LST REVIEW

Volume 18 Issue 242 December 2007

CORPORATE GOVERNANCE IN SRI LANKA

LAW & SOCIETY TRUST

CONTENTS

Printed by:
Law & Society Trust,
3, Kynsey Terrace, Colombo 8
Sri Lanka
Tel: 2691228, 2684845 Tele/fax: 2686843
e-mail: lst@eureka.lk
Website: http://www.lawandsocietytrust.org

ISSN – 1391 – 5770

Editor's Note ... ...

The December Issue of the Review contains the new Directions on Corporate Governance for Licensed Banks in Sri Lanka. The Directions were issued on 26 December 2007 by the Monetary Board of the Central Bank under Section 46(1) of the Banking Act, No 30 of 1988 (as amended).

The principles contained in Direction 2 explain the rationale for the mandatory rules contained in Direction 3. These principles *inter alia,* detail the responsibilities of a Board of Directors and include the salutary caution that directors should be 'fit and proper persons' in order to be eligible to hold office. The corollary principle that 'it is very likely that the effectiveness of such commitment and contribution would tend to decrease with the advanced age of directors and more particularly, if the age of such director is well beyond the normal age of retirement, as generally accepted in the country" (vide Direction 2(3) (ii)) is somewhat more contentious if articulated as a general principle. However, a known phenomenon of abuse of director positions in this country appears to have been the rationale for this particular principle.

The various sub clauses in Direction 2 lead to rules being laid down in regard to the composition of a Board in Direction 3(2) as well as the stipulation of criteria to assess the fitness and propriety of directors in Direction 3(3), in respect of which strict compliance must be evidenced. However, the criteria thus detailed are notable for their absence of a far more expansive test in judging the fitness and propriety of directors that was contained in the earlier Exposure Draft on the Mandatory Code of Corporate Governance.

This Exposure Code was released on August 31, 2007 and periodically revised thereafter until the finalisation of the 26 December 2007 Directions on Corporate Governance. The Code specified in Section 3, *inter alia,* a number of conditions relating to the fitness and propriety of directors. Non-compliance with any one of the conditions was mandated to disqualify a person to be appointed, elected or nominated as a director or to continue as a director. These conditions included the committal, or any connection with the committal of, any act involving fraud, deceit, dishonesty or any other similar type of improper conduct.

The same prohibition applied to any finding issued by a regulatory/supervisory authority or a professional body regarding the same or a director being made the subject of any investigation or inquiry into the same. Similarly, any person against whom a conviction was entered by any court in Sri Lanka or abroad in respect of a crime committed in connection with financial management or of any offence involving moral turpitude was barred from holding any directorship. The absence of these precedent conditions in the 26 December 2007 Directions on Corporate Governance is somewhat puzzling.

It may be contended that Section 42(1) of the Banking Act, No 30 of 1988 (as amended) (hereafter the Act) which prohibits the election/appointment of any person as a director of a licensed commercial bank if *inter alia,* he is found to be of unsound mind, or declared insolvent or bankrupt or convicted of an offence involving moral turpitude punishable with a term of imprisonment, already provides for such prohibitions thus rendering the reiteration of the same prohibitions in the Directions unnecessary. However, the prohibitions, as contained in the Exposure Draft on Corporate Governance, (which has been summarized briefly above), imposes a commendably more stringent standard of corporate governance than Section 42(1) of the Act. Consequently, the inclusion of these prohibitions in the final Directions may have been justified and their absence is to be deplored.

Meanwhile, the Directions on Corporate Governance call upon all licensed commercial banks to ensure that it does not engage in transactions with 'related parties' in a manner that would grant such parties 'more favourable treatment' than that accorded to other constituents of the bank carrying on the same business (Direction 2(7)(i)). The applicable rule therefore, as laid down in Direction 3(7), enjoins a bank to take necessary steps to avoid conflicts of interests and defines categories of persons who may be considered as 'related parties.'

The stipulation as to the four board committees (Direction 36)) directed to be maintained by a bank - namely the audit committee, the human resources and remuneration committee, the nomination committee and the integrated risk management committee – is, meanwhile, an important part of the Directions.

A further pertinent principle relates to disclosures with the objective of achieving transparency of information relating to affairs and risk management of banks (Direction 2(8)). The Rules in that regard are set out in Direction 3(8) and include particularly the stipulation that the Annual Report should contain details of the directors, including names, fitness and propriety, transactions with the bank and the total of fees/remuneration paid by the bank.

While these Directions are perhaps not the optimum pushed for by the few conscientious business leaders that this country is fortunate to retain, there is no doubt that their content will be opposed by powerful sections of the business community who will be loath to allow even this limited extent of scrutiny for the objective of effective corporate governance. From a different perspective, the perennial problem in Sri Lanka is not the absence of laws, regulations and directions but rather the abysmal implementation of the same and the recurrent practice of granting exemptions for favourites which is prevalent in the private sector as much as in the public sector. The strict implementation of these Directions (at a point when ongoing court action is concluded and the validity of the Directions are affirmed or revised as the case may be) should therefore plead no exemptions.

A related question also arises as to the rules of corporate governance in a context where the lustre of the Central Bank itself has diminished due to increased politicisation of the Bank. The current Directions apply to licensed commercial banks only. In that context, it is appropriate to question whether, in particular, members of the Monetary Board itself should be subjected to rules relating to the 'fitness and propriety' of directors.

The Review publishes as a useful supplement to these discussions, a brief note on additional compliance measures in regard to enforcement of rules relating to corporate governance by a noted business leader in Sri Lanka, ***Chandra Jayaratne.***

Finally, it publishes a discussion paper on Corporate Governance Regulations by ***Subhash Abhayawansa*** which traces the history of previous attempts to enforce corporate governance in Sri Lanka.

Kishali Pinto Jayawardena

DIRECTIONS
BANK ING ACT DIRECTION NO. 11 OF 2007
CORPORATE GOVERNANCE FOR LICENSED COMMERCIAL BANKS IN SRI LANKA

In the exercise of the powers conferred by Section 46(1) of the Banking Act No 30 of 1988, last amended by the Banking Act No 46 of 2006, the Monetary Board hereby issues the following Directions on Corporate Governance for Licensed Commercial Banks in Sri Lanka.

These Directions may be cited as the Banking Act Direction No. 11 of 2007. The Sections referred to in these Directions will be those of the Banking Act No. 30 of 1988, last amended by the Banking Act No. 46 of 2006.

1. **Responsibilities and Empowerment under the Banking Act and the Monetary Law Act**

1(1) In terms of Section 46(1) of the Banking Act No 30 of 1988 last amended by No 46 of 2006, in order to ensure the soundness of the banking system, the Monetary Board has been empowered to issue Directions to licensed commercial banks regarding the manner in which any aspect of the business of such banks is to be conducted.

1(2) In terms of Section 5 of the Monetary Law Act No 58 of 1949, the Central Bank of Sri Lanka is charged with the duty of securing as far as possible by action authorised by such Act, the two objectives, namely, (a) economic and price stability and (b) financial stability.

1(3) In terms of Section 10 (c) of the Monetary Law Act, the Monetary Board, in the exercise of its powers, duties, functions and responsibilities, is empowered to make such rules and regulations as the Monetary Board may consider necessary, in relation to any matter affecting or connected with or incidental to the exercise, discharge or performance of the powers, functions, and duties of the Central Bank of Sri Lanka.

1(4) Under the provisions of the Monetary Law Act No 58 of 1949, the supervision of banks has been made a duty of the Central Bank on account of specific reasons as stated in John Exter's Report on the Monetary Law Act which states, *inter alia*, as follows: "*Banking is an economic activity which affects the public welfare to an unusual degree; it touches in one way or another, almost every phase of a country's economic life. Sound banking is essential to healthy and vigorous economic development. Supervision of banks helps to protect the public against mismanagement, bank failures, and loss of confidence in the banking system. It helps to protect depositors and stock-holders against loss and frequently enables bank directors and officers to manage the affairs of their banks more wisely and intelligently.*"

1(5) Accordingly, in order to enhance the overall banking sector stability which is fundamental to financial system stability, the Monetary Board, hereby issues Directions under Section 46(1) of the Banking Act No. 30 of 1988 to improve and sustain the corporate governance processes and practices of the licensed commercial banks in Sri Lanka.

1(6) For purposes of this Direction, Corporate Governance processes and practices shall be deemed to be the management framework that facilitates the conduct of the banking business in a responsible and accountable manner so as to promote the safety and soundness of the individual banks, thereby leading to the stability of the overall banking sector.

1(7) The rules of corporate governance as contained in Direction 3 of these Directions have, therefore, been developed on the basis of certain fundamental principles as set out in Direction 2 of these Directions with a view to facilitating the underlying supervisory responsibilities of the Central Bank and to promote safety and soundness of the banking system.

2. The Principles upon which the rules of Corporate Governance have been based upon and developed are the following:

The principles set out in this Direction 2 should be referred to for explanatory purposes and/or for clarification purposes only, so as to understand the rationale for the rules as contained in Direction 3 hereof. Hence, strict compliance under these Directions shall only be in respect of the rules that are set out under Direction 3.

2(1) Principle: The Responsibilities of the Board

2(1) (i) The board of directors should assume the overall responsibility and accountability in respect of: (a) the management of the affairs of the bank, i.e. conduct of business and maintenance of prudent risk management mechanisms; and (b) the safety and soundness of the bank.

2(1) (ii) Towards this end, the board should: (a) determine the structure of the management of affairs of the bank; (b) delegate business operations to key management personnel led by the chief executive officer designated by the board; (c) assume policy making and risk management for the business; and (d) ensure the effective role of the key management personnel. Key management personnel shall mean such key executives of the bank as defined in the International Accounting Standards.

2(1) (iii) The overall responsibility of the board should not be construed as an obligation to undertake the inspection of day-to-day activities, but should rather be understood as an obligation to oversee and ensure that the key management personnel are carrying out the day-to-day activities of the bank in a safe and sound manner in accordance with the policies set out by the board.

2(1) (iv) Directors should understand the business and risk management mechanism of the bank and take objective decisions in the interest of the bank's depositors, creditors, shareholders and other stakeholders. Further, they should ensure that the bank does not act in a manner that is detrimental or prejudicial to the interests of, and obligations to, depositors and creditors.

2(1) (v) The board should take the responsibility for compliance with accepted rules of corporate governance. They should also ensure compliance with all regulatory and supervisory requirements. Further, they should ensure that an effective combination of professionals with practical experience in relevant subjects such as banking, finance, economics, business management, human resource management, law, marketing, information technology or any other discipline relevant or complementary to banking operations, is available in the banks to undertake its operations and discharge its responsibilities.

2(1) (vi) The directors should be aware of potential civil and criminal liabilities that may arise from their failure to discharge their duties diligently. They should also understand that they should act with due care and prudence. In addition, the directors of state owned banks should be aware of the additional liabilities that arise from the status of such banks being state enterprises and consequently being accountable to the public. It is, therefore, necessary that directors commit sufficient time and energy to fulfilling the board's responsibilities in managing the affairs of the bank in a prudent manner.

2(2) Principle: The Board's composition

2(2) (i) The board should be composed of a healthy mix of executive directors and non-executive directors. Some of the non-executive directors should also be independent so that there is strong independent element brought into the decision- making process.

2(2)(ii) The board's composition should ensure a balance of skills and experience as may be deemed appropriate and desirable for the requirements of the bank.

2(2)(iii) The banking industry worldwide is making tremendous progress and undergoing rapid change with new innovations, instruments, technologies, products, systems and processes being introduced regularly. It is vital therefore, that the directors should be persons who would: (a) be able to keep abreast with these changes, and (b) provide continuous contribution and guidance to the board decision-making process.

2(2) (iv) There should be a gradual infusion of new ideas into the board. There should also be assurance that the relationships between the directors amongst themselves as well as between the directors and the key management personnel is at a level that does not suggest the existence of excessive familiarity, undue influence or coercion. In this context, it should be noted that very long-standing relationships could sometimes impair the high sense of values, independence and objectivity that is needed in the discharge of the duties of a director of a bank.

2(3) Principle: Criteria to assess the Fitness and Propriety of Directors

2(3) (i) In addition to the principles under the board's composition in Direction 2(2) above, directors should be fit and proper persons in order to be eligible to hold office as directors of a bank and no person should serve as a director unless such person is a fit and proper person.

2(3)(ii) There is strong need for commitment and effective contribution to the prudent management of the affairs of the bank. It is very likely that the effectiveness of such commitment and contribution would tend to decrease with advanced age of directors and more practically, if the age of such director is well beyond the normal age of retirement, as generally accepted in the country.

2(4) Principle: Management functions delegated by the Board

2(4) (i) The board should have a formal schedule of matters specifically reserved to it for decision. The board should also give clear directions to key management personnel, as to the matters that should be approved by the board before decisions are made by key management personnel, on behalf of the bank.

2(5) **Principle: The Chairman and the Chief Executive Officer**

2(5) (i) There are two key aspects of the management of every bank, viz., (a) the overall governance by the board, and (b) the day-to-day management of the bank's business by the CEO, in line with board approved strategic objectives, corporate values, overall risk policy and risk management procedures.

2(5)(ii) There should be a clear division of these responsibilities at the board level and the executive management level to ensure a greater balance of power and authority, so that powers are not concentrated in any one individual.

2(5) (iii) The board should appoint a chairman as well as chief executive officer. The division of responsibilities between the chairman and chief executive officer should be clearly established and set out in writing.

2(6) **Principle: Board appointed Committees**

2(6) (i) The board should appoint separate board committees for audit, selection, remuneration, integrated risk management and such other subjects as determined by the Board to ensure its oversight and control over the affairs of the bank.

2(6)(ii) Where the board appoints a committee, it should set out the authority of the committee, and in particular, whether the committee has the authority to act on behalf of the board or simply has the authority to examine a particular issue and report back to the board with recommendations.

2(6) (iii) Each committee should be chaired by a non-executive director who has some expertise in the relevant subject, and who preferably should be independent too. The majority of the members of the board committee should consist of non-executive directors with at least one independent director in the committee. If a need arises, professionals from outside may be invited or hired to serve in a committee. Bank staff may be present at the board committees for advice or special assignments, or on invitation.

2(7) **Principle: Related party transactions**

2(7)(i) The board should ensure that the bank does not engage in transactions with "related parties" in a manner that would grant such parties "more favourable treatment" than that accorded to other constituents of the bank carrying on the same business.

2(8) **Principle: Disclosures**

2(8) (i) The objective of disclosure is the transparency of information relating to affairs and risk management of banks which would help to promote market discipline of the respective banks.

2(8) (ii) Since market disclosure is the focus of the Pillar III of the risk management based capital standard known as Basel II recommended by the Basel Committee on Banking Supervision at the Bank for International Settlements, (which is the globally accepted body on introducing international standards on Bank Supervision), the extent of disclosures should be commensurate with the size, ownership structure, systemic importance, risk profile and the business model of the bank. Accordingly, it should be noted that the adequate and timely public disclosure of relevant information by banks would facilitate enhanced market discipline and lead to better and more effective corporate governance.

2(8) (iii) Disclosures by banks should generally include disclosures relating to capital adequacy, key performance indicators, business concentrations, transactions with related parties, corporate governance statements, financial statements, etc., and should be consistent with accounting standards, regulatory requirements as well as with any other information disclosed on voluntary basis.

3, **The following rules of Corporate Governance shall be complied by all licensed commercial banks in Sri Lanka and such compliance shall be as provided for in Direction 3(9) (i) hereof.**

3 (1) **The Responsibilities of the Board**

3(1)(i) The board shall strengthen the safety and soundness of the bank by ensuring the implementation of the following:

a) Approve and oversee the bank's strategic objectives and corporate values and ensure that these are communicated throughout the bank;
b) Approve the overall business strategy of the bank, including the overall risk policy and risk management procedures and mechanisms with measurable goals, for at least the next three years;
c) Identify the principal risks and ensure implementation of appropriate systems to manage the risks prudently;
d) Approve implementation of a policy of communication with all stakeholders, including depositors, creditors, shareholders and borrowers;
e) Review the adequacy and the integrity of the bank's internal control systems and management information systems;
f) Identify and designate key management personnel, as defined in the International Accounting Standards, who are in a position to: (i) significantly influence policy; (ii) direct activities; and (iii) exercise control over business activities, operations and risk management;
g) Define the areas of authority and key responsibilities for the board directors themselves and for the key management personnel;
h) Ensure that there is appropriate oversight of the affairs of the bank by key management personnel, that is consistent with board policy;
i) Periodically assess the effectiveness of the board directors' own governance practices, including: (i) the selection, nomination and election of directors and key management personnel; (ii) the management of conflicts of interest; and (iii) the determination of weaknesses and implementation of changes where necessary;
j) Ensure that the bank has an appropriate succession plan for key management personnel;
k) Meet regularly, on a needs basis, with the key management personnel to review policies, establish communication lines and monitor progress towards corporate objectives;
l) Understand the regulatory environment and ensure that the bank maintains an effective relationship with regulators;

m) Exercise due diligence in hiring and oversight of external auditors.

3(1) (ii) The board shall appoint the chairman and the chief executive officer and define and approve the functions and responsibilities of the chairman and the chief executive officer in line with Direction 3(5) of these Directions.

3(1)(iii) The board shall meet regularly and board meetings shall be held at least twelve times a year at approximately monthly intervals. Such regular board meetings shall normally involve active participation in person of a majority of directors entitled to be present. Obtaining the board's consent through the circulation of written resolutions/papers shall be avoided as far as possible.

3(1)(iv) The board shall ensure that arrangements are in place to enable all directors to include matters and proposals in the agenda for regular board meetings where such matters and proposals relate to the promotion of business and the management of risks of the bank.

3(1)(v) The board procedures shall ensure that notice of at least 7 days is given of a regular board meeting to provide all directors an opportunity to attend. For all other board meetings, reasonable notice maybe given.

3(1)(vi) The board procedures shall ensure that a director who has not attended at least two-thirds of the meetings in the period of 12 months immediately preceding or has not attended the immediately preceding three consecutive meetings held, shall cease to be a director. Participation at the directors' meetings through an alternate director shall, however, be acceptable as attendance.

3(1) (vii) The board shall appoint a company secretary who satisfies the provisions of Section 43 of the Banking Act No 30 of 1988, whose primary responsibilities shall be to handle the secretariat services to the board and shareholder meetings and to carry out other functions specified in the statutes and other regulations.

3(1) (viii) All directors shall have access to advice and services of the company secretary with a view to ensuring that board procedures and all applicable rules and regulations are followed.

3(1) (ix) The company secretary shall maintain the minutes of board meetings and such minutes shall be open for inspection at any reasonable time on reasonable notice by any director.

3(1) (x) Minutes of board meetings shall be recorded in sufficient detail so that it is possible to gather from the minutes, as to whether the board acted with due care and prudence in performing its duties. The minutes shall also serve as a reference for regulatory and supervisory authorities to assess the depth of deliberations at the board meetings. Therefore, the minutes of a board meeting shall clearly contain or refer to the following: (a) a summary of data and information used by the board in its deliberations; (b) the matters considered by the board; (c) the fact-finding discussions and the issues of contention or dissent which may illustrate whether the board was carrying out its duties with due care and prudence; (d) the testimonies and confirmations of relevant executives which indicate compliance with the board's strategies and policies and adherence to relevant laws and regulations; (e) the board's knowledge and understanding of the risks to which the bank is exposed and an overview of the risk management measures adopted; and (f) the decisions and board resolutions.

3(1) (xi) There shall be a procedure agreed by the board to enable directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the bank's expense. The board shall resolve to provide separate independent professional advice to directors to assist the relevant director or directors to discharge his/her/their duties to the bank.

3(1) (xii) Directors shall avoid conflicts of interests, or the appearance of conflicts of interest, in their activities with, and commitments to, other organisations or related parties. If a director has a conflict of interest in a matter to be considered by the board, which the board has determined to be material, the matter should be dealt with at a board meeting, where independent non-executive directors [refer to Direction 3(2) (iv) of these Directions] who have no material interest in the transaction, are present. Further, a director shall abstain from voting on any board resolution in relation to which he/she or any of his/her close relation or a concern in which a director has substantial interest, is interested and he/she shall not be counted in the quorum for the relevant agenda item at the board meeting.

3(1) (xiii) The board shall have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the bank is firmly under its authority.

3(1) (xiv) The board shall, if it considers that the bank is, or is likely to be, unable to meet its obligations or is about to become insolvent or is about to suspend payments due to depositors and other creditors, forthwith inform the Director of Bank Supervision of the situation of the bank prior to taking any decision or action.

3(1) (xv) The board shall ensure that the bank is capitalised at levels as required by the Monetary Board in terms of the capital adequacy ratio and other prudential grounds.

3(1) (xvi) The board shall publish in the bank's Annual Report, an annual corporate governance report setting out the compliance with Direction 3 of these Directions.

3(1)(xvii) The board shall adopt a scheme of self-assessment to be undertaken by each director annually, and maintain records of such assessments.

3(2) **The Board's Composition**

3(2)(i) The number of directors on the board shall not be less than 7 and not more than 13.

3(2)(ii) (A) The total period of service of a director other than a director who holds the position of chief executive officer shall not exceed nine years, and such period in office shall be inclusive of the total period of service served by such director up to January 1, 2008.

(B) In this context, the following transitional provisions shall apply:

a) In the event that there is only one director on the board who has served more than nine years as at January 1, 2008, he/she shall be deemed to have vacated the office as a director as at December 31, 2008.

b) In the event that there are two or more directors on the board who have served more than nine years as at January 1, 2008, the following provisions shall apply:

I. Of those directors whose period of service has exceeded nine years, the longest serving director, shall be deemed to have vacated office as a Director on December 31, 2008.

II. Thereafter, at the end of each succeeding year, the remaining directors shall be deemed to have vacated office in sequence, at least one director each year, (on the basis of the longest to the shortest length of service as a director), until all directors who have served a period in excess of nine years as at January 1, 2008, have been to have vacated office. Provided also, that all directors of the bank who have served more than nine years as at January 1, 2008 shall be deemed to have vacated their office by or before December 31, 2011.

c) In the event there are any directors who are due to complete nine years of service between January 1, 2008 and December 31, 2010, such directors shall also be deemed to have vacated office, in sequence, at least one director each year, (on the basis of the longest to the shortest length of service as a director), after the directors as set out in Direction 3(2)(ii)(B) (b) have vacated their office as directors. Provided, however, that all such directors covered by this sub-direction (c) shall also be deemed to have vacated their office by or before December 31, 2011.

3(2)(iii) An employee of a bank may be appointed, elected or nominated as a director of the bank (hereinafter referred to as an "executive director") provided that the number of executive directors shall not exceed one-third of the number of directors of the board. In such an event, one of the executive directors shall be the chief executive officer of the bank.

3(2)(iv) The board shall have at least three independent non-executive directors or one third of the total number of directors, whichever is higher. This sub-direction shall be applicable from January 1, 2010 onwards.

A non-executive director shall not be considered independent if he/she:

a) has direct and indirect shareholdings of more than 1% of the bank;
b) currently has or had during the period of two years immediately preceding his/her appointment as director, any business transactions with the bank as described in Direction 3 (7) hereof, exceeding 10% of the regulatory capital of the bank.
c) has been employed by the bank during the two year period immediately preceding the appointment as director;
d) has a close relation who is a director or chief executive officer or a member of key management personnel or a material shareholder of the bank or another bank. For this purpose, a "close relation" shall mean the spouse or a financially dependent child;
e) represents a specific stakeholder of the bank;
f) is an employee or a director or a material shareholder in a company or business organization:

I. which currently has a transaction with the bank as defined in Direction 3(7) of these Directions, exceeding 10% of the regulatory capital of the bank, or
II. in which any of the other directors of the bank are employed or are directors or are material shareholders; or
III. in which any of the other directors of the bank have a transaction as defined in Direction 3(7) of these Directions, exceeding 10% of the regulatory capital of the bank;

3(2) (v) In the event an alternate director is appointed to represent an independent director, the person so appointed shall also meet the criteria that applies to the independent director.

3(2)(vi) Non-executive directors shall be persons with credible track records and or/have necessary skills and experience to bring an independent judgment to bear on issues of strategy, performance and resources.

3(2) (vii) A meeting of the board shall not be duly constituted, although the number of directors required to constitute the quorum at such meeting is present, unless more than one half of the number of directors present as such meeting are non-executive directors. This sub-direction shall be applicable from January 1, 2010 onwards.

3(2) (viii) The independent non-executive directors shall be expressly identified as such in all corporate communications that disclose the names of directors of the bank. The bank shall disclose the composition of the board, by category of directors, including the names of the chairman, executive directors, non-executive directors and independent non-executive directors in the annual corporate governance report.

3(2) (ix) There shall be a formal, considered and transparent procedure for the appointment of new directors to the board. There shall also be procedures in place for the orderly succession of appointments to the board.

3(2) (x) All directors appointed to fill a casual vacancy shall be subject to election by shareholders at the first general meeting after their appointment.

3(2) (xi) If a director resigns or is removed from office, the board shall: (a) announce the director's resignation or removal and the reasons for such removal or resignation including but not limited to information relating to the relevant director's disagreement with the bank, if any; and (b) issue a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders.

3(2) (xii) A director or an employee of a bank shall not be appointed, elected or nominated as a director of another bank except where such bank is a subsidiary company or an associate company of the first mentioned bank.

3(3) **Criteria to assess the fitness and propriety of directors**

In addition to provision of section 42 of the Banking Act No 30 of 1988, the criteria set out below shall apply to determine the fitness and propriety of a person who serves or wishes to serve as a director of bank. Non-compliance with anyone of the criteria as set out herein shall disqualify a person to be appointed, elected or nominated as a director or to continue as a director.

3(3) (i) The age of a person who serves as director shall not exceeded 70 years.

(A) Where a director who is currently serving at a bank is over 70 years of age at January 1, 2008, the following transitional provision shall apply, subject however to the provisions as set out in Direction 3(2) (ii) hereof.

a) If a director is over 75 years of age as at January 1, 2008, such director may continue to serve as a director for a further period that shall not extend beyond December 31, 2008, and shall be deemed to have vacated office on December 31, 2008;

b) If a director is between 70 – 75 years of age as at January 1, 2008, such director may continue to serve as a director for a further period that shall not exceed beyond December 31, 2009, and shall be deemed to have vacated office on December 31, 2009.

(B) Where a director who is currently serving at a bank reaches the age of 70 years, between January 1, 2008 and December 31, 2009, such director may, subject to the provisions as set out in Direction 3(2) (ii) hereof, continue to serve as a director for a further period that shall not extend beyond December 31, 2010 and shall be deemed to have vacated office on December 31, 2010.

3(3) (ii) A person shall not hold office as a director of more than 20 companies/entities/institutions inclusive of subsidiaries or associate companies of the bank. Of such 20 companies/entities/institutions, not more than 10 companies shall be those classified as Special Business Entities in terms of the Sri Lanka Accounting and Auditing Standards Act No 15 of 1995.

3(4) Management functions delegated by the Board

3(4) (i) The directors shall carefully study and clearly understand the delegation arrangements in place.

3(4)(ii) The board shall not delegate any matters to a board committee, chief executive officer, executive directors or key management personnel, to an extent that such delegation would significantly hinder or reduce the ability of the board as a whole to discharge its functions.

3(4) (iii) The board shall review the delegation processes in public on a periodic basis to ensure that they remain relevant to the needs of the bank.

3(5) The Chairman and Chief Executive Officer

3(5) (i) The roles of chairman and chief executive officer shall be separate and shall not be performed by the same individual.

3(5) (ii) The chairman shall be a non-executive director and preferably an independent director as well. In the case where the chairman is not an independent director, the board shall designate an independent director as the Senior Director with suitably documented terms of reference to ensure a greater independent element. The designation of the Senior Director shall be disclosed in the bank's Annual Report.

3(5)(iii) The board shall disclose in its corporate governance report, which shall be an integral part of its Annual Report, the identity of the chairman and the chief executive officer and the nature of any relationship [including financial, business, family or other material/relevant relationship(s)], if any, between the chairman and the chief executive officer and the relationship among members of the board.

3(5) (iv) The chairman shall; (a) provide leadership to the board; (b) ensure that the board works effectively and discharges its responsibilities; and (c) ensure that all key and appropriate issues are discussed by the board in a timely manner.

3(5)(v) The chairman shall be primarily responsible for drawing up and approving the agenda for each board meeting, taking into account where appropriate, any matters proposed by the other directors for inclusion in the agenda. The chairman may delegate the drawing up of the agenda to the company secretary.

3(5)(vi) The chairman shall ensure that all directors are properly briefed on issues arising at board meetings and also ensure that directors receive adequate information in a timely manner.

3(5)(vii) The chairman shall encourage all directors to make a full and active contribution to the board's affairs and take the lead to ensure that the board acts in the best interests of the bank.

3(5)(viii) The chairman shall facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

3(5) (ix) The chairman, shall not engage in activities involving direct supervision of key management personnel or any other executive duties whatsoever.

3(5)(x) The chairman shall ensure that appropriate steps are taken to maintain effective communication with shareholders and that the views of shareholders are communicated to the board.

3(5) (xi) The chief executive officer shall function as the apex executive-in-charge of the day-to-day management of the bank's operations and business.

3(6) Board appointed Committee

3(6)(i) Each bank shall have at least four board committees as set out in Directions 3(6)(ii), 3(6)(iii), 3(6)(iv) and 3(6)(v) of these Directions. Each committee shall report directly to the board. All committees shall appoint a secretary to arrange the meetings and maintain minutes, records etc., under the supervision of the chairman of the committee. The board shall present a report of the performance on each committee, on their duties and roles at the annual general meeting.

3(6) (ii) The following rules shall apply in relation to the Audit Committee:

a) The chairman of the committee shall be an independent non-executive director who possesses qualifications and experience in accountancy and/or audit.
b) All members of the committee shall be non-executive directors.
c) The committee shall make recommendations on matters in connection with: (i) the appointment of the external auditor for audit services to be provided in compliance with the relevant statutes; (ii)

the implementation of the Central Bank guidelines issued to auditors from time to time; (iii) the application of the relevant accounting standards; and (iv) the service period, audit fee and any resignation or dismissal of the auditor; provided that the engagement of the Audit partner shall not exceed five years, and that the particular Audit partner is not re-engaged for the audit before the expiry of three years from the date of the completion of the previous term.

d) The committee shall review and monitor the external auditor's independence and objectivity and the effectiveness of the audit processes in accordance with applicable standards and best practices.

e) The committee shall develop and implement a policy on the engagement of an external auditor to provide non-audit services that are permitted under the relevant statues, regulations, requirements and guidelines. In doing so, the committee shall ensure that the provision by an external auditor of non-audit services does not impair the external auditor's independence or objectivity. When assessing the external auditor's independence or objectivity in relation to the provision of non-audit services, the committee shall consider;

   I. Whether the skills and experience of the audit firm make it a suitable provider of the non-audit services;
   II. whether there are safeguards in place to ensure that there is no threat to the objectivity and/or independence in the conduct of the audit resulting from the provision of such services by the external auditor; and
   III. Whether the nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate relative to the audit firm, pose any threat to the objectivity and/or independence of the external auditor.

f) The committee shall, before the audit commences, discuss and finalise with the external auditors the nature and scope of the audit, including: (i) an assessment of the bank's compliance with the relevant Directions in relation to corporate governance and the management's internal controls over financial reporting; (ii)the preparation of financial statements for external purposes in accordance with relevant accounting principles and reporting obligations; and (iii) the co-ordination between firms where more than one audit firm is involved.

g) The committee shall review the financial information of the bank, in order to monitor the integrity of the financial statements of the bank, its annual report, accounts and quarterly reports prepared for disclosure, and the significant financial reporting judgments contained therein. In reviewing the bank's annual report and accounts and quarterly reports before submission to the board, the committee shall focus particularly on: (i) major judgmental areas; (ii) any changes in accounting policies and practices; (iii) significant adjustments arising from the audit; (iv) the going concern assumption; and (v) the compliance with relevant accounting standards and other legal requirements.

h) The committee shall discuss issues, problems and reservations arising from the interim and final audits, and any matters the auditor may wish to discuss including those matters that may need to be discussed in the absence of key management personnel, if necessary.

i) The committee shall review the external auditor's management letter and the management's response thereto.

j) The committee shall take the following steps with regard to the internal audit function of the bank:

   I. Review the adequacy of the scope, functions and resources of the internal audit department, and satisfy itself that the department has the necessary authority to carry out its work;

   II. Review the internal audit programme and results of the internal Audit process and , where necessary, ensure that appropriate actions are taken on the recommendations of the internal audit department;

   III. Review any appraisal or assessment of the performance of the head and senior staff members of the internal audit department.

   IV. Recommend any appointment or termination of the head, senior staff members and outsourced service providers to the internal audit function;

   V. Ensure that the committee is appraised of resignations of senior staff members of the internal audit department including the chief internal auditor and any outsourced service providers, and to provide an opportunity to the resigning senior staff members and outsourced service providers to submit reasons for resigning;

   VI. Ensure that the internal audit function is independent of the activities it audits and that it is performed with impartiality, proficiency and due professional care;

k) The committee shall consider the major findings of internal investigations and management's responses thereto;

l) The chief finance officer, the chief internal auditor and a representative of the external auditors may normally attend meetings. Other board members and the chief executive officer may also attend meetings upon the invitation of the committee. However, at least twice a year, the committee shall meet with the external auditors without the executive directors being present.

m) The committee shall have: (i) explicit authority to investigate into any matter within its terms of reference; (ii) the resources which it needs to do so; (iii) full access to information; and (iv) authority to obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary.

n) The committee shall meet regularly, with due notice of issues to be discussed and shall record its conclusions in discharging it duties and responsibilities.

o) The board shall disclose in an informative way, (i) details of the activities of the audit committee; (ii) the number of audit committee meetings held in the year; and (iii) details of attendance of each individual director at such meetings.

p) The secretary of the committee (who may be the company secretary or the head of the internal audit function) shall record and keep detailed minutes of the committee meetings.

r) The committee shall review arrangements by which employees of the bank may, in confidence, raise concerns about possible improprieties in financial reporting, internal control or other matters. Accordingly, the committee shall ensure the proper arrangements are in place for the fair and independent, investigation of such matters and for appropriate follow-up action and to act as the key representative body for overseeing the bank's relations with external auditor.

3(6) (iii) The following rules shall apply in relation to the Human Resources and Remuneration Committee:

a) The committee shall determine the remuneration policy (salaries, allowances and other financial payments) relating to directors, Chief Executive Officer (CEO) and key management personnel of the bank.
b) The committee shall set goals and targets for directors, CEOs and the key management personnel.
c) The committee shall evaluate the performance of the CEO and key management personnel against the set targets and goals periodically and determine the basis for revising remuneration, benefits and other payments of performance based incentives.
d) The CEO shall be present at all meetings of the committee, except when matters relating to the CEO are being discussed.

3(6) (iv) The following rules shall apply in relation to the Nomination Committee:

a) The committee shall implement a procedure to select/appoint new directors, CEO and key management personnel.
b) The committee shall consider and recommend (or not recommend) the re-election of current directors, taking into account the performance and contribution made by the director concerned towards the overall discharge of the board's responsibilities.
c) The committee shall set the criteria such as qualifications, experience and key attributes required for eligibility to be considered for appointment or promotion to the post of CEO and the key management positions.
d) The committee shall ensure that directors, CEO and key management personnel are fit and proper persons to hold office as specified in the criteria given in Direction 3(3) and as set out in the Statutes.
e) The committee shall consider and recommend from time to time, the requirements of additional /new expertise and the succession arrangements for retiring directors and key management personnel.
f) The committee shall be chaired by an Independent Director and preferably be constituted with a majority of Independent Directors. The CEO maybe present at meetings by invitation.

3(6) (v) The following rules shall apply in relation to the Integrated Risk Management Committee

a) The committee shall consist of at least three non-executive directors, chief executive officer and key management personnel supervising broad risk categories, i.e. credit, market, liquidity, operational and strategic risks. The committee shall work with key management personnel very closely and make decisions on behalf of the board within the framework of the authority and responsibility assigned to the committee.
b) The committee shall assess all risks, i.e., credit, market, liquidity, operational and strategic risks to the bank on a monthly basis through appropriate risk indicators and management information. In the case of subsidiary companies and associate companies, risk management shall be done, both on a bank basis and group basis.

c) The committee shall review the adequacy and effectiveness of all management level committees such as the credit committee and the asset-liability Committee to address specific risks and to manage those risks within quantitative and qualitative risks limits as specified by the committee.

d) The committee shall take prompt corrective action to mitigate the effects of specific risks in the case such risks are at levels beyond the prudent levels decided by the committee on the basis of the bank's policies and regulatory and supervisory requirements.

e) The committee shall meet at least quarterly to assess all aspects of risk management including updated business continuity plans.

f) The committee shall take appropriate actions against the officers responsible for failure to identity specific risks and take prompt corrective actions as recommended by the committee, and/or as directed by the Director of Bank Supervision.

g) The committee shall submit a risk assessment report within a week of each meeting to the board seeking the board's views, concurrence and/or specific directions.

h) The committee shall establish a compliance function to assess the bank's compliance with laws, regulations, regulatory guideline, internal controls and approved policies on all areas of business operations. A dedicated compliance officer selected from key management personnel shall carry out the compliance function and report to the committee periodically.

3 (7) Related party transactions

3(7) (i) The board shall take necessary steps to avoid any conflict of interest that may arise from any transaction of the bank with any person, and particularly with the following categories of persons who shall be considered as "related parties" for the purposes of this Direction:

a) Any of the bank's subsidiary companies;
b) Any of the bank's associate companies;
c) Any of the directors of the bank;
d) Any of the bank's key management personnel;
e) A close relation of any of the bank's directors or key management personnel;
f) A shareholder owning a material interest in the bank;
g) A concern in which any of the bank's directors or a close relation of any of the bank's directors or any of its material shareholders has a substantial interest.

3(7)(ii) The type of transaction with related parties that shall be covered by this Direction shall include the following:

a) The grant of any type of accommodation, as defined in the Monetary Board's Directions on maximum amount of accommodation,
b) The creation of any liabilities of the bank in the form of deposits, borrowings and investments,
c) The provision of any services of a financial or non-financial nature provided to the bank or received from the bank,
d) The creation or maintenance of reporting lines and information flows between the bank and any related parties which may lead to the sharing

of potentially proprietary, confidential or otherwise sensitive information that may give benefits to such related parities.

3(7) (iii) The board shall ensure that the bank does not engage in transactions with related parties as defined in Direction 3(7) (i) above, in a manner that would grant such parties "more favourable treatment" than that accorded to other constituents of the bank carrying on the same business. In this context, "more favourable treatment" shall mean and include treatment, including the:

a) Granting of "total net accommodation" to related parties, exceeding a prudent percentage of the bank's regulatory capital, as determined by the board. For purposes of this sub-direction:
   I. "Accommodation" shall mean accommodation as defined in the Banking Act Directions No 7 of 2007 on Maximum Amount of Accommodation.
   II. The "total net accommodation" shall be computed by deducing from the total accommodation, the cash collateral and investments made by such related parties in the bank's share capital and debt instruments with a maturity of 5 years or more.
b) Charging of a lower rate of interest than the bank's best lending rate or paying more than the bank's deposit rate for a comparable transaction with an unrelated comparable counterparty;
c) Providing of preferential treatment, such as favourable terms, covering trade losses and/or waiving fees/commissions, that extend beyond the terms granted in the normal course of business undertaken with unrelated parties;
d) Providing services to or receiving services from a related-party without an evaluation procedure;
e) Maintaining reporting lines and information flows that may lead to sharing potentially proprietary, confidential or otherwise sensitive information with related parties, except as required for the performance of legitimate duties and functions.

3(7) (iv) A bank shall not grant accommodation to any of its directors or to a close relation of such director unless such accommodation is sanctioned at a meeting of its board of directors, with not less than two-thirds of the number of directors other than the director concerned, voting in favour of such accommodation. This accommodation shall be secured by such security as may from time to time be determined by the Monetary Board as well.

3(7) (v) (a) Where any accommodation has been granted by a bank to a person or a close relation of a person or to any concern in which the person has a substantial interest, and such person is subsequently appointed as a director of the bank, steps shall be taken by the bank to obtain the necessary security as maybe approved for that purpose by the Monetary Board, within one year from the date of appointment of the person as a director.

(b) Where such security is not provided by the period as provided in Direction 3(7) (v) (a) above, the bank shall take steps to recover any amount due on account of any accommodation, together with interest, if any, within the period specified at the time of the grant of accommodation or at the expiry of a period of eighteen months from the date of appointment of such director, whichever is earlier.

(c) Any director who fails to comply with the above sub-directions shall be deemed to have vacated the office of director and the bank shall disclose such fact to the public.

(d) This sub-direction, however, shall not apply to a director who at the time of the grant of the accommodation was an employee of the bank and the accommodation was granted under a scheme applicable to all employees of such bank.

3(7) (vi) A bank shall not grant any accommodation or "more favourable treatment" relating to the waiver of fees and/or commissions to any employee or a close relation of such employee or to any concern in which the employee or close relation has a substantial interest other than on the basis of a scheme applicable to the employees of such bank or when secured by security as may be approved by the Monetary Board in respect of accommodation granted as per Direction 3(7)(v) above.

3(7) (vii) No accommodation granted by a bank under Direction 3(7)(v) and 3(7)(vi) above, nor any part of such accommodation, nor any interest due thereon shall be remitted without the prior approval of the Monetary Board and any remission without such approval shall be void and of no effect.

3 (8) Disclosures

3(8) (i) The board shall ensure that: (a) annual audited financial statements and quarterly financial statements are prepared and published in accordance with the formats prescribed by the supervisory and regulatory authorities and applicable accounting standards, and that (b) such statements are published in the newspapers in an abridged form, in Sinhala, Tamil and English.

3(8) (ii) The board shall ensure that the following minimum disclosures are made in the Annual Report:

a) A statement to the effect that the annual audited financial statements have been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures.
b) A report by the board on the bank's internal control mechanism that confirms that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements.
c) The external auditor's certification on the effectiveness of the internal control mechanism referred to in Direction 3(8)(ii)(b) above, in respect of any statements prepared or published after December 31, 2008.
d) Details of directors, including names, fitness and propriety, transactions with the bank and total of fees/remuneration paid by the bank.
e) Total net accommodation as defined in 3 (7) (iii) granted to each category of related parties. The net accommodation granted to each category of related parties shall also be disclosed as a percentage of the bank's regulatory capital.
f)The aggregate values of remuneration paid by the bank to its key Management personnel and the aggregate values of the transactions of the bank with its key management personnel, set out by broad categories such as remuneration paid, accommodation granted and deposits or investments made in the bank.

g) The external auditor's certification of the compliance with these Directions in the annual corporate governance reports published after January 1, 2010.

h) A report setting out details of the compliance with prudential requirements, regulations, laws and internal controls and measures taken to rectify any material non-compliances.

i) A statement of the regulatory and supervisory concerns on lapses in the bank's risk management, or non-compliance with these Directions that have been pointed out by the Director of Bank Supervision, if so directed by the Monetary Board to be disclosed to the public, together with measures taken by the bank to address such concerns.

3(9) **Transitional and other general provisions**

3(9) (i) Compliance with this Direction shall commence from January 1, 2008 onwards and all licensed commercial banks shall fully comply with the provisions of this Direction by or before January 1, 2009 except where extended compliance dates have been specifically provided for in this Direction.

3(9) (ii) In respect of the banks that have been incorporated by specific statutes in Sri Lanka, the boards as specified in such statutes shall continue to function in terms of the provisions of the respective statutes, provided they take steps to comply with all provisions of this Direction that are not inconsistent with the provisions of the respective statutes.

3(9) (iii) This Direction shall apply to branches of the foreign banks operating in Sri Lanka to the extent that it is not inconsistent with the regulations and laws applicable in such bank's country of incorporation. The branch of a foreign bank shall also publish its parent bank's annual corporate governance report together with its annual report and accounts of the branch operations in Sri Lanka.

3(9) (iv) In the event of a conflict between any of the provisions of this Direction and Articles of Association.(or Internal Rules) pertaining to any bank, the provisions of this Direction shall prevail. However, if the Articles of Association of an individual bank set a more stringent standard than that specified in this Direction, such provisions in the Articles of Association may be followed.

Additional Compliance Measures in regard to Enforcing Corporate Governance for Licensed Banks in Sri Lanka

Chandra Jayaratne[•]

The Central Bank of Sri Lanka should be commended for committing towards the mandatory application of the Code of Corporate Governance from mid 2008.

However, taking cognizance of the importance of retaining public confidence and upholding stakeholder interests (especially the interests of the depositors), it is without doubt that the role played by the Board of Directors of Licensed Banks - their commitment, capability (knowledge, skills, attitudes and values), accountability, independence of thought and judgment, with a well structured, strategically driven, long term focused operating environment, within delegated, controlled and risk managed organizations led by competent and professional Chief Executive Officers - will be key to the assurance of good governance, stakeholder value enhancement, stability and risk mitigation of Licensed Banks.

In the above context, the following suggestions and additional compliance commitments recommended focus mainly on areas which further enhance the role, commitment, capability, accountability, and independence of directors and the effectiveness of the operating environment, effectiveness of the management structure and effective discharge of the management functions.

The additional compliance commitments set out herein arise from actual case studies of

1. Weaknesses seen in licensed banks in Sri Lanka
2. Positive measures adopted by licensed banks in Sri Lanka
3. Measures of good governance adopted in well managed entities in Sri Lanka outside the banking sector

Some of the suggestions and compliance measures suggested may be seen by some as controversial and ahead of our times and thus may be argued to be inappropriate in the context of the current operating environment. It is necessary therefore to encourage wider participation and public debate in regard to these suggestions.

Affirmation of Fit and Proper Persons' Declaration

The directors and top management should be required annually to declare and affirm in a sworn affidavit placed before the Board that they have, individually and collectively, engaged throughout the year in managing the affairs of the bank and the resources of the bank, acting at all times in the interests of the stakeholders of the bank, (including the depositors), and that they individually and collectively

- Are 'fit and proper persons' in terms of the Banking Act

[•] Past Chairman of the Ceylon Chamber of Commerce; Fellow of the Institute of Chartered Accountants of Sri Lanka; Fellow of the Chartered Institute of Management, UK.

- Have duly discharged their duties and obligations as directors and officers with diligence, care and professionalism
- Have acted within the applicable laws, regulation and accepted best business practices of the banking sector
- Have exercised their judgment and decision making without any bias
- Have maintained the confidentiality of information received in the performance of their duties
- Have not used client and other privileged information for personal, family or third party gain
- Have not at any time acted in conflict of interests
- Have adhered at all times to Business Standards and Ethics of the Bank
- Have not acted in any manner enhancing the risks of the bank and its stakeholders including the depositors
- Have not at any time acted in any manner prejudicial to the interests of the stakeholders of the bank including depositors

The Directors report or the governance report of the annual report should confirm compliance with above by the directors and the top management

Mandatory Retirement Age and Annual Retirement of Directors

Recognizing that the directors and top management are key to the stability, performance effectiveness and growth of licensed banks and especially in upholding the interests of the depositors, and are thus required to retain optimum capability, commitment and alertness in managing the affairs and significant resources in trust within the bank (large part held on behalf of a large number of depositor stakeholders), it is recommended, irrespective of the application of the provisions of the Companies Act and / or Articles of Association or contracts of service, that directors and top management be required without exception to retire upon reaching the age of 65.

All directors upon reaching the age of 60 should be required to retire on an annual basis and come up for re-election. These requirements should be in addition to the directors being required to retire by rotation in terms of other stipulations.

Re-election of Directors above the Age of 60 Years

Any director proposed to be re-elected to the Board after the age of sixty years should be recommended for such re-election following a fit and proper review by the nominations committee of the Board. For this purpose, the nominations committee will assess the commitment, capability (knowledge, skills, attitudes and values), accountability, and independence of thought and judgment of the recommended director in comparison with potential other alternate nominees for election to the Board. The nominations committee will also review the declaration made by the director in terms of 1 (ii) c of the Code of Corporate Governance and the annual declaration made referred to below.

The directors' recommendation for re-election of any director above the age of 60 years should stipulate the rationale and the justification for the same.

Annual Declaration of Directors

All directors of a licensed bank irrespective of age should be required to place annually before the nominations committee, prior to the holding of the next annual general meeting, a sworn affidavit affirming that he/she is a fit and proper person to hold the office as a director of a licensed bank, having duly complied with the -

- Commitments stipulated in terms of the Banking Act including compliance with 'Fit and Proper Persons' stipulations;
- Commitments stipulated in terms of the Code of Corporate Governance;
- Commitment to devote annually a minimum of 80 hours to 120 hours in the performance of duties as a member of the Board, including time devoted to enhance general and specific capability(in relation to the functional specialism of the director and also in relation to the business of the bank and its operations), capability in effective performance of the duties and responsibilities as a director, pre-meeting reviews, attendance of meetings, and post-meeting follow up;
- Commitment to remain relevant in the performance of the duties as a director of a licensed bank and towards which objective, commit to devote time to meaningfully understand the present and future business environment, its impact on the sector and business of the bank, likely risks and challenges of the sector and the bank as well as strategies in respect of stakeholder value enhancement and risk mitigation;
- Requirement to avoid conflicts of interests as well as confirmation of having duly made required declarations and entered such interests in the interests register in terms of the requirements of the Companies Act;
- Requirement to manage negative reputation risks, not engaging in any unethical and immoral practices nor engaging in any acts in defiance of accepted societal norms and values;
- Necessary risk management procedures and mitigation plans that are put into place in the context of operations of the bank, to assure the long term stability and solvency of the bank;

The annual self assessment declaration of the directors in terms of 1 (ii) c of the Code of Corporate Governance should state the contribution made during the year by the director to enhance the performance, stability, growth and risk management of the Bank and in upholding the rights and interests of depositors. The Directors report or the governance report of the annual report should confirm compliance by all directors of the above.

Resignation of Directors

Where so requested in writing by all other members of the Board of a licensed bank that a director tender his / her resignation such director shall tender his /her resignation in the interests of good governance of the bank.

Annual Assessment of the Effectiveness of the Board

The Board should be required to annually assess the effectiveness of the Board and thereafter take such steps to eliminate any weaknesses identified. There should be a manifested commitment to further enhance such effectiveness, for which purpose the Board should use a structured framework or questionnaire.

The directors' report or the governance report of the annual report should confirm compliance with the above and also provide details of the structured approach adopted as well as the dates of review.

The Board Meeting Agenda

Within the formal schedule of matters to be dealt within the Board meeting agenda, there shall be the following standard items -

- Review of the Macro Economy, Operating Environments and the Emerging Risks and Challenges;
- Review of the Competitive Environment and consequential Risks and Challenges;
- Minutes and Reports of Board Sub Committees;
- Review of Risks and Risk Management including Asset Liability Management, Solvency and Liquidity Management, Non Performing Loans, Loan Loss Provisions and Anti Money Laundering;
- Audit and Control Issues;
- Human Resource Management Issues including those connected with assuring in the longer term, that a competent and professional Chief Executive Officer and a management team will be in place;
- Organizational Issues including delegation of authority and responsibility to the Chief Executive Officer and the management team;

Independence, Capability, and Empowerment of the Chief Executive Officer and Top Management Team

The Board should be required to ensure that appropriate Human Resource Management policies, practices, systems and procedures are in place to assure that a competent, capable and professional team of Executive Management is in charge of the management of the affairs of the Bank.

The Board should be further required to ensure that appropriate organization structures, with effective delegation of authority and responsibility, training and development plans as well as succession plans are in place to assure the independence, capability (knowledge, skills, attitudes and values) and empowerment of the Chief Executive Officer and the top management team.

The directors' report or the governance report of the annual report should provide the above assurance and detail the structure in place and action strategies implemented.

Formal Delegation of Authority to the Chief Executive Officer

A formal framework of delegation of authority and responsibility to the Chief Executive Officer should be in place within the overall governance system of licensed banks and should be reviewed and updated by the Board half yearly and / or as and when necessary.

Along with such a framework, a list of powers reserved for the Board and the shareholders must also be agreed upon. The directors' report or the governance report of the annual report should provide details of the structure in place.

Quarterly Assessment of Solvency, Capital Adequacy and Going Concern Status

The Board should be required to assess on a quarterly basis, the Solvency, Capital Adequacy and Going Concern Status of the Bank and be satisfied of due compliance with the same. The assessment should also ensure that the bank operates according to best practice guidelines and regulatory stipulations.

Quarterly accounts and published advertisements should confirm that the Board has duly complied with this requirement.

Long Term Planning

The Board should be required to meet at least twice a year to review long term business plans, assess likely business, competitive, and regulatory environments and the associated business challenges as well as likely impact and risks and agree on a long term strategic action for management of the business, risk mitigation, capital planning and enhancement of the stakeholder value of the same.

Business Standards

In order that the tone and culture of the organization is structured to uphold the standards of good corporate citizenship, to assure that the actions of the bank and its management and employees are aligned and to assist directors and employees to make appropriate judgments and decisions in the course of their work, it is proposed that a set of Standards of Business Conduct should be adopted by the Boards setting out *inter alia* policies, standards and behaviors expected in regard to;

- Bribery & Corruption;
- Charitable Contributions;
- Competition Laws;
- Conflicts of Interest;
- Entertainment and Gifts;
- Rules of Client Engagement and Commitments;
- Insider Information and Corporate Opportunity;
- Insider Dealings and Market Abuse;
- Money Laundering;

- Political Contributions;
- Adherence to Rules, Regulations and Sanctions;
- Whistle Blowing;

The directors, the Chief Executive Officer and top management should annually confirm that effective procedures have been put in place to uphold Business Standards and that there has been due compliance with the same.

The governance report of the annual report should provide assurance of due compliance with business standards by the Company and its employees.

Related Party Transactions and Transactions with Conflicts of Interests

The Board and the top management should collectively commit by a sworn affidavit affirmed on an annual basis that the best practices of good governance, business standards and ethics have been practiced by them individually and collectively in managing related party transactions and transactions with conflicts of interests.

The governance report of the annual report should provide assurance of due compliance of the above.

Public Communications

The Board should assure that there are in place, appropriate systems, procedures and controls to ensure that all public communications including advertisements, promotional material and other marketing communications, provide a true and fair representation of facts, client offers and client benefits and are in accordance with the best practices of good governance.

The governance report of the annual report should provide assurance of due compliance of the above.

Audit Committee Effectiveness

The effectiveness of the Audit Committee should be assessed annually and the Board should take the required steps to eliminate any weaknesses identified and further, commit to enhance further the effectiveness of the same. A structured framework or questionnaire may be used for that purpose.

The Audit Committee Report of the annual report should confirm compliance and also provide details of the structured approach adopted as well as dates of review

In the conduct of the annual external audit, in addition to the review and agreement of the scope of audit, the Audit Committee should arrange for an 'early warning note' to be received from the Auditors by an agreed date of any areas of concern in carrying out the audit and providing a satisfactory audit report.

The Audit Committee should be required to ascertain from the external auditors, following the completion of the annual audit, in a closed-door meeting without the participation of the executive management, that

- They have received all books of account, information, explanations and assistance required for the purposes of carrying out an independent audit and details of any short comings in that regard;
- They have raised queries and sought clarifications as necessary for the conduct of an independent audit and have received satisfactory clarifications and information from the executive management;
- They have included with the audit report and annual management letter all areas of concern and have not been persuaded by management to leave out any areas of concern in issuing the final audit report and management letter;
- There are no other issues, concerns, information or risks other than those referred to in the audit report and management letter that they wish to bring to the notice of the Audit Committee;

The Audit Committee Report of the annual report should confirm compliance with above and provide details of the structured approach adopted and dates of review.

The Audit Committee should review on a half quarterly basis, a statement of compliance with the provisions of the Banking Act, Regulations of the Central Bank and directions issued by the Director Bank Supervision. The Audit Committee Report of the annual report should confirm compliance with the above and also provide details of the structured approach adopted as well as dates of review.

The Audit Committee should have in place a key-controls checklist covering all key operating and functional areas of the business in assuring the achievement of the objectives of business within an effective risk and controlled environment. The Chief Executive Officer and top management should confirm due compliance, any short comings and action taken in regard to the same. The duly completed key-controls checklist should be placed before the Audit Committee annually and periodically at Audit Committee meetings. The divisional management should present detailed plans and action taken towards assuring due compliance.

Nominations Committee Report

The nominations committee and the Board should affirm that all recommendations made to the Board in respect of the appointment and re-election of independent directors and appointments of the Chief Executive Officer and top management team as members of the Board / top management team are based entirely upon meritocracy criteria and are made up of persons with professionalism, commitment, capability (knowledge, skills, attitudes and values), accountability, and independence of thought and judgment, with their capabilities and competencies matching the needs of the Board in effectively managing the affairs of the bank.

The directors' report or the governance report of the annual report should confirm compliance of the same.

An Overview of Corporate Governance Regulations in Sri Lanka

Subhash Abhayawansa•

Abstract

Reliability of financial reporting, fraud risk and corporate governance are among the principal criteria used to evaluate the investment potential of a country. The importance of corporate governance as a mechanism to build confidence in the financial statements and the integrity of the Board intensified with the corporate scandals in the dawn of the new millennium and the consequent demise of a Big 5 auditor. Developing countries such as Sri Lanka, which are dangerously dependent on foreign funds, are forced on to this corporate governance bandwagon. This paper examines the need for corporate governance in Sri Lanka and the factors causing the adoption of corporate governance guidelines on a mandatory level. An attempt is made to track the development of corporate governance regulations in the background of its more recent history. The principles and provisions included in the various corporate governance codes that have been introduced to date are reviewed and evaluated emphasising the Standard on Corporate Governance for Listed Companies issued in January 2007, for mandatory compliance by all listed companies. Potential problems arising from complying with this Code and the draft corporate governance code issued by the Central Bank of Sri Lanka for licensed banks are also discussed in this paper.

1. Introduction

Major corporate collapses of the likes of Enron, WorldCom, Parmalat, Vivendi, HIH, One.Tel, that shook the public confidence in financial statements and the accounting profession, brought corporate governance to the forefront of public debate. Some of these corporate failures represent classic examples of how poor corporate governance can undermine the livelihoods of many, including investors, creditors, employees, suppliers, customers and retirees. Scandals such as Enron questioned the effectiveness of the corporate regulatory regimes of highly developed countries and saw the introduction of the 2002 Sarbanes Oxley Act (SOX) in the US and corporate governance reforms in many other countries. These laws, regulations and governance guidelines were supposed to 'fix the problem' as it were.

Corporate governance refers to the framework of rules, relationships, processes and systems by which corporations are directed and controlled. It comprises a gamut of issues from Board composition, independence of directors, Board subcommittees such as audit, remuneration and appointment committees, minority protection, risk management, accountability, to transparency and disclosure.

The origins of corporate governance lie in agency theory. The separation of ownership and control, which was first apparent in joint stock companies in the early 19th century, called for a mechanism for the

• Lecturer, Faculty of Business & Enterprise Swinburne University of Technology, Australia

contributors of financial capital, who were not involved in day-to-day operations of the company, to obtain an assurance that directors and managers acted in the best interests of the owners, and reported the financial outcome of the business faithfully. Historically, the focus of corporate governance has been the shareholders. From an agency perspective, the benefits of corporate governance will mainly accrue to listed companies whose ownership is widespread. Therefore, corporate governance is well suited for developing countries whose capital markets are dominated by such firms.

Most developing countries, including Sri Lanka, are characterised by a majority of small firms that are not listed, and large companies whose shares are either unlisted or, if listed, are closely held by few individuals (OECD, 2006). Dominance of family firms is another unique character of the business landscape of many developing countries. The differences between developed and developing countries in relation to the institutional framework have created doubts in the minds of some policy-makers about the significance of corporate governance for developing countries (OECD, 2006). The benefits of corporate governance are not limited to developed countries. Developing countries can obtain equal, if not more, gains from corporate governance.

The paper commences with a discussion of the need for corporate governance in Sri Lanka. The third section summarises the country's corporate governance reform process. A review of the corporate governance regulations introduced by professional and regulatory bodies in Sri Lanka is included in the fourth section. The penultimate section debates on the practical issues facing the implementation and functioning of the corporate governance and regulatory measures that have been introduced. Section six summarises and concludes the paper.

2. Need for corporate governance regulations in Sri Lanka

Upholding shareholders' perception that corporate managers will not act in their own interest to the detriment of shareholders underpins the content of many corporate governance regimes that have been introduced in the recent past (Clarke & Dean, 2007). Commentators have been quick to criticise these governance regimes as knee-jerk reactions, which only create an appearance that corporate activities will be conducted honestly, without really guaranteeing them. However, creating such an appearance may essentially be important to developing countries.

Sri Lanka's development policy in the last three decades has been predominantly based on private enterprise and foreign investments. Since opening up the economy in 1977, previous Sri Lankan governments have actively promoted trade liberalisation and private/foreign investments by privatising state owned enterprises, removing barriers for business and providing handsome incentives for trade and investments[1]. The country's dependence on foreign direct investments (FDI) to develop infrastructure and fuel economic growth which is targeted at 8% in 2008, amidst the on going war in the North and East, is

[1] The government's intentions were made clear by privatising more than 80 state-owned companies in the past years, reducing tariff levels on many items, lightening the regulations governing the repatriation of profits, granting tax exemptions and tax holidays for foreign investments and making privatization a priority in most of its budgets. Since 1995, plantation, telecommunication, ports, power and aviation sectors have been subject to privatisation as a result

more pronounced today (Wickramasooriya, 2005). In 2006, the government tripled the amount of inward foreign direct investment target to a record US$ 1 billion a year. The country needs to sustain a high level of FDI to catalyse the development process.

Saudagaran & Diga (2003, p.245) conducted a survey of investment institutions dealing with emerging markets and observed that a major factor in evaluating the investment potential of a market was the accounting and legal infrastructure underlying that market. A global survey conducted by Ernst & Young Global Markets Limited (2006) identified that 20% of foreign investors decide against investing in emerging markets due to fraud risk. These findings suggest that countries such as Sri Lanka, which is highly dependent on foreign investments, need to initiate action to build confidence in financial reports presented by companies and enhance corporate governance to ensure reliability of financial statements and minimise fraud risk. The apex government authority responsible for foreign investment, namely the Board of Investment of Sri Lanka, acknowledges the importance of good governance and strong legislation, among other factors, in the investment decisions of major international companies, and the importance of formulating strategies to build a climate conducive to this type of investments. President Rajapakse's government stresses the need to combine an efficient private sector with a facilitative public sector, while strengthening the prerequisites for growth. Among these prerequisites are modernising the country's legal and regulatory framework, and improving transparency, accountability and governance (Central Bank of Sri Lanka, 2005).

A major factor contributing to a strong capital market is drawing more companies, including state firms, to the bourse. More listings of state firms will increase liquidity, which is a major incentive to attract foreign investors and sustain the market's strong performance (Attygalle, 2005). In the 2005 budget speech, the Finance Minister stated the government's intention of offering the state owned companies in the hospitality sector to the public through the market. The Public Enterprises Reform Commission (PERC), in its attempt to develop and broaden the capital market, intends to use the Colombo Stock Exchange (CSE) as the preferred medium for divesting companies it controls.[2] CSE has also focused attention on attracting family business to the bourse (The Sunday Times Online, 2007a) in a bid to make it more attractive to investors. As important as increasing the number of listed firms is the promotion of corporate governance practices among listed firms, in order to build confidence that minority shareholders and other stakeholders are not being discriminated against (Jacoby, 2005). In the words of the president of International Federation of Accountants 'Sound corporate governance practices have become critical to the worldwide efforts to stabilize and strengthen global capital markets and protect investors' (Ward, 2006).

A reason often found in academic literature in support of corporate governance is the resulting reduction in cost of equity of companies adopting and communicating good governance practices. Corporate governance helps to build confidence in the investors that corporate affairs are conducted with integrity

---

of the work undertaken by the Public Enterprise Reform Commission. The 2005 budget speech revealed governments intentions of offering the remaining state owned hospitality companies to the market.

[2] To encourage that the entities being divested by PERC seek stock exchange listing, it prefers to offer 30 percent of the holding to the market with 60 percent to strategic holders and 10 percent to employees (ADB, 2005, p.113).

and fairness. This confidence reduces the risk premium specific to the security, and consequently increases the market value of the share. Markets that promote best practices of corporate governance are in an advantageous position to attract investors compared to the markets that lack such regulations. As a stock market that competes for foreign investments with other markets in the South Asian region, Sri Lanka cannot afford to overlook any possibility of increasing its competitiveness.

The need for implementing regulatory mechanisms for better corporate governance has been identified in the 10 year capital market development master plan devised by the Securities and Exchange Commission (SEC) of Sri Lanka and is accepted by the government. Mandating the 'Rules on Corporate Governance for Listed Firms', formulated by the SEC and the Institute of Chartered Accountants of Sri Lanka (ICASL) in consultation with the Colombo Stock Exchange, for all listed companies and the issuance of draft rules on corporate governance for banks by the Central Bank of Sri Lanka (CBSL) are the main initiatives taken by the government in this regard.

Sri Lanka is reliant on international donors and multilateral lending institutions such as the Asian Development Bank (ADB) and the World Bank. A prerequisite for their support is the commitment by the government to strengthen the accountability and governance infrastructure (Saudagaran & Diga, 2003) and they indirectly pressurise the government to improve the financial transparency and the reliability of financial reporting in the country. The Asian Development Bank, (ADB) in particular, has provided the Sri Lankan government with a technical assistance grant to promote an environment conducive to private sector development, which includes an agenda to boost corporate governance practices (Dow Jones International News, 2004b). A recently attempted trade agreement with the European Union, to obtain favourable tariffs, was qualified by a request to comply with international standards for labour, corporate governance and social responsibility (Dow Jones International News, 2004a). Inability to meet these demands and failure to build an effective corporate governance infrastructure may result in international monetary aid and foreign investments going elsewhere. A report issued by the ADB in 2002 found deficiencies in auditor independence and objectivity and recommended improvement in corporate governance practices (Athukorala & Reid, 2002).

The most recent reason for the enthusiasm in corporate governance regulations in Sri Lanka can be attributed to the wave of corporate collapses triggered by Enron and global interest in this subject. The fall of the Pramuka Bank, the first ever Sri Lankan commercial bank to face bankruptcy, in 2002, coupled with alleged insider dealing cases pending before the SEC of Sri Lanka at that time, were timely reasons to initiate corporate governance reforms in the country. However, Sri Lanka lagged behind most of the other countries in regard to corporate governance reforms (Daily Mirror Online 27 February 2003).

3. Corporate governance reform process

The ICASL inaugurated initial reforms in the field of corporate governance in Sri Lanka. In 1996, the Council of the ICASL appointed a committee to make recommendations on matters relating to financial aspects of corporate governance. The Code of Best Practice on Matters Relating to Financial Aspects of Corporate Governance was issued by this committee in the draft form in December 1997. The rules embedded in this Code were largely based on the Cadbury Committee Report and governance codes in other jurisdictions (Watawala, 2006). This Code was directed towards voluntary compliance by all listed companies, unit trusts, fund management companies, finance companies, banks and insurance companies. Table 1 provides a list of recommendations suggested in this Code.

On the 4th of January 2000, the SEC issued a circular calling all directors of public companies to practice good corporate governance and to consider adopting the Code of Best Practice on Matters Relating to Financial Aspects of Corporate Governance on a voluntary basis (Mansoor, 2000). This was pursuant to a similar circular directed at all commercial corporations and government owned businesses which was issued by the Department of Public Finance in November 1999 (Mansoor, 2000).

In an attempt to further strengthen the corporate governance process, in line with global developments on this subject, ICASL appointed a committee to revise, enlarge and expand the existing Code in January 2000 (ICASL, 2003). This Committee issued the Code of Best Practice on Audit Committees in May 2002 (hereinafter '2002 Code') and included detailed guidance on the role, objects and composition of audit committees, as well as a methodology to achieve the objectives (ICASL, 2002).

In October 2001, the National Committee on Corporate Governance (NCGC) was constituted. The two main strategic objectives of the NCGC were to improve the competitiveness of the Sri Lankan corporate sector and to encourage international investments in this sector by promoting corporate governance (Hemmathagama, 2001). The ICASL as an invitee to the NCGC took a lead role in developing a comprehensive governance code, namely the Code of Best Practice on Corporate Governance, in March 2003 (hereinafter '2003 Code') (ICASL, 2003). Compared to the previous Codes issued by ICASL, the 2003 Code was comprehensive and included a number of principles to enable the proper functioning of a corporate Board. The 2003 Code refers the readers to the 2002 Code for guidance in relation to audit committees.

Table 1: Corporate governance recommendations included in the Code of Best Practice on Matters Relating to Financial Aspects of Corporate Governance

Themes	Requirements in the Code of Best Practice on Matters Relating to Financial Aspects of Corporate Governance
Role of Chairman separate from CEO	• Clear division of responsibilities between the Chairman and the Chief Executive Officer
Non Executive Directors (NEDs)	• The calibre and number of non executive directors on a board should be such that their views will carry significant weight in the board's decisions
Appointment of NEDs	• The appointment of non executive directors should be a matter for the board as a whole, and their selection process should be based mainly on merit
Training for directors	• Formal training for directors to give them basic knowledge in areas other than their own including short in house courses
Audit Committee	• Audit Committee to be chaired by a NED • Procedures to be laid down for the functioning of Audit Committee

Remuneration Committee	• Remuneration Committee to be chaired by a NED • Procedures to be laid down for the functioning of Remuneration Committee • The Remuneration Committee will report to the Board regarding the remuneration of executive directors
Responsibility of the Board	• The finance function of the company will be the specific responsibility of a Board director • The Board of Directors should draw up codes of ethics and statements of business practices for board members as well as employees and publish them internally
Disclosures	• Annual reports should include a statement regarding directors' responsibilities for financial statements. This is in addition to a formal statement in the notes to the accounts stating that accounts have been prepared in accordance with Sri Lanka Accounting Standards • directors' statement in the annual report regarding effectiveness of the company's systems of internal control • directors' statement in the annual report regarding the extent to which statutory payments have been made, provision for retirement gratuities and payment of management fees • The Chairman's review should cover the performance of the company during the past year, and the future prospects during the year • directors' statement indicating that they are satisfied about the company being a going concern

Source: Mansoor (2000)

Consequent to the unfolding of major corporate debacles in the USA and the subsequent demise of Arthur Anderson, the role and independence of auditors and the role of audit committees was seen as an area that needed regulation. Although the 2002 Code provided guidelines for audit committees, the SEC felt the need to revise this Code and to introduce provisions to strengthen the independence of auditors. In 2003, the SEC appointed Stakeholder Committee prepared a draft Code by revising several clauses in the 2002 Code and recommended additional clauses to be incorporated in relation to audit committees. The new Code which was developed in consultation with ICASL, Guidelines for Listed Companies in respect of Audit and Audit Committees (hereinafter '2004 Code'), in April 2004, was promoted for voluntary compliance by listed companies with a view to subsequently making it mandatory (SEC Sri Lanka, 2003; SEC Sri Lanka, 2004c). These Guidelines covered two important aspects, namely guidelines for audit of listed companies and guidelines for audit committees. The former included provisions on the qualifications, appointments, powers and remuneration of auditors, independence of auditors, disclosure requirements, restricted and permissible non-audit services which an external auditor would follow, which was considered timely due to the expanding and evolving role of auditors (SEC Sri Lanka, 2004d). The latetr addressed the duties, powers and objectives of audit committees of listed companies. However, the Code never achieved mandatory status.

The SEC felt a need to revise the prior Codes and formulate a composite Code of corporate governance covering all relevant aspects that could be issued to listed companies for voluntary adoption (SEC Sri Lanka, 2004a). In May 2006, ICASL and SEC in consultation with the Colombo Stock Exchange (CSE) formulated a new Code, 'Rules on Corporate Governance for Listed Companies' (hereinafter '2006 Code'), proposed for mandatory compliance by companies listed on the CSE. This Code prescribes a balanced but minimal level of corporate governance so that the eminent requirements for sound corporate governance would be addressed without imposing an excessive regulatory burden (SEC Sri Lanka, 2006). The main reason for the issuance of this Code, which is much less comprehensive than the 2003 Code, is to provide an actionable set of governance guidelines which could also be monitored by the CSE for compliance. The Rules relate to the minimum number of non-executive directors, the basis for determining independence, disclosure requirements in respect of directorate, and minimal requirements in respect of audit committee and remuneration committee. Commenting on the draft rules, the Director General of SEC, stated as follows;

> "The changes will be incorporated in the CSE listing rules and corporate governance and best practice methods will be mandatory from January [2007]"
>
> (Gunasekera, 2006)

In January 2007, the SEC issued a press release confirming the adoption of the 2006 Code with a minor amendment to the section on independence of directors. The amended Code, namely the Standard on Corporate Governance for Listed Companies (hereinafter '2007 Code') was included in the Listing Rule of the CSE, effective from 1 April 2007, and was to be implemented in two stages with a view to provide adequate time for listed companies to comply with the requirements (The Sunday Times Online, 2007b). The first stage of compliance includes the publication of a table in the annual report confirming that the company is adhering to the Standards on Corporate Governance set out in the Listing Rules and, if not, explaining the reasons for non-compliance with identified items. All listed companies are subject to the first stage of compliance in the financial year commencing on or after 1 April 2007. Compliance with the Corporate Governance Standards in the Listing Rules will be mandatory in the second stage and the annual report of companies should contain the relevant affirmative statement (The Sunday Times Online, 2007b). The second stage is effective for companies in their financial year commencing on or after 1 April 2008. Failure to comply with the standard will be treated as a failure to comply with the relevant Listing Rules and will thus incur penalties.

Table 2: Chronology of Sri Lankan corporate governance guidelines

Year	Issuer/s	Title
Dec 1997	ICASL	Code of best practice on maters relating to financial aspects of corporate governance
May 2002	ICASL	Code of best practice on audit committees
Mar 2003	ICASL	Code of best practice on corporate governance
May 2004	SEC & ICASL	Guidelines for Listed Companies in respect of Audit and Audit

		Committees
May 2006	SEC, ICASL & CSE	Rules on corporate governance for listed companies
Jan 2007	SEC, ICASL & CSE	Standards on corporate governance for listed companies

Source: Abhayawansa & Johnson (2007, p.91)

Codes of Corporate Governance can also be found in relation to banks and public sector enterprises in Sri Lanka. The Central Bank of Sri Lanka (CBSL) issued a Code of Corporate Governance for voluntary compliance by banks and financial institutions in 2002. The level of compliance with this Code was never tested. The banking regulator recently issued a revised Code of Corporate Governance for mandatory compliance by all licensed banks in the country. Given that not all licensed banks are listed on the stock exchange and given also the sensitive nature of the banking industry, this initiative is timely. The new Code, initially in the form of an Exposure Draft♦, is expected to be implemented by 1 January 2008 and complied by 30 June 2008, after considering the views of the bankers and interested parties (Abeywardane, 2007). According to CBSL, this Code is a response to the developments in corporate governance practices globally and addresses the conflicts of interests arising from large shareholdings observed in Sri Lankan banks. The proposed rules comprise stringent provisions suited to deal with situations such as conflicts of interest and management control. A corporate governance code is also in operation within the public sector enterprises, which was issued by the Department of Public Enterprises under the Ministry of Finance.

4. Reforms to corporate governance

Corporate governance guidelines in Sri Lanka mainly address the composition of corporate Boards, non-executive directors, independence of non-executive directors, training for and financial acumen of directors, audit committees, nomination and remuneration committees, and corporate governance disclosures.

4.1. Corporate Boards

The 2003 Code is the first ever set of guidelines, introduced in the country to regulate corporate governance in relation to corporate Boards (i.e. size and composition of the Board in relation to executive and non-executive/independent directors, roles of the chairman and CEO, need for lead directors, various committees on the Board, functions of the Board and performance evaluation of the Board and CEO). The recently issued 2007 Code also addresses this aspect of corporate governance. The later Code is a more concise and descriptive version of the original and takes a more practical and actionable approach. The rationale for making the Code concise is not to saddle listed companies with excessive regulation and

♦ Ed Note; this segment of the analysis was written prior to the release of the 26 December 2007 Directions on Corporate Governance for Licensed Banks in Sri Lanka.

disclosure requirements. Since the intention is to make the rules mandatory, the Code is structured in such a way that compliance with it can be properly disclosed and monitored.

Present corporate governance regimes endeavour to construct an independent Board which comprises a majority of non-executive directors. Such a Board shall practice objective judgement in corporate affairs, minimise any potential conflicts of interest and enhance the integrity of reported results. However, a danger exists in allowing outsiders (who are unlikely to be as knowledgeable about the company's business and operations as an equally skilled executive manager) to make decisions affecting the company's future (The Daily Mirror Online, 2003). The aforementioned two Codes try to encourage a balanced Board that can uphold independent judgment but at the same time not sacrifice performance by prescribing that at least a third of a Board should include non-executive directors and that at least 1/3rd (or 2 whichever is higher) of such directors should be independent. The 2003 Code had provisions to enhance the Board's financial and business proficiency where non-executive directors are concerned by recommending training for directors not only in general aspects of directorship but also matters specific to the particular industry/company concerned (Section A..1.7). Nonetheless, these important provisions are absent in the 2007 Code which is currently operational. However, it is expected that the corporate Boards may take appropriate measures to ensure that the directors are not disadvantaged.

Finding suitably skilled independent directors remains a problem in Sri Lanka as the number of qualified candidates for these roles are limited and the demand for such skills are high. The situation is further exacerbated by the prevalence of complex group structures and the closely knit corporate scaffold with institutional cross-ownership linkages in the country (ADB, 2005). To overcome this issue, Mr. Vivendra Lintotawela, Chairman of John Keells Holdings, has suggested that the role of non-executive directors to be that of "selecting executive directors and ensuring complete integrity towards all stakeholders" (The Daily Mirror Online, 2003). This is, however, partially achieved by nomination committees that should be manned predominantly by non-executive directors. Nonetheless, a nomination committee is not required by the 2007 Code though it was included in the 2003 Code. The 2003 Code advocates that the Chairman and majority of members of the nomination committee should be non-executive directors.

The 2007 Code provide detailed criteria to decide on the independence or non-independence of directors. However, the Code provides freedom to the Board to decide a director as independent in the event a director does not qualify as 'independent' under any of the criteria. The basis of such determination should be disclosed together with the unsatisfied criteria. Every year, the Board should assess the independence of each non-executive director on the Board. Further, the onus of declaring one's independence should be put back on the non-executive directors by requiring the submission of a signed declaration of independence annually.

Combining the position of the chairman of the Board and CEO in one position is widely held as undesirable from an internal control perspective. The 2003 Code identifies this potential control threat and recommends that majority of the Board should comprise non-executive directors, if such a situation arises. Surprisingly, this important governance aspect is not addressed in the currently effective 2007

Code. Table 3 compares the corporate governance reforms focusing on Boards addressed in the 2003 Code and 2007 Code.

Table 3: Corporate governance reforms

	Code of Best Practice on Corporate Governance (2003 Code)	**Standards on Corporate Governance for Listed Companies (2007 Code)**
Number of non-executive directors (NEDs) on the Board	Not less than 1/3rd of the Board If the same person holds the posts of Chairman and CEO, NEDs should comprise a majority of the Board.	Not less than 1/3rd of the Board or 2 which ever is higher
Independence of the NEDs	Majority of NEDs should be independent	Majority of NEDs should be independent
Post of Chairman separate from CEO	The post of Chairman of the Board and CEO should not be held by the same individual. A decision to combine the two positions in one person should be justified.	
Disclosure of NEDs in annual report	Independent NEDs should be identified in the annual report	BODs shall determine and disclose annually independence or non-independence of NEDs
Disclosure of directors details	Brief resume of directors to be published in the annual report detailing their nature of expertise in relevant functional areas and directorships held in other company Boards	Brief resume of directors to be published in the annual report detailing their nature of expertise in relevant functional areas and directorships held in other company Boards
Criteria for defining independence	Broad and not specific	Sets out detail criteria
Training for directors	Every director should receive appropriate training on the first occasion they are appointed to a Board of a listed company	
Reporting on corporate governance	Directors should include a Corporate Governance Report detailing the manner and extent to which the company has complied with the code in its annual report.	
Appointment & remuneration of	Nomination committee should be established to make recommendations to	

directors	the Board on all new Board appointments and remuneration committee should be established to decided director/CEO remuneration	

Source: Johnson & Abhayawansa (2007, p.101)

4.2. Remuneration committees

The 2007 Code provides valuable recommendations with regard to the composition and conduct of the remuneration committee. Independence of the remuneration committee is ensured by requiring it to exclusively comprise non-executive directors, the majority of whom are independent. The transparency of the remuneration committee is enhanced by requiring disclosure of membership of the committee in the annual report together with a statement of the remuneration policy and the aggregate remuneration paid to executive and non-executive directors. Compared with the transparency of executive remuneration in developed countries, these disclosure requirements can be further improved to show the remuneration paid to each individual executive and non-executive director.

4.3. Disclosure

Among the guidelines in the 2004 SEC Code is the requirement for a Chief Executive Officer or Chief Financial Officer to certify that all reasonable steps have been taken to ensure that financial statements show an accurate position (Section 4.A.1). This is considered good corporate governance practice and is found in the SOX. Surprisingly, this requirement, together with several other governance aspects on financial reporting has been dropped from the 2007 Code, which superseded the former. Important reporting requirements abandoned in the same manner includes requirement to notify the SEC where material multiple audit adjustments are evidenced, an Initial Public Offering (IPO) prospectus to contain an Accountant's/Auditor's report and quarterly reports to be reviewed by an independent accountant.

4.4. Audit committees

The IFAC report on rebuilding public confidence in financial reporting recommends that

> 'all public interest entities should have an audit committee, or similar governance body or bodies, formed from directors independent of management with clearly defined responsibilities, including monitoring and reviewing the integrity of financial reporting, financial controls, the internal audit function and relations with the independent auditors. All members of the committee should be financially literate and should receive relevant training.'' (IFAC, 2003, p.2)

Sri Lankan corporate governance reforms have acknowledged the importance of audit committees as a means of ensuring reliable financial reporting, internal control and risk management. This is evident in the statement made by the Director General of SEC;

> 'More and more members and investors examine that type of good corporate practices followed by companies when they make investment decisions, and it is no longer possible to be oblivious to the important role played by Audit Committees' (Daily News Online, 2006).

Among the important contributions of an audit committee are prevention, detection and correction of material financial statement misstatements; determining key operational and financial risks and ensuring adequate controls are in place to deal with the risks; ensuring the independence of auditors, supporting the external audit, increasing the credibility of auditors work and financial statements, and compliance with laws and policies (Johnson & Rusak, 2007).

Guidelines on the size, composition, roles and functions of audit committees have been included in all the corporate governance codes issued to date, emphasising the importance of this Board Sub-Committee. Co-chair of the combined committee that worked on the 2004 Code stated that 'some functions of the audit committee, one of the most important Board Sub-committees, needs mandating' (Lanka Business Report News Desk, 2004). Among the functions of audit committees mandated in the 2007 Code are the power to make recommendations to the Board on appointment, re-appointment and removal of external auditors, approve remuneration and terms of engagement of the external auditors, and assess the independence and quality of work of the Company's external auditors (SEC Sri Lanka, 2006).

Considering the pivotal role played by an audit committee as a mechanism to build renewed confidence in financial statements and in sound corporate governance of public companies, the 2007 SEC Code stipulated all listed companies to comprise an audit committee. According to the Code, the audit committee should comprise the higher of a minimum of two independent non-executive directors or exclusively of non-executive directors a majority of whom shall be independent. In order to ensure that the audit committee is equipped with accounting and financial capabilities, the Code stipulates that at least one member of the committee needs to be a member of a professional accounting body.

A survey on audit committees of listed companies conducted by SEC, in 2005, revealed that around 38% of listed companies (i.e. 50 companies) did not have an audit committee (SEC Sri Lanka, 2005). Therefore, with the mandating of audit committees these companies are likely to experience an increase in compliance costs. However, the benefits are expected to outweigh the costs. Much variation in the composition, functions and operational modalities with regard to audit committees were also unearthed in this study (SEC Sri Lanka, 2005).

The spirit of the rule of having only non-executive directors in an audit committee is to enable independent judgement to be exercised without any influence from executive management. Most international corporate governance guidelines proscribe having the executive management or executive directors on an audit committee. However, the 2007 Code allows the chief executive officer (CEO) and the chief financial officer (CFO) of a listed company to attend audit committee meetings unless the audit committee decides otherwise. This is a subtle change from the position taken by the prior governance codes which allowed the CEO and CFO to attend only by invitation (ICASL, 2002; ICASL, 2003; SEC Sri Lanka, 2004b). Thus what was once an exception is now the norm. The rationale for taking this stance may be the need to supplement the audit committee with financial and accounting knowledge and the knowledge of the business, which may be lacking in the non-executive directors (Johnson & Abhayawansa, 2007).

The country's corporate governance guidelines illustrate a chronological intensification of emphasis on ensuring financial wisdom in audit committees. For example, the 2002 Code merely provided that the audit committee should have an 'expert accounting and financial knowledge' (ICASL, 2002) whereas the 2007 Code stipulates that the chairman of one member of the committee should be a member of a recognised professional accounting body (SEC Sri Lanka, 2006). On a pragmatic level, this may be difficult to achieve due to the insufficiency of qualified independent/non-executive directors with sufficient financial acumen to function in audit committees. The SEC survey on audit committees in Sri Lankan listed companies justified this concern by finding that more than half of the audit committee chairpersons of listed companies, did not have a formal accounting related qualification let alone membership of a professional accounting body (SEC Sri Lanka, 2005). It will be interesting to see how listed companies take up this challenge when they start complying with the 2007 Code embedded in the Listing Rules from April 2008.

The 2002 and 2004 Codes provided that the chairman of the audit committee should be an independent non-executive director (ICASL, 2002; SEC Sri Lanka, 2004b). However, the 2007 Code does not require the chairman of the audit committee to be independent. This position can be held by a non-executive (not necessarily independent) director. The dilution of the rule can be attributed to the finding of the SEC survey on audit committees that a majority of audit committee chairpersons were not independent directors (SEC Sri Lanka, 2005). Watering down the provision in relation to the Chairman of the audit committee is an example of how the country's unique circumstances, the scarcity of suitably qualified independent non-executive directors, have influenced the corporate governance guidelines that are ultimately being implemented. Table 4 compares the provisions in relation to audit committees as included in the governance Codes issued in Sri Lanka.

Table 4: Reforms relating to audit committees

	Code of Best Practice on Audit Committees (2002 Code)	**Code of Best Practice on Corporate Governance (2003 Code)**	**Guidelines for Listed Companies (2004 Code)**	**Rules/Standard on Corporate Governance for Listed Companies (2006/ 2007 Codes)** (Johnson & Abhayawansa, 2007)
Minimum membership		Not less than 3 members	Not less than 3 members	Not less than two members
Committee composition	Exclusively include NEDs majority of whom shall be independent. CEO and CFO shall attend audit committee	Exclusively include NEDs majority of whom shall be independent	Include at least 3 independent non-executive directors	The audit committee should be comprised exclusively by NEDs majority of whom shall be independent. CEO and CFO shall attend audit committee meetings but they are not members of the audit committee

	meetings by invitation but they are not members of the committee			
Chairman of the committee	Should be independent		Must be an independent NED	Should be a NED
Qualifications of committee members	Members of the committee should have basic financial literacy, with at least one member having expert accounting and financial knowledge		Chairman of the audit committee should have experience and familiarity with financial reporting	Chairman or one member of the audit committee should be a member of a recognised professional accounting body
Disclosure in annual report		Disclose the names of directors comprising the audit committee.		Disclose the names of directors comprising the audit committee.
Committee meetings	At least 4 times a year		Once every quarter	
Audit committee of a parent functioning for subsidiary company				Where both parent company and the subsidiary company are listed companies, the audit committee of the parent company may function as the audit committee of the subsidiary

5. Practical and implementation issues

Corporate governance provides proprietary benefits to the companies adopting them. An important benefit to a company is the reduction in cost of equity and debt, enabling it to attract funds with relative ease and at a lower cost. However, when left alone for voluntary adoption, very few companies apply the best practices in corporate governance with legitimate intentions. The survey conducted by SEC on audit committees of listed companies in 2005, while the 2004 Code was in operation, revealed the lethargy with which the main corporate governance principles were followed by the sampled companies. The key findings of this study were discussed in the previous section. In this backdrop, problems of compliance with the 2007 Code may become evident.

However, potential non-compliance with certain provision cannot exclusively be attributed to companies not recognising the real benefits of corporate governance. Implementation of the local corporate governance codes within the country's corporate sector remains an issue. As discussed in the previous section, scarcity of suitably skilled independent non-executive directors and non-executive directors with membership in professional accounting bodies to be appointed to audit committees may constitute potential problems.

Controlling shareholders of family businesses and companies dominated by one or more closely related individuals that are listed on the CSE may not welcome certain corporate governance principles which threaten the exercise of their power in business decision making. Wijemanne (2007), drawing on research evidence, states that family businesses experience problems in relation to the best practices relating to Board procedures, ownership, succession, independency or directors, compensation and Board-family relations when restructuring or complying with corporate governance rules. Alerting the entrepreneurs in family firms about the benefits of good corporate governance and providing proper advice and assistance (Wijemanne, 2007) is important to overcome such tendencies, especially at a time where CSE is actively promoting family firms to go public (Lanka Business Online, 2007). Albert Jan Thomassen from the Family Business Consulting Group of Netherlands states that it helps to;

> "better balance the entrepreneurial impulsiveness with well thought through and grounded decision making, it increases the quality of management information, [and] it brings in more expertise through external Board members the family business otherwise would not have had access to."

Current statistics on compliance with the listing rules indicates that approximately 3 - 5% of listed companies are in the CSE Default Board for various non-compliances relating to financial reporting regulations (CSE, 2005). The number of companies obtaining CSE listings has been 6 on average in 1994-2004 (CSE, 2003). An important reason for the reluctance on the part of public companies to obtain stock exchange listings is the increased administrative and financial reporting onus. It was found that 75% of the companies registered in the country are formed as private companies in order to avoid excessive administrative and reporting requirements (Perera, 2003). Corporate governance rules form an additional layer of regulation needed to be complied with by listed companies. Compliance with these rules will also see a significant increase in costs for small and family companies which may not yet be ready for it. This can adversely affect the capital market by discouraging companies to seek CSE listing, which is already at low level, and can cause companies already listed to opt out of it. A more pragmatic approach in a country such as Sri Lanka to avoid such negative consequences, may be to continue with the stage 1 compliance procedure adopted in relation to the 2007 Code. That is: to require companies to state the level of compliance with the Code and whenever non-compliance is noted to explain reasons for it. This practice is already in operation not only in developing countries but also in developed countries, including Australia.

The regulators face the dilemma of gauging the right threshold of regulation which would achieve the objectives of good governance while at the same time, not discouraging entrepreneurs with an excessive regulatory burden. This dilemma also resulted in the delay of corporate governance rule becoming mandatory. The first stage compliance with the 2007 Code will enable the regulators to understand the potential problems faced by companies in complying with the rules and, if necessary, amend the rules before these rules can subsequently act as mandatory regulations. This approach is appropriate to achieve the right balance between accountability and performance through corporate governance.

6. Summary and Conclusion

The series of corporate scandals in the west brought corporate governance into the forefront. Many developed countries, starting with the US, were quick to regulate in the area of corporate governance with the intention of avoiding such disastrous failures in the future and to rebuild public confidence in financial statements and the integrity of financial institutions. Investors increasingly urged companies to adopt good corporate governance practices and this was emphasized when they invested in foreign countries, mainly emerging markets (EYGM Limited, 2006; Grant Thornton, 2006). Sri Lanka's response to corporate governance reform can be explained against this backdrop. As a country dependent substantially on FDI for economic growth and infrastructure development, foreign investment in the capital markets, foreign debt and donations, and favourable terms with trading partners in developing countries, corporate governance is an essential mechanism to achieve these objectives. The country not only has a need to avoid costly corporate failures, akin to the Pramuka Bank, occurring in the future through promoting best practices in corporate governance but also to *appear* as adopting these practices to keep abreast with international community and global investors (Abhayawansa & Johnson, 2007).

The corporate governance reform process in Sri Lanka was inaugurated by ICASL in 1997. The ICASL took a lead role in formulating corporate governance codes. To date the country has seen six corporate governance guidelines where ICASL has been involved and the active participation of the SEC and CSE is also evident in the more recent Codes. In addition, the CBSL has issued two guidelines on corporate governance to be applied by banks and financial institutions and the Department of Public Enterprises under the Ministry of Finance issued a governance code for public sector enterprises. The Standards on Corporate Governance for Listed Companies issued by ICASL and SEC in consultation with CSE, in January 2007, is the only corporate governance code that is mandatorily complied by listed entities. The corporate governance code issued by the CBSL is planned to be mandated from 2008, but it is still in draft form.

Corporate governance guidelines in Sri Lanka mainly address the size and composition of corporate Boards in relation to executive and non-executive directors, independence of non-executive directors, training for and financial acumen of directors, audit committees, nomination and remuneration committees, functions and roles of the Board and its various subcommittees and corporate governance disclosures.

Potential problems are envisaged in implementing certain provisions contained in the 2007 Code. These problems relate to the scarcity of suitably skilled and qualified non-executive/ independent directors, non-executive directors not having the intricate knowledge about the business as do executive management, and the existence of family businesses and companies dominated by few individuals to which standard rules of corporate governance in not appropriate. In order to overcome these problems, it is argued that the role of non-executive directors should be limited to the selection of executive directors (The Daily Mirror Online, 2003). Alternately, an "if not why not" approach should be adopted as is the case in India where companies are not required to comply with all rules but are required to provide reasons for non-compliance when a rule is not complied with. It is expected that the most suitable corporate governance framework for listed companies will emerge with the experience obtained in monitoring compliance with the 2007 Code by the CSE.

Corporate governance and regulations should also be introduced to non-listed public companies. Given that a number of banks and majority of financial institutions operate as either non-listed public companies or private enterprises, there is an urgent need to improve governance in these public deposit-taking institutions. There is scope to improve the Governance Code introduced by the Central Bank of Sri Lanka and make it mandatory for these institutions to enhance confidence in the banking system, which is the lifeblood of the country's financial corpus. It is apt to conclude by stating that ineffective regulatory regimes, despite spectacularly constructed governance codes and rules, have failed to provide security to stakeholders and to encourage trade and investment flows.

References

Abeywardane, G. 2007, 'Bankers shaken by corporate governance draft - but CB says it's aimed at creating a stable banking and financial sector', *The Nation on Sunday*, viewed 3 November 2007, available at: www.nation.lk/2007/09/09/busi.htm

Abhayawansa, S. & Johnson, R. 2007, 'Corporate governance in developing countries: Accountability versus performance?' in *Readings in Auditing*, vol. II, ed. R. Johnson, John Wiley & Sons Australia, Queensland, pp. 84-98.

ADB 2005, *Sri Lanka: financial sector assessment*, Asian Development Bank: Manila.

Athukorala, S. L. & Reid, B. 2002, *Diagnostic Study of Accounting and Auditing Practices: Sri Lanka*, Asian Development Bank: Philippines.

Attygalle, A. 2005, *Sri Lanka Plans to List More State Firms*, Dow Jones & Company Inc, viewed 15 February 2005, available at: http://www.djnewswires.com.

Central Bank of Sri Lanka 2005, *Annual report*, Central Bank of Sri Lanka: Colombo.

Clarke, F. & Dean, G. 2007, *Indecent Disclosure - Gilding the Corporate Lily*, Cambridge University Press, New York.

CSE 2003, *Annual Report*, Colombo Stock Exchange: Colombo

CSE 2005, *Stock Market Daily - Tuesday 12th April 2005*, Colombo Stock Exchange: Colombo.

Daily News Online 2006, *Listed companies sans audit committees shocks SEC*, The Associated Newspapers of Ceylon Ltd, viewed 26 August 2006, available at: http://www.dailynews.lk/2006/01/05/bus03.htm.

Dow Jones International News 2004a, *Duty concessions for Lanka exports to EU*, viewed 15 February 2005, available at: http://www.djnewswires.com.

Dow Jones International News 2004b, *Sri Lanka Gets $800,000 - ADB for Private Sector Development* Dow Jones International News, viewed 15 February 2005, available at: http://www.djnewswires.com.

EYGM Limited 2006, *Ninth global fraud survey: fraud risk in emerging markets*, Ernst & Young Global Markets Limited: London.

Grant Thornton 2006, *Risky Business: Financial fraud, an unpleasant reality*, Grant Thornton (NSW) Pty Ltd.

Gunasekera, M. 2006, *Clean closet: corporate governance to be made mandatory from next Jan: Sri Lanka's SEC*

Hemmathagama, A. 2001, *National Committee on Corporate Governance formed*, Daily Mirror Online, Wijeya Newspapers Ltd, viewed 15 February 2005, available at: http://www.dailymirror.lk/archives/231101/business.html.

ICASL 2002, *Code of Best Practice on Audit Committees*, Institute of Chartered Accountants of Sri Lanka, Colombo.

ICASL 2003, *Code of Best Practice on Corporate Governance*, Institute of Chartered Accountants of Sri Lanka, Colombo.

IFAC 2003, *Rebuilding public confidence in financial reporting: an international perspective*, International Federation of Accountants: New York.

Jacoby, M. 2005, 'Corporate governance (a special report) - The global agenda: wherever investors go, demands for better governance follow', *The Wall Street Journal*, 17 October.

Johnson, R. & Abhayawansa, S. 2007, 'Corporate governance reforms in Sri Lanka and India: Part 1 ', in *Readings in Auditing*, vol. II, ed. R. Johnson, John Wiley & Sons Australia, Queensland, pp. 99-109.

Johnson, R. & Rusak, A. 2007, 'Audit committees: effectiveness and diligence ', in *Readings in Auditing*, vol. II, ed. R. Johnson, John Wiley & Sons Australia, Queensland, pp. 173-187.

Lanka Business Online 2007, *Family affair - Sri Lanka family firms going public could outperform index: expert*, Lanka Business Online, viewed 3 November 2007, available at: www.lbo.lk.

Lanka Business Report News Desk 2004, *SEC and the national accounting body brings a new governance code for listed companies*, Lanka Business Online, viewed 31 August 2006, available at: www.lankabusinessonline.com.

Mansoor, J. 2000, 'Corporate Law: Issues in Focus', *Corporate law in the millennium legal writing competition for juniors*, Colombo, available at: http://www.lawnet.lk/docs/articles/sri_lankan/HTML/CV12.html.

OECD 2006, *Corporate governance in development: the experience of Brazil, Chile, India and South Africa*, OECD Development Centre and Centre for International Private Enterprise, viewed 16 October 2006, available at: www.oecd.org.

Perera, S. 2003, *Action on SEC insider deals -Finance Minister assures Parliament*, Daily Mirror Online, Wijeya Newspapers Ltd, viewed 15 February 2005, available at: http://www.dailymirror.lk/2003/01/29/frontpage/2.htm.

Saudagaran, S. M. & Diga, J. G. 2003, 'Economic Integration and Accounting Harmonisation options in Emerging Markets: Adopting the IASC/ IASB Model in ASEAN', *Research in Accounting in Emerging Economies*, vol. 5, pp. 239-266.

SEC Sri Lanka 2003, *Guidelines for listed companies - audit and audit committees*, Securities and Exchange Commission of Sri Lanka, Colombo.

SEC Sri Lanka 2004a, *Annual Report*, Securities and Exchange Commission of Sri Lanka: Colombo.

SEC Sri Lanka 2004b, *Guidelines for listed companies - audit and audit committees*, Securities and Exchange Commission of Sri Lanka, Colombo.

SEC Sri Lanka 2004c, *SEC issues guidelines for listed companies in respect of audit and audit committees*, Securities and Exchange Commission of Sri Lanka, viewed 15 February 2005, available at: http://wwvv.sec.gov.lk/press.html.

SEC Sri Lanka 2004d, *The SEC recommends a revision of the recent ICASL code on corporate governance*, Securities and Exchange Commission of Sri Lanka, viewed 15 February 2005, available at: http://www.sec.gov.lk/press.html.

SEC Sri Lanka 2005, *Audit committees of listed companies of Sri Lanka*, Securities and Exchange Commission of Sri Lanka: Colombo.

SEC Sri Lanka 2006, *Rules on corporate governance for listed companies*, Securities and Exchange Commission of Sri Lanka: Colombo.

The Daily Mirror Online 2003, *The blue chip JKH's chief has his say*, Wijeya Newspapers Ltd, viewed 3 November 2007, Available at: www.dailymirror.lk

The Sunday Times Online 2007a, *CSE targets family businesses*, Wijeya Newspapers Ltd, viewed 3 November 2007, Available at: www.sundaytimes.lk

The Sunday Times Online 2007b, *Rules on corporate governance for listed companies*, Wijeya Newspapers Ltd, viewed 3 November 2007, Available at: www.sundaytimes.lk

Ward, G. 2006, *Building an Investment Climate of Trust*, International Federation of Accountants, viewed 25 November 2006, available at: http://www.ifac.org/Library/ArticleFiles/GWard_Sri_Lanka_CFO_Speech_Jan06.doc.

Watawala, L. R. 2006, *Workshop on development, structure, capacity and roadmap for enhancing corporate governance standards in Commonwealth member countries in Asia: Country report - Sri Lanka*, viewed 23 August 2006, available at: http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/South_Asia_CG_Workshop_June06_Sri_Lanka/$FILE/Sri+Lanka+Presentation+-+Corporate+Governance.ppt.

Wickramasooriya, S. 2005, *New foreign investment strategy*, viewed August 26 2006, available at: http://www.recoverlanka.net/data/SLDF05/paper-14.pdf.

Wijemanne, Y. 2007, *Corporate governance key to success of family businesses*, The Associated Newspapers of Ceylon Ltd, viewed 3 November 2007, available at: http://www.dailynews.lk/2006/01/05/bus03.htm

Subscriptions

The annual subscription rates of the LST Review are as follows:

Local: Rs. 1250 (inclusive of postage)

Overseas:	South Asia/Middle East	US$ 36
	S.E.Asia/Far East/Australia	US$ 41
	Europe/Africa	US$ 46
	America/Canada/Pacific Countries	US$ 51

Individual copies at Rs.150/- may be obtained from the Trust, No. 03 Kynsey Terrace, Colombo-08, and BASL Bookshop at No.153, Mihindu Mawatha, Colombo-12.

For further details, please contact;

Law & Society Trust
No. 3, Kynsey Terrace
Colombo-08
Tel: 2691228 / 2684845
Fax: 94 11 2686843

Law & Society Trust

3, Kynsey Terrace, Colombo 8, Sri Lanka
Tel: 2691228, 2684845 Tele/fax: 2686843
E-mail: lst@eureka.lk Website: http://www.lawandsocietytrust.org.