Standard & Poor's Corporate Governance Scores

Criteria, Methodology And Definitions

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Standard & Poor's Governance Services

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1. INTRODUCTION

There is no one model of corporate governance that works in all countries and all companies. Indeed, there exist many different codes of “best practices” that take into account differing legislation, board structures and business practices in individual countries. However, there are standards that can apply across a broad range of legal, political and economic environments. With this in mind, the Business Sector Advisory Group on Corporate Governance to the OECD has articulated a set of core principles of corporate governance practices that are relevant across a range of jurisdictions. These are:

- Fairness
- Transparency
- Accountability
- Responsibility

These same principles can be used as cornerstones in a corporate governance scoring methodology for individual companies.

This methodology presents Standard & Poor’s approach to analyzing corporate governance both at a country and at a company level. These two dimensions can be assessed jointly or separately.

2. THE CONCEPT OF CORPORATE GOVERNANCE SCORES

2.1. Definitions

A company *Corporate Governance Score* (‘CGS’) reflects Standard and Poor's assessment of a company’s corporate governance practices and policies and the extent to which these serve the interests of the company’s financial stakeholders, with an emphasis on shareholders’ interests.

For purposes of the CGS, corporate governance encompasses the interactions between a company’s management, its board of directors, shareholders and other financial stakeholders.

A Corporate Governance Score (‘CGS’) is assigned on a scale from CGS-10 (highest) to CGS-1 (lowest).

In addition, scores from 10 (highest) to 1 (lowest) are awarded to the four individual components that contribute to the overall CGS. These are:

- Ownership Structure & Influence
- Financial Stakeholder Rights & Relations
- Financial Transparency and Information Disclosure
- Board Structure & Process

In these definitions, *financial stakeholders* include both a company’s shareholders and creditors. This reflects the premise that the quality of a company’s governance process can affect its ability both to honor contractual financial obligations to creditors and to maximize the value of a company’s equity and distributions for its shareholders.

Different models of corporate governance around the world reflect the nature of local legal and regulatory systems, as well as differing approaches to economic management. The Anglo-Saxon system focuses primarily on the shareholder, while others, such as the German system, are often perceived as achieving a greater balance of interests between shareholders and other external stakeholders (including creditors, employees, the community, the environment, etc). By addressing the interests of both creditors and shareholders, the CGS recognizes the importance of stakeholders’ rights beyond the rights of the shareholder. Hence, this system can be applied generally in many countries around the world, operating with differing general approaches to corporate governance. However, it should be noted strongly that Standard & Poor’s Corporate Governance Scores are designed specifically for financial stakeholders, primarily shareholders.

2.2 Corporate Governance Service Structure

As mentioned above, a *Company Governance Score* reflects Standard & Poor’s assessment of an individual

company's corporate governance practices and policies. This focuses on the *internal* governance structure and processes at an individual company

Standard & Poor's does not currently score individual countries. However, some consideration of a country's legal, regulatory and market environment is an important element in the overall analysis of the risks associated with the governance practices of an individual company (see section 4 for Standard & Poor's current approach to the analysis of country factors). For example, two companies with the same Company Scores, but domiciled in countries with contrasting legal, regulatory and market standards, present different risk profiles. In the event of deterioration in governance standards at a particular company, investors and stakeholders are likely to receive better protection in a country with stronger and better-enforced laws and regulations.

That is why substantial analytical work is completed at the country level before any Company Scores are assigned in specific countries. In the future, S&P plans to develop a more formal country governance analysis/evaluation, which will enable S&P to assign:

Country Governance Classification: the effectiveness of the legal, regulatory informational and market infrastructure. This will tell how *external* forces at a macro level can influence the quality of a company's corporate governance.

Both these micro and macro components are important to the practice of corporate governance. Specific scoring factors can be identified in order to analyze governance practices and facilitate objective and comparative analysis of corporate governance practices at individual companies. Inclusion of the country analysis will enable the individual company scores to be placed in a more international context, facilitating a comparison of country governance environments.

A CGS represents an independent opinion, based upon transparent criteria and a standardized analytical process. It is not an audit, a rating, financial advice, nor a recommendation for a specific course of action. Information may be available to Standard & Poor's Rating Services that is not available to Standard & Poor's Corporate Governance Services and *vice versa*

2.3 Relationship to Credit Ratings

The term *Corporate Governance Score* is used to distinguish corporate governance scoring results from credit ratings. A credit rating is generally an opinion of the financial ability of an entity to meet its debt obligations in accordance with their terms. A CGS and the accompanying analysis is a composite assessment of various company practices. Its scope is to benchmark the recent and current standards of corporate governance, rather than to opine on specific financial or commercial performance.

While corporate governance can affect a company's creditworthiness and equity attractiveness, the score does not itself express an opinion about a company's credit quality or share valuation.

Standard & Poor's corporate governance analysts are housed within a division separated from credit rating analysts. Accordingly, confidential information obtained during the corporate governance scoring process will not be shared with credit rating analysts unless the client gives written consent to the contrary.

3. COMPANY CORPORATE GOVERNANCE SCORE

3.1. Introduction

Governance standards practiced by individual companies may reflect compliance with externally imposed governance standards. In countries where the external environment is weak, these individual company practices may also reflect the extent to which internal company governance discipline may or may not offset the weaker external infrastructure.

The CGS is intended to be relevant to different national approaches to corporate governance. Scoring criteria, as summarized

below, are based on the application of broad principles (fairness, transparency, accountability) to individual companies.

The OECD Principles of Corporate Governance (1999) represent an important effort to establish overarching indicators of the status of corporate governance in multiple national jurisdictions. These principles form the basis of the methodology used to determine a Corporate Governance Score. In addition to the OECD principles, the work of many other codes and guidelines have also been consulted and synthesized into a set of criteria. Among these are those of the World Bank, TIAA-CREF, the CACG Guidelines, the European Association of Securities Dealers, leading international companies and others.

3.2. Score and Analytical Process

Over one hundred standardized prompts guide analysts through sets of interrelated observations. These prompts have been designed to reveal the quality of corporate governance arrangements and minimize jurisdictional influences to the greatest extent possible. The information received from the prompts are measured by reference to Standard & Poor's proprietary scoring guidelines, thus ensuring a high degree of objectivity.

The process involves analysts from Standard & Poor's Corporate Governance Services and may also include analysts from Standard & Poor's affiliates, local law firms and other professionals in corporate governance where appropriate.

Analysts meet with the management and other officials (including outside/independent directors, shareholders and the company secretary) of the company being evaluated to discuss the company's corporate governance process based on the criteria outlined in this document. The company may be provided with questions in advance, drafted to reflect their specific environment.

A *Corporate Governance Score* (CGS) is assigned to a company as a result of voting of the scoring committee. The CGS reflects Standard & Poor's opinion of the extent to which a company adopts and conforms to codes and guidelines of good practices of corporate governance overall. A scale of CGS-10 (highest) to CGS-1 (lowest) is used. A score of 0 will be awarded where a company is unable or unwilling to provide enough information for a meaningful analysis.

In addition, each of four components (see below) that contribute to the CGS receive individual scores of 10 (highest) to 1 (lowest). Standard & Poor's also analyses sub-categories of the four main components, to evaluate the corporate governance standards of individual companies. These four components, and the sub-categories, are as follows:

Component 1 - Ownership Structure & Influence
Sub-categories:
- Transparency of ownership
- Concentration and influence of ownership

Component 2 - Financial Stakeholder Rights and Relations
Sub-categories:
- Voting and shareholder meeting procedures (including regularity, ease of access to, information provided, etc.).
- Ownership and Financial rights (including dividends, ability to exercise rights, registration and transferability of shares)
- Takeover defenses

Component 3 - Financial Transparency and Information Disclosure
Sub-categories:
- Quality and content of public disclosure.
- Timing of, and access to, public disclosure
- Independence and integrity of audit process

Component 4 - Board Structure & Process
Sub-categories:
- Board structure and composition.
- Role and effectiveness of board.
- Role and independence of outside directors.
- Director and executive compensation, evaluation and succession policies.

Each of these components contributes to the overall score. However, in the case of extremely poor financial transparency and

information disclosure, a meaningful assessment of other governance factors may not be possible. So poor transparency by itself can either result in a low overall governance score or it can mean that a governance score is not possible.

3.3. Components and their Scoring Guidelines

3.3.1. Ownership Structure

Understanding the ownership structure of the company is essential, especially when there is a known majority holder or when *de facto* majority holdings may exist on the basis of collusive shareholding arrangements. Similarly, the existence of a large number of nominee shareholders will make any analysis of the concentration of share ownership difficult.

Whilst the presence of a large, or majority blockholder, is not necessarily a negative governance issue, Standard & Poor's examines the relationship of any blockholder with the company in order to assess the extent to which that blockholder acts in the interests all shareholders.

An understanding of whether the company engages in transfer pricing with other companies on non-market terms with other companies, or whether intercompany linkages give rise to intercompany advances, arrears or subsidies is important. This is particularly true to the extent that management may engage in transactions that may have a detrimental effect on the company and its minority shareholders and creditors.

(a) Transparency of Ownership

Criteria:

- There should be adequate public information on the company's ownership structure, including, where relevant, information on beneficial ownership behind corporate nominee holdings.
- The company's actual ownership structure should be transparent, and should not be obscured by cross-holdings, management controlled corporate holdings, nominee holdings, etc.

Key analytical issues:

- Breakdown of shareholdings
- Identification of substantial / majority holders (including indirect ownership and voting control)
- Director shareholdings
- Evidence of indirect shareholdings
- Management shareholdings

(b) Concentration and Influence of Ownership

Criteria:

- If large blockholders exist, these should not exert influence that is detrimental to the interests of other stakeholders. Minority shareholders should be protected against loss of value or dilution of their interests (e.g. through capital increases, from which some shareholders are excluded, or through transfer pricing with connected companies).
- Concentration of economic interest and influence of controlling shareholders of the parent/holding company on independent board/management action should not occur through block holdings of key operating subsidiaries and through effective control of key customers and suppliers.
- Shareholders should not be disadvantaged by management and insider shareholders who are shielded from accountability.

Key analytical issues:

- Affiliations amongst shareholders
- Commercial arrangements between the company and affiliates / third parties
- Corporate structure, shareholding and management of key affiliates
- Outside holdings of major shareholders
- Terms of key contracts and licenses
- Internal financial and operational control system
- Management shareholding/voting control
- Contracts with directors / management

3.3.2. Financial Stakeholder Rights and Relations

Financial stakeholder relations reflect a company's treatment of its financial stakeholders. The corporate governance score reflects Standard & Poor's assessment of a company's corporate governance practices and policies and the extent to which these serve the interests of the company's financial stakeholders, with an emphasis on shareholders' interests. In this sense, the CGS reflects what a company does rather than whether it complies with minimum requirements of law, regulation or custom.

(a) Voting and Shareholder Meeting Procedures (including regularity of, ease of access to, and information provided about meetings).

Criteria:

- Shareholders holding an appropriate percentage of voting rights should be able to call a special meeting and shareholders should have the opportunity to ask questions of the board during the meeting and to place items on the agenda beforehand.
- A shareholders' assembly should be able to control appropriate decisions through processes that ensure participation by all shareholders.
- The processes and procedures used for advising shareholders of general meetings should provide for equal access of all shareholders and should ensure that shareholders are furnished with sufficient and timely information so that they are able to make informed voting decisions.

Key analytical issues:

- Shareholder meeting procedures:
- Notices of meeting
- Documents sent to shareholders
- Charter provisions on the convening of meeting
- Arrangements for shareholders' participation at meetings
- Previous meeting minutes
- Shareholder information on voting procedures
- Any deposit agreement for overseas listing
- Proxy arrangements
- Charter provisions on voting thresholds
- Shareholder attendance records

(b) Ownership Rights and Financial Rights (including dividends).

Criteria:

- There should be secure methods of ownership of shares and full transferability of shares.
- A company's share structure should be clear and control rights attached to shares of the same class should be uniform and easily understood.
- A shareholders' assembly should be able to exercise decision rights in key areas, and procedures should be in place that ensure that minority shareholders are protected against dilution or other loss of value (e.g. through related party transactions on non-commercial terms)
- All common shareholders should receive equal financial treatment including the receipt of an equitable share of profits (i.e. dividends or other profit distributions).

Key analytical issues:

- Charter provisions
- Arrangements with registrar
- Share structure – classes and rights of common and preferred shares
- Charter provisions – shareholder and board authorities
- Shareholder agreements
- Dividend history
- Examples of share repurchases and swaps

(c) Takeover Defenses and Corporate Control Issues

Criteria:

- The company should maintain a level playing field for corporate control, and should be open to changes in management and ownership that provide increased shareholder value.
- Takeover defenses are not necessarily

considered to be negative governance features on their own; such defenses are analyzed against the current ownership structure to determine how virulent or benign they are in practice and how the board intends to use them to increase shareholder value.

Key analytical issues:

- Effects of provisions in company charter or articles of association
- Arrangements as disclosed in regulatory filings or their equivalent, annual reports, records of resolution, notices of meetings and proxy materials
- Interviews with the Board Secretary

3.3.3. Financial Transparency and Information Disclosure

Transparency involves the timely disclosure of adequate information concerning a company's operating and financial performance and its corporate governance practices. For a well-governed company, standards of timely disclosure and transparency are high. This enables shareholders, creditors and directors to effectively monitor the actions of management and the operating and financial performance of the company. Strong transparency means that the financial reporting facilitates a clear understanding of a company's true underlying financial condition. In part, this means that contingent liabilities and non-arm's length relationships with other related companies are disclosed.

In certain countries where accounting standards are limited, a commitment to transparency may mean that the company adopts internationally recognized accounting principles in addition to local accounting standards.

Transparency also dictates openness regarding non-financial performance—particularly relating to a company's business operations and competitive position. Public disclosure of corporate charter, by-laws, and a clearly articulated corporate mission also promote high standards of transparency. From a board perspective, it is important to have clear disclosure of who the company directors are, the basis of their remuneration and the extent to which they are independent or insiders.

(a) Quality and content of Public Disclosure

Criteria:

- Financial reporting and disclosure should be clearly articulated and completed to a high standard.

Key analytical issues:

- Comprehensiveness of financial statements and reports (including data on key affiliates) disclosed to shareholders and investment community
- Quality of non-financial information
- Quality of corporate records available at company's headquarters

(b) Timing of and Access to Public Disclosure

Criteria:

- All publicly disclosable information should be promptly available and freely accessible to the investment community and shareholders. Public disclosure is a function of internal transparency and effective internal control policies.
- The company's by-laws, statutes and/or articles should be clearly articulated and readily accessible to all shareholders.
- The company should maintain a website and make company reports, summary reports and / or other investor relevant information available in English and the local language, if applicable.

Key analytical issues:

- Timeliness of filing financial and other statements with regulatory bodies
- Procedures for disclosure of market sensitive information
- Briefing materials for investment community presentations
- Availability of records to all shareholders at the company's headquarters
- Reports to shareholders
- Quality of website and online reporting

(c) Independence and effectiveness of audit process

Criteria:

- Auditors should be independent of the board and management in all material respects. They should also be reputable.
- There should be procedures in place to maintain the independence of the outside auditors.

Key analytical issues:

- Audit contract
- Finance and control systems, and audit committee process
- Charter provisions prescribing relationships with auditor
- Audit reports

3.3.4. Board Structure and Process

Board Structure and Process addresses the role of the corporate board and its ability to provide independent oversight of management performance and hold management accountable to shareholders and other relevant stakeholders.

Separation of authority at the board level is important. Boards with high accountability often include a strong base of independent outside directors that look after the interests of all shareholders—both majority and minority holders. Conversely, companies with a strong, self-interested majority shareholder—or dominated by a few such shareholders—may have boards with limited accountability to all shareholders. This may be case when the company's management is heavily represented on the corporate board. Boards often have key committees, and the composition of these committees—particularly the balance between independent and non-independent directors-- can be significant in providing oversight over key functions like audit and remuneration of executives.

Another significant board governance factor is the structure of executive remuneration and benefits. With regard to the selection of board members, a cumulative voting structure may allow for board representation for minority shareholders in appropriate cases. Where shareholders do not have the power to convene special meetings themselves, annual election of all directors ensures the possibility of material change on the board.

The process by which outside directors are nominated and elected to the board, and the methods by which they are compensated for their board duties, are important considerations relevant to an assessment of the board's accountability and practice.

(a) Board Structure and Composition

Criteria:

- A board should be structured in such a way as to ensure that the interests of all the shareholders may be represented fairly and objectively.

Key analytical issues:

- Board size and composition
- Board leadership and committees
- Representation of constituencies

(b) Role and effectiveness of the Board

Criteria:

- The board should bear overall accountability for the performance of the company.
- The board should be ultimately responsible for the system of internal risk control at a company.

Key analytical issues:

- Definitions of board role
- Board-level processes for identifying, evaluating, managing and mitigating risks faced by the company
- Board and committee meeting's agenda and papers
- Management compensation process

(c) Role and Independence of Non-employed Directors

Criteria:

- An appropriate proportion of the non-employed directors should be truly independent and act as such. Independent or outside directors should ensure that the long-term interests of all

shareholders are represented by including that the interests of other stakeholders are duly taken into account.
- Directors should be elected under a transparent system in which they are not able to participate.

Key analytical issues:

- Relationships between outside board members and senior management
- History of involvement of outside directors with company
- Terms of outside director engagement
- Control committee independence and activity
- Articulation of the specific role of outside directors
- Director election procedures

(d) Board and Executive Compensation, Evaluation and Succession Policies

Criteria:

- Directors and executives should be fairly remunerated and motivated to ensure the long-term success of the company.
- Appropriate incentives should be in place connecting executive pay to the performance of the company.
- There should be clearly articulated performance evaluation and succession policies/plans for employed directors of the company.

Key analytical issues:

- Level and form of compensation
- The extent to which pay is connected to financial or other performance measures
- Performance evaluation criteria
- Independence and integrity of compensation setting process
- Succession planning

3.4. Corporate Governance Scoring Committee

The Scoring Committee includes the analytical team and other senior personnel from Standard & Poor's Corporate Governance Services. It may also include other individuals, including local legal counsel and affiliate services staff. Standard & Poor's affiliates may also participate in committees in accordance with agreed affiliate operating guidelines.

3.5. Surveillance

The surveillance of a CGS will depend on the nature of the scoring assignment. If the project is a simple point-in-time governance assessment, no subsequent follow-up may be required. Longer-term surveillance may be required depending on the nature of the engagement or the ongoing needs of an information service. This will entail ongoing dialogue with the company and probably at least one annual review visit.

3.6. Company Report Format

Following meetings with a company, a detailed report will be prepared covering the main elements of the analysis and will also articulate the CGS and individual scores for each of the four components.

The logic underlying the individual scores and variables is presented by the analyst in the Scoring report.

The report will be in the following format:

1. *Executive Summary Rationale*. This will present the aggregate governance score with a rationale together with summaries of key features of component scores and identify the main strengths and weaknesses for each.
2. *Company Description:* Basic operating, financial, management and ownership information.
3. *Methodology:* Scores and analysis for each of:
    - Ownership Structure & Influence
    - Financial Stakeholder Rights and Relations
    - Financial Transparency and Information Disclosure
    - Board Structure and Process

4. COUNTRY GOVERNANCE ANALYSIS

Prior to assigning Corporate Governance Scores in a particular country, the S&P corporate governance analysts undertake an informal review and analysis of the

corporate governance laws, regulations, and practices that are prevalent in the country. From time to time, a report summarizing the findings of this review/analysis will be published by S&P. Going forward it is expected that a more formal review system will be developed, allowing the country governance environment to be classified by a determined classification system.

In assessing a country's corporate governance our corporate governance analysts determine the extent to which the external environment in a given country supports or inhibits healthy governance practices at the corporate or micro level.

The external environment can be important in motivating good or bad internal governance practices by individual companies. It is also of importance in formulating answers to the following questions:

- What are the rights of financial stakeholders and how do these impact the company's relations with its financial stakeholders?
- How effectively does the relevant infrastructure encourage and protect these rights?

The first question attempts to clarify what stakeholder rights exist as defined by legislation and regulatory practice. The second question addresses the relevance of these rights in practice.

In addition to an assessment of pertinent laws and regulation, the analytical process may involve discussions with investors, company directors, lawyers, accountants, regulators, stock exchange officials, economists and relevant trade associations.

The four main areas of focus in this analysis are:
- *Legal infrastructure*
- *Regulation*
- *Information infrastructure*
- *Market infrastructure*.

4.1 Legal infrastructure

An effective legal environment is essential to good corporate governance. Stakeholders' legal rights should be clearly defined. The judicial process should allow for consistent and effective law enforcement in the event that stakeholder rights are abused. In a broader context, the general rule of law and order is also important.

Of the various types of law, *company law* is perhaps the most important. Company law covers fundamental issues, including how companies are formed, what rights exist for shareholders and other stakeholders, how shares are registered, and the responsibilities of board directors and management. In cases where majority and minority shareholders exist, it is important to understand how minority shareholder rights are defined and protected. *Securities law* ranks prominently with company law in assessing a country's legal infrastructure in the context of corporate governance.

Other important areas of law include *bankruptcy and pledge law*. While these are less central, *per se,* to the practice of corporate governance than company law, they nonetheless form an important part of the commercial legal infrastructure. Particularly in the case of bankruptcy law, it is important that creditors and shareholders are in a position to reach settlement on whether to liquidate or restructure an insolvent company.

The effectiveness of *law enforcement* will affect the extent to which financial stakeholder legal rights are relevant in a practical sense. This analysis addresses the fairness and consistency with which laws and regulations are administered. Again, the effectiveness of enforcement for minority shareholders and creditors is a particular focus. The degree of effectiveness of a country's legal system will be broadly addressed through positive and negative examples of governance cited in discussions with lawyers and investors.

Factors considered by Standard & Poor's Corporate Governance Services when analyzing a country's legal infrastructure:

- What are the relevant laws that address corporate governance in the country and its various jurisdictions?
- How are shareholder and other stakeholder rights defined?
- What laws exist that govern:
    - Insider trading

- Reporting and disclosure
- Duties and composition of boards of directors
- Shareholder registry and share depository
- Proxy rights at shareholder meetings
- Voting procedures (including cumulative)
- Minority shareholder rights
- Rights of foreign creditors and shareholders

- How extensive are these laws?
- Is a shareholder registry necessary to prove ownership?
- Are outside directors required?
- Does a licensed registrar keep the shareholder registry?
- What is the nature of the judicial system in law enforcement?
- Is violation of the law a common occurrence?
- Do examples exist that point to judicial success in promoting and enforcing corporate governance?
- Are there examples of poor corporate governance where the law is not effective in principle or in practice?
- Are investor lawsuits relating to corporate governance related disputes common? How effective are the available legal remedies?
- What is the track record of these legal processes? What is the timeframe?
- How does the legal system operate in practice?

4.2 Regulation

The legal and regulatory environments are closely interlinked, with regulatory bodies often being charged with ensuring that markets conform to existing laws. Regulatory bodies also attempt to ensure orderly and efficient market environments, and can play a key role in setting and enforcing standards for public disclosure. Regulatory regimes differ on a country-to-country basis, and the system in each country will be understood and evaluated before firm-specific corporate governance scores are assigned. Regulatory bodies governing specific industries and markets may exist within individual government ministries, a central bank or these may have a more autonomous structure. For investors, the role of securities regulators in supporting effective corporate governance is highly important. Other important regulators may focus on specific interests of financial institutions, insurance, pensions and on general competitive practices. In many countries, Self-Regulatory Organizations (SROs) exist to complement the regulatory process established by formal government bodies.

Factors considered by Standard & Poor's Corporate Governance Services when analyzing a country's regulation:

- What regulatory bodies exist and what is their purview?
- Are there regulatory gaps or areas in which regulatory responsibility overlaps among bodies?
- Do the different regulatory bodies work in co-operation or conflict with one another?
- Do market participants view specific regulations as inappropriate?
- Do SROs play a role that is relevant from the perspective of corporate governance?
- What new legislation is on the regulatory agenda?
- What are the information and timing requirements for public disclosure?
- How effectively are securities and disclosure regulations followed and enforced?
- Do regulators have sufficient resources and practical enforcement tools to achieve their mission?
- Is there a securities regulator? How long has it been in place?
- What is the relationship of securities and other regulators to stock exchanges?
- Examples of regulatory successes and failures.

4.3 Informational infrastructure

Accounting principles differ from country to country, with differences often reflecting varying business practices, reporting practices (managerial versus tax) and disclosure preferences.

For corporate governance to be effective, official regulation of public disclosure will produce company information that is accurate, complete and timely. Public

information will be useful enough to enable existing and potential financial stakeholders to monitor a company's governance, as well as its operating and financial performance. Where information standards are poor, proper corporate monitoring can be either difficult or impossible, leaving open possibilities for corporate governance abuses.

Standard & Poor's does not endorse one particular accounting system over another, but rather assesses the degree to which standards in individual countries provide meaningful and timely disclosure. In some countries, however, and particularly in emerging economies, accounting standards may be incomplete. In such cases, Standard & Poor's Governance Services regards the simultaneous use of International Accounting Standards, US GAAP, or other internationally recognized standards of accounting, as a positive feature.

Factors considered by Standard & Poor's Corporate Governance Services when analyzing a country's informational infrastructure:

- Number, quality and independence of public auditors
- Is there a requirement for independent financial audit?
- Local accounting standards versus international accounting standards:
    - Basis of consolidation
    - Operating data in addition to financial data
    - Financial position of subsidiaries whose health is material to the interests of the company and individual shareholders.
    - Segment data: financial performance of individual business or business units.
    - Methods of asset valuation.
    - Definitions of revenues, expenses, profits and losses.
    - Cash flow: sources and uses of funds.
    - All real and contingent liabilities.
- Evidence of transfer pricing, hidden transfers or subsidies.
- Arrears with related companies.
- What is the required timing of disclosure?
- Is there ease of access to independently audited financial statements?

4.4 Market infrastructure

Other country-specific aspects of how markets function can influence the practice of corporate governance. These need not be designated as factors that are intrinsically positive or negative; they simply should be understood for a clear appreciation of the environment for corporate governance. For example, in transition countries, it is important to understand how the process of privatization has proceeded. In some countries this has given rise to individual managed funds with significant ownership stakes. In other countries this has led to concentration of ownership and cross-ownership between banks and industrial enterprises.

The functioning of public capital markets is important in this regard because it reflects the extent to which companies are publicly listed, as well as the liquidity/transferability of shares and ownership rights. Differing approaches to public versus private capital markets can be important in understanding the role of banks in the corporate sector. It can also help the understanding of how bank influence or ownership can affect public transparency and disclosure. This is particularly the case when financial-industrial groups play an important role in the functioning of the market. The presence of one versus two-tiered board structures must be appreciated in the context of local norms. While either structure can be acceptable for a healthy governance process, the structure should be understood to assess how the board acts to promote the interests of financial stakeholders.

Factors considered by Standard & Poor's Corporate Governance Services when analyzing a country's market infrastructure:

- What is the prevalence of listed companies or significant private ownership?
- What is the prevalence of state ownership?
- Is there ease of access to public exchanges?
- For transition economies and other countries with state-owned enterprises: what methods of privatization exist and

what impact do these have on ownership structures?

- What is the importance of institutional investors (mutual funds, pension funds, insurance companies, etc.)?
- Is there a universal banking system versus separation between commercial and investment banking?
- Do banks commonly hold significant equity stakes in industrial companies?
- Are financial-industrial groups prevalent? What is the degree of transparency in their intercompany relationships?
- Do market distortions exist in the form of uncompetitive industry structures or government protection of individual companies or sectors?
- Are there signs of macroeconomic stability or stress?
- What is the nature of the political environment? Is this relevant to the practice of corporate governance in the country?

5. HOW COMPANY SCORE AND COUNTRY GOVERNANCE CLASSIFICATION WILL FIT TOGETHER

As mentioned above, S&P expects to develop a more formal Country Governance Classification system in the future. This *Country Governance Classification* will reflect the degree to which the macro legal, regulatory, informational and market environments provide a supportive infrastructure for effective corporate governance.

A high Country Governance Classification (i.e. strong support) will not mean that an individual company will be highly scored itself. There is no “floor”: An individual company in a positively assessed country can receive a low CGS if so warranted.

Likewise, because the analysis focuses on what a company does, rather than what is required by law or regulation and because the analysis benchmarks a company’s corporate governance standards to codes and guidelines of good corporate governance practices, there is no sovereign constraint. A low score for a country, i.e. weak support, will not necessarily mean that a company in that country will receive a low CGS. A well-governed company in a negatively assessed country may receive a high CGS. The importance of the *Country Governance Classification* is that it indicates Standard & Poor's opinion about the degree of protection that investors, and other financial stakeholders, would receive should a previously highly scored company’s corporate governance standards deteriorate.

Corporate Governance Scores allow the comparison of individual companies within a national context as well as comparisons of companies in different jurisdictions.

APPENDIX

I. INFORMATION REQUIRED PRIOR TO A CORPORATE GOVERNANCE SCORING MEETING

Typically, Standard & Poor’s analysts will visit the company to make an inspection of relevant documentation prior to meeting with officers of the company and other relevant individuals. Analysts will examine a number of company documents including the following:-

- Company annual and intra year reports.
- Company Charter/By-laws.
- Filings with Government Regulatory Agencies.
- Records of recent shareholder meetings (past three years), general and extraordinary.
- Minutes of recent board meetings (past three years).
- Disclosure of new share issuance (including options) at the company or the subsidiary level.
- Identification of key shareholders and creditors.
- Records of any penalties, fines or other violations relating to abuse of shareholder rights on public record, including pending items.
- Disclosure of board structure and composition.
- Disclosure of company auditor.
- Disclosure of major scale transactions in past three years (over 10% of Company net assets).
- Identification of share registrar.

II. TYPICAL INTERVIEWEES FOR THE SCORING PROCESS

Following examination of the documents described above, Standard & Poor’s analysts will meet with officers of the company and other relevant individuals, among whom the following is a representative list of typical interviewees:

- Chief Executive
- Finance Director
- Company Secretary/Corporate Counsel
- Board of Directors (in particular the Chairman and independent directors)
- Shareholder relations personnel
- Key shareholders and creditors
- Company’s auditor