed decision-making:

- Alignment with strategic direction
- Financial impact and considerations

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- Economic and financial assumptions
- Key risks and dependencies
- Legal and regulatory obligations
- Availability of resources (internal and/or external)
- Ethical and environmental dimensions
- Shareholder and stakeholder perspectives
- Description of due diligence completed
- Benefits or outcomes that are measurable and can later be tested
- Contingencies to deal with unexpected developments
- Monitoring and accountability mechanisms.



## Decision-making outside the Boardroom

There will be situations where decisions need to be taken before the next scheduled Commissioners/ Directors' meeting. It is usually permissible to circulate a resolution for approval by Directors without the need to convene a meeting, though this process should be reserved for urgent matters or more procedural matters. The resolution must be signed by all Commissioners/ Directors entitled to vote on the matter and it is deemed as being passed when all have signed. Once the resolution has been passed, it must be minuted and noted at the next meeting.

## Board minutes

The company is required to document and keep a record of the minutes of general meetings and other meetings. Each minute requires the signature of all members of the BoC and the BoD who have attended the meeting. In the event that one of the attendees failed to sign the minutes, he/she is required to produce a written statement stating the reasons which is to be attached to the minutes.<sup>194</sup> The company is required to retain records of the minutes in the domicile of the company for 10 years.<sup>195</sup> The BoD is obliged to maintain all minutes of the company.<sup>196</sup> Minutes should be documented very carefully, and with due regard to being potentially referred to as documents with legal significance in instances of litigation. It is therefore paramount that Commissioners/Directors review and approve the minutes carefully and give the level of attention warranted, rather than simply treating it as an administrative exercise. Once signed, minutes are evidence of a proceeding, resolution or declaration to which it relates. If inadvertent errors are detected in

<sup>194</sup> No. 33/POJK.04/2014, Article 19

<sup>195</sup> Law 40/2007, Article 100 (2); Law 8/1997, Article 11 (1)

<sup>196</sup> Law 40/2007, Article 100 (1)

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signed minutes, Commissioners/Directors may pass a resolution at a future meeting to correct them. The Commissioners/Directors may agree not to proceed with an agreed course of action as set out in the signed minutes. In these circumstances, it will be necessary for the Commissioners/Directors to pass a resolution to rescind previous resolutions. The minutes should be formally approved at the next meeting.

The level of detail included in the minutes will vary from company to company. General inclusions would be:

- Company name
- Meeting venue, date and commencement time
- President Commissioner or President Director and attendee names, including those physically present and those participating through the use of technology (e.g. teleconference)
- Absence with apologies
- Presence of a quorum
- Minutes of the previous meeting
- Directors' declarations of personal interest
- Proceedings and resolutions (including a brief outline of material factors in reaching a decision)
- Title, version reference and date of all papers tabled
- Action plans, timelines and responsibilities for implementation
- Closure time
- Signature of the President Commissioner or President Director (at the subsequent meeting).

## Meeting evaluation

The meeting should conclude with decisions agreed. All Commissioners and Directors should be aware of the action plans that require their attention for discussion in subsequent meetings. Following a meeting, the Corporate Secretary should distribute minutes promptly to allow Commissioners and Directors to respond timely and for issues to be discussed more meaningfully in the next meeting.



# Section C

Key governance  
functions



# 9. Insightful Strategy

The BoC and the BoD are responsible for ensuring the company is sufficiently agile to respond to changes in the business and economic environment and is able to take advantage of emerging opportunities.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. Is there an annual strategic planning day(s) with the BoC and the BoD members to discuss and approve the strategic objectives?
2. Does the BoC drive the BoD to develop a business model that provides the organization with a competitive advantage?
3. Does the BoC have a well-defined process in place to monitor the quality of the BoD's strategy execution, in terms of agreed strategic objectives and performance measures?
4. For major projects, does the BoD provide an in-depth business case which is independently verified?
5. Have the BoC and the BoD defined shareholder value and how it is measured?
6. Does the BoC challenge and question the BoD to achieve better strategy formulation?
7. Does the BoD periodically provide the BoC with performance benchmarks against the published figures of industry peers?
8. Are the strategic options presented by the BoD based on robust and thorough analysis using established tools and methodologies?
9. Are post implementation reviews completed for all major projects?

## RED FLAGS

1. The BoC accepts the BoD's strategy without in-depth probing or questioning
2. The BoC does not fully understand the nature and implications of the proposed strategy
3. The external environment is not fully considered in strategy development
4. Not all Commissioners/Directors attend meetings where strategy is discussed and approved
5. Risks inherent in the strategy are not identified or managed
6. Mechanisms for measuring shareholder value are not fully understood
7. BoC and BoD meetings are not strategically focused
8. Too much emphasis is placed on financial performance measures

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### Overview

Good CG is about performance as well as conformance. The performance dimension focuses on business strategy and the pursuit of shareholder value. The conformance element is ensuring the business complies with all relevant regulations and requirements.

The nature and extent of the BoC and BoD's participation in strategy depends on the company's size, industry and particular circumstances. It is, however, essential that cooperative and interactive strategic planning processes are instituted which enable the BoC and the BoD to:

- Make, review and assess strategic decisions
- Understand the key drivers of company performance
- Align the company's strategy, operations and external environment
- Understand potential risks and incorporate risk management into strategic decision-making.

### Defining the role of the BoC and the BoD in strategy

Better practices suggest that the BoC is responsible for setting the company's strategic direction while the BoD ensures the company's strategy is carefully implemented. The BoC is also responsible for evaluating the company's risk tolerance<sup>197</sup> in addition to regularly reviewing and evaluating the company's strategy and business plan. The BoC is accountable to shareholders for approving the company's financial projections. New members appointed to the BoC should be informed by the Corporate Secretary of the company's strategy and business plan.

<sup>197</sup> CG Code, Part IV, C.4.3

Commissioners may often struggle to make a meaningful impact on the strategy process. This can occur for a number of reasons, including:

- Limited knowledge of the company's operating context
- Time constraints
- BoC time being taken up with compliance issues
- BoD being unwilling to incorporate Commissioner input
- Not having a forum for participation (such as a specific strategic planning workshop).

As a result, the BoC may find it is sidelined in the strategy development process, being confined to merely approving or rejecting proposals. Reviewing, adding value to and approving the strategy are crucial to the BoC's governance role. Through the BoC's unique position, Commissioners can contribute by providing:

- Market information and industry trends
- Experience and expertise accumulated during their professional careers
- New perspectives and fresh ideas
- An independent and objective viewpoint.

These strengths, combined with the BoD's in-depth company knowledge and experience, mean that collaborative decision-making often leads to better strategy. Commissioners are more likely to add value to the strategy process if they possess a strong understanding of the company and its environment, have a strong, meaningful working relationship with each other as well as the BoD and are able to communicate and exchange information.



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## Understanding shareholder value

The BoC and the BoD must ensure that all strategic initiatives are designed to enhance shareholder value, but with appropriate consideration given to other relevant stakeholders. Shareholders define value from a different perspective to the company. To shareholders, value may be simply the dividends or cash equivalents they receive, plus the increase (or decrease) in the market value of their shareholdings and the ambiguity of market valuations. It is important for the BoC and the BoD to define and measure shareholder value. This definition will guide decision-making at all levels of the organization.

There are two broad approaches for measuring shareholder value:

- Traditional – based on conventional financial accounting measures
- Net value – seeks to remove distortions and claims to identify movements in net shareholder value.

TRADITIONAL	NET VALUE
Net income/net profit	Cash Flow Return on Investment (CFRoI)
Earnings Per Share (EPS)	Market Value Added (MVA)
Return on Equity (RoE)	Total Shareholder Return (TSR)
Return on Assets (RoA)	Total Business Return (TBR)
Return on Net Assets (RoNA)	Shareholder Value Added (SVA)
Return on Capital Employed (RoCE)	Cash Value Added (CVA)
Net Tangible Assets per share (NTA)	

## Sustainable competitive advantage

The fundamental aim of corporate strategy is to provide an organization with sustainable competitive advantages. This refers to the unique value-creating processes that set an organization apart from its competitors. Sources of competitive advantage may include:

- Use of a leading edge business model
- Innovation
- Effective use of assets and resources, such as patents and other intellectual property, corporate reputation and physical locations
- Dynamic product lines
- The collective skills and experience of the executive and management team
- A lock on the market and/or customer base
- Strong focus and differentiation.

Most competitive advantages are short-lived because environments change rapidly. Creating sustainable competitive advantage over the long-term necessitates that companies be flexible and responsive. In fact, organizational agility and the ability to re-deploy organizational resources to take advantage of opportunities can be a sustainable competitive advantage in itself.

### Thinking strategically

A good corporate strategy presents a vision for the future and a roadmap for how the company will get there. An effective, well-articulated, strategic plan is critical for organizational success. Developing a strategy that presents a clear picture of where the company is heading is the joint responsibility of the BoC and the BoD.

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The BoC and the BoD should develop a culture of strategic thinking that can be assisted by:

- Creating a climate where strategic thinking is a valued activity
- Challenging and evaluating the processes for developing strategy, not just the strategies themselves
- Upholding high expectations for strategic plans
- Setting aside adequate time and resources to discuss strategy in a meaningful way
- Establishing methodologies, tools and policies for strategic decision-making and monitoring management adherence to them
- Ensuring that all company decisions align with the strategy.

### Stakeholder involvement in strategic planning

A critical step in the strategic planning process is engaging with key stakeholders. A company's stakeholders are those groups who affect and/or are affected by the company and its activities, such as investors, lenders, analysts, employees and customers. In leading organizations, stakeholder engagement has migrated from an optional consideration to an integral part of the business strategy.

The BoC and the BoD face ongoing scrutiny and increasingly high expectations from stakeholders. As part of their responsibility for governance oversight, Commissioners and Directors need to identify and understand the expectations of the company's stakeholders, which may vary across industries and are continually changing.

It is considered good practice to incorporate stakeholder views into the strategy development process, whether directly through consultation with stakeholder representatives, or by indirectly acknowledging their goals when generating strategy. Stakeholders bring expert advice or represent the interests of groups that can have a major effect on the success of the strategy. A diverse range of views and ideas can lead to more innovative problem solving. There should also be enhanced communication and trust, leading to mutual understanding and collaboration, potentially reducing legal and reputational risks and associated costs.

### Strategic risk

The BoC and the BoD must identify, assess and manage the risks inherent in any strategic plan. Strategic plans often do not achieve their desired aims, are poorly executed or fail to keep pace with changes to the business environment.

Commissioners and Directors have a responsibility to satisfy themselves that an effective strategic risk management plan is in place and is being followed. Such plans seek to:

- Identify and evaluate strategic risks
- Consider emerging risks and trends
- Measure what is happening
- Prepare for and take appropriate corrective action.

The BoC and the BoD must try to balance both short and longer-term strategic risk. Strategic risk increases as the time horizon expands – the longer the timeframe, the more unpredictable it becomes, and thus the more sophisticated the organization's risk management

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capabilities need to be. Many organizations develop scenarios that deal with a variety of alternatives to mitigate this problem. Risk management is an increasingly vital part of organizational accountability and strategic decision-making. Refer to Chapter 11 - Risk Management and Internal Controls.

### Strategy review

Strategy needs to be continually reviewed. It is the BoC's responsibility to conduct a thorough analysis of current strategy and progress towards the agreed objectives, and to evaluate company performance in light of these objectives. This is a key part of the BoC's monitoring role and should be completed without interference from the BoD. The BoC will normally review strategic direction at least annually. Strategies should also be subject to reviews to ensure that they remain appropriate to the organization's needs. There is a danger that organizations become complacent in their strategy, making incremental adjustments while their environments continue to change rapidly. More agile competitors will quickly overtake companies that merely react to the environment, rather than challenging, questioning and even influencing it.

In addition, the BoC needs to be vigilant in assessing company performance in achieving the strategy. Periodic reporting from the BoD (such as a quarterly report card incorporating exception reporting) can help the BoC quickly come to terms with what is not working and why.

It is important that the BoC receives the appropriate facts and information to make an accurate assessment. Financial and operational reports are a good starting point, but the BoC also requires non-financial performance indicators. These may include indicators of customer satisfaction, employee engagement, workplace health and

safety and community involvement. The BoC is there to look objectively at company strategy and make the tough decision to change a company's course when it is no longer viable.

Rather than trying to predict the future, the BoC and the BoD can ensure that the organization's capabilities and resources are sufficient to manage uncertainty and that strategic plans are flexible. In-built flexibility is promoted by:

- Scanning the environment constantly and keeping abreast of changes that could materially affect the achievement of strategic objectives
- Exploring how environmental shifts will impact strategy
- Inviting subject experts to address the BoC and the BoD
- Ensuring accurate and timely information reaches the BoC and the BoD and is discussed candidly by Commissioners and Directors scheduling 'break-out' sessions to allow the Commissioners to challenge the current strategy.

### Using the balanced scorecard

The balanced scorecard method is used by many companies globally as a better practice approach to setting performance measures and subsequently measuring actual performance. The idea of a balanced scorecard arises from the fact that financial measures are the end result of a range of other activities and processes taking place in companies. To increase sales, cut costs, lift margins, raise profits and improve return on investment, companies must do things such as engage in activities, processes, programs and projects. Commissioners and

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Directors must get behind the financials to discover these value drivers. They must learn to measure value drivers if they are to manage them.

The balanced scorecard approach recommends that the BoC and the BoD view their business from many perspectives.

- Financial perspective – how does our performance look to shareholders? Are we adding value?
- Customer perspective – how do customers see us?
- Internal business perspective – what must we excel at?
- Innovation and learning perspective – can we continue to innovate and create value?
- Community and environment – how do we meet all stakeholder expectations?

Using a balanced scorecard approach, companies set themselves goals or business objectives for each perspective. They then select the measures that best calculate progress in achieving these goals. These goals and measures must be geared to the circumstances of individual companies.

The balanced scorecard provides a performance information framework that allows companies to evaluate the effectiveness of their strategy. The balanced scorecard methodology has been promoted mainly as a management process, but it makes an excellent reporting framework for company Boards.



# 10. Ethical Culture

Developing a company culture of ethics and compliance is a business imperative. Culture is the basic fabric of an organization that shapes 'how we do business here'.<sup>198</sup>

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. Are the code of ethics and conduct and compliance programs regularly reviewed to determine if they need updating due to business, legal or regulatory changes?
2. Have any compliance investigations arisen from a cultural problem?
3. Is there an effective whistle-blowing policy and process in place?
4. Do individuals receive the information required to understand the company's core values, code of ethics and conduct and the specific policies, laws and regulations related to their jobs?
5. Has a corporate culture been developed and maintained that creates an environment of openness, honesty and the immediate reporting of bad news?
6. Does the BoD fully inform the BoC about potential or actual conflicts between the company's values and the business practices in countries where it operates?
7. Are there processes and practices in place to promote ethical behavior?
8. Has the BoC considered how BoD compensation aligns with the desired ethics and compliance culture?

## RED FLAGS

1. The BoC/BoD has power factions that inhibit teamwork
2. The BoC/BoD suffers from a 'group think' mentality
3. The code of conduct has not been reviewed in recent years
4. There are a concerning number of internal and external complaints
5. The BoC/BoD receives no reports or information regarding the whistleblower policy
6. The BoC virtually 'ticks the box' for President Director recommendations
7. The BoC/BoD culture does not allow discussion of difficult, controversial or sensitive matters in the respective meetings

<sup>198</sup> KPMG, *Survival of the Most Informed: G R C Comes of Age – How to Envision, Strategize and Lead to Achieve Enterprise Resilience, 2010.*

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The commitment of the entire organization is essential in order to design, develop and implement an effective ethics and compliance program. The BoD sets the 'tone at the top', which influences the entire organization. The BoC and the BoD should ensure that appropriate values, ethics and culture are upheld throughout the organization.

The 'tone at the top' refers to the character and behavior displayed by leaders of an organization that forms a model of appropriate conduct for every level of the organization. The BoC and the BoD bear ultimate responsibility for company culture, including the values and ethical environment that underpin that culture.

The 'tone at the top' should be underpinned by clearly articulated values and policies, a code of ethics and conduct, ongoing ethical awareness training and an ethics management process that is embedded across all the organization's activities.

Ethics and compliance programs are often initiated in response to legal requirements and other guidelines, though it is important that the program is more than just adherence to rules and policies. Instead, it should embed an ethical culture into a company.<sup>199</sup> Merely meeting legal requirements is unlikely to be sufficient to satisfy the ethical concerns of employees, clients, customers, shareholders and other stakeholders.

Recent corporate scandals highlight the importance of building a corporate culture that supports the giving and receiving of 'bad news' on a timely basis, i.e. creating an environment of openness and honesty and the presentation of the hard truth.

A culture where an early warning system for problems exists can provide for timely and appropriate intervention and/or the redefining of strategy. A climate in which full disclosure is delivered in a timely manner should be fostered by the BoD and endorsed by the BoC to encourage employees to immediately bring forth concerns.

### Business ethics

The BoC and the BoD are responsible for setting the company's values and standards (including ethical standards). Business ethics refers to rules, standards, stated organizational values and behaviors that determine what is acceptable or unacceptable in specific situations. They are inextricably linked to notions of honesty, integrity, trust, accountability, transparency and social responsibility.<sup>200</sup> Ethical conduct is a key factor in the long-term viability and success of companies. Moreover, the reputations of individual Commissioners and Directors are tarnished when a business is seen not to have acted ethically, or has otherwise breached community standards.

A company's business ethics and corporate culture may be revisited in conjunction with a BoC/BoD review or a review of the organization's pay practices. Perceived failures, adverse media exposure and episodes of high staff turnover are examples of possible catalysts for a re-awakening interest in business ethics and corporate culture; a tool to revitalize the organization.

An effective business ethics process should generate real benefits, including:

<sup>199</sup> KPMG, *The Road to a Model Ethics and Compliance Program*, 2009.

<sup>200</sup> KPMG, *A view from the top – Business Ethics and Leadership*, 2005.

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- Increasing the integrity of financial reports and information
- Minimizing the incident and encouraging the reporting of fraud and other organizational misconduct
- Creating confidence that unethical behavior will be reported and addressed
- Producing a working environment that fosters pride, responsibility and a sense of both purpose and value.

The following is an example of a business ethics framework:

- A code of ethics that clearly and concisely articulates an organization's values and behaviors
- A code of conduct which underpins all organizational activities, sets out the organization's employment practices and that provides direction on how management will manage the business. Ethics and awareness training should be delivered and reinforced regularly to all employees and included in induction programs for new employees
- Formal processes providing guidance to employees facing ethical dilemmas, and the mechanisms for reporting wrongdoings and making suggestions about how business ethics can be improved
- A performance management process that not just measures results, but considers how these results have been achieved.

### Organizational values and ethics

Organizational values not only guide company personnel, but also create expectations on the part of external stakeholders about acceptable behavior within the

organization. Strong values shared by both an organization and its employees have been found to increase employee commitment and satisfaction.

Once agreed, values should be embedded in documented policies and procedures and then actively embraced and practiced by all company personnel. An effective ethics and compliance program requires senior management involvement to entrench and uphold values, organization-wide commitment, an effective communications system and an ongoing monitoring system.

### Code of ethics and code of conduct

The law requires the BoC and the BoD of issuers and public companies to set up a code of ethics that is binding for all members of the BoC and the BoD, BoC committees and all employees of the company. The code of ethics must contain the following, among other things:<sup>201</sup>

- Principles for the implementation of duties that include good faith, prudence and full of responsibility
- Provisions for members of the BoC and the BoD, BoC committees and all employees governing issues related to conflicts of interest.

The code of ethics needs to be communicated and socialized to all employees and must be posted on the company's website in its entirety.<sup>202</sup>

Good CG is ultimately about personal and organizational integrity. Though this cannot be regulated, investor confidence can be enhanced if the company clearly articulates acceptable practices for Commissioners, Directors and employees. Indonesian's CG Code prescribes the following principles regarding business ethics and code of conduct:<sup>203</sup>

<sup>201</sup> No. 33/POJK.04/2014, Article 36 (2)

<sup>202</sup> No. 33/POJK.04/2014, Article 36 (3 and 4)

<sup>203</sup> CG Code, Part III, 1, 2 and 3

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1. Each company must have company values that constitute its moral basis in achieving its vision and mission
2. Each company must formulate business ethics that manifest its values and has been agreed to by the company's management and all employees
3. The company's values and business ethics should be elaborated in a code of conduct to ensure proper understanding and implementation.

A code of conduct is intended to provide guidance regarding “conflicts of interest, presenting and receiving gifts and donations, compliance with laws and regulations, confidentiality of information and reporting of unethical behavior.”<sup>204</sup>

As the BoC and the BoD are responsible for setting the tone and ethical standards of the organization and overseeing adherence to them, they must demonstrate that the agreed codes and standards are equally applicable to them and lead by example. Organizations that ‘walk the talk’ with regard to their code develop a reputation for honesty, integrity and principled business behavior, which forms a key element of a company's brand and enhances its reputation.<sup>205</sup>

When overseeing the implementation of the code, Commissioners and Directors must ensure that it is effectively communicated by management. The BoC and the BoD should make certain that the code of ethics and conduct is taken seriously throughout the organization and that breaches will give rise to disciplinary measures.

Merely issuing a code, however, does not ensure that it will be observed. To add value, the code must extend beyond a compliance focus and strive to cultivate and maintain an organization-wide culture that focuses on

encouraging positive moral behavior while simultaneously striving to prevent ethical lapses.<sup>206</sup>

The code must continue to evolve with the changing environment. This includes laws and regulations, the operational environment, public opinion, and focus on acceptable business behavior. Those developing or revising the code of ethics and conduct should consult frequently with legal experts and other specialists in areas addressed by the code.

## Cultural issues

### Global operations

Companies with significant global operations face additional difficulties in evolving and implementing codes of ethics and conduct. The BoC and the BoD should be fully informed about conflicts between the company's values and business practices in various countries as a lack of understanding of cultural differences may contribute to a lack of performance, loss of key employees and time consuming conflicts.

Multi-national companies are faced with several issues:

- How to foster a culture of ethical conduct in all countries of operation
- How to engage a global workforce in understanding and adopting its corporate values
- How to meet all the legal and compliance obligations throughout all locations
- Language barriers between different global units.

When selecting leadership roles within a multinational company, cultural ‘fit’ may be a relevant consideration, in an attempt to promote consensus on a global,

<sup>204</sup> CG Code, Part III, 3.1.b

<sup>205</sup> Questions Directors Should Ask about Codes of Conduct, Gunns, M. & Wexler, M. 2010.

<sup>206</sup> K. M. Gilley, C. Robertson, T. C. Mazur, *The bottom-line benefits of ethics code commitment*, 2010.



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organization-wide culture, particularly when appointing local leaders across international business units.

A failure to consider an organization-wide code of conduct may lead to significant cultural differences in the executive levels of the company around the world, potentially fostering a lack of understanding and commonality of purpose that may lead to conflicts and poorly communicated decisions. Global principles, based on corporate values, should be promoted across the organization, while still recognizing local cultural traditions within international business units.

### Mergers and acquisitions

A 2008 KPMG survey<sup>207</sup> revealed that cultural differences are a major post-deal issue, and companies frequently associate integration issues with cultural variation and complexity. Organizations should pre-empt these issues, as opposed to blaming cultural differences for difficulties experienced during post deal integration.

Central considerations in managing the integration of company cultures include:

- Closeness of cultural fits
- Implications for future ways of working
- Retention of, and rewards for, key people
- Understanding what makes the business successful, and how this will be retained and built on.

It should be considered whether the cultures of the two organizations are compatible, and if one will be dominant, how employees operating under the alternative culture will be embraced. If one culture is to prevail, retaining key leaders of that organization to serve as role models is essential in order to promote the integrated culture.

A key objective in a merger or acquisition is to incorporate the advantages of each organization's culture, ultimately resulting in synergy. A plan for the merging of cultures should be devised, incorporating educational efforts to assist employees to understand the corporate values they should adopt in the workplace.

Difficulties encountered in mergers and acquisitions are amplified in cross-cultural situations involving multinational companies.

### Whistleblower policy

The term 'whistleblower' refers to anyone who alerts superiors or the appropriate authorities to misconduct within an organization. All employees and any other persons should be encouraged to raise genuine concerns about possible improprieties in the conduct of an organization's business.

Employees may fear retaliation if they take their concerns to management or believe their allegations will not be taken seriously. They might not know who they should take the matter up with, and this becomes a more acute concern when the subject of the allegation is their manager or someone more senior. Whistleblowing measures will yield little unless employees trust the system and are comfortable using it. It is possible that if employees believe their complaints will be ignored or covered up, or that complainants will be victimized, they may take their concerns directly to the news media or law enforcement agencies. Effective codes provide whistleblowers with several channels to speak candidly and confidentially about ethical concerns in order to improve the likelihood that individuals will seek to resolve issues and concerns internally.<sup>208</sup>

<sup>207</sup> KPMG, *All to Play For: Striving for Post Deal Success*, 2008.

<sup>208</sup> *20 Questions Directors Should Ask about Codes of Conduct*, Gunns, M. & Wexler, M. 2010.

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Many companies use externally operated anonymous, independent fraud and misconduct reporting services to eliminate the fear of retaliation. These services usually provide staff with a toll-free telephone number for reporting their concerns about fraudulent or improper conduct. All whistleblower reports should be investigated and reported to the BoC.<sup>209</sup> The BoC is required to receive and ensure proper arrangements by which staff of the company and any other persons may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.<sup>209</sup> This is to ensure that arrangements are in place for such concerns to be raised and independently investigated, and for appropriate follow-up action to be taken in a timely manner.

The CG Code also recommends companies develop rules to protect whistleblowers. The BoC may assign a committee to be responsible for supervising the implementation of this provision.<sup>210</sup> In 2008, the National Committee on Governance issued a guideline on whistleblowing systems and procedures. Issuers and public companies are obliged to report their whistleblowing policies (if they have any) in the Annual Report, including the following:<sup>211</sup>

- Methods of reporting violations
- Whistleblower protection
- Complaints handling
- Complaints manager
- Results of the handling complaints.

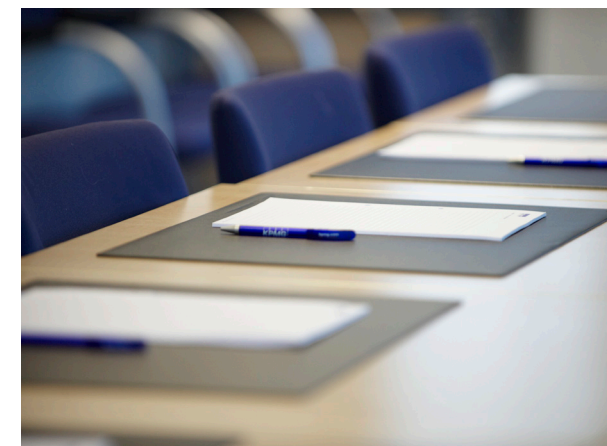
### Boardroom dynamics

Culture underpins BoC and BoD dynamics and has a decisive influence on performance. A well-functioning BoC

and BoD generally displays coherence, trust and common values between members, encourages and has regard for differing viewpoints and opinions and is able to reach a decision without animosity. Healthy boardroom dynamics will encourage sound decision-making that delivers value to shareholders.

The working relationship between Commissioners and Directors is one of the most influential factors in Board effectiveness. Most productive relationships are built on mutual trust and respect, where the BoC and the BoD work in partnership, each with an acute appreciation of the vital role played by each other in building shareholder value. Dysfunction can occur where either the President Commissioner or the President Director is overly controlling and this behavior goes unchecked.

Informal communication is one of the most effective ways of sharing information, building knowledge and fostering constructive working relationships. For this reason, BoCs and BoDs that communicate regularly, when necessary, with each other are typically strong decision-makers.



<sup>209</sup> CG Code, Part III, 3.6.a

<sup>210</sup> CG Code, Part III, 3.6.b

<sup>211</sup> Bapepam Regulation X.K.6, Article 2 (g.13)

# 11. Risk Management and Internal Controls

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Ultimate responsibility for risk lies with the BoC and the BoD. Consequently, risk management and internal controls are a focus of the BoC, the BoD, key oversight functions and business operations.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. Are the relevant roles and accountabilities for governance, risk and compliance properly formalized and documented?
2. Are the right risks being identified, assessed and managed?
3. Are there early warning systems in place to alert the BoC and the BoD to emerging risks?
4. Has the BoC approved the risk appetite/tolerance levels for the company?
5. Does the BoC challenge the BoD's risk approach, risk reporting and management plans?
6. Does the BoC provide oversight on plans for crisis management and business continuity?
7. Is the BoD establishing the 'tone at the top' to reinforce and promote a risk aware culture?

## RED FLAGS

1. Risk is considered in isolation from strategic planning and/or major decision-making in the organization
2. Leadership from the top is lacking
3. Risk management is positioned as a compliance and backroom exercise
4. Risk reporting and risk management plans are not challenged at the BoC and the BoD level
5. A healthy risk culture is not embedded throughout the organization
6. Risks identified are generic and do not appear to change significantly over time
7. Risks and mitigating actions are not regularly reviewed and prioritized to be implemented
8. Mitigating actions are often overdue
9. There is little guidance or explanation about how the risk, internal control and assurance framework are linked

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Commissioners and Directors should be aware of the key requirements that specify responsibilities and actions relating to risk management and internal controls. The key requirements are found in the following instruments:

- Indonesia's CG Code 2006 (Part IV)
- Indonesia's CG Manual on Risk Management 2012

The BOC is required to govern and oversee the BOD's implementation of a sound system of risk management and internal controls.

### Risk governance requirements

According to the CG code, the BoD is responsible for developing and implementing sound risk management and internal control systems to safeguard shareholders' interests and the company's assets. Key requirements regarding risk management and internal control are presented below:<sup>212</sup>

#### Risk Management

The coordinated activities to direct and control an organization with regard to risk.<sup>213</sup>

- The BoD should establish and implement a sound risk management system within the company covering all aspects of the company's activities
- Each strategic decision taken, including the creation of new products or services, should be carefully considered against its risk exposure to ensure an appropriate balance between benefit and risk
- To ensure proper implementation of risk management, the company should have a work unit or person in charge of this function.

<sup>212</sup> CG Code, Part IV, D.3.2 and 3.3

<sup>213</sup> ISO 31000. International Risk Management Standard

<sup>214</sup> CG Code, Part IV, C.4.1.a

### Internal Control

A process conducted by the BoD and employees to provide a reasonable assurance regarding the effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and its internal regulations.

- The BoD should establish and maintain a sound internal control system to safeguard company's assets, its performance and its compliance with laws and regulations
- Issuers and public companies are required to have an internal control function or unit
- The internal control unit should assist the BoD in achieving the company's objectives and business sustainability by evaluating the implementation of the company's program, providing recommendations to improve the effectiveness of the risk management process, evaluating the company's compliance with laws and regulations and facilitating sound coordination with the external auditor
- The internal control unit is responsible to the President Director or the Director in charge of this function. The internal control unit has a functional relationship with the BoC through the AC.

In addition, the BoC, through the AC, is required to ensure that the internal control structure is adequate and effective.<sup>214</sup> In discharging its duties, the BoC may also establish an RPC to review the risk management system established by the BoD and to evaluate the company's risk tolerance.<sup>215</sup> The BoD is responsible for the implementation of the risk management system while the BoC is in charge of monitoring and reviewing its implementation.<sup>216</sup>

<sup>215</sup> CG Code, Part IV, C.4.3

<sup>216</sup> CG Manual on Risk Management, Chapter II, 2.c

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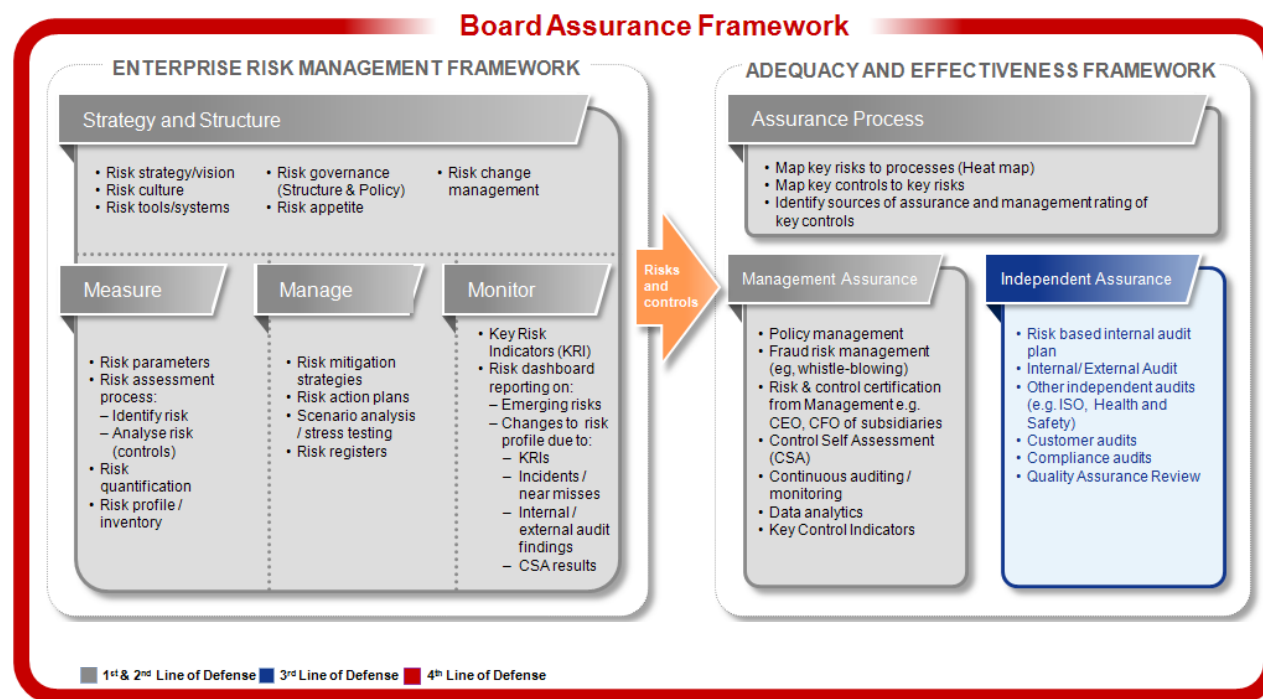
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## Board Assurance Framework

To satisfy duties and obligations regarding risk management and internal controls, Commissioners and Directors need to ensure there is a holistic Board Assurance Framework (BAF) in place that links Enterprise Risk Management (ERM), internal controls and assurance activities. A BAF provides the BoC and the BoD with an overview of existing procedures in place to identify the key risks facing the business, how they are being managed and what is being done to check that the system is adequate and effective.

KPMG has developed a BAF to encourage the BoC and the BoD to consider what is needed to establish an ERM framework alongside an Assurance framework. This allows the adequacy and effectiveness of risk management and internal controls to be assessed across the '4 Lines of Defense' model.

The ERM framework will be covered in detail in this chapter. The Adequacy and Effectiveness (Assurance) framework will be covered in detail in Chapter 12 Receiving Assurance.



Source: KPMG's Board Assurance Framework

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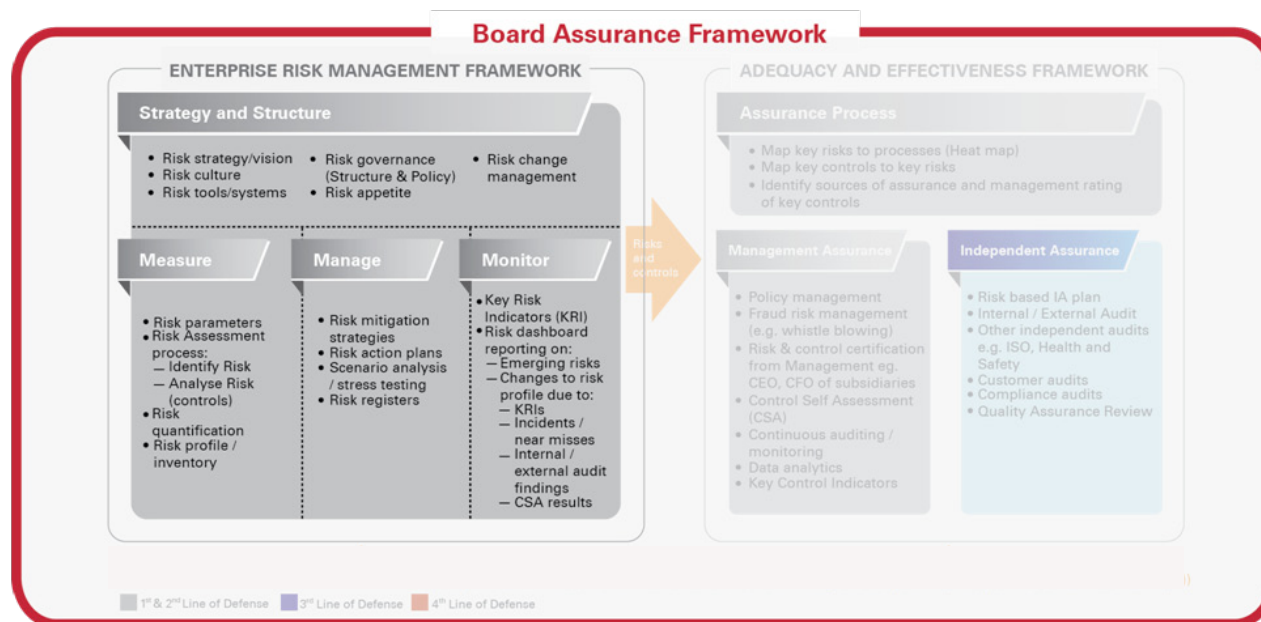
## Enterprise Risk Management framework

Given the nature, speed and velocity of risks facing companies, the BoC and the BoD need to ensure there is a structured approach that enables risks to be identified, assessed, prioritized, managed and communicated in a timely manner to key stakeholders.

To satisfy the BoC and the BoD's accountability for risk governance, they should ensure there is an adequate and effective ERM system in place that is relevant for the nature, size, structure and complexity of their company.

There are a number of ERM and internal control frameworks commonly used by companies (e.g. the International Standards Organization (ISO) 31000:2009 ERM Principles and Guidelines or the Committee of Sponsoring Organizations (COSO) ERM and Internal Control Frameworks).

The BAF highlights the key elements of an ERM framework outlined below:



Source: KPMG's Board Assurance Framework

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While all aspects of the ERM framework need to be adequate and effective, the critical areas for the BoC and the BoD to focus on include:

#### Risk and strategy

There is an intrinsic link between the development of strategy and the risks that threaten its achievement. Despite the benefits of integrating these two key processes, many organizations struggle to do this. However, integration is essential if organizations are to extract the most out of both strategic and risk management processes.

Experience suggests that organizations that make risk management an integral part of their strategy are more resilient in dealing with adverse events and uncertainty. Poor management of material business risks has been widely recognized as one of the key contributors to corporate failures during the global financial crisis. The global downturn provided useful lessons that listed entities can draw on to improve risk management and risk disclosures to stakeholders.

#### Risk appetite

The BoC should evaluate the company's levels of risk tolerance.<sup>217</sup> Risk appetite is the amount and the type of risk that an organization is willing to accept.<sup>218</sup> Risk tolerance is defined as the readiness/willingness of an organization or its shareholders to bear risk after accounting for risk-mitigating activities in the pursuit of its objectives.<sup>219</sup> It will reflect the risk management philosophy and the organization's capacity to take on risk. It will be based on strategic objectives and stakeholder demands. The notion of risk appetite can add discipline and focus when responding to an uncertain and constantly shifting risk environment. A risk appetite

statement can provide a decision-making framework for the strategic and operational handling of risk.

#### Risk governance

Risk governance is the architecture within which risk management operates in a company. It defines the way in which a company undertakes risk management. It provides guidance for sound and informed decision-making and effective allocation of resources.

Risk governance encompasses the overarching risk management structure to facilitate the management of risks across an organization.

The common risk governance structures are:

- Oversight by AC
- Oversight by RPC
- Oversight by BoC.

Many ACs today have oversight responsibility for the company's ERM process, as well as other major risks facing the company – including financial, operational, cyber security, IT, legal and regulatory compliance.

Refer to Chapter 4 BoC committees where this is covered in more detail.

#### Risk resources

##### *Risk management unit*

To ensure proper implementation of risk management, the CG Code recommends companies have a work unit or a person in charge of the risk management function.<sup>220</sup>

##### *Chief Risk Officer*

A number of businesses have appointed a Chief Risk Officer (CRO) or risk manager. The existence of a CRO

<sup>217</sup> CG Code, Part IV, C.4.3

<sup>218</sup> CG Manual on Risk Management, Chapter 1.4.w

<sup>219</sup> CG Manual on Risk Management, Chapter 1.4.x

<sup>220</sup> CG Code, Part IV, D.3.2.c

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centralizes risk management, but also brings several other benefits. One is to understand relationships between risks across separate business units that might not have been apparent before. This is increasingly important with the greater diversity and complexity of global businesses; risks that seem acceptable to an individual business unit may be inappropriate from the point of view of the enterprise as a whole. Using a comprehensive risk matrix, CROs can identify such linkages across the business and manage them more effectively.

Another important way CROs can benefit the business is by enabling the organization to make decisions based on a better appreciation of the relationship between risk and reward. CROs are most effective when they provide the Board with a clear vision of where enterprise risks lie, help define a policy for distributing and offsetting those risks and work to communicate that vision so that individual managers understand and support it. The CRO provides a framework for risk management, but it is for frontline managers and employees to determine the criteria for 'acceptable risks'.

#### Risk management policy

Risk management policies should reflect the company's risk profile and should clearly describe all elements of the risk management and internal audit function. The policy should be an instrument to communicate the company's risk management approach and should include, at a minimum:

- a definition of 'risk' and 'risk management' relative to the organization
- goals and strategies for risk management
- the organization's risk appetite/tolerance

- how risk management targets will be measured
- accountabilities for risk management.

There should be formal policies and procedures in place for key risk areas, disciplines and reporting.

#### Risk culture

The BoC and the BoD should not overlook the importance of embedding the right culture throughout the organization, alongside any improvements in techniques and processes. For risk management to be effective:

- There is a need for openness throughout the organization. This will enable management and employees to escalate concerns in a timely manner without fear. Good culture results in better judgment, which reduces the reliance on process and provides greater comfort to the BoC and the BoD
- The BoC and the BoD need to lead by example and set the right tone at the top in order to influence the behavior of management and staff. The leaders, in particular the President Commissioner and the President Director, should be seen to embody the values they espouse.

Some practices that may help create a risk-aware organization and a common risk culture include:

- Establishing values statements and codes of conduct
- Communicating the BoC and the BoD vision, strategy, policy and responsibilities and reporting lines to all employees as well as stakeholders
- Developing training programs for risk management
- Identifying and training "risk champions"



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- Clear communication about risks or practices for which there is zero tolerance
- Clear communication of the boundaries within which employees can operate
- Periodic risk reports to the BoC, the BoD and/or the appropriate BoC committee
- Periodic discussions of risk and risk issues with management
- Clear allocation of responsibility for managing specific risks
- Developing a knowledge-sharing system
- Review and evaluation of performance against rewards.

The company's remuneration framework and policy should include a component on risk management. There must be alignment with the risk tolerance and overall risk strategy of the company to encourage the desired behavior of staff. The NRC should conduct periodic reviews of the framework to ensure relevance and consistency.

### Crisis management

Companies should have crisis management plans in place. Such plans should include reference to the BoC and the BoD's role during a crisis and should be considered as part of their risk management responsibility.

The BoC and the BoD should ensure that crisis management plans contain a robust communications element. Without effective communication, companies may inflict additional damage on themselves including:

- Losing control of their communications process
- Allowing facts to be displaced by rumor and speculation

- Reputational harm
- Putting employee morale and trust at risk
- Alienating shareholders, customers, suppliers and other stakeholders.

### Business continuity

Planning for potential disaster scenarios is considered a crucial practice as all businesses face the risk of a serious event occurring that can damage the organization's ability to continue operating.

Business continuity management focuses on an organization's responsiveness to an organizational or external crisis that puts its ongoing operations at risk. The aim is to foster and develop preparedness for all types of events that may significantly affect an organization and enable a company to respond and resume normal business operations after they occur.

The ultimate goal of business continuity is to develop a response to events to enable the organization to maintain its most critical operations, and survive all but the most extreme forms of operational disruption. The key elements of effective business continuity planning are flexibility and simplicity.

A well-prepared organization will be able to make the right decisions at the right time, based not on rigid instructions contained in a detailed manual, but on tried and tested alternative ways of working. These arrangements must:

- Be integrated into everyday business
- Look inside as well as outside the organization
- Be understood by employees and stakeholders
- Be regularly and effectively tested to ensure they remain relevant.

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## Enterprise risk management framework-process

Framework Element	Description
<b>Strategy and Structure</b>	
1. Risk Strategy & Appetite	Knowing what you aim for – Define ERM vision and strategy to support strategic objective and derive the best fit ERM target operating model.
2. Risk Organization & Governance	Setting and communicating the rules of the game – Define the risk management mandate, risk roles and responsibilities across the organizational levels and develop risk policies.
3. People & Culture	Educating and engaging people – Evaluating common and specific characteristics of risk culture to serve as an aiming point for ERM change program.
4. Risk Data & Infrastructure	Fostering data analytics – Use of technological enablers to document, monitor and report risk data and enable accurate risk assessment and performance evaluation.
<b>Measure and Manage</b>	
5. Risk Assessment	Connecting the top with the bottom – Identify, evaluate and manage key strategic, financial, operational, compliance and information technology risks throughout the various organizational levels.
6. Risk Techniques & Methods	Getting tactical and technological – Apply appropriate qualitative and quantitative tools with ‘forward looking’ techniques designed for uncertain environments and proactive risk management.
<b>Monitor</b>	
7. Risk Monitoring & Reporting	Driving risk hindsight and foresight – Monitor and report significant risks from operations up to the Board.

# 12. Receiving Assurance

To assist the BoC, the AC and/or the RPC evaluate the adequacy and effectiveness of the company's risk management and internal control system, an assurance framework should be established.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. Are the BoC, the BoD and relevant BoC committees satisfied with management's assurances on the company's risk management and internal control systems?
2. Do the BoC and the BoD receive regular independent assurance on the adequacy and effectiveness of the business risk management framework and controls?
3. Has an assurance map been developed that provides a consolidated view on who provides assurance across the organization's key risks and processes?
4. Does the external auditor test and challenge elements of the financial reporting, disclosure, risk and control environment?
5. Is the BoC, through the AC, satisfied that the internal audit function is operating effectively and efficiently?
6. Is the internal audit plan clearly linked to the up-to-date risk profile?
7. Does the company have an effective and efficient integrated assurance framework – how do risk management activities integrate within the wider system of internal control?
8. Does the governance and assurance framework add value to the organization?

## RED FLAGS

1. A compliance map does not exist to provide a gap analysis on assurance activities
2. The BoC and the BoD do not review the risk profile and internal audit plan on a periodic basis
3. Uncertainty exists over the processes supporting management attestations
4. The internal audit function appears to be under-resourced and not staffed with a team of experienced people who are kept abreast of developments and changes that may impact the internal audit work
5. Internal audit projects are being cancelled or delayed by management
6. Recommendations made by assurance providers are not being tracked and implemented
7. The AC reports to the BoC do not provide an overview of the internal audit work plan
8. There are significant accounting disagreements between management and the external auditor
9. The external auditor is not present when the BoC and the BoD consider the annual financial statements

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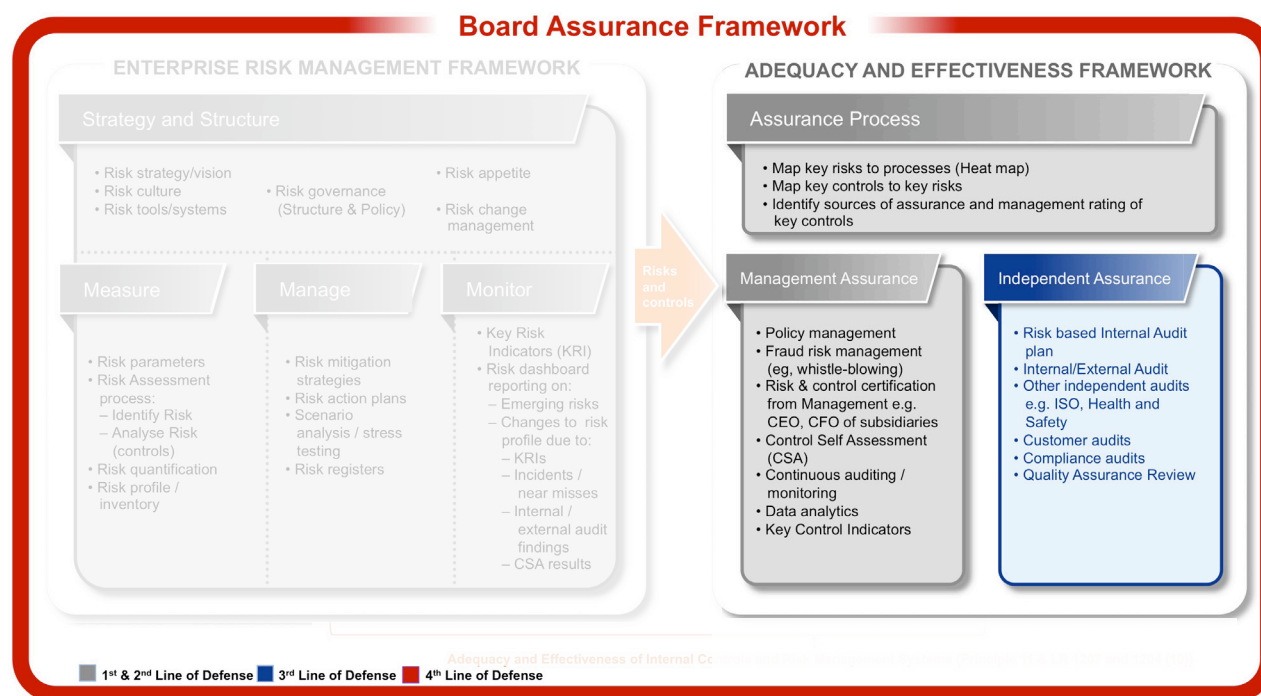
### What is assurance?

Assurance is an assessment process by which one can obtain a level of confidence over the matter at hand. A robust governance framework will allow companies to be more resilient during economic downturns and respond better to changing legislation and regulations.

KPMG's BAF highlights a range of assurance activities that BoC and the BoD could consider in reviewing the existing sources of assurance for their companies. This

is to ensure the sources of assurance provide accurate, complete and timely insights into the adequacy and effectiveness of the risk management and internal control framework.

Companies should adopt a balanced mechanism in obtaining assurance from management, its oversight functions and independent assurance providers as highlighted in KPMG's four lines of defense model. The model can be used to structure roles, responsibilities and accountabilities for decision making across governance, risk management and assurance activities.



Source: KPMG's Board Assurance Framework

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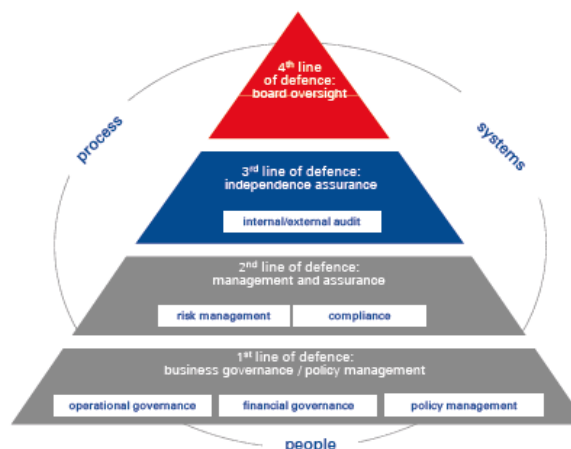
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### Overview – the four lines of defense in the control environment



As seen above, assurance can be received from several functions:

#### 1. First line of defense: business operations – risk and control in the business

The BoC may obtain some level of assurance on the risk and control environment of the company from BoD's attestation. Line management should be adequately skilled to identify risks and conduct risk assessments. The risk profile should be periodically reviewed and updated to reflect the changing business environment and emerging risks.

Continuous monitoring and regular risk reporting will allow the company to timely identify and address risks as they arise, thus conferring strategic advantage and opportunities over competitors.

The attestation can include:

- integrity of the financial reports
- adequacy and effectiveness of risk management and internal control systems covering financial, operational, compliance and information technology risk compliance with company policies and regulatory requirements.

The BoC should review and comment in the Annual Report on the adequacy and effectiveness of the company's risk management and internal control systems, including financial, operational, compliance and information technology controls. In addition, the BoC is required to disclose in the Annual Report whether it has received assurance from the BoD indicating:

- (a) the financial records have been properly maintained and the financial statements give a true and fair view of the company's operations and finances; and
- (b) the effectiveness of the company's risk management and internal control systems.<sup>221</sup>

It is therefore paramount that the President Director and the CFO establish mechanisms to enable them to provide assurance to the BoC to identify significant risks and key controls of financial reporting regarding adequacy and effectiveness of the risk management and internal control system.

Management can use a Control Self-Assessment (CSA) program to assess the control effectiveness and the business processes within the organization. This tool is effective in identifying and assessing risks as well as designing the processes to address the risks, since employees' participation will raise their risk awareness and reinforce their responsibility for a robust control environment. Management should present the results of

<sup>221</sup> CG Code, Part VII, 3.2.e

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the CSA, action plans and progress of implementation to the AC and/or the RPC on a periodic basis.

Internal audit or an external advisor can be engaged to assess the effectiveness of the CSA program and this will also give an independent assessment to the AC and/or the RPC with regards to management's attitude towards risk and control issues.

### 2. Second line of defense: the oversight functions

These are the groups which draft and implement policies and procedures and typically consist of people from the Human Resource, Finance, Quality, Compliance and Risk Management functions. They are responsible for providing direction and guidance in the implementation of policies and procedures. Their oversight of the business processes and risks would cover designing policies, setting direction, introducing leading practices, ensuring compliance and providing assurance oversight to the BoC, the AC and/or the RPC.

### 3. Third line of defense: independent assurance providers

#### *Internal audit*

Issuers and public companies are required to establish an internal audit unit.<sup>222</sup> The unit is led by a Chief of Internal Audit who is appointed and dismissed by the President Director with the BoC's approval.<sup>223</sup> OJK must be notified within 14 days following the appointment, replacement or dismissal of the Chief of Internal Audit.<sup>224</sup>

The internal auditor's role is pivotal in providing an independent appraisal, objective assurance and consulting activities to the BoD or the AC. Its main responsibilities include evaluating internal control systems, assessing risks

and components of risk management, communicating and providing advice to improve the company's operations and systems. The main objective of the internal auditor is to advise management and ensure the company has sound internal control systems to protect the organization against losses. As such, internal audit should be a major source of information to the AC on the company's financial health and overall performance. It is therefore imperative that the AC evaluates and monitors the performance of the internal audit function<sup>225</sup> and that a strong relationship is forged between the two.

The following are some additional duties and responsibilities of the internal audit unit:<sup>226</sup>

- Compiling and performing annual internal audit plans
- Reviewing and evaluating the operation of internal control and risk management in accordance to the company policy
- Performing audits and assessing the efficiency and effectiveness in the areas of finance, accounting, operations, human resource, marketing, information technology and other activities
- Performing compliance audits on related regulations and laws
- Providing objective information and improvement advice regarding audited activities for all levels of management
- Reporting and delivering the audit results to the President Director and Commissioners
- Monitoring, analyzing and reporting the progress of recommended actions

<sup>222</sup> Bapepam Regulation IX.1.7, Article 2

<sup>223</sup> Bapepam Regulation IX.1.7, Article 6

<sup>224</sup> Bapepam Regulation IX.1.7, Article 10

<sup>225</sup> CG Manual on AC, Part 6.b.VII

<sup>226</sup> Bapepam Regulation IX.1.7, Article 8

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- Cooperating with the AC
- Developing a program to evaluate the quality of its internal audit
- Performing special audits if necessary.

The AC's role relating to internal audit includes:<sup>227</sup>

- Providing recommendations regarding the appointment or dismissal of the Chief of Internal Audit to the President Director
- Approving the overall charter of the internal audit function, which includes its role and scope of work, responsibility and accountability, objectivity and independence, operating principles, reporting and quality of service
- Reviewing the structure of the internal audit function
- Evaluating the internal audit's annual plan
- Ensuring that the internal audit function is adequately equipped and resourced to fulfill its charter and annual plan
- Reviewing internal audit reports
- Monitoring the performance of the internal audit function
- Ensuring that the internal audit function fulfills relevant professional standards.

#### *External audit*

The external auditor, having knowledge of the company's financial affairs, is also in a position to provide the BoC assurance through the AC on the effectiveness of the entity's financial reporting and legislative compliance frameworks.

<sup>227</sup> CG Manual on AC, Part 6.a

<sup>228</sup> Law 40/2007, Article 68 (1)

The primary objective of external audit is to add credibility to the company's financial statements. Shareholders rely on the external auditor to express an independent opinion on whether the company's financial statements are reliable. The BoD of an issuer or public company is required to submit an Annual Report of the company, which includes the company's financial statements audited by an external auditor before it can be ratified by the GMS.<sup>228</sup> The external auditor also assesses the internal control environment over financial reporting.

The AC typically meets with the external auditor throughout the year. Some of the key functions performed by the AC in assisting the BoC in its oversight of the external auditor include:<sup>229</sup>

- Recommending to the BoC the selection, appointment, rotation and removal (if necessary) of the external auditor
- Reviewing and approving the terms of engagement and the reasonableness of audit fees prior to the commencement of the audit
- Reviewing the scope, plan and results of the external audit
- Monitoring the performance of the external auditor
- Ensuring that the service provided by the external auditor is compliant with the professional standards, particularly in regards to independence.

#### *Other assurance providers*

Management may seek other assurance service providers depending on the nature of the company's business operations. This may include quality control, clinical, training, safety and regulatory compliance audits.

<sup>229</sup> CG Manual on AC, Part 6.a

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The BoC and the BoD can put in place an overarching view of who provides assurances across the organization's key risks. An assurance map can be used as a tool to outline the key business processes and risks and related assurances aimed at providing the BoC, the BoD, the AC and/or the RPC confidence that:

- There is a consistent, common and shared view on the level of appropriate assurances required for each risk
- There are no gaps in the level of expected assurances and no duplication of assurances
- Internal and external audits are planned and aligned with the risk management framework
- There is accountability by management and/or external assurance providers
- Relevant parties are receiving assurance reports.

A formal escalation process should be established and the BoC and the BoD should be kept informed of all pertinent findings or issues arising from the assurance activities.





# 13. Reporting and Disclosures

A critical component of good CG is providing accurate, timely, complete and relevant information to key stakeholders such as regulators, investors and other key stakeholders.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

- |   |   |
|---|---|
| <ol style="list-style-type: none"> <li>1. Are all members of the BoC and the BoD aware of their reporting duties and obligations?</li> <li>2. Do BoC and BoD members receive accurate, timely, complete and relevant information to support decision-making and satisfy reporting obligations?</li> </ol> | <ol style="list-style-type: none"> <li>3. Have the BoC and the BoD established a process to review and receive feedback on the type and quality of information/reports received?</li> <li>4. How does the company reporting and disclosures compare to competitors/other leading relevant companies?</li> </ol> |
|---|---|

## RED FLAGS

- |   |  |
|---|--|
| <ol style="list-style-type: none"> <li>1. Mandatory company reports/filings are submitted late or not submitted</li> <li>2. Key reports to the BoC and the BoD regularly contain errors</li> <li>3. BoC and BoD regularly request additional information/ supporting documents</li> </ol> | <ol style="list-style-type: none"> <li>4. Financial statements have not been audited recently</li> <li>5. Stakeholders regularly provide feedback that the company does not provide open and transparent information on key matters</li> </ol> |
|---|--|

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### Statutory reporting obligations

Shareholder and investor communications start with statutory reporting. For listed companies, statutory reporting is based on:

- The Limited Liability Company Law
- IDX LR
- OJK Regulations
- Indonesia's CG Code (non-statutory).

The key elements of the statutory reporting portfolio for issuers and public companies include:

- Annual Report
- Annual audited financial statements
- Notices for AGMS
- Additional disclosure requirements.

While it is common practice for the BoC to allocate the oversight of statutory reporting to its AC, or equivalent, it is unable to abrogate its ultimate responsibility for the accurate and thorough preparation and timely release of statutory reports. Consequently, all Commissioners need to understand, not only the content of the reports, but what reports are required and by which authorities.

The BoD needs to exercise appropriate due diligence in matters of financial disclosures. Inaccurate and false statements could leave Directors personally liable under the Limited Liability Company Law.<sup>230</sup>

The BoC and the BoD should also insist that effective systems are in place to ensure that all formal shareholder and investor communications (including financial reports):

- Result from a designated review and approval process
- Include all the information required by the relevant laws and standards
- Adhere to statutory timing requirements
- Follow the format prescribed by the relevant laws and standards
- Produce information that is accurate and not misleading.

Some companies may also have reporting requirements to overseas regulators. For example, the US SEC requires foreign registrants to file a number of reports and documents, including the *comprehensive Form 20-F Annual Report of a Foreign Private Issuer*.

### Annual Report

Issuers and public companies are required by law to submit Annual Reports to the OJK, which must be made available to shareholders and the public at the company's website.<sup>231</sup> The Annual Report must be submitted to the GMS no later than six months following the end of a company's accounting year.<sup>232</sup> The Annual Report must contain the following information:<sup>233</sup>

- Summary of financial highlights
- Report of the BoC
- Report of the BoD
- Company profile
- Management analysis and discussion
- CG Implementation

<sup>230</sup> Law 40/2007, Article 69 (3)

<sup>231</sup> Bapepam Regulation X.K.6, Article 1.a, 1.d, 1.f

<sup>232</sup> Law 40/2007, Article 66 (1)

<sup>233</sup> Bapepam Regulation X.K.6, Article 2.a.1

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- Corporate social responsibility
- Audited financial statements, including statements of financial position, comprehensive income, changes in equity and cash flows and explanatory notes<sup>234</sup>
- Statement of responsibility by the BoC and the BoD certifying the integrity of the Annual Report.

Increasingly, companies are choosing to include additional material in their Annual Reports. Emerging areas of optional reporting include sustainability, which is being used to not only satisfy stakeholder demands for extra information, but as a proactive step in the stakeholder management process.

#### BoC Report

The Commissioners must prepare a BoC Report as part of the Annual Report, which includes the following:<sup>235</sup>

- Evaluation of the BoD's performance in managing the company
- Opinion on the company's business prospects included in the BoD Report
- Changes in the membership of the BoC with accompanying reasons (if any).

#### BoD Report

Directors must prepare a BoD Report as part of the Annual Report, which includes the following:<sup>236</sup>

- The company's performance, including strategic policy, difference between target and actual results and challenges faced by the company
- The company's business prospects
- Implementation of the CG code

- Changes in the membership of the BoD with accompanying reasons (if any).

#### Corporate Governance

Issuers and public companies must provide information on their CG status at the annual GMS and in their Annual Reports. Such information must at least consist of:<sup>237</sup>

- Members and structures of the BoC and the BoD
- Activities of the BoC and the BoD
- Activities of Independent Commissioners
- Activities of BoC committees
- Disclosure of tasks and functions of the Corporate Secretary
- Disclosure of tasks and functions of internal audit
- Information about ownership of company's shares by Commissioners and Directors.

#### Major share ownership

Commissioners, Directors and owners of at least 5% of outstanding shares of issuers and public companies are required to report to OJK regarding their share ownership and changes in ownership within ten days of such transactions.<sup>238</sup> The report contains the following information:<sup>239</sup>

- Name, address, and citizenship
- The amount of shares that were purchased/sold
- The price of shares that were purchased/sold
- Transaction date
- Purpose of transaction.

<sup>234</sup> Bapepam Regulation X.K.2, Article 1.c

<sup>235</sup> Bapepam Regulation X.K.6, Article 2.c

<sup>236</sup> Bapepam Regulation X.K.6, Article 2.d

<sup>237</sup> Bapepam Regulation X.K.6, Article 2.g

<sup>238</sup> Bapepam Regulation X.M.1, Article 1 and 2

<sup>239</sup> Bapepam Regulation X.M.1, Article 3

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### Periodic financial statements

Issuers and public companies are required to submit periodic financial statements to OJK, which include annual and semi-annual financial statements. These financial statements must be presented in Bahasa Indonesia and prepared in accordance with Indonesian generally accepted accounting principles.<sup>240</sup>

Requirements for the annual financial statements:<sup>241</sup>

- The annual financial statements must be accompanied by an auditor's report with an opinion and be submitted to OJK no later than the last day of the third month after the Annual Report date
- The annual financial statements must be published in at least two Indonesian newspapers, one of which has a nation-wide circulation, and be made available at the company's domicile no later than the last day of the third month after the Annual Report date.

Requirements for the semi-annual financial statements:<sup>242</sup>

- The semi-annual financial statements must be submitted to OJK no later than the last day of the first month after the semi-Annual Report date if they are unaudited, no later than the last day of the second month after the semi-Annual Report date if they accompanied by an auditor's limited review report and no later than the last day of the third month after the semi-Annual Report date if they are audited and accompanied by the auditor's opinion
- The semi-annual financial statements must be published in at least one Indonesian newspaper with a nationwide circulation.

### Auditor's Report

An auditor must report to members on whether the auditor is of the opinion that the financial statements are in compliance with Indonesian accounting standards and that the report provides a true and fair view of the financial position and performance for the financial year.

The Auditor's Report must also describe any defects or irregularities in the financial statements and any deficiencies, failures or shortcomings relating to:

- Obtaining all information, explanations and assistance necessary for the conduct of the audit
- Keeping sufficient financial records to enable financial statements to be prepared and audited
- Keeping other records and registers required by law.

### Other disclosures in the Annual Report

In addition to required statutory disclosures, many companies include additional information in their Annual Reports, such as overviews of business strategies, key drivers and non-financial performance and activities, conveying these areas using charts, artwork and photographs. They might also, for example, use the Annual Report to indicate their environmental achievements and compliance record and to report on various communities, social and 'corporate citizenship' initiatives.

In approving the content and format of Annual Reports, the BoC and the BoD should keep in mind the following points:

<sup>240</sup> Bapepam Regulation X.K.2, Article 1

<sup>241</sup> Bapepam Regulation X.K.2, Article 2

<sup>242</sup> Bapepam Regulation X.K.2, Article 3

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- As far as Commissioners and Directors are concerned, the annual financial reporting parts of Annual Reports are legal documents – compliance with the legal requirements remains a key consideration for any BoC and BoD
- Awareness of Annual Reporting ‘best practices’ for the nature and extent of disclosures and presentation of information
- Good reports usually incorporate a straightforward, logical and accurate account of the company’s performance, together with a simple explanation of how the company intends to tackle the opportunities and problems confronting it
- Whether it is more suitable to make the Annual Report readily available online or to distribute hard copies to shareholders.

### Continuous disclosure obligations

The Capital Market Law requires issuers and public companies to publish periodic reports on their business information and financial status, submit such reports to the OJK and make them available to the public. These companies are also required to keep their shareholders and the OJK informed of any material information<sup>243</sup> regarding events that may affect the price of securities within two working days following such events, such as:<sup>244</sup>

- A merger, acquisition, consolidation or establishment of a joint venture
- A stock split or distribution of stock dividends
- An unusual dividend
- An acquisition or loss of an important contract

<sup>243</sup> *Material information includes any important and relevant facts concerning events, incidents, or data that may affect the price of a security on an exchange or that may influence the decisions of investors, prospective investors, others that have an interest in such information (Law 8/1995, Article 1 (7)).*

- A significant new product or innovation
- A change in control or significant change in management
- A call for the purchase or redemption of debt securities
- A sale of a material amount of securities to the public or in a limited manner
- A purchase, or loss from the sale, of a material asset
- A relatively important labor dispute
- Any important litigation against the company and/or the company’s Directors or Commissioners
- An offer to purchase securities of another company
- The replacement of the auditor who audited the company
- The replacement of the company’s Trust Agent
- A change in the company’s fiscal year.

### Trade Related Aspects of Intellectual Property Rights

As one of the countries that have ratified the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement, Indonesia is obliged to implement its provisions, especially related to protection of business secrets. All persons can prevent such information, lawfully in their control, from being disclosed to, acquired by or used by others, without their consent, so long as such information:<sup>245</sup>

- (a) is secret, in the sense that it is not generally known among or readily accessible to other persons;
- (b) has commercial value because it is secret; and

<sup>244</sup> *Law 8/1995, Article 86 (1); Bapepam Regulation X.K.1, Article 2*  
<sup>245</sup> *Agreement on Trade-Related Aspects of Intellectual Property Rights, Part III, Section 7, Article 39*

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(c) has been subject to reasonable steps taken by the person lawfully in control of the information to be kept secret.

### Audit Committee

The BoC and the BoD should ensure that the internal governance systems include adequate involvement of the external auditor, internal audit and the AC. The AC should review all significant financial disclosures before sign-off by the BoC.

The AC typically focuses on a range of key issues for statutory reporting purposes. It should review:

- Any significant accounting and reporting issues, including professional and regulatory announcements, and understand their effect on the company's financial statements
- All quarterly, semi-annual and full year result announcements and the annual financial statements of the company, as well as any other periodic disclosures that require approval of the Board. The process typically results in a detailed page-by-page review by the AC of these reports with the external auditor and management present
- The assurance provided by the President Director and CFO
- The processes, policies and procedures for compliance with the company's continuous disclosure obligations
- All related party transactions for potential conflicts of interest, providing approvals on an ongoing basis.

### Sustainability reporting

Sustainability reporting is not a mandatory requirement for Indonesian listed companies. Globally, there is increased interest in sustainability issues, including the economic, environmental and social impact a company has on its community. Assurance from a sustainability report increases stakeholders' confidence in the accuracy and completeness of the information, as well as adds credibility to the report. It is also an important feedback mechanism for listed companies in improving the quality of their sustainability reports.

Sustainability reporting complements financial disclosures to give a comprehensive account of how the company has performed. Companies should provide a balanced and objective view of their performances by including both positive and negative impacts. Refer to Chapter 15.

### Investor decision-making

If companies are to maximize returns to their shareholders, they must not only create value, but be seen as providing prospects for value creation in the future. This is essentially a matter of communicating with shareholders, potential shareholders and third parties in a position to influence investors' share buying, retention and selling decisions.

Regular and effective reporting and communications between the company and these parties influence the decision-making of shareholders and potential investors.

It is, however, widely acknowledged that traditional information flows (e.g. general purpose statutory financial

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reporting) and engagement practices (e.g. GMS) do not typically address the broad range of issues of concern to individuals and entities seeking to make timely, accurate and precise decisions on their investments, or potential investments, in the company. Therefore, companies need to address the limitations of traditional reporting to fulfill their intended purpose and seek ways to better inform investors.

A new model of business reporting and communication that creates reports based on what the company wants to communicate – and on what investors want and need to know – can ensure that shareholders will make the right decisions, at the right time, about the things that matter to the company. Reporting and communication strategies should be directed to balancing the performance/reward equation and aligning business rewards – capital, licenses to operate and reputation – with company performance.

Integrated reporting of this kind articulates the:

- Business strategy
- Performance in executing the strategy
- Insights about the drivers of and risks threatening the successful execution of the strategy
- Outlook for future performance if the strategy is well executed.

This model implies specific reporting on performance drivers, such as infrastructure, people, business processes, strategic management, risk management and governance performance and the dynamic interplay between all of these factors.

Through integrated reporting, shareholders can gain an appreciation of the strength of the business model in terms of its:

- Velocity (speed of business processes)
- Versatility (flexibility and agility in the face of changing external forces and market conditions)
- Vulnerability (to shocks from business risks)
- Volatility (consistency of business processes in the face of change).

Reporting and communication must be underpinned by rigorous business modeling and measurement methodologies to support clear and precise reporting of the business strategy and model in a form that can be easily understood and acted upon by key shareholders and investors.

Business reporting and communication methodologies and tools help organizations decide what to report, in what format, to whom and when. Among other things, the process requires a filtering mechanism centered on balancing the measurement power of particular Key Performance indicators (KPI), including those relating to risk management (an information supply perspective), and how and when key shareholders and investors can and should build strategy, performance insights, and outlook into their decision-making models (an information demand perspective).

### The BoC's role in business reporting

Business reporting should accurately reflect and communicate the real corporate picture. The BoC is in a unique position to step back from the day-to-day perspective of management and view the organization from all perspectives. It should be able to assist in improving the quality of reporting by identifying any major gaps between what is being reported to shareholders and

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investors by the BoD and what should be reported, having regard for stakeholder needs, concerns, influences and decision-making behavior.

The following factors should be considered, which may impact the extent of disclosure:

- The risk of litigation if forward-looking statements are not met
- The release of competitively sensitive information
- Information that may be subject to rapid change or volatility
- A lack of willingness on the part of competitors and industry participants to be more forthcoming with voluntary disclosures
- No agreed industry reporting standards
- Concern that capital markets will not digest/synthesize the extra information
- Markets being only interested in short-term performance.

There are a number of ways to improve business reporting, including:

- Encouraging more direct involvement by the BoC in shaping reporting and disclosures
- Aligning internal and external reporting (statutory reporting, results announcements, investor presentations, corporate social responsibility reporting and other reporting such as pro-forma/non-GAAP earnings guidance, production reports or balanced scorecards looking at the performance of non-financial KPIs)

- Improving consistency and clarity in the company's messages (strategic goals/objectives) and the linkages between financial and non-financial reporting
- Streamlining reporting and creating a balanced portfolio of reports
- Educating shareholders on the implications and value of reporting changes
- Using technology for reporting automation and diffusion (e.g. XBRL, web-based and real-time reporting, enterprise and data modeling).

### Company's website

Websites of issuers and public companies should contain the following information at a minimum:<sup>246</sup>

- The company's general information
- Information for shareholders/investors
- Information on the company's CG implementation
- Information on the company's corporate social responsibility.



<sup>246</sup> No.8/POJK.04/2015, Article 6



# 14. Other Governance Requirements

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The number of regulatory requirements for many geographies and industry segments means that companies are increasingly taking an integrated approach, rather than reacting to a specific regulation in isolation.

### QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. In which markets is the company listed? What regulations must you follow in those markets?
2. Is there potential for the company to improve investor confidence by meeting stricter CG standards of markets it is not listed in?
3. What are current shareholders expectations of CG?
4. Who is in charge of making sure CG standards are met?
5. Is the company in a position where it will be able to meet increasingly strict standards?
6. Is management kept abreast of changes in CG standards?
7. Is management aware of the CG expectations of some of the larger institutional investors?
8. Is management aware of the diversity of CG standards across different jurisdictions?

### RED FLAGS

1. The company is a dual-listed or multi-listed, but only follows the governance code of its primary listing location
2. No member of the BoC and the BoD is accountable for keeping up to date with CG requirements and legislation
3. CG rarely appears on BoC/BoD meeting agendas
4. The company's Annual Report does not include all disclosures required by CG principles
5. Commissioners and Directors are unfamiliar with CG and risk management best practice standards

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Companies face an expensive and confusing regulatory landscape with changing laws and tougher enforcement. Given the number and mandates of regulators, it is no longer enough to adopt a reactive, episodic approach to compliance.

### Governance and regulation around the world

The first code of good governance was established in the US in the late 1970s, however, it was not until the UK's 1992 Cadbury Report and introduction of the Organization for Economic Co-operation and Development (OECD) Principle that codes of good governance began to proliferate. Governance codes that followed included South Africa's King Report in 1994, the U.S. CalPERS Principles in 1998, the Singapore Exchange CG code in 2001 and Indonesian CG Code in 1999. The OECD

Principles are currently under revision. More recently, better practice recommendations have been incorporated into the listing rules of stock exchanges around the world, including in Australia, Toronto, New York, London and Singapore. Multi-lateral organizations, such as the OECD, the International Monetary Fund (IMF), the World Bank and the ICGN are leading the charge for global standards of good governance.

This section references some key principles and governance codes for awareness from other jurisdictions.

### Organization for Economic Cooperation and Development

The OECD Principles have been described as an international benchmark for CG, a summary of which is included in this toolkit. The entire OECD Principles of CG can be found at

<http://www.oecd.org/dataoecd/32/18/31557724.pdf>

#### SUMMARY OF OECD PRINCIPLES

##### Ensuring the basis for an effective corporate governance framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

##### The rights of shareholders and key ownership functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

##### The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

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### SUMMARY OF OECD PRINCIPLES

#### The role of stakeholders in corporate governance

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises.

#### Disclosure and transparency

The CG framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.

#### The responsibilities of the Board

The CG framework should ensure the strategic guidance of the company, the effective monitoring of management by the Board and the Board's accountability to the company and the shareholders.

### Australia

*The Australian Securities Exchange (ASX) CG Principles and Recommendations*

The ASX CG Council's CG Principles and Recommendations (ASX Principles) provide a set of CG guidelines for ASX listed entities, which are designed to promote investor confidence and to assist listed entities to meet stakeholder expectations. The ASX Listing Rules require listed entities to report against the Council's recommendations and, where they do not conform, to disclose that fact and the reasons why.

The ASX CG Council revised the ASX Principles which were released in March 2014.

### United Kingdom (UK)

*The UK CG Code*

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.

The FRC suggests that the UK's principles-based system of business regulation reduces the cost to global businesses of introducing procedures to comply with detailed regulations, many of which unnecessarily constrain business practice and innovation.

In that regard, the FRC has developed and reviews the CG Code. The FRC notes that while it is expected that listed companies will apply the code's provision most of the time, it is recognized that departure from the provisions of the code may be justified in particular circumstances. Every company must review each provision carefully and give a considered explanation if it departs from the code provisions. The code was last revised in September 2014.

### United States (US)

*US Securities and Exchange Commission (SEC)*

The SEC regulates the US securities industry and enforces US federal securities laws. The SEC describes its mission as:

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“... to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation...”

The laws and rules that govern the securities industry in the US derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it...”

<http://www.sec.gov/about/whatwedo.shtml>

For more information about the SEC visit <http://www.sec.gov/>

#### *Sarbanes-Oxley Act*

The introduction of the Sarbanes Oxley Act (SOX) of 2002 in the US was a direct result of a number of major corporate collapses in late 2001. With the credibility of financial reporting falling sharply, the US Congress responded with what George W. Bush described as, “The most far reaching reform of American business practices since the time of Franklin Delano Roosevelt.”

As a result of the introduction of SOX compliance, management is now required to both assess and report on the effectiveness of Internal Control over Financial Reporting (ICFR). As a result, auditors evaluate and test a company’s internal control in a different light and in greater depth. The overall goal of SOX compliance is to strengthen ICFR, provide more reliable information to investors and renew investor confidence in the US capital markets.

For more information on Sarbanes-Oxley visit <http://www.sec.gov/spotlight/sarbanes-oxley.htm>

#### *Dodd-Frank Wall Street Reform and Consumer Protection Act*

Following the global recession of the late 2000’s the Dodd-Frank Act was introduced in the US to increase consumer protection, reduce or even eliminate ‘too big to fail’ corporate bailouts and increase the transparency of credit rating agencies and exotic financial instruments, along with many other changes. The Act has been described as, “A rewrite of rules touching every corner of finance... the biggest expansion of government power over banking and markets since the Depression.”

“Among other things, the SEC will require disclosure of any links, between executive compensation actually paid and the company’s financial performance, taking into account any change in the value of the company’s shares and dividends and any distributions.” Chairman Sullivan and Cromwell, H.Rodgin Cohen

Shareholders are also asked to approve compensation of executive officers every one, two or three years. For more information on the changes being implemented by the Dodd-Frank act see <http://www.sec.gov/spotlight/dodd-frank.shtml>

## Asia

#### *People’s Republic of China*

The China Securities Regulatory Commission and the State Economic and Trade Commission issued the Code of CG for Listed Companies in China in 2002. The preface to the code states that it, ‘... is formulated to promote the establishment and improvement of a modern enterprise

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system by listed companies, to standardize the operation of listed companies and to bring forward the healthy development of the securities market of our country.' The code is applicable to all listed companies within the boundary of the People's Republic of China; and is used as a benchmark to assess whether a listed entity has a satisfactory governance structure.

### *India*

The Securities and Exchange Board of India (SEBI) published a report on CG in 2003 from the Narayan Murthy Committee evaluating the adequacy of existing CG practices. In 2004 SEBI published a revised Clause 49 of the Listing Agreement relating to CG, including changes to the composition of a Board's minimum numbers of independent Directors, requirements for the Board to establish and maintain internal controls and take action where they are deficient and mandates for the composition of an AC.

In addition, the Indian Companies Act was revised (effective from 1 October 2014) to include a number of CG requirements.

For more information visit  
<http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf>

### *Japan*

'J-SOX' is an unofficial term for the Financial Instruments and Exchange Act that refers to Japanese requirements similar to the US Sarbanes-Oxley Act, Section 302 (management certification) and Section 404 (management evaluation and report on internal controls). J-SOX requires management of all public company listed on stock exchanges in Japan to conduct an assessment

and reporting of ICFR on a consolidated basis. As such, overseas subsidiaries and affiliates also fall within the scope of this assessment and reporting.

On 5 March 2015, Japan's Financial Services Agency released a CG Code that is based on the OECD Principles of CG and incorporates the 'comply or explain' principle. The Code was effective June 2015 and is applicable to all listed companies.

### *Singapore*

*The Singapore Exchange Limited (SGX) CG Principles and Recommendations*

The SGX CG Council's CG Principles and Recommendations (SGX Principles) provides a set of CG guidelines for SGX listed entities, which are designed to promote investor confidence and to assist listed entities to meet stakeholder expectations. The SGX Listing Rules require listed entities to report against the Council's recommendations and, where they do not conform, to disclose that fact and the reasons why.

The SGX CG Council revised the SGX Principles which were released on 1 May 2012.

### *South Korea*

Code of Best Practices for CG was first published in 1999 and made a significant contribution to enhancing governance of listed corporations. In 2002, there was a review of the code and in early 2003 a revised code was accepted. While CG in Korea has improved over the last decade, attributable largely to an increase in outside ownership and strengthened minority shareholder rights, many still have reservations about the quality of CG in South Korea. The Korea Economic Institute attributes at

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least part of Korea's relatively low level of investment, poor price-to-earnings ratios and low production growth to a lack of high quality CG.

For more information visit <http://www.keia.org/publication/progress-corporate-governance>.

### Industry standards

To be able to effectively exercise their duties, Commissioners and Directors must have an understanding of the company's business and the industry in which it operates, including a general awareness of any applicable industry standards or codes.

A high-level summary providing an example of these standards is included below:

#### ISO 9000 and 9001

ISO 9000 is a set of quality management standards that provide a framework for processes and systems required for organizations to meet the needs of customers and other stakeholders. The standards are published by the International Organization for Standardization. ISO 9000 deals with the fundamentals of quality management systems, while ISO 9001 deals with the requirements that organizations wishing to meet the standards have to fulfill.

There is widespread use of these standards across many Indonesian companies and industry segments.

#### Social Welfare

Effective 1 January 2014, Indonesia implemented a universal social security system. The system is intended to cover all Indonesian citizens and residents (including foreign residents) under a single health care system

by 2019 and a single employment benefit system by 2029. BPJS Health Care (BPJS **Kesehatan**) administers health care benefits, and BPJS Employment (BPJS **Ketenagakerjaan**) administers employment benefits, which include old-age pension, workplace accident and death benefits.

#### Health

In 2014, the Indonesian government launched a compulsory national health insurance system with the aim of providing universal healthcare by 2019. The national health insurance scheme, *Jaminan Kesehatan Nasional* (JKN), was implemented by the newly-formed social security agency *Badan Penyelenggara Jaminan Sosial Kesehatan* (BPJS **Kesehatan**). All citizens are able to access services provided by public health facilities and some private organizations that have opted to join the new scheme as providers.



# 15. Stakeholder Engagement

Evolving community expectations of the corporate sector are resulting in effective stakeholder engagement emerging as a critical success factor for the long-term sustainability of operations.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. Do the BoC and the BoD know who their key stakeholders are?
2. Have stakeholders with the ability to affect strategic and business objectives been engaged effectively?
3. Have the risks of not engaging key stakeholders (financial and reputational) been considered and, if applicable, quantified?
4. Is stakeholder engagement embedded into the company's vision, mission and strategy statements?
5. Does the company have a stakeholder engagement framework aligned with best practices?
6. Are the BoC and the BoD seeking and maintaining relationships with their key stakeholders at the leadership level?
7. Has the company considered making a public disclosure about stakeholder management and corporate social responsibility?
8. Is effective stakeholder management used as a strategic, preventive mechanism, rather than a responsive tool?

## RED FLAGS

1. The company maintains no stakeholder mapping, tiering or profiling information
2. Stakeholders are defined narrowly as clients and customers
3. In most decisions, stakeholders are not considered or consulted
4. The risk of not engaging stakeholders is not discussed or is often dismissed quickly by some members of the BoC/ BoD
5. Dialogue with stakeholders mostly occurs in the event of disputes and negative media coverage
6. Online coverage of the company is mostly negative

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The BoC and the BoD's role is to ensure that obligations to shareholders and other stakeholders are understood and met.

Stakeholder engagement is the process of identifying and involving the key groups of people and organizations who are affected by, or have the capacity to influence, the company's activities and operations.

Ordinarily, a BoC/BoD's direct involvement with its key stakeholder groups may be limited to the President Commissioner, President Director or the respective chairman of the AC or the Environmental Committee, where the latter exists. In extraordinary circumstances (e.g. crisis mode) the BoC may become involved in engagement activities and communication.

However, the BoD is increasingly turning to Commissioners to tap into expertise and relationships to facilitate engagement, advocacy and lobbying with key stakeholders. Commissioners and Directors who possess 'change agent' competencies can be influential in championing particular courses of action. Although there is no legal standard or requirement for formal stakeholder engagement, most Commissioners now consider that their BoDs could, and should, be much more effective in their understanding and oversight of key stakeholder engagement strategies.

### Why focus on engaging stakeholders

Companies exist within an environment where there is increasing scrutiny over the sustainability and integrity of their operations. In the same way as companies perceived as acting in a detrimental fashion can suffer losses, companies that collaborate with and mobilize their

stakeholder base are able to present a positive public image and reap the rewards of the reputational and financial benefits that follow.

Other than reputational and public perception implications, for some companies certain revenue (i.e. government contracts) can be dependent on the fulfillment of sustainability, community relations and other stakeholder engagement criteria. For such arrangements, effective stakeholder engagement processes are essential in providing companies with the ability to compete with their industry rivals.

### Establishing an effective shareholder engagement framework

In establishing a stakeholder management function, companies are increasingly formalizing the arrangements and processes, including developing stakeholder engagement plans.

Common themes of sound stakeholder engagement frameworks include:

- Stakeholder maps and tiering
- Responsibilities for developing relationships with agreed accountabilities (BoC and BoD)
- Defined methods for gathering information on stakeholders (i.e. surveys, research, etc.)
- Methods and accountabilities for monitoring stakeholder concerns, influences and sensitivities
- Established positions on relevant public or industry-specific policies
- A variety of methods of communication, including forums, meetings, site visits, etc.



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The AA1000 Stakeholder Engagement Standard (AA1000SES) provides an internationally recognized framework to help organizations ensure stakeholder engagement processes are purpose driven, robust and deliver results, and form a basis for designing and implementing effective stakeholder engagement in a credible way.<sup>247</sup>

### Stakeholder engagement beyond the customer base

Stakeholders in companies can include (but are not limited to):

- Regulators and government
- Employees and unions
- Customers and suppliers
- Local communities and environmental advocacy groups
- Lobby groups and representational bodies.

The concerns of these stakeholders are not just financial; they span the so-called 'triple bottom line' of financial, social and environmental objectives.

### Stakeholder engagement at a BoC/BoD level

Companies with effective stakeholder engagement possess a common theme of a strong 'tone at the top'. The BoD is responsible for setting the general policies and direction of the organization. It shapes the organization's framework for accountability and it should lead by example in fostering an outward looking approach by collaborating with stakeholders, ensuring mutual benefits from business dealings and acting with integrity.

At a BoC/BoD level, stakeholder engagement should be defined as a core organizational value. Commissioners and Directors should identify the key risks associated with evolving societal expectations and set expectations with their executive management group around effectively engaging the stakeholder base. Further, members of the BoC and the BoD should also consider their own interface with their stakeholders, bringing the integration of stakeholder issues into the GMS, public reporting and invitations for senior stakeholders to periodically address BoC/BoD meetings.

### Reputational advantages of effective stakeholder management

*"It takes 20 years to build a reputation and 5 minutes to ruin it." Warren Buffet*

A good corporate reputation is a prized asset that is earned over time. It can be a source of competitive advantage, influencing the level of engagement with the company by employees, customers, suppliers and other stakeholders. By way of contrast, failure to manage reputation can have a deleterious and prolonged effect on a business. Reputational damage affects Commissioners' and Directors' personal reputations, employee morale, investor confidence and company performance. Reputation risk has been identified as one of the most important risks a company faces. Loss of reputation is usually the result of poor risk management processes across all risk areas, including compliance, finance, environmental considerations and operations. A robust and systematic enterprise-wide risk management strategy is essential to maintain a company's reputation.

<sup>247</sup> For further information please refer to AA1000 Stakeholder Engagement Standard [http://www.accountability.org/images/content/3/6/362/AA1000\\_SES%202010%20PRI\\_NT.pdf](http://www.accountability.org/images/content/3/6/362/AA1000_SES%202010%20PRI_NT.pdf)

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In turn, a company's reputation is directly linked to the BoC and the BoD's role in both strategy and risk. Their starting point in developing a positive corporate reputation is the right 'tone at the top', fostering appropriate organizational values that drive organizational culture. A reputation management system, underpinned by straightforward and open communications, protects this intangible, but vital asset. Some companies are going further, defining and measuring their reputation and benchmarking it against other participants in the market.

Despite the best risk mitigation program, when things go wrong, a period of reputational volatility can ensue. Reputation is affected by the way an accident/incident is managed and/or the company's ability to react to and handle such a crisis. The company needs to prepare itself for such potential catastrophes. The media is a critical influencer of public opinion, especially in a crisis.

### Increasing trend of sustainability reporting

The business biosphere, for many companies, is no longer about reaching the bare minimum in adhering to laws and regulations, as there is an emphatic shift in achieving and exceeding stakeholder expectations. To put this into perspective, 95% of the 250 world's largest companies publish sustainability reports.<sup>248</sup>

In Indonesia, sustainability reporting remains voluntary – there is no legislative requirement for companies to publish such reports, although some companies may, for example, be required to prepare specific environmental reports to achieve compliance with particular legislation. Better practice recommends all listed companies to consider sustainability reporting as an integral part of good CG. Sustainability reporting is particularly relevant for listed companies which:

- Operate in industries that are susceptible to environmental and social risks

- Operate in industries that produce significant environmental pollutants
- Are heavy users of natural resources
- Are part of a supply chain where end customers demand that suppliers and contractors behave responsibly.

Specifically, listed companies which are operating in the industries that are extremely sensitive to environmental and social issues should set the tone and undertake sustainability reporting:<sup>249</sup>

- Agriculture
- Air transportation
- Chemicals and pharmaceuticals
- Construction
- Food and beverages
- Forestry and paper
- Mining and metals
- Oil and gas
- Shipping
- Water.

Companies should understand and respond to key trends and developments that affect sustainability reporting, including:

- Developing more concise sustainability reports
- Expanding reporting boundaries to include value chain considerations and spheres of influence
- Developing innovative reporting strategies that are more responsive to stakeholder needs
- Placing an increased focus on communicating sustainability opportunities that a company may seek to explore.

<sup>248</sup> KPMG International Survey of Corporate Responsibility Reporting, 2011.

<sup>249</sup> Guide to Sustainability Reporting for Listed Companies, 2011, Singapore Exchange

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## Components of an effective sustainability response

The relative importance of particular sustainability-related risks and opportunities varies significantly between industry sectors and between companies within particular sectors. However, there is commonality in the key components of what may be described as an 'effective sustainability response'.

These components are primarily concerned with the management team's ability to:

- Understand broad sustainability-related concepts and issues, particularly those of potential relevance to their industry sector/company
- Establish effective stakeholder engagement processes
- Identify and appropriately prioritize sustainability-related risks and opportunities (often using a documented framework that seeks to consider the relative materiality of particular issues)
- Develop an appropriate sustainability strategy (and associated vision/objectives)
- Communicate the developed sustainability strategy
- Execute the agreed strategy and integrate this within mainstream business activities
- Establish appropriate performance indicators and track progress (performance against target)

- Distribute sustainability performance information to key stakeholder groups (e.g. through a formalized sustainability report)
- Establish feedback/review mechanisms to monitor the effectiveness of sustainability-related activities and modify the underlying strategy in light of this feedback.

## The emergence of 'tax morality'

Managing tax risk is becoming an increasingly important challenge. Companies are realizing that tax requires strategic direction at the BoC and the BoD level. An effective response to the changing world of tax can bring significant financial benefits through the optimization of the organization's effective tax rate.

Fundamentally, attitudes and approaches to tax are changing. As globalization continues to change corporate structures, the tax arrangements of global companies are increasingly entering the world of corporate social responsibility. Now, tax and the issue of paying 'your fair share' is one of the most prominent areas being scrutinized by governments, the general public and, to a great extent, the media. Just like corporate responsibility and environmental issues, brand damage can occur if there is a perception that a company's tax affairs are perceived as overly aggressive or 'unfair'.

### RECENT EXAMPLE - G8 makes 'the 3Ts: Taxes, Transparency & Trade' the theme of the 39<sup>th</sup> G8 summit (June 2013)

As a result of reports of various multinational companies engaging in complex international tax and transfer pricing arrangements, UK Prime Minister and host of the 39<sup>th</sup> G8 Summit, David Cameron, declared that the agenda would focus on "trade, transparency and tax".

The announcement of the agenda items coincides with recent showings of public discontent over the tax arrangements of multinational corporations and statements by various governments around the world announcing their intentions to further investigate the tax schemes of global companies.

Source: Cameron announces that G8 will focus on 3Ts: Taxes, Transparency and Trade <http://www.forbes.com/sites/kellyphillips/2013/06/17/cameron-announces-that-g8-will-focus-on-3ts-taxes-transparency-trade>

# 16. Private Equity

Private Equity (PE) deals are now being transacted with heightened CG expectations. Commissioners and Directors operating in this environment will need to understand their governance responsibilities, issues and priorities.

## QUESTIONS THAT COMMISSIONERS AND DIRECTORS SHOULD ASK

1. Do we possess the protocols for managing conflicts of interest with participating Commissioners and Directors?
2. Are protocols in place to secure independent review of any approach?
3. Do we need to set up an independent sub-committee to lead decision-making and process-manage a potential transaction?
4. Do the BoC and the BoD understand the position of key shareholders?
5. Should a broader sale process be initiated to maximize shareholder value?
6. Are the BoC and the BoD clear on the requirements regarding when and what to disclose to the markets?
7. Do the BoC and the BoD have a 'defense protocol' for a potential approach by a prospective bidder that enhances the company's responsiveness and mitigates potential risks?
8. What will the impact of the PE approach have on the BoC/BoD's normal agenda?

## RED FLAGS

1. The BoC and the BoD have in the past been caught unaware by PE bids
2. No strategy has been developed for dealing with PE bids and it is rarely discussed at BoC/BoD meetings
3. Continuous disclosure issues have been raised against the company over past PE bids
4. Commissioners' and Directors' messages are inconsistent or unclear regarding their position on PE bids
5. Independent advisers are usually not engaged to examine PE submissions

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## What is private equity?

The term PE covers a broad range of activities related to investing in unlisted companies. It may include taking listed companies private. It represents an alternative model to that of the dispersed ownership of a publicly listed entity.

## Pre-private equity considerations for BoC and BoD

The BoC and the BoD need to be on the right foot when PE comes knocking. A plan of action developed beforehand regarding how to respond to a bid, be it from PE or anyone else, is a good idea.

The BoC cannot leave the initial response to a PE approach to the BoD, which is very likely to possess a conflict through its involvement in the transaction via a management buyout.

The BoC and the BoD's fiduciary duty is to continue to act in the best interests of shareholders. Commissioners and Directors should consider:

- Understanding whether the PE approach is a 'sounding out' conversation or an immediate precursor to a bid
- Obtaining market perceptions reports
- Procuring up-to-date valuations (can set the tone for subsequent negotiations and discussions)
- Arranging a panel of selected advisers (speaking with them in closed sessions without management)
- Ensuring policies are appropriate and clear (e.g. conflict of interests)

- Setting ground-rules (roles and responsibilities) for the BoC, BoD, President, BoC committee and individual Commissioner/Director involvement
- Understanding the shareholder base (current and future) and the role a PE investor might have as a potential source of funding for future growth and expansion strategies
- Establishing a due diligence process, particularly around the degree of access, if any, that may be granted to this or any other bidders and areas of possible synergies from merging with potential bidders (which may be part of a defense/price maximization strategy)
- Providing institutional investors with enough information for them to do their own valuations.

Despite the focus and commitment in dealing with a PE approach, it will be "business as usual" at the front line. The BoC and the BoD also need to consider the impact of an approach on their normal agendas. To assist with this, and to isolate Commissioners/Directors who may have a conflict of interest, an ad hoc BoC committee can take control of the company's response to a PE offer.

This BoC committee should:

- Comprise Commissioners/Directors who are free of conflicts
- Have access to its own advisers who are also free of conflicts
- Possess appropriate authority
- Pay careful attention to the documentation presented and produced (and if necessary, have the

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authority to obtain an independent fairness opinion/valuation)

- Tightly monitor continuous disclosures and any transparency issues with price sensitive information during the transaction (including decisions on when to go public and the control and provision of confidential information by Commissioners/Directors to the BoC and the BoD)
- Continuously monitor the market for other possible opportunities.

The committee needs to be open-minded, willing to take advice and consider all options and alternative strategies (defense strategies, further independent valuation, auction strategies and overcoming impasses).

The existence of the committee does not, however, relieve other Commissioners/Directors of their obligations during PE activity. The key objective is to provide good counsel to shareholders on the PE proposal.

### PEC board considerations

In principle, Private Equity Committee (PEC) Boards should observe many of the same governance practices adhered to by publicly listed companies. The OECD has rejected calls for different and separate CG guidelines for PECs, whereas some venture capital associations have issued broad governance guidelines for PECs to observe.

A PEC Board is typically structured in the best interests of the investee company. The composition of the PEC Board will inevitably change with greater representation from the PE investor. Good practice

includes maintaining an independent President and ensuring that a majority of Commissioners/Directors are independent. However, Board appointees should continue to be individuals of appropriate competencies, skill and experience who can provide value and insight to the PEC. The relationship between the BoC and the BoD should be clear and supported by the appropriate documentation of roles and responsibilities, with effective conflict of interest policies. In some cases, the BoC monitors a 'management agreement' between the investors, the BoC and the BoD to assist this cause. The Board charter depends on what the PE owners expect. This may also be dependent on what the lender(s) demand.

As many PECs eventually re-emerge as publicly listed entities, PEC Boards will be better served if their governance frameworks allow a seamless transition to public trading.



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### Appendix A: Summary of Commissioner and Director Potential Liabilities

Commissioners and Directors have considerable responsibilities and potential liabilities. Each member of a BoC and BoD is fully and personally liable for a company's losses if they result from his/her fault or negligence.<sup>250</sup> In the event that a BoC/BoD consists of two members or more, the responsibility and potential liability would apply jointly and severally to each member.<sup>251</sup>

Felonies	Effect
Engaging in capital market business activities without an appropriate license, approval or registration <sup>252</sup>	Imprisonment for a maximum of five years and fine not exceeding IDR 5 billion
Engaging in fraud, market manipulation and/or insider trading <sup>253</sup>	Imprisonment for a maximum of ten years and fine not exceeding IDR 15 billion
Conducting a public offering without submitting a Registration Statement to the OJK <sup>254</sup>	Imprisonment for a maximum of ten years and fine not exceeding IDR 15 billion
Failure to submit a Registration Statement to the OJK by public companies <sup>255</sup>	Imprisonment for a maximum of three years and fine not exceeding of IDR 5 billion
Intent to deceive or to cause loss to another person, to mislead OJK or loses, destroys, erases, obscures, hides or falsifies records of registered issuers or public companies <sup>256</sup>	Imprisonment for a maximum of three years and fine not exceeding of IDR 5 billion
Misdemeanors	Effect
Engaging in business without a license <sup>257</sup>	Imprisonment for a maximum of one year and fine not exceeding IDR 1 billion
An investment manager or affiliated person receiving direct or indirect compensation that might influence him/her to buy or sell securities for an investment fund <sup>258</sup>	Imprisonment for a maximum of one year and fine not exceeding IDR 1 billion
Disobeying or obstructing formal investigations by the OJK <sup>259</sup>	Imprisonment for a maximum of one year and fine not exceeding IDR 1 billion

<sup>250</sup> Law 40/2007, Article 97 (3) and 114 (3)

<sup>251</sup> Law 40/2007, Article 97 (4) and 114 (4)

<sup>252</sup> Law 8/1995, Article 103 (1)

<sup>253</sup> Law 8/1995, Article 104

<sup>254</sup> Law 8/1995, Article 106 (1)

<sup>255</sup> Law 8/1995, Article 106 (2)

<sup>256</sup> Law 8/1995, Article 107

<sup>257</sup> Law 8/1995, Article 103 (2)

<sup>258</sup> Law 8/1995, Article 105

<sup>259</sup> Law 8/1995, Article 109

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## Commissioners and Directors' Indemnities and Insurance

Companies are allowed to purchase and maintain insurance for Commissioners and Directors against any liability in relation to discharging their duties. In addition, the AoA may contain an indemnity provision for the company's Commissioners and Directors to be indemnified against any liability incurred in relation to the discharge of their duties if they have acted honestly, in good faith, in the best interest of the company and in compliance with the laws, the AoA and internal regulations.

However, a company cannot by provisions of the AoA or any other contract exempt a Commissioner or Director from or indemnify a Commissioner or Director against any liability in respect to negligence, default, breach of duty or trust which, by law, he/she may be guilty of.



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## Appendix B: Board Charter

The purpose of a Board charter is to describe the Board's terms of reference and outline the Board's approach to important governance practices. Research into a selection of Board charters of Indonesia's top listed companies indicates that charters typically cover the following issues:

Section	Sub-Sections	BoC guidance	BoD guidance
<b>1. Objective</b> Sets out the high-level objectives of the governing body in terms of what it is trying to achieve.	-	Chapter 2 Overview	Chapter 3 Overview
<b>2. Authority</b> Specifies the key authorities provided to the governing body by key regulations and the AoA. May also include reference to the delegated authorities set out for the governing body.	-	Chapter 2 Authorities	Chapter 3 Authorities
<b>3. Membership</b> Defines the key composition requirements of the governing body (size, portion of independent members, skills/competencies, etc.) and sets out the nomination/appointment protocols, resignation/dismissal protocols and term of office.	Size and composition	Chapter 2 Composition	Chapter 3 Composition
	Independence requirements	Independence	Independence
	Membership requirements	Membership requirements	Membership requirements
	Concurrent positions	Concurrent positions	Concurrent positions
	Nomination and appointment	Chapter 7 Appointment	Chapter 7 Appointment
	Resignation and dismissal	Resignation Dismissal	Resignation Dismissal
Term of office	Tenure	Tenure	

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Section	Sub-Sections	BoC guidance	BoD guidance
<b>4. Corporate Secretary</b> Defines the key roles and responsibilities of Corporate Secretary in supporting the effective functioning of the governing body.	-	Chapter 8 Corporate Secretary	Chapter 8 Corporate Secretary
<b>5. Meetings</b> Specifies the procedures for conducting board meetings, including frequency, quorum, decision-making and minutes.	Frequency	Chapter 8 Meeting frequency and duration	Chapter 8 Meeting frequency and duration
	Quorum	Meeting attendance	Meeting attendance
	Decision-making process	Decision-making process	Decision-making process
	Minutes	Board minutes	Board minutes
<b>6. Responsibilities</b> Outlines the key responsibilities of the governing body as specified by key regulations and the AoA.	-	Chapter 2 Responsibilities	Chapter 3 Responsibilities
<b>7. Reporting Requirements</b> Specifies the key statutory reporting requirements of the governing body.	Reporting	Chapter 13 Annual Report	Chapter 13 Annual Report
	Continuous disclosure	Continuous disclosure obligations	Continuous disclosure obligations
<b>8. Other Matters</b> Other matters may include establishing induction and training program.	-	Chapter 7 Board induction and education program	Chapter 7 Board induction and education program

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## Appendix C: BoC Committee Charter

The purpose of a committee charter is to describe the committee's terms of reference and outline the committee's approach to important governance practices. Research into a selection of committee charters of Indonesia's top listed companies indicates that charters typically cover the following issues:

Section	Sub-Sections	AC	NRC	RPC	CGC
<b>1. Objective</b> Sets out the high-level objectives of the committee in terms of what it is trying to achieve.	-	Chapter 4 Audit Committee	Chapter 4 Nomination and Remuneration Committee	Chapter 4 Risk Policy Committee	Chapter 4 Corporate Governance Committee
<b>2. Membership</b> Defines the key composition requirements of the committee (size, portion of independent members, etc.) and sets out the appointment and dismissal protocols.	Size and composition	Chapter 4 AC size and composition  AC appointment and dismissal	Chapter 4 NRC size and composition	Chapter 4 Risk Policy Committee	Chapter 4 Corporate Governance Committee
	Membership requirements				
	Concurrent positions				
	Nomination and appointment				
	Resignation and dismissal				
Term of office					

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<b>3. Meetings</b> Specifies the procedures for conducting meetings, including frequency, quorum and minutes.	Frequency	Chapter 4 AC meetings	Chapter 4 NRC regular and planned meetings	Chapter 4 Risk Policy Committee	Chapter 4 Corporate Governance Committee
	Quorum				
	Decision-making process				
	Minutes				
<b>4. Responsibilities</b> Outlines the key responsibilities of the committee as specified by key regulations and the AoA.	-	Chapter 4 AC duties and responsibilities	Chapter 4 NRC duties and responsibilities	Chapter 4 RPC duties and responsibilities	Chapter 4 Corporate Governance Committee
<b>5. Reporting Requirements</b> Specifies the key reporting requirements of the committee.	-	Chapter 4 AC meetings	Chapter 4 Reporting by the NRC	Chapter 4 Committee/BoC interaction and reporting	Chapter 4 Committee/BoC interaction and reporting
<b>6. Other Matters</b> Other matters may include establishing induction and training program.	-	Chapter 4 Committee induction framework	Chapter 4 Committee induction framework	Chapter 4 Committee induction framework	Chapter 4 Committee induction framework

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## Appendix D: Sample Audit Committee Annual Agenda

A comprehensive documented annual agenda assists the AC to discharge its duties in a coordinated manner. The following provides a suggested example of an AC annual agenda.

	Scheduled meetings			
	Feb	May	Aug	Nov
<b>Assuming Financial Year-End 31 December</b>				
<b>Assess financial information</b>				
Review significant accounting and reporting issues and assess material financial estimates and assumptions used				
Review and approve quarterly financial statements and announcements				
Review budget and forecasts				
Review conflicts of interest and related party transactions				
<b>AC composition and effectiveness</b>				
Review AC charter, annual agenda and attendees				
Assess AC composition including individual member's performance, qualifications (e.g. Financial literacy, skills and experience) and member rotation/succession planning				
<b>Risk management and internal controls</b>				
Review the adequacy and effectiveness of: - risk management (e.g. Risk profile, risk appetite) - internal controls (e.g. IA and CSA findings and results)				
Review President Director assurance to BoC regarding effectiveness of risk management and internal control				

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
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External auditors				
Recommend appointment and re-appointment and evaluation of the external auditors (including review of fees, provision of non-audit services, objectivity/independence, review of audit plan)				
Review external auditor’s report, findings and progress on BoD actions (discuss issues with auditor in the absence of BoD)				
Internal auditors				
Review IA charter (if necessary), approve appointment of IA and review performance				
Review IA plan (including progress, implementation of BoD actions, changes to the plan and/or resource issues) - discuss issues with the internal auditor in the absence of BoD				
Compliance and other responsibilities (If delegated to the AC)				
Review legal and regulatory matters that may have a material impact on the company				
Review compliance report from BoD and correspondence (if any) from regulatory bodies (with a material impact on the company)				
Review whistle-blowing arrangements and reports as well as irregularities (including fraud) reports				
Conduct special investigations and perform other activities, as appropriate				
Reporting				
Maintain minutes and report to the BoC				

 Recommended timing  
 As required

Source: KPMG Risk Consulting

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## Appendix E: Example Board and Committee Induction Framework

A formal induction program for new committee members is essential. A comprehensive committee induction program could include an information package, training sessions and meetings with key executives. The following outlines suggested inclusions in an induction framework:

	Information package	Induction training topics	Meetings
<b>General induction for all BoC and BoD members</b>	Articles of Association BoC/BoD charter BoC/BoD annual agenda BoC/BoD papers and minutes (past 12 months) Strategic Business Plans Annual Financial Statements/Reports Risk Reports Significant Group Risk Policies (including Code of Conduct)	BoC/BoD roles and responsibilities (including conflicts of interest/ independence declarations) Code of Ethics/Conduct Overview Strategic Business Plan Overview	President Director Committee Chairmen Chief Financial Officer Internal Auditor Chief Risk Officer (where available) Compliance Officer (where available) Company Secretary General Legal Counsel External Auditor
<b>Induction for AC members</b>	AC charter AC annual agenda AC papers and minutes (past 12 months) Internal Audit Plan and Reports External Audit Reports Risk Reports Whistleblowing Reports	Financial Reporting Process overview (including key accounting policies) Internal Audit overview External Audit overview Risk Management Framework overview	Chief Financial Officer Internal Auditor Chief Risk Officer (where available) Compliance Officer (where available) External Auditor Chief Information Technology Officer

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	Information package	Training topics	Meetings
<b>Induction for NRC members</b>	NRC charter NRC annual agenda NRC papers and minutes (past 12 months) BoC/BoD nomination and remuneration process	BoC/BoD/Committee Nomination/Selection Framework overview Remuneration framework overview	Head of Human Resources
<b>Induction for RPC members</b>	RPC charter RPC annual agenda RPC papers and minutes (past 12 months) Risk Reports Risk Management and Internal Control System Overview	Strategic Business Plan overview Risk Management Framework overview	Internal Auditor Chief Risk Officer (where available) Chief Information Technology Officer Chief Operating Officer
<b>Induction for CGC members</b>	CGC charter CGC annual agenda CGC papers and minutes (past 12 months)	Corporate Governance Framework overview (including disclosures)	Internal Auditor Chief Risk Officer (where available) Compliance Officer (where available)

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<b>AA1000SES</b>	AA1000 Stakeholder Engagement Standard
<b>AC</b>	Audit Committee
<b>AGMS</b>	Annual General Meeting of Shareholders
<b>AoA</b>	Articles of Association
<b>ASX</b>	Australian Securities Exchange
<b>BAF</b>	Board Assurance Framework
<b>BoC</b>	Board of Commissioners
<b>BoD</b>	Board of Directors
<b>BPJS Kesehatan</b>	Badan Penyelenggara Jaminan Sosial Kesehatan (Social Security Agency for Health)
<b>CEO</b>	Chief Executive Officer
<b>CFO</b>	Chief Financial Officer
<b>CG</b>	Corporate Governance
<b>CG Code</b>	Indonesia's Code of Good Corporate Governance 2006
<b>CGC</b>	Corporate Governance Committee
<b>COSO</b>	Committee of Sponsoring Organizations
<b>CRO</b>	Chief Risk Officer
<b>CSA</b>	Control Self-Assessment
<b>EGMS</b>	Extraordinary General Meeting of Shareholders
<b>ERM</b>	Enterprise Risk Management

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<b>FRC</b>	Financial Reporting Council
<b>GMS</b>	General Meeting of Shareholders
<b>ICFR</b>	Internal Control over Financial Reporting
<b>ICGN</b>	International Corporate Governance Network
<b>IDX</b>	Indonesia Stock Exchange
<b>IDX LR</b>	IDX Listing Rules
<b>IMF</b>	International Monetary Fund
<b>ISO</b>	International Standards Organization
<b>JKN</b>	Jaminan Kesehatan Nasional (National Health Insurance)
<b>KPI</b>	Key Performance Indicator
<b>MOLHR</b>	Minister of Law and Human Rights
<b>NRC</b>	Nomination and Remuneration Committee
<b>OECD</b>	Organization of Economic Board Co-operation and Development
<b>OJK</b>	Otoritas Jasa Keuangan (Financial Services Authority)
<b>PE</b>	Private Equity
<b>PEC</b>	Private Equity Committee
<b>PT</b>	Perseroan Terbatas (Limited Liability Company)
<b>RPC</b>	Risk Policy Committee
<b>SEBI</b>	Securities and Exchange Board of India
<b>SEC</b>	U.S. Securities and Exchange Commission
<b>SGX</b>	Singapore Exchange Limited

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<b>SOX</b>	Sarbanes Oxley Act
<b>TRIPS</b>	Trade Related Aspects of Intellectual Property Rights
<b>UU 13/2003</b>	Undang Undang No.13 Tahun 2003 (Law No.13 Year 2003 on Manpower)
<b>UU 36/2008</b>	Undang Undang No.36 Tahun 2008 (Law No.36 Year 2008 on Income Tax)

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